

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 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

INITIAL BRIEF OF THE UNITED STATES POSTAL SERVICE

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.  
Chief Counsel

Kenneth N. Hollies  
Eric P. Koetting  
Nan K. McKenzie  
Sheela A. Portonovo  
Brian M. Reimer  
Scott L. Reiter  
David H. Rubin  
Michael T. Tidwell  
Keith E. Weidner

475 L'Enfant Plaza West, S.W.  
Washington, D.C. 20260-1137  
202/268-2989

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## PROCEDURAL HISTORY

On April 8, 2005, the Postal Service filed with the Postal Rate Commission a Request for a recommended decision on new rates and fees, pursuant to 39 U.S.C. § 3622(a). The policy testimony of Postmaster General John E. Potter (USPS-T-1) indicates that the Postal Service initiated the proceeding solely as a consequence of the passage of Public Law (PL) 108-18. PL 108-18 established a requirement that the Postal Service place in escrow, during Fiscal Year 2006, funds in the approximate amount of \$3.1 billion. Under the terms of the statute, these funds would be classified as operating expenses, but would not be available to be used for operations or investment. Postmaster General Potter testified that, but for this statutory financial obligation, the Postal Service would not have sought to increase postal rates and fees at this time.

The Postal Service's Request set forth cost, volume and revenue projections using FY 2004 as a Base Year, and a Test Year running from October 1, 2005, through September 30, 2006 (FY 2006). With the limited exceptions of fees for Registered Mail, the special service Confirm, and Within-County Periodicals Mail, the Postal Service proposed uniform 5.4 percent across-the-board rate and fee increases for existing classes of mail and special services.<sup>1</sup> The Postal Service's Request was accompanied

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<sup>1</sup> Due to rounding constraints, the increases proposed for certain mail categories and services deviate slightly from 5.4 percent. The Postal Service proposed fee increases of approximately 70 percent for Registered Mail, in light of perceived substantial increases in costs since the most recent general rate proceeding. The Postal Service did not propose fees for Confirm, pending results of an internal review and evaluation of that special service. The Postal Service proposed rate decreases for Within-County Periodicals mail, pursuant to controlling provisions of existing statutory law.

by the written direct testimonies of 31 witnesses and numerous other documents submitted pursuant to the Commission's Rules.

On April 12, 2005, the Commission issued Order No. 1436 noticing the Postal Service's Request and designating the instant proceeding as Docket No. R2005-1. The Commission gave interested parties until May 2, 2005, to intervene in the proceeding. Shelley S. Dreifuss, Director of the Office of the Consumer Advocate, was designated as the representative of the general public. Forty-three parties have intervened as full or limited participants.

On April 8, 2005, the Postal Service submitted with its Request a motion for expedition and for consideration of procedures that would facilitate settlement. The Postal Service stated that, substantially in advance of filing its Request, it had consulted with mailers, mailer associations, and other parties, who had participated in the most recent general postal rate case (Docket No. R2001-1), and who were likely to intervene in Docket No. R2005-1. Based on those discussions, the Postal Service reported its belief that a significant number of potential participants would be favorably inclined to enter into a joint Stipulation and Agreement. In Order No. 1436, the Commission authorized settlement negotiations and appointed the Postal Service as settlement coordinator.

A majority of participants convened on May 5, 2005, at a Prehearing Conference, followed by a joint settlement conference. While many of the parties expressed interest in settlement, a consensus developed favoring completion of discovery and examination of the Postal Service's direct testimony prior to individual participants' determinations on

a proposed Stipulation and Agreement. On May 10, 2005, the Postal Service submitted its first report as settlement coordinator, stating the above.

The Presiding Officer issued Ruling No. R2005-1/11 on May 19, 2005, establishing the procedural schedule. The schedule acknowledged the parties' intent toward narrowing issues and reducing the need for cross-examination, and thus provided less time for cross-examination and discovery on the direct testimony of intervenors than had been the norm in past Commission cases. The ruling set two distinct dates for the completion of discovery on Postal Service witnesses. Discovery on the majority of the witnesses would extend through June 10. Discovery on witnesses whose testimony related to mail processing costs and city carrier out of office costs would extend through June 17.<sup>2</sup> Hearings to receive the direct testimony of the Postal Service were scheduled to take place between June 27 and July 8, 2005.

On June 27, 2005, during the hearings, the Presiding Officer gave notice of his intention to ask, on July 8, 2005 for a report on any progress made toward settlement, and whether settlement of some or all of the issues presented in this case remained a reasonable possibility.<sup>3</sup> In light of that expectation, the Postal Service submitted its second report on the status of settlement.<sup>4</sup> The Postal Service noted that since its first settlement report, the proceeding had advanced through the discovery stage directed at the Postal Service's case and cross-examination of its witnesses. Discovery requests

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<sup>2</sup> In this docket, the Postal Service advanced two cost attribution studies which proposed new treatment of mail processing costs and city carrier out of office costs. The Commission noted that several participants had submitted pleadings requesting more time for discovery on these aspects, and thus extended discovery on this group of witnesses.

<sup>3</sup> Tr. 2/45.

<sup>4</sup> Second Report of the United States Postal Service as Settlement Coordinator, Docket No. R2005-1 (July 7, 2005).

from some of the parties had been extensive. However, in comparison to previous cases in which settlement had not been actively pursued, other parties had not been as active in conducting discovery. Furthermore, there had been limited cross-examination of only some of the Postal Service's witnesses. Based on conversations with participants, the Postal Service believed that the relative inactivity of some of the parties was the result of expectations that settlement would be worthwhile and possible.

As for its efforts to shape a generally acceptable Stipulation and Agreement, the Postal Service stated that it had discussed provisions and language contained in several drafts of an agreement with counsel representing most of the participants in the case. On Friday, July 1, 2005, the Postal Service circulated a draft agreement to the entire service list, with the intent to solicit suggestions for further refinements, prior to submitting the Stipulation and Agreement for signature. The Postal Service continued to believe that settlement by a majority of active participants in the case was possible and likely, but that the settlement would not be unanimous.

On July 19, 2005, Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. (Valpak) challenged the Postal Service's specific rate and fee proposals by filing two pieces of direct testimony concerning Standard Enhanced Carrier Route Mail. On July 22, 2005, the Postal Service submitted a Stipulation and Agreement, noting that Valpak was the only party to challenge the Postal Service's proposals.<sup>5</sup>

The Stipulation and Agreement adopts, with limited exceptions, the Postal Service's proposal to adjust existing rates and fees by a uniform 5.4% across-the-board.

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<sup>5</sup> Notice of the United States Postal Service Submitting Stipulation and Agreement, Docket No. R2005-1 (July 22, 2005)

It seeks a Recommended Decision from the Commission no later than October 31, 2005. As in Docket No. R2001-1, the Postal Service submitted the Stipulation and Agreement with only its own signature, but transmitted a copy of the Stipulation and Agreement to all parties of record and asked that those participants who are inclined to settle return a signed signature page to the Postal Service no later than August 5, 2005.<sup>6</sup>

Discovery against Valpak's direct testimony began on July 19, 2005, and continued until August 9, 2005. On August 24, 2005, evidentiary hearings on the cases-in-chief of Valpak were held. On September 8, the Postal Service and Advo, Inc. submitted rebuttal testimony. From September 14 to September 15, hearings were held on the rebuttal to Valpak's direct testimony.

The date for filing initial briefs is set for September 26, 2005, with October 3, 2005 set as the date for filing reply briefs. On September 23, 2005, the Postal Service filed the signatures to the Stipulation and Agreement.<sup>7</sup> There are 36 signatories.

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<sup>6</sup> August 5 corresponded to the then-current date for the termination of discovery against Valpak's testimony.

<sup>7</sup> Notice of United States Postal Service of Filing Signatures for Stipulation and Agreement, Docket No. R2005-1 (September 23, 2005).

I. THE POSTAL SERVICE HAS PROVIDED THE FULL RANGE OF EVIDENCE TYPICALLY PROVIDED IN AN OMNIBUS RATE FILING

The nature of the Postal Service's proposed changes in rates and fees in this docket is unique and relatively simple -- moderate across-the-board increases for all rates and fees (with some limited exceptions)<sup>8</sup> in order to recover a single, Congressionally-imposed escrow obligation -- and there are no proposed classification changes. The Postal Service has, however, supported its Request with the same array of evidence that it has provided in more traditional omnibus rate filings. In addition, the Postal Service has provided two new testimonies -- that of the Postmaster General and the "roadmap" witness -- not found in previous filings.

First, the Postal Service provided the testimony of Postmaster General Potter (USPS-T-1) as a policy witness. As explained by Mr. Potter, "[t]he Postal Service's decision to seek changes in postal rates and fees at this time represents a policy judgment about the most reasonable, practical and effective way to meet a currently unavoidable financial obligation in Fiscal Year 2006," namely the requirement in Public Law No. 108-18 that the Postal Service hold designated funds in escrow, for which no purpose has been established, and classify them as an operating expense. USPS-T-1 at 2-4. The Postmaster General also explained that a compelling justification for the Postal Service's across-the-board approach was the likelihood that it would enhance the prospects for settlement and thereby permit an expeditious conclusion to this docket. USPS-T-1 at 5. This likelihood has materialized to a large extent, considering the fact that 36 participants

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<sup>8</sup> For reasons explained by witnesses Taufique (USPS-T-28) and Robinson (USPS-T-27), limited exceptions to the across-the-board approach are necessary for Within County Periodicals Rates, fees for Registered Mail (based on increases in volume variable costs), and the fee for Periodicals Re-Entry Application.

have signed a settlement agreement. Moreover, only one participant other than the Postal Service (Valpak) filed its own direct case.

Second, the Postal Service provided the testimony of a "roadmap" witness -- witness Alenier (USPS-T-33) -- in accordance with Rule 53(b) of the Commission's Rules of Practice and Procedure. This testimony provides participants with an overview of the Postal Service's filing, including the subject matter of each witness' testimony, the interrelationships between the various testimonies, and the changes in cost methodology, volume estimation, or rate design as compared to the manner in which the Commission calculated them to develop recommended rates and fees in the most recent general rate proceeding.

In addition to these two testimonies not found in previous Requests, the Postal Service provided the full array of evidence that characterized previous omnibus rate filings. First, the Postal Service provided revenue, pieces, and weight information by mail category, as well as its traditional cost reports gathered from its ongoing data collection systems (e.g., IOCS, TRACS, and CCS).<sup>9</sup> Second, the Postal Service provided extensive costing testimony, including testimony that addresses segments of the CRA.<sup>10</sup> Third, the Postal Service provided a base year witness who incorporates these costs.<sup>11</sup> Fourth, the Postal Service provided volume forecasting witnesses who develop a set of mail volume forecasts into the test year based on the identification and quantification of factors that

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<sup>9</sup> See USPS-T-4 (RPW); USPS-T-2 (IOCS); USPS-T-3 (TRACS); USPS-T-5 (CCS).

<sup>10</sup> See USPS-T-11 (mail processing costs), USPS-T-12 (mail processing costs), USPS-T-13 (facility costs for mail processing), USPS-T-13 (carrier cost econometrics), USPS-T-15 (carrier costs data collection), USPS-T-16 (carrier costs by shape), USPS-T-17 (transportation costs), and USPS-T-31 (transportation/window costing).

<sup>11</sup> See USPS-T-9.

affect mail volumes.<sup>12</sup> Fifth, the Postal Service provided operations witnesses who discuss the postal operating environment from the base year to the test year (and beyond).<sup>13</sup> Sixth, the Postal Service provided revenue requirement and rollforward witnesses who project the Postal Service's estimated test year revenue needs.<sup>14</sup> Seventh, the Postal Service provided special cost studies witnesses that explore costing issues below the subclass level, including the costs avoided by worksharing.<sup>15</sup> Eighth, the Postal Service provided a witness who estimates incremental costs for the base year and the test year.<sup>16</sup> Finally, the Postal Service provided full pricing testimony: witness Taufique (USPS-T-28) describes how the ratemaking objectives set forth by the Postmaster General are accomplished through relatively uniform adjustments to current rates and fees, and witness Robinson (USPS-T-27) addresses the cost coverages that are implied by the relationship between test year costs and revenues resulting from this rate design.

Overall, the Postal Service provided the testimony and exhibits of 31 witnesses, encompassing 33 testimonies and 116 library references, in its direct case, representing the full range of evidence typically provided in an omnibus rate filing.<sup>17</sup> Accordingly, as will be set forth in greater detail below, the record in this case is complete, and forms a

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<sup>12</sup> See USPS-T-7, USPS-T-8.

<sup>13</sup> See USPS-T-29; USPS-T-30.

<sup>14</sup> See USPS-T-6 (revenue requirement); USPS-T-10 (rollforward).

<sup>15</sup> See USPS-T-19, USPS-T-20; USPS-T-21; USPS-T-22; USPS-T-23; USPS-T-24; USPS-T-25; USPS-T-26; USPS-T-32.

<sup>16</sup> See USPS-T-18.

<sup>17</sup> Thus, this docket is unlike Docket No. R94-1, in which the Commission criticized the Postal Service's filing by noting that the Postal Service provided testimony from only 11 witnesses to support a requested across-the-board increase, and failed to provide new or updated cost studies estimating its cost savings from mailer worksharing. See Docket No. R94-1, Opinion and Recommended Decision at I-2, I-9-10. The Commission concluded that these deficiencies were "inappropriate." *Id.* at I-9-12. These concerns are not present in the instant docket.

sufficient basis for the Commission to recommend the rates and fees proposed in the Postal Service's Request and the settlement agreement.<sup>18</sup>

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<sup>18</sup> The proposals encompassed by the Postal Service's Request include changes in rates and fees for all classes of mail and special services, with the exception of the Special Service, Confirm. For reasons expressed in the Notice of Intent to Address Rates and Fees for Confirm in a Separate Proceeding, filed today, the Postal Service intends to file a separate proceeding in the future to address the rates, fees, and classification for Confirm.

## II. THE COMMISSION SHOULD BASE ITS RECOMMENDATIONS ON THE PROPOSED SETTLEMENT AGREEMENT

For the second consecutive time in an omnibus postal rate proceeding, a substantial majority of active participants have agreed to support the Postal Service's proposals for rate and fee increases. Prior to Docket No. R2001-1, the prospects for settlement in a general rate case seemed remote.<sup>19</sup> Due primarily to the extraordinary circumstances after September 11, 2001, however, the parties in Docket No. R2001-1 united in a nearly unanimous settlement agreement that the Commission adopted as the basis for its recommendations. While current circumstances provide a much different context, they, nevertheless, establish a solid foundation for the settlement. The Postal Service strongly advocates that the Commission recommend the rates and fees proposed in the Stipulation and Agreement submitted in this proceeding.<sup>20</sup>

### A. The Settlement Proposals Enable the Postal Service's Policy Goals and Meet the Standards for Recommendation of Settlement in Omnibus Rate Proceedings

1. Settlement is an integral element of the Postal Service's policy objectives.

As noted by Postal Service rebuttal witness Kiefer, the Postmaster General (USPS-T-1) testified establishing the policy basis for the Postal Service's proposed rate and fee increases.<sup>21</sup> Mr. Potter explained that the Postal Service's Request

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<sup>19</sup> See Chairman Omas' remarks. Tr. 1/40.

<sup>20</sup> The Stipulation and Agreement was submitted on July 22, 2005. Notice of the United States Postal Service Submitting Stipulation and Agreement, Docket No. R2005-1 (July 22, 2005). The signatures of adherents to the settlement agreement were filed September 23, 2005. Notice of the United States Postal Service Submitting Signatures and Motion for Adoption of Stipulation and Agreement, Docket No. R2005-1 (Sept. 23, 2005)

<sup>21</sup> USPS-RT-1, at 4-5; Tr. 11/6152-53.

represented a policy decision by the Board of Governors to raise revenue to fund the escrow requirement, pursuant to P.L. 108-18. USPS-T-1, at 2-3. In the Postal Service's view, furthermore, litigation of the case would require maximum procedural expedition. Otherwise, new rates would not be able to produce sufficient revenues in 2006 to substantially meet the escrow obligation.<sup>22</sup>

The Postal Service believed that settlement was the most practical means to obtain a Recommended Decision that could be implemented as early as January 2006. The need for expedition through settlement, furthermore, influenced the choice of the Postal Service's across-the-board pricing approach. Mr. Potter testified:

We have determined...that acting now to secure the funds needed through moderate rate and fee increases would be responsible stewardship. In particular, while appropriately spreading the burden to all postal customers, this approach creates the prospect of encouraging settlement of issues among usually very contentious rate case participants. It is my hope that efforts to settle this case will lead to an early Recommended Decision and permit implementation early enough in 2006 to meet the lion's share of the escrow obligation.

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<sup>22</sup> In the Postal Service's motion for expedition filed with its Request, the situation was described as follows:

Early resolution of the Postal Service's request and early implementation are key factors in the Postal Service's proposal. A Recommended Decision ten months after today would fall on February 8, 2006. Allowance of time to permit the Governors to review and act on the recommendations, and a reasonable amount of time to prepare for implementation, would take the earliest effective date into March or April of 2006. This would result in a potential delay in implementing the proposed changes, if recommended, about three months after a possible effective date at the beginning of January. Yet the financial objectives of the proposed increases are tailored to an expected effective date for the proposed increases in early January 2006.

United States Postal Service Request for Expedition and Early Consideration of Procedures Facilitating Settlement Efforts, Docket No. R2005-1, at 3 (April 8, 2005) (footnote omitted) (Hereinafter referred to as Request for Expedition).

USPS-T-1, at 2-3.

The settlement objective thus fundamentally shaped the structure of the Postal Service's proposals and the Postal Service's conduct in the proceedings. In fact, settlement efforts began even prior to filing the Request. In its Request for Expedition, the Postal Service noted the following:

The Postal Service has already gained a substantial head start in the timing of settlement efforts. For approximately the past two months, the Postal Service has been consulting individually with mailers, mailer associations, and other likely participants in the upcoming proceedings. We have been explaining the details and reasoning supporting the Postal Service's approach to its revenue requirement, as well as the structure of the case, and the specific pricing proposals. We have been asking the prospective parties to seriously consider the possibility of settling on the Postal Service's proposals and have been exploring possible incentives and obstacles to a successful agreement.

Request for Expedition, at 5-6. These settlement efforts in turn have had a dominant effect on the procedural development of the case. The Presiding Officer did not adopt all of the Postal Service's proposals for procedure and timing, but early in the proceedings he established a procedural schedule that favored expedition and settlement.<sup>23</sup> Moreover, from the beginning, many parties were favorably disposed to settle. As a consequence, fewer parties than usual participated in discovery, and only one party, Valpak, chose to submit a direct case challenging the Postal Service's proposals. These developments have shaped the record to favor approval of the settlement agreement as the most logical and defensible outcome of the proceedings.

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<sup>23</sup> Presiding Officer's Ruling Establishing Procedural Schedule, Ruling No. R2005-1/11, Docket No. R2005-1 (May 19, 2005).

2. The proposed settlement meets both legal and technical standards for evaluation under the Postal Reorganization Act and Commission practice.

The Commission has recently summarized the role of settlement in its proceedings. 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 for the Commission to make decisions in a more timely fashion as the procedural schedule will not have to accommodate the eliminated tasks.<sup>24</sup>

Prior to Docket No. R2001-1, the Commission had never relied on a settlement agreement in an omnibus postal rate proceeding. Stipulation and Agreements were offered for complete settlement in Docket Nos. R74-1 and R94-1. In both instances, however, the Commission concluded that it should not base its recommendations entirely on the agreements.

In Docket No. R2001-1, the Commission was again faced with a proposal to accept settlement. In its Opinion, the Commission discussed the two previous

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<sup>24</sup> Order Establishing Procedural Framework for Reconsideration, Order No. 1443, Docket No. MC2004-3, at 14-15 (August 23, 2005).

attempts.<sup>25</sup> It summarized its failure to rely on settlement in Docket No. R74-1 as follows:

The Commission explained that the reason for rejecting the settlement proposal was its incompatibility with the analyses of costing and rate design contained in the Commission's opinion. It also pointed out that, although some of the rates it recommended were identical or similar to the settlement rates, the Commission had "arrived at the former rates by an independent analysis of the record in the light of the Reorganization Act's requirements."

*Id.* at 19 (footnote omitted). With regard to Docket No. R94-1, the Commission explained that, in that case, it had found that the proposed rates, in part, conflicted with facts on the record. *Id.* at 20. The Commission also found

the across-the-board rate increase proposal to be "inconsistent with cost-based ratemaking" because it "ignores changing differences in costs between the classes of mail, includes no analysis of changing cost patterns within subclasses; and would result in substantial changes in the allocation of institutional cost burden" to four subclasses of mail. It also found the proposed rates' implicit "allocation of institutional cost burdens [to be] not in accordance with the statute." Consequently, it found "that some significant revisions to the rates proposed by the Postal Service are required by the rate setting criteria enumerated in section 3622(b)[,]" and accordingly recommended an adjusted set of rates in its decision.

*Id.* at 20-21.

Faced with a more robust settlement attempt in Docket No. R2001-1 than Docket No. R94-1,<sup>26</sup> the Commission carefully analyzed the record in light of its obligation and authority to evaluate proposed settlements. In this regard, the Commission long ago

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<sup>25</sup> See PRC OP. R2001-1 at 18-20 (March 22, 2002).

<sup>26</sup> Docket No. R94-1 also involved Postal Service proposals to adjust existing rates by a uniform percentage across-the-board. In that proceeding, however, only two-thirds of the participants agreed to settle, and eight parties opposed settlement. In Docket No. R2001-1, nearly every participant agreed to settle, and only one party (APWU) opposed.

determined that settlement was a legitimate goal in its proceedings where applicable.<sup>27</sup>

In its Opinion in Docket No. MC84-2, furthermore, the Commission stated:

Our rule requires us to allow the opportunity to reach settlement; its language literally permits parties to submit for our consideration a nonunanimous settlement; and *Pennsylvania Gas*, construing similar language in the APA, shows that such a settlement is capable of adoption.<sup>28</sup>

Regarding its own responsibilities, the Commission stated:

[T]he Commission encourages and welcomes settlement negotiations and settlement proposals. We do not believe, however, that a unanimous settlement proposal relieves this Commission of its statutory duty to recommend a classification schedule which is fair and equitable [citing 39 U.S.C. § 3623(c)(1)] and rates which recover the Postal Service's attributable and assignable costs of rendering that service. [citing 39 U.S.C. § 3622(b)(3)]

The Commission cannot discharge this responsibility unless it determines that the statutory criteria have been met. The Commission recognizes that, when it is considering a unanimous settlement, the record need not be as detailed as with contested proposals. [citing PRC Order No. 148, at 5-6] If parties with divergent interests can reach an agreement, there is a reasonable expectation that they have considered the statutory criteria for changing the mail classification schedule and establishing equitable rates. The Commission, however, has the duty to

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<sup>27</sup> As early as Docket No. MC73-1, the Commission stated:

We are, like most other agencies, required by the Administrative Procedure Act to facilitate the settlement of cases...as a useful, convenient and fair means of disposing of complex cases. (*citing Southern Louisiana Area Rate Cases v. FPC*, 428 F.2d 407 (5<sup>th</sup> Cir. 1970); *cert. denied*, 400 U.S. 950 (1970)).

PRC Op. MC73-1, at 6 (Apr. 15, 1976).

<sup>28</sup> PRC Op. MC84-2, at 5 (Dec. 21, 1984) (citing *Pennsylvania Gas & Water Co. v. FPC*, 463 F.2d 1242, 1247 (DC Cir. 1972)). The Commission also cited *Michigan Consolidated Gas Co. v. FPC*, 283 F.2d 204 (DC Cir. 1960), *cert. Denied sub nom Panhandle Eastern Pipeline Co. v. Michigan Consolidated Gas Co.*, 364 U.S. 913 (1960), and *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 313-14 (1974) for the proposition that nonunanimous offers of settlement must be considered. PRC Op. MC84-2, at 5, n. 6. See also, PRC Op. MC79-4, at 3, 12-13 (Apr. 21, 1980).

ascertain whether the record demonstrates that the statutory criteria are met by the proposed settlement.<sup>29</sup>

In Docket No. R2001-1, the Commission elaborated further on its approach to settlement proposals in an omnibus rate case.<sup>30</sup> The Commission explained that, in order to pass muster, proposed settlement rates must satisfy both legal and “technical” standards. With regard, to legal standards, the Commission stated:

the policies and criteria of the Reorganization Act constitute the primary source of legal standards, as they do in all proceedings under Chapter 36. Consistency with statutory provisions – particularly requirements such as § 3622(b)(3) – is the fundamental benchmark against which the proposal must be judged. Even if participants unanimously agree upon a proposed rate, the Commission cannot lawfully recommend that rate if the record shows it would fail to recover the attributable costs of the pertinent subclass or service.

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<sup>29</sup> PRC Op. MC84-2, at 12-13. (citing *Texas Eastern Transmission Corp. v. FPC*, 306 F2d 345, 354-57 (5<sup>th</sup> Cir. 1962), *cert. denied*, 375 US 941 (1963)).

<sup>30</sup> Prior to Docket No. R2001-1, the Commission had issued 17 Recommended Decisions adopting non-unanimous settlement agreements. See PRC Op. MC73-1 (Apr. 15, 1976); PRC Op. MC76-4 (Jan 12, 1977)(Concerning Zone-Rated Military Mail); PRC Op. MC76-4 (Jan. 12, 1977)(Concerning Mailings of Alaska Gold); PRC Op. MC 76-1 (Jan. 17, 1977)(Concerning the Elimination of Airmail from the Domestic Mail Classification Schedule); PRC Op. MC76-4 (Apr. 25, 1977)(Concerning Mailing of Maps and the Elimination of the Requirement that Special Rate Fourth Class Printed Educational Reference Charts Be Permanently Processed for Preservation); PRC Op MC76-1 (June 15, 1977)(Concerning Express Mail and Mailgram); PRC Op. MC79-4 (Apr. 21, 1980); PRC Op. MC84-2 (Dec. 21, 1984); PRC Op. MC91-2 (Nov. 22, 1991); PRC Op. MC 97-3 (Sept. 4, 1997); PRC Op. MC 97-4/C97-1 (Sept. 4, 1997); PRC Op. MC 99-1 (May 14, 1998); PRC Op. MC99-2 (July 14, 1999); PRC Op. MC99-4 (August 19, 1999); PRC Op. MC2000-1 (Feb. 3, 2000); PRC Op. MC 2001-1 (May 25, 2001); PRC Op. 2001-3 (Jan. 11, 2002). See *also*, Order Remanding Certified Settlement, Order No. 148, Docket No. MC76-4 (Jan 12, 1977). Since Docket No. R2001-1, the Commission has issued 7 more recommended decisions adopting non-unanimous settlement agreements. See PRC Op. MC2002-1 (July 26, 2002); PRC Op. MC2002-3 (Dec. 20, 2002); PRC Op. 2003-1 (June 6, 2003)(This settlement was opposed by two parties); PRC Op. MC2003-2 (Aug. 26, 2003); PRC Op. 2004-1 (July 7, 2004); PRC Op. 2004-2 (Oct. 6, 2004); PRC Op. 2005-1 (April 15, 2005). In addition, substantial settlement agreements had significant roles in two other Commission proceedings. PRC Op. MC2002-2 (May 15, 2003); MC2004-3 (Dec. 17, 2004).

PRC Op. R2001-1, at 22. The Commission further explained that, where a proposed settlement was opposed, the Commission must consider the evidence offered in favor of the opposition, after having afforded the opponent the full opportunities of due process under applicable procedures.<sup>31</sup> Finally, the Commission outlined the role of postal policy in assessing the settlement proposals, in light of the statutory legal standards. Regarding the conditions supporting the proposal in Docket No. R2001-1, the Commission clarified the role of Postal Service policy as follows:

The Postal Service asks the Commission to assign compelling weight to the unprecedented set of financial and operational challenges it faces in the wake of September 11, 2001 and ensuing events, and to the financial benefits that will accrue to the Service as a result of prompt approval of the settlement. The Commission agrees that these critical matters are entitled to an unprecedented degree of influence in this case, as “such other factors as the Commission deems appropriate” for consideration under 39 U.S.C. § 3622(b)(9). They also bear on postal policy considerations, particularly the sustenance of the Postal Service’s ability to “provide prompt, reliable, and efficient services to patrons in all areas and [to] render postal services to all communities.” 39 U.S.C. § 101(a). Consequently, in responding to the policies of the Reorganization Act and in balancing the statutory factors in 39 U.S.C. § 3622(b), the Commission’s deliberations in the case will assign special importance to the exigencies of the Postal Service’s current condition. As the opinion in Docket No. R94-1 declared, “the Commission is willing and able to cooperate with the Service to help it meet its ratemaking goals, subject to the applicable statutory requirements.” PRC Op. R94-1, para 1025.

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<sup>31</sup> *Id.* at 22-23. The Commission stated:

As in Docket Nos. R74-1 and R94-1, the resulting dispute on issues of material fact requires that the settlement be treated as one competing proposal on the merits. This means that the Commission’s evaluation of the agree-upon rates must include not only the usual decisional analysis summarized above, but also must consider the evidence presented by [the opponent] to resolve the remaining factual dispute. Further, to the extent the opponent suggests an alternative outcome, the Commission must adequately address the alternative proposal in making rate recommendations.

*Id.*

*Id.* at 24.

In describing the “technical standards” to be applied, the Commission noted that, in the context of a widely accepted settlement agreement, its consideration shifted focus from formulation of rates to the review of rates accepted by the signatories. *Id.* at 25.

The Commission observed that widespread settlement resulted in a record that tended to be limited to the data and information submitted by the Postal Service to support and explain its direct case. *Id.* at 25-26. One consequence of this situation was that the technical standards for reviewing the Postal Service’s proposals, as embodied in the settlement agreement, changed somewhat from a normal case in which the Postal Service’s proposals and testimony were challenged by other parties. *Id.* The Commission stated:

[T]he Commission believes that 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. Similarly, where rates currently in effect do not incorporate the Commission’s recent rate recommendations, the latter can provide guidance on the appropriateness of various rate design features.

Overall, in view of the widespread acceptance of the settlement rates among participants and the special needs of the Postal Service at this time, the Commission believes that the agreed-upon rates should be held to a standard of reasonable consistency with past ratemaking practices, as illustrated in pre-existing rates and rate relationships. Where the record can be fully analyzed through the lens of established methodologies, the Commission will report its findings in those terms. Where this is not possible, the Commission will note the apparent technical deficiencies, and assess the merits of the settlement by reference to the results in the most recent omnibus rate proceeding, Docket No. 2000-1.

*Id.* at 26-27.

In applying the technical and legal standards described above in Docket No. R2001-1, the Commission carefully reviewed the record created by the Postal Service's filing and its responses to various inquiries during discovery and at hearings. It evaluated this evidence against the legal and technical standards, and considered the evidence and argument presented by the one party filing a direct case challenging settlement (APWU), as well as evidence presented by several participants contesting the opposition.

The Commission identified two "key technical standards" that must be met before it could recommend the settlement rates:

- (1) they must generate sufficient total revenue in the test year to meet the total revenue requirements of the Postal Service and
- (2) the revenue generated for each subclass must exceed by a reasonable amount the costs attributed to the subclass.

*Id.* at 28. The Commission then reviewed these standards against the record established on the Postal Service's revenue requirement, its estimates of volumes, and its estimates of attributable costs. *Id.* at 28-35. Based on this review, it concluded that the proposed rates satisfied both the total revenue and attributable cost standards it had outlined for technical sufficiency under the Act. *Id.* at 35-36.

In evaluating the proposals against legal standards, the Commission considered the policies and provisions established in 39 U.S.C. §§ 3621 and 3622(b), as well as public policy considerations and other policies in the Act. *Id.* at 39-40. Significantly, it found that the unique factual circumstances surrounding the Postal Service's proposals and the settlement effort "elevate[d] criterion 9, other factors deemed appropriate by the Commission, to a prominent role in the Commission's pricing deliberations." *Id.* at 41.

The Commission concluded that these considerations contributed substantially to its conclusions that the rates and fees proposed in the settlement agreement were consistent with the policies in the Act and the public interest. *Id.* at 45.

Finally, the Commission assessed all of the rates individually and independently.

In this regard, the Commission stated:

This greater reliance on criterion 9 was not to the exclusion of the remaining ratemaking criteria of the Act. The Commission reviewed each proposed rate level for consistency with the Act and concludes that each reflects due regard for the ratemaking criteria of the Act. While the proposed cost coverages and resulting markups may not be precisely what the Commission may have employed had this been a fully litigated proceeding, they nonetheless fall within acceptable target ranges to produce rates that under the circumstances are fair, equitable, and supported by substantial evidence. This conclusion is in accord with the Commission's observation that "[t]here is no single set of rates which is so 'right' that any deviation from it would produce rates which would be unlawfully unfair or inequitable." PRC Op. R87-1, para 4001.

*Id.* at 45.

In the current case, the Postal Service believes that the rate and fee proposals embodied in the settlement agreement withstand the careful scrutiny followed by the Commission in adopting the settlement in Docket No. R2001-1. As explained in detail below, the settlement rates produce sufficient revenues to cover the costs and other needs estimated for the test year in the Postal Service's revenue requirement. Furthermore, rates for each relevant mail category and special service meet the strict requirements of 39 U.S.C. § 3622(b)(3) governing allocation of attributable and other costs. All rates have been evaluated under the policies outlined in section 3622(b) and other provisions of the Act and have been found to be consistent with those legal standards, in accordance with the expert testimony of the Postal Service's pricing witnesses. In particular, the unique circumstances of this case, including the Postal

Service's policy objectives and the consensus embodied in the settlement, justify the across-the-board pricing approach embodied in the Postal Service's proposals.

In its Opinion in Docket No. R2001-1, the Commission observed that the settlement distinguished that case from prior omnibus rate cases, since most of the participants supported the rates proposed in the settlement agreement and refrained from presenting alternative pricing proposals. *Id.* at 40. The only opponent of settlement (APWU) did not itself advocate a different rate level, but rather focused on rate design issues. In the current case, the one party presenting testimony opposing the settlement rates (Valpak) has tended to emphasize rate design issues, but it has also advocated altering the cost coverage for the Standard Mail ECR subclass, and has proposed that rates for that category not be increased. As we argue below, however, that distinction on the current record does not invalidate adoption of the across-the-board settlement proposals. Particularly in light of the widespread acceptance of the settlement rates, Valpak has not addressed the consequences of treating the ECR subclass separately, or established a record that would provide practical guidance to the Commission. Furthermore, even for ECR, Valpak has not justified departure from the cost and rate relationships embodied in the current rates that the Postal Service's pricing approach would preserve.

**B. The Stipulation and Agreement Effectively Represents the Interests of a Large Majority of Participants and Provides a Sound Foundation for Commission Recommendation of Rates and Fees**

In developing the consensus represented in the Stipulation and Agreement, the Postal Service has sought the widest possible involvement by mailers and organizations interested in its proposed rate and fee changes. As described in the Motion for

Expedition filed with its Request in this docket, the Postal Service began consulting with parties active in the previous omnibus rate case (Docket No. R2001-1) substantially in advance of its filing in the current docket.<sup>32</sup> Prior to filing its Request, the Postal Service addressed a general invitation to all participants in Docket No. R2001-1, seeking their involvement and input in the settlement process, and inviting their comments on a possible Stipulation and Agreement.<sup>33</sup> Subsequent to filing its Request, the Postal Service proposed and conducted a group settlement conference to which all participants were invited.<sup>34</sup> At the settlement conference, representatives of a wide spectrum of participants attended and participated in general discussions regarding the possibilities for settlement.

Throughout the case, the Postal Service has sought input and participation on the development of a settlement agreement.<sup>35</sup> Through consultation with active participants in the docket, it drafted a proposed agreement and circulated it to all parties of record.<sup>36</sup> After further lengthy discussions with interested intervenors and the OCA, the Postal Service circulated a proposed Stipulation and Agreement to all parties of

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<sup>32</sup> Motion for Expedition at 5-6. See List of Participants in Docket No. R2001-1 Consulted Individually Prior to Docket No. R2005-1, attached to *Id.*

<sup>33</sup> See Letter to Parties of Record in Docket No. R2001-1 (April 4, 2005), attached to *Id.*

<sup>34</sup> Motion of the United States Postal Service for Settlement Conference Following Prehearing Conference, Docket No. R2005-1 (April 27, 2005); Presiding Officer's Ruling on Motion for Settlement Conference, Docket No. R2005-1 (April 28, 2005). By separate letter sent to participants in Docket Nos. R2001-1 and R2005-1, interested mailers and other organizations were given notice of the Postal Service's motion for a settlement conference and were invited to participate. Letter to Parties of Record, Docket No. R2001-1, Parties of Record, Docket No. R2005-1 (April 27, 2005).

<sup>35</sup> The Postal Service was designated settlement coordinator and submitted two reports on the status of settlement. First Report of the United States Postal Service As Settlement Coordinator, Docket No. R2005-1 (May 10, 2005); Second Report of the United States Postal Service as Settlement Coordinator, Docket No. R2005-1 (July 7, 2005).

<sup>36</sup> Letter to Parties of Record, Docket No. R2005-1 (July 1, 2005).

record, and filed it with the Commission.<sup>37</sup> On September 23, 2005, the Postal Service submitted signatures of 36 participants in Docket No. R2005-1 who have adhered to the settlement agreement.<sup>38</sup>

The Postal Service's rate and fee increase proposals embodied in its Request filed April 8, 2005, provided the foundation for the substantive terms of the Stipulation and Agreement. Unlike the development of the settlement agreement in Docket No. R2001-1, the rate and fee proposals in the current case were characterized by uniform, across-the-board adjustments of current rates, with a few limited exceptions. No concessions to this approach were adopted in settlement negotiations, and, once the Stipulation and Agreement was filed, it was not modified. This contrasts with the experience in Docket No. R2001-1, in which the settlement agreement was modified several times. The stability of the agreement in the current docket reflects the moderate, even-handed pricing approach in the Postal Services proposals, as well as the general agreement among the signatories to support the proposed changes.

Generally, the terms and conditions embodied in the Stipulation and Agreement are similar in structure and content to settlement agreements offered in previous Commission proceedings. The agreement expresses the fundamental principle that the Stipulation and Agreement represents a negotiated settlement of the Postal Service's Request for recommendations on rates and fees, filed pursuant to 39 U.S.C. §§ 3622 and 3623. Apart from the proposed rate schedules, the salient provisions include the following:

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<sup>37</sup> Letter to Parties of Record, Docket No. R2005-1; Notice of the United States Postal Service Submitting Stipulation and Agreement, Docket No. R2005-1 (July 22, 2005).

<sup>38</sup> Notice of United States Postal Service Filing Signatures for Stipulation and Agreement, Docket No. R2005-1 (Sept. 23, 2005).

- The parties acknowledge that the proceeding was initiated for the purpose of meeting the escrow requirement pursuant to P.L. 108-18, and agree that this purpose is consistent with the policies and provisions of the Postal Reorganization Act (title 39, United States Code).
- For this case, the parties agree that the across-the-board pricing approach adopted in the Postal Service's proposals is not inconsistent with the policies and provisions of the Act.
- The parties agree that the Commission should recommend increases in rates and fees by applying a uniform percentage adjustment (5.4%) to current rates and fees, subject to the requirement of 39 U.S.C. § 3622(b)(3).
- The parties agree that the testimony, documentation, discovery responses, and other materials filed by the Postal Service in the docket provide substantial evidence for establishing the rates and fees proposed in the agreement, and that the changes accord with the policies embodied in title 39, United States Code, including 39 U.S.C. § 3622(b)(9).
- The parties agree that the Stipulation and Agreement should be included as part of the record.
- The parties agree that, if recommended and approved or allowed to take effect, the Postal Service will recommend to the Board of Governors that the rate and fee changes should not be implemented prior to January 1, 2006.
- The parties agree not to file pleadings or testimony opposing the settlement or proposing changes other than those in the agreement. This restriction will not prohibit testimony or argument concerning a proposed rate or fee different from the settlement rates, or judicial appeal from adoption of a rate or fee different from the settlement rates.
- The parties agree that the force of the agreement will be broken if the Commission fails to recommend the settlement changes by October 31, 2005, or if the Governors fail to approve such recommendations.
- The parties agree that any party, upon notice given, could withdraw from the agreement on August 26, 2005, if it concludes that its interests are no longer furthered by the agreement.

- The parties agree that the Stipulation and Agreement shall not constitute agreement with any ratemaking principle, approach, methodology, legal interpretation, or fact underlying the rate, fee, and classification proposals.
  - The parties agree that the Stipulation and Agreement will apply only to Docket No. R2001-1 and does not create any precedent for any other proceeding.
- C. Valpak Has Not Established a Cogent Basis for Rejection of the Settlement Proposals

As noted above and discussed below, only Valpak has presented testimony challenging the settlement rates. Among the several bases for Valpak's opposition, a principal thrust of its position is that neither the Act nor the participants in this proceeding are well-served by the Postal Service's pricing proposals and their linkage to a widely accepted settlement effort. Valpak validates its own choice of contesting the settlement proposals by strongly implying that the choices of most participants to settle are inappropriate. In this regard, Valpak's witness Mitchell (VP-T-1, Tr. 9/5264-5394) contends that the Postal Service's across-the-board (ATB) pricing proposals do not conform to the requirements of the Postal Reorganization Act. His testimony decrees: "An ATB Approach is inconsistent with the General Ratemaking Scheme of the Act." Tr. 9/5285.

Mr. Mitchell's indictment arises out of several conclusions. In the section of his testimony introduced by the statement quoted above, he argues in particular that the Act outlines a specific process for review of Postal Service proposals to change rates and fees. See 9/5285-88. The process he describes appears to have both substantive and procedural elements. Substantively, he contends that the across-the-board pricing proposals are deficient because they do not require, or arise from, a detailed

examination of the particular cost behavior of specific types of mail, and because they are not linked to a prior, individual assessment of the markups associated with each type of mail. Tr. 9/5285-86. He characterizes this analytical process as the course normally followed by the Commission in determining which set of rates is “best for the nation.” In discovery, he further clarified his position. When asked to identify which criteria (e.g., cost coverages, markup indices, § 3622(b)) he would look at to determine whether rates were best, he stated:

I do not contend that one can focus on the items you identify, or on any other list, and specify how certain treatment of them would lead to the best rates. Rather, I define rates that are best for the nation in terms of the result of a deliberative process.

Tr. 9/6374.

With reference to procedure, Mr. Mitchell is also very critical of settlements in omnibus rate cases. In the current case, he challenges them in two respects. First, to the extent that settlement contributes to the policy underpinnings of the Postal Service’s proposals, he contends that settlement as an objective to achieve expedition cannot justify an across-the-board approach. He states:

[A]dopting a particular rate approach in hopes of facilitating a settlement, rather than according to the requirements of the Act, simply is not appropriate ratemaking. Put another way, increasing the likelihood of achieving settlement is not one of the non-cost factors of the Act. And arguments that the Postal Service has a financial interest in implementing rates a month or so sooner lack merit.

Tr. 9/5282. Second, Mr. Mitchell contends that settlement efforts in an omnibus case interfere with the appropriate path toward the best rates, since they, in effect, short circuit the development of a full record normally encountered in a fully-contested rate proceeding. He states:

The Act establishes a set of guidelines for setting rates and provides for review and decision-making by five commissioners. The process is guided as well by Commission rules and by principles the Commission has adopted. The usual procedure is for the Commission to be presented by proposals and testimony from the Postal Service and interested parties. When the Commission is presented with a complete record (meaning, for present purposes, that it is not presented with a settlement agreement, unanimous or not), I view a recommended decision coming from such circumstances as the best for the nation.

Tr. 12/6371-72.

In rebuttal, the Postal Service presented the testimony of Dr. James Kiefer, one of the Postal Service's pricing experts (USPS-RT-1, Tr. 11/6144-80). Dr. Kiefer thoroughly discussed Mr. Mitchell's views against settlement. Tr. 11/6159-66. He concluded that nothing in the Act or in logic would exclude consideration of settlement as an objective to justify the Postal Service's pricing approach.<sup>39</sup> Tr. 11/6160. He further concluded that, far from excluding settlement as inappropriate, the Act, the Commission's rules, and its practice favored settlement efforts, even in an omnibus rate case. Tr. 11/6164-65.

On cross-examination, Valpak tried to establish that Dr. Kiefer had mischaracterized Mr. Mitchell's testimony, or had misrepresented its meaning. See, e.g., Tr. 11/6182-89. Valpak appeared to emphasize that Mr. Mitchell had not contended that the across-the-board pricing approach was prohibited by the Act. Rather, it was his recommendation that another approach would be preferred, and that

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<sup>39</sup> Dr. Kiefer also noted that Mr. Mitchell's testimony implied his personal criticism of the Postal Service's decision to file its Request later than might have been possible, and the Board of Governors' decision to fund the escrow requirement through rate changes, rather than some other means, such as borrowing. Dr. Kiefer concluded that these choices fell within the exclusive authority of the Board to decide, and were supported on the record by Postal Service testimony. Tr. 11/6160-62.

the Commission should not, as opposed to cannot, recommend across-the-board increases. Tr. 11/6184.

On the contrary, Dr. Kiefer did not misrepresent Mr. Mitchell's testimony. In fact, he openly acknowledged Mr. Mitchell's position by quoting him directly. See Tr. 11/6163-64. Regardless of whether Valpak is arguing that the Commission should not or cannot recommend the settlement rates,<sup>40</sup> however, the conclusion is the same. Mr. Mitchell and Valpak are wrong. As Dr. Kiefer testified:

Mr. Mitchell's claim that the Postal Service's proposals should be rejected because the Act intends or "encompasses" a particular "ratemaking scheme" or "regulatory scheme," as he defines it, is wrong and misleading. While the Act prescribes a legal process, as guaranteed under statutory guidelines implemented by Commission rules of procedure, it does not dictate any particular course for any proceeding initiated by the Postal Service; nor does it dictate the form or contents of the record developed to review any particular proposal. The Commission's rules, furthermore, do not specify or limit the Postal Service's proposed pricing approach in any case, or require participants to disagree with the Postal Service, if an acceptable settlement can be reached. Rather, ...the Commission's rules specifically governing omnibus rate cases, for the most part, merely set out the type of information and explanations that the Postal Service must provide when it requests rate and fee changes. 39 C.F.R. § 3001.54. Far from proscribing settlement efforts the rules are constructed to facilitate them. 39 C.F.R. § 3001.29.

Tr. 11/6164.

Sound policy, reinforced time and again in Commission practice, favors honest attempts to settle otherwise contentious proceedings. This principle applied in Docket No. R2001-1, when the Presiding Officer wisely steered the proceedings toward

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<sup>40</sup> Mr. Mitchell's testimony will speak for itself: "An ATB approach is inconsistent with the general ratemaking scheme of the Act." Tr. 9/5285. "A quantitative showing that an ATB case is generally inconsistent with the rate-setting scheme under the Act." Tr. 9/5290. On cross-examination, Dr. Kiefer illustrated that Mr. Mitchell routinely practiced double-speak. See, e.g., Tr. 11/6186-89. "[H]e gives with the first sentence and he takes away with the last." Tr. 11/6189.

settlement, as well as it applies in the current case, where settlement plays an integral role in pursuing the Board's policy decision regarding the preferred means to fund a particular financial obligation. In this case, the great majority of participants have elected to settle. Even Mr. Mitchell would agree that such conduct is not without significance.<sup>41</sup> Nor can Valpak seriously contend that settlement is not appropriate under any reading of the Act, where, as in this case, Valpak has been afforded a full opportunity to conduct discovery and cross-examination against the settlement proposals, and present and argue its own case to the Commission. As the Commission recently reaffirmed:

The Commission policy favoring settlement is consistent with that of courts in other areas of the law. Case law is replete with examples of the courts favoring settlements in many different contexts. For instance, in *D.H. Overmyer Co. v. Loftin*, 440 F.2d 1213, 1215 (5<sup>th</sup> Cir. 1971) the court states: "Settlement agreements are highly favored in the law and will be upheld whenever possible because they are a means of amicably resolving doubts and uncertainties and preventing lawsuits." In *Pfizer Inc. v. W. Lord*, 456 F.2d 532, 543 (8<sup>th</sup> Cir. 1972) the court stated: "the policy of the law encourages compromise to avoid the uncertainties of the outcome of litigation as well as the avoidance of wasteful litigation and expense incident thereto."

Statutory policy also favors the independent settlement of issues. The Administrative Procedure Act (APA), 5 USCA § 554(c) directs agencies to provide opportunities for settlement:

The agency shall give all interested parties opportunity for – (1) the submission and consideration of facts, arguments, offers of settlement, or proposals of adjustment when time, the nature of the

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<sup>41</sup> Before "taking away" the concession, Mr. Mitchell stated:

Most observers would probably agree, as I do, that "willingness to enter into a settlement agreement adopting a particular set of rates is "an indication" of the acceptability of the rates involved, and I would presume that "participants adhering to the agreement" have considered the effects of the rates.

proceeding, and the public interest permit; and (2) to the extent that the parties are unable so to determine a controversy by consent, hearing and decision on notice and in accordance with sections 556 and 557 of this title.

The Commission follows this direction in its rules: "Any participant in a proceeding may submit offers of settlement or proposals of adjustment at any time and may request a conference between the participants to consider such offers or proposals." 39 C.F.R. § 3001.29.

Order No. 1443, Docket No. MC2004-3, at 15-16 (Aug. 23, 2005).

D. In the Unique Circumstances of This Proceeding, Settlement Would Further the Interests of the Public and the Mailing Community

The Postal Service does not blindly reject the reasoning embodied in Valpak's position or conduct in this case. As in any omnibus rate case, the types of issues Valpak raises are not frivolous. Nor does the Postal Service repudiate the relevance of the conclusions the Commission reached in Docket No. R94-1, when it declined to follow the settlement supporting another across-the-board pricing proposal. In Docket No. R2001-1, the Commission itself squarely faced that precedent in much different circumstances and concluded that settlement was in the public interest. The Commission stated:

These unique factual circumstances elevate criterion 9, other factors deemed appropriate by the Commission, to a prominent role in the Commission's pricing deliberations. While the Commission has ruled on numerous settlements, principally in classification cases, this settlement is distinguishable from the two others submitted in omnibus rate proceedings in its timing and virtual unanimity. These features alone make it noteworthy. Its uniqueness, however, is more a product of the unprecedented circumstances that led to it. The Postal Service's deteriorating finances, largely attributable to the national crisis, served as a backdrop for settlement negotiations. Expenses rose sharply; volumes were down significantly. As a result, the projections underpinning its Request became somewhat problematic, made more so by the softening of the nation's economy.

PRC Op. R2001-1, at 41.

As in Docket No. R2001-1, the Postal Service proposes that the Commission rely on its authority under 39 U.S.C. § 3622(b)(9) to consider factors not specifically enumerated in section 3622(b). In this case, the Postal Service is asking the Commission to give weight to the Board's policy judgment regarding the best way to address the extraordinary imposition of an escrow requirement that has no clear status or specifically defined use in the context of postal operations and finances.

We admit that the current situation is not similar to the perilous uncertainty facing the nation and the postal community following September 11, 2001. Nevertheless, in the current context, the Board's judgment makes sense, and has been succinctly explained and justified by Mr. Potter, who became the first Postmaster General to appear in Commission rate proceedings to support the Postal Service's Request and proposals. Moreover, the financial policy has been clearly presented in the testimony of the Postal Service's revenue requirement witness, Mr. Tayman. USPS-T-6, at 16-17. See Tr. 2/65, 89-90, 94, 108, 157-58, 167, 204, 209-10, 226-27, 229, 231-32, 249-50. In light of the sound reasons supporting the Board's decision, the public interest lies in giving appropriate weight to the judgment of the managers entrusted with the authority to oversee the operations of the Postal Service. As reflected in the strong support for settlement, furthermore, the mailing community will benefit from the moderate, across-the-board adjustments embodied in the Postal Service's proposals.

As we have argued and shown above, the Commission clearly has the authority to consider such factors, and it has clearly expressed a willingness to respect the Postal Service's financial position and its management policies in evaluating proposals for rate and fee increases. In this regard, the Postal Service believes that the Board's exclusive

authority to manage postal operations and finances should be given substantial weight. The Commission, however, need not agree that it is impelled by the Act to follow the Board's decision in this case. The policy justification for the Postal Service's Request has been substantially supported by un-refuted testimony on the record. Virtually all of the active parties in the case, furthermore, have agreed that this evidence supports the settlement rates, in the unique circumstances of this case.

Moreover, while the facts surrounding this rate increase are not the same as in Docket No. R2001-1, there is good reason to believe that the economic uncertainties of the future have a bearing on the Commission's judgment, particularly in light of recent national weather catastrophes affecting postal operations and expenses and the national economy. Admittedly, updated estimates reflecting these conditions have not been established on the evidentiary record, but current circumstances contribute to understanding the Postal Service's position.<sup>42</sup> In the current case, where the Postal Service, as a matter of policy, has elected to construct a revenue requirement containing a zero contingency amount,<sup>43</sup> these considerations take on a heightened importance.

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<sup>42</sup> As the Postmaster General testified:

Again, there are many, many factors that have to be considered going forward. In particular, right now, we're very concerned about the price of fuel. It's much higher than was anticipated in this rate case. It's having a significant impact on CPI, and CPI drives COLA. So at this point in time, we're anticipating probably the highest COLA payment ever in the history of the Postal Service next year unless fuel prices are mitigated somewhat over the next month.

Tr. 2/63.

<sup>43</sup> See USPS-T-6, at 17-18.

Finally, the Postal Service is not unmindful of the relevance of considerations raised by Mr. Mitchell in this case, and the Commission in previous cases, regarding the importance of costs and rate relationships in adjusting rates and fees for all categories of mail and special services. Dr. Kiefer, in fact, acknowledged that in most circumstances it may be desirable to reflect cost changes in rates (Tr. 11/6170), and that Mr. Mitchell has raised important issues concerning cost coverages and markups. Tr. 11/6175. The Postal Service is also acutely aware that the Commission's approach to evaluating the settlement proposals in Docket No. R2001-1 relied heavily on cost and rate relationships explored in the previous rate case. In the current docket, the settlement signatories ask the Commission to rely on relationships established in a case that was itself settled. Valpak in essence argues that the reliance on existing and prior relationships results in a factual and analytical foundation that is inappropriately attenuated.

Notwithstanding this reasoning, as we have argued above and show in more detail below, the evidentiary record in this case provides sound, reliable support for the settlement rates. The current relationships relied upon have been carefully reviewed with reference to the facts established in the previous two omnibus rate cases, and the validity of the Postal Service's proposed pricing approach has been affirmed by the Postal Service's witnesses. Their conclusions, furthermore, are supported by reliable facts estimated using the most recent cost and financial information available. Only Valpak has chosen to challenge that factual basis on the record of the current proceeding. The large majority of the active participants in this case have chosen to support the settlement rates.

In this regard, the proximity of the next omnibus rate case has an important bearing on the Commission's consideration. We cannot state categorically when the next rate case will be filed. Only the Board of Governors has the authority to determine the timing of the next Request for recommendations on general changes in rates and fees. We do know, however, that, if it were not for P.L. 108-18, the Postal Service would not have filed this rate case,<sup>44</sup> and the relationships embodied in the current rates -- which largely are preserved by the across-the-board rate adjustments being proposed -- would likely prevail for some time. Tr. 11/6227. We also know that the Postal Service is currently working to develop its proposals for the next case. Tr. 11/6228-30. In those circumstances, the results of the current case are likely to be overtaken by the results of a more conventional rate case in the foreseeable future.

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<sup>44</sup> USPS-T-1, at 7; Tr. 2/65.

### III. COMMISSION RECOMMENDATION OF THE SETTLEMENT AGREEMENT WOULD BE IN ACCORD WITH THE POSTAL SERVICE'S REVENUE REQUIREMENT

As noted above, the Commission is once again faced with an omnibus rate request in a context far different from the norm. Fortunately, it is not a context of tragedy, as was the last, but of a unique legislative mandate. Nevertheless, this unique cause, like the tragic circumstances surrounding the filing of the last one, has prompted a significantly successful settlement effort, as the best way to prepare for more routine changes in the future.

In any effort to assess the future financial needs of the Postal Service, such as that which falls under the general heading of "revenue requirement" in the rate case environment, a wide variety of potential factors require attention. Probably most prominent on that list, however, are expected trends in mail volume. The close relationship between a rate case revenue requirement and the corresponding volume forecast is obvious, as volume is a primary driver of both costs and revenues. In terms of both theory and practice, obtaining a volume forecast is the first step in preparing the revenue requirement. For purposes of most efficiently discussing the financial background of the Postal Service's filing and the settlement agreement, this portion of the brief presents a combined discussion of volume forecasting, and then the broader revenue requirement issues.

#### A. The Volume Forecasts Included with the Postal Service's Filing Are Predicated on the Well-Established Forecasting Methodology Employed in Previous Cases

To obtain its test year volume forecasts in this proceeding, the Postal Service relied upon familiar expert witnesses employing familiar forecasting procedures.

Although this case constitutes the first omnibus rate proceeding in well over twenty-five

years that Dr. George Tolley has not been the primary sponsor of the Postal Service's volume forecasts, his associates, themselves veterans of the last several cases, have ably fulfilled that function. The testimony of witness Thress appears as USPS-T-7, and the testimony of witness Bernstein appears as USPS-T-8. As those witnesses explain, test year forecasts are based primarily on a careful examination of the markets in which mail services are offered, the factors which have explained mail volume changes historically, and the best available information as to how those factors are expected to change going forward. Such a forecasting procedure has in the past generally proven highly accurate in providing mail volume forecasts over the typical rate case time horizon.

One feature of the Postal Service's forecasting presentation in this case is a continuing focus on the impact of technological diversion on the Postal Service. Both witness Bernstein and witness Thress address trends in technological diversion, and current efforts to actually integrate the expected impact of such technological diversion into the test year forecasts. While these subjects are addressed continually throughout the testimonies, the most salient discussions appear in the testimony of witness Bernstein (USPS-T-8) at pages 22-35 and 45-50, and in the testimony of witness Thress (USPS-T-7) at pages 23-33, and 296-304. The witnesses included available and projected information on expenditures on Internet Service Providers, number of broadband subscribers, and Internet advertising expenditures as additional components of their First-Class and Standard Mail demand analyses and forecasts. Their testimonies, moreover, jointly show why technological diversion due to innovations such as the Internet is likely to be a growing concern for the foreseeable future.

While the forecasting witnesses provided hundreds of pages of context and discussion, the actual volume forecasts are essentially summarized in Table 1 on pages 9-10 of the testimony of witness Thress. For each mail category, actual volume is shown for FY 2002 and FY 2004, along with the average annual growth rate over that period, and forecast volume is shown for the test year (FY 2006) assuming current rates (denominated as TYBR), and for the test year assuming implementation on October 1, 2005 of the Postal Service's proposed rates (denominated as TYAR), along with the implicit annual growth rates associated with each forecast. Table 1 shows that the Postal Service is expecting volume declines in First-Class Mail, Priority Mail, Express Mail, and Periodicals, and volume growth in Standard Mail, Package Services, and Special Services. Overall, the growing subclasses are expected to generate more additional pieces than the declining subclasses are expected to lose, with a consequent forecast of total domestic mail pieces growing slightly (in the 1-2 percent range) between FY 2004 and FY 2006. These figures show growth that cannot be considered robust in comparison with historical averages over the decades of the 1980s and 1990s, and serve to highlight significant evolutions in the postal environment in the last several years.

**B. The Revenue Requirement Testimony of Witness Tayman Compellingly Documents the Postal Service's Need for Additional Revenue**

The testimony of witness William P. Tayman, Jr., USPS-T-6, provides the basis for the Postal Service's revenue requirement of \$73.2 billion before rates in the test year (FY 2006). With revenue at current rates estimated for the test year at \$70.3 billion, that would leave a revenue deficiency of approximately \$22.9 billion. The proposed rate increase would increase revenue from \$70.3 billion to \$72.9 billion, a 3.7 percent

revenue increase. Expenses would decrease to \$72.6 billion resulting in a net surplus of \$281.5 million.<sup>45</sup>

Witness Tayman's testimony presents the Postal Service current financial position and its recent financial history.<sup>46</sup> He describes the positive trends that have led the Postal Service to such financial success<sup>47</sup> that, for instance, it has fully recovered its past losses and is not including a provision for recovery of prior years' losses in the revenue requirement.<sup>48</sup> He describes in detail the financial details and effects of Public Law 108-18 and how they have led the Postal Service to file this request for the additional revenue needed to make the congressionally mandated escrow payment in FY 2006.<sup>49</sup> As he testified, "in the absence of the additional escrow expense required by Public Law 108-18, the Postal Service's success in improving productivity would have allowed it to operate without a general rate increase in FY 2006."<sup>50</sup> Given current levels of service, the principal alternative to offsetting the loss resulting from the escrow requirement, other than a general rate increase, would be to increase debt. This option, which involves imposing a burden on future ratepayers, was deemed to be inconsistent with both legislative intent and with prudent financial management. Rather than defer the present requested increase and seek a larger increase in the future, the Postal Service, as explained by witness Tayman and by the Postmaster General, decided that

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<sup>45</sup> USPS-T-6, at 54 and Exhibit USPS-6A, as revised by errata filed June 9, 2005. These figures do not reflect the impact of the information provided in response to Presiding Officer's Information Request No. 13, question 1 (Sept. 1, 2005). If incorporated, this information would increase test year expenses.

<sup>46</sup> USPS-T-6, at 5-15.

<sup>47</sup> *Id.* at 5-9.

<sup>48</sup> *Id.* at 17.

<sup>49</sup> *Id.* at 9-12. *See also id.* Appendix A.

<sup>50</sup> *Id.* at 16.

the prudent and responsible approach to funding the escrow requirement and to manage the finances of the Postal Service was to request a moderate increase now.<sup>51</sup>

Witness Tayman's testimony begins with a summary of the "uneven path" that the Postal Service's financial condition has followed over the last ten years.

As he stated:

[The Postal Service] experienced noteworthy financial success in the early part of this period; suffered losses driven by external events in the mid part of the period; and, ended the period with financial success driven by Public Law 108-18. However, this same legislation imposes on the Postal Service, new and continuing financial obligations on the Postal Service, which, if not addressed, will threaten its the Postal Services financial health in FY 2006 and beyond. As stated in the testimony of Postmaster General Jack Potter, (USPS T-1), were it not for the escrow funding requirement imposed by Public Law 108-18 beginning in FY 2006, there would be no need to request an increase in postal rates at this time.<sup>52</sup>

Witness Tayman describes the first part of the ten-year period as one of "low, but increasing cost inflation, combined with solid volume growth in both First-Class Mail and Standard Mail, resulting in significant net incomes." But the next few years were less bright: "Net income began to decline sharply ... due to inflationary pressure on compensation costs, particularly benefits costs, leading to a small net loss in FY 2000."

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Then, of course, came the extraordinary and tragic events of September and October 2001. At that same time, First-Class Mail volume began to stagnate, resulting in net losses in the next two years. This was followed, however, by growth in productivity, driven by the 2002 Transformation Plan efforts, and by the enactment of

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<sup>51</sup> Unlike past revenue requirements, the unique circumstances of this expense led the Postal Service to forgo a traditional provision for contingencies and to set it at zero percent. *Id.* at 17-18. This further limited the size of the rate increase proposed.

<sup>52</sup> *Id.* at 5.

<sup>53</sup> *Id.*

Public Law 108-18, which reduced the Civil Service Retirement System component of compensation costs, resulting in net incomes in the last two fiscal years. This allowed for the full restoration of equity, as noted above.<sup>54</sup>

With respect to the *2002 Transformation Plan's* success in focusing postal management on improving productivity and efficiency, witness Tayman noted:

FY 2004 marked the fifth consecutive year of productivity gains. These gains are estimated to be equivalent to over \$6.1 billion in cost savings. An example of the impact of the transformation process is the reduction of career complement through attrition from 797,795 at the beginning of FY 2000 to 707,485 at the end of FY 2004. Management has committed to continue the transformation process through the Test Year. This will result in estimated additional cost reductions of \$1,276 million for FY 2005 and \$1,333 million in FY 2006, totaling \$3,885 million over the two-year period.

The good news ends in FY 2006, however. Witness Tayman explained that “the beneficial bottom-line financial impact of Public Law 108-18 will cease in FY 2006 with the introduction of the escrow provisions.” Witness Tayman describes in detail the provisions of the law to reduce CSRDF and its effect on postal finances to date:

Reductions in Civil Service Retirement and Disability Fund contributions under Public Law 108-18 are defined as “savings.”

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“Savings” in FY 2003 and FY 2004 were used to reduce postal debt. “Savings” for FY 2005 are being used to hold postage rates unchanged and to reduce postal debt. Any “savings” after FY 2005 by law are to be considered operating expenses of the Postal Service and, until otherwise provided for by law, are to be held in escrow and may not be obligated or expended. To date, Congress has provided no legislative direction concerning the use of escrowed funds.

The escrow is a legislated expense, over which management has no control, and provides no economic benefit to the Postal Service. The amount of the escrow expense is arbitrarily determined in the sense that it represents the difference between the funding requirement relating to a

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<sup>54</sup> *Id.* at 6.

legitimate estimate of Postal Service's CSRS obligations and an estimate of these obligations that was determined to be substantially in error.<sup>55</sup>

Witness Tayman explains how this situation forms the basis for the rate request:

By the end of FY 2005, the "savings" realized under Public Law 108-18 will have been fully absorbed by the escalating costs of postal operations. Factors contributing to the rise in costs are increasing personnel compensation costs, driven largely by benefits inflation, energy costs, and the continuing need to serve an ever-larger delivery and retail network. But in the absence of the additional escrow expense required by Public Law 108-18, the Postal Service's success in improving productivity would have allowed it to operate without a general rate increase in FY 2006.<sup>56</sup>

Also explained is the rationale underlying the Postal Service's determination to include a provision for contingencies of zero percent:

Under its current definition, the escrow represents a true tax or burden on the system. Furthermore, the escrow has been imposed in circumstances that would not otherwise have led the Postal Service to propose rate changes pursuant to section 3621.<sup>57</sup>

Witness Tayman reasons that, although "[u]nforeseen expenses represent an inevitable potential in postal operations," and that a contingency provision would be justified by the Postal Reorganization Act, the fact is that without the need to make the escrow payment, a general rate increase would not have been needed to fund postal operations. Thus, as witness Tayman stated, "if the escrow requirement were to be eliminated, the Postal Service would withdraw this request for rate increases."<sup>58</sup>

Witness Tayman points out, as noted above, that financing the escrow requirement through debt would be inconsistent with the intent of the law, could

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<sup>55</sup> *Id.* at 11-12.

<sup>56</sup> *Id.* at 16.

<sup>57</sup> *Id.* at 18.

<sup>58</sup> *Id.*

result in reaching the Postal Service's borrowing limit of \$3 billion in FY 2007, and would unjustifiably burden future ratepayers at a time of stagnating or decreasing First-Class Mail volumes.<sup>59</sup> Accordingly, witness Tayman summarizes that "as discussed by Postmaster General Potter (USPS-T-1), the Postal Service has decided that the prudent and responsible approach to funding the escrow requirement and to managing the finances of the Postal Service is to request a moderate general rate increase at this time to fund the escrow requirement, and mitigate the amount of the subsequent rate increase."<sup>60</sup> Mr. Tayman's testimony leaves no doubt that the Postal Service's need for requested additional revenue has been fully justified.

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<sup>59</sup> *Id.* at 16-17.

<sup>60</sup> *Id.* at 17.

#### IV. THE POSTAL SERVICE'S COMPREHENSIVE COSTING PRESENTATIONS AMPLY SUPPORT THE SETTLEMENT RATES

As explained in previous sections, the Postal Service's primary intent in developing this case was to address its FY 2006 escrow obligations with rate proposals most likely to facilitate consensus on streamlined litigation and implementation. Against that backdrop, however, the Postal Service also realized that its costing presentation in support of those rate proposals would need to be comprehensive, and would benefit from updated analyses and recognition of real world changes in its operating environment. Therefore, the Postal Service sought to establish a balance between the need to keep the costing portion of the case as simple as possible by straightforward reliance on costing approaches from previous cases, and the need to pull in new approaches based on new operating relationships that have developed, or new sources of information that have become available, in the several years since the last omnibus rate proceeding.

The Postal Service's costing presentation in this case is comprehensive in that it provides not only the analyses behind the CRA (so-called subclass-level costing), but also the various cost studies that further disaggregate costs below the subclass level. While the necessity of such cost studies (the results of which are normally used for rate design purposes in a more conventional rate case) is less apparent in the context of an across-the-board rate proposal, the Postal Service included the full panoply of cost studies in its costing presentation. To the extent possible, however, the Postal Service refrained from proposing new methodologies in those cost studies, relying instead on the established methodologies as appropriate.

In terms of subclass costing, however, the Postal Service for several reasons had no choice but to incorporate new methodologies in its presentation. For example, changes in operations over time had rendered certain costing methodologies obsolete. Additionally, updates of certain methodologies had been conducted and incorporated into CRA reports even prior to the base year in this proceeding. It would have been unreasonable to revert to outdated procedures and approaches as if the new information and analyses did not exist. The testimony of base year costing witness Meehan (USPS-T-9) at pages 6-11 spells out the changes that were made in subclass costing, the rationale for the changes, and identified the witnesses providing further information. Some of the changes in subclass costing certainly had implications for the cost studies intended to disaggregate the resulting subclass costs.

As noted above, the base year (subclass) costing witness was witness Meehan (USPS-T-9), who presented FY04 volume variable costs for each subclass and service. The base year incremental cost presentation, on the other hand, was sponsored by witness Kay (USPS-T-18). The foundation of the base year costs comes from the data system witnesses. In this case, witness Shaw (USPS-T-2) testified on the In-Office Cost System (IOCS), witness Hunter (USPS-T-3) testified on the Transportation Costing System (TRACS), witness Pafford (USPS-T-4) testified on Revenue, Pieces, and Weight (RPW), and witness Harahush (USPS-T-5) testified on the city and rural Carrier Cost Systems (CCS).

Cost attribution witnesses focused on the variability and/or the distribution of the costs in specific cost segments. As in the last case, witnesses Van-Ty-Smith (USPS-T-11) and Bozzo (USPS-T-12) addressed issues pertaining to mail processing costs (C/S

3), as did witness Smith (USPS-T-13), who also discussed facility costs (C/S 15). Witnesses Bradley (USPS-T-14), Stevens (USPS-T-15), and Kelley (USPS-T-16) sponsored portions of a new City Carrier Street Time Study (CCSTS), which had its main impact on the estimated costs of carrier street time (C/S 7). Transportation costing (C/S 14) issues were primarily addressed by witnesses Nash (USPS-T-17) and Bradley (USPS-T-31).

Of the methodologies presented by the subclass costing witnesses, certainly the most attention was garnered by the new CCSTS. In his direct testimony, Prof. Bradley paid considerable attention to the deficiencies in the established city carrier methodology. USPS-T-14 at 1-11. He explained how the new CCSTS was specifically designed to address and resolve those deficiencies, and thus provides a more solid foundation for analysis. *Id.* at 11-14. Although the differences in results are not that radical, moving forward, the new study will constitute a valuable improvement over the old approach to carrier costing.

The base year volume variable and accrued costs were rolled forward to project test year volume variable and accrued costs by witness Waterbury (USPS-T-10). For this endeavor, witness Waterbury employs the standard roll-forward procedures used over numerous cases (albeit in this case with a new software platform). Beyond base year costs from the costing witnesses, witness Waterbury also must obtain roll-forward projection factors from both the revenue requirement witness and the forecasting witnesses. Using this aggregation of inputs, she presented volume variable and accrued cost estimates for FY06, both before-rates and after-rates. (Comparable test year incremental costs were presented by witness Kay, USPS-T-18).

As noted above, the cost study witnesses sought to minimize methodological changes in their approaches to the disaggregation of test year subclass costs and the estimation of test year cost avoidances. The one prominent exception to this was witness Kelley (USPS-T-16), who was compelled to undertake a wholesale revision of the disaggregation of delivery costs by virtue of the existence of the entirely new approach to subclass delivery cost estimation sponsored by witnesses Bradley, Stevens, and Kelley. Witness Kelley also took the opportunity to conform his analysis (USPS-LR-K-67) to revised rural carrier compensation definitions, and to propose an explicit DAL adjustment for Saturation ECR.

The other cost study witnesses focused on updating previous work and were generally able to avoid any major new proposals in their presentations. Witness Miller presented two pieces of testimony, USPS-T-19 regarding disaggregated mail processing estimates for flats, and USPS-T-20 regarding disaggregated mail processing estimates for parcels. Disaggregated mail processing costs estimates for letters, as well as worksharing related cost estimates, nonmachinable surcharge cost estimates, and Address Correction Service estimates, were the subject of the testimony of witness Abdirahman (USPS-T-21). Witness Hatcher (USPS-T-22) testified regarding BRM and QBRM costs, and the costs of On-Call and Scheduled pick-ups, as well as other special service cost estimates. Witness Page (USPS-T-23) presented testimony on volume variable costs for categories of Express Mail, for stamped envelopes, and on Final Adjustments used in the rollforward. Costs for delivery confirmation, signature confirmation, and return receipt were covered in the testimony of witness Wesner (USPS-T-24). Witness Mayes (USPS-T-25) addressed dropship cost avoidances, the

transportation costs for Parcel Post and BPM, and Bulk Parcel Return Costs. The testimony of witness Cutting (USPS-T-26) discussed a variety of topics, including window service costs, mail processing costs, and cost savings related to the use of pallets for Periodicals. Lastly, witness Loetscher (USPS-T-32) extracted mail characteristic information (e.g., weight, shape, etc.) for application in several different contexts.

Almost all of the costing witnesses (subclass costing and cost study) received some amount of discovery, either from the parties, or via Presiding Officer Information Requests. Many of them, in fact, endured an amount of discovery commensurate with that received in a more typical omnibus rate proceeding. Nevertheless, presumably because of efforts to avoid contention and settle the case, only one intervenor witness presented testimony challenging the Postal Service costing presentation. As discussed next, however, the testimony of Valpak witness Haldi presents no valid basis to contest the settlement rates on the grounds of costing deficiencies.

A. The Issues Raised by Dr. Haldi Either Lack Substance, or Fail to Present Sufficient Reasons to Reject the Settlement Rates

In his “Purpose of Testimony” section, Dr. Haldi (VP-T-2) identified three purposes of his testimony, all relating to the costing of ECR Saturation mail. Tr. 9/5481. The first was to emphasize that all costs associated with DALs should be assigned to flats, not to letters. *Id.* The second was to assert that the methodology jointly employed by the Postal Service and the Commission fails to develop correct estimates of marginal costs for categories of ECR Saturation mail. *Id.* The third was to propose an alternative estimate of the number of DALs to be used when making a DAL cost adjustment. *Id.*

With respect to the first purpose, there is no disagreement from any party regarding whether the costs of DALs should be treated as letter costs or flat costs. As even Dr. Haldi acknowledges (Tr. 9/5492), the Postal Service itself proposed a new DAL adjustment in USPS-LR-K-67 to shift to flats DAL carrier costs that otherwise would go to letters, and he urges the Commission (Tr. 9/5493, 5501-02) to adopt the Postal Service procedure, or something similar. Moreover, he notes that for in-office costs, the IOCS will code a tally associated with a DAL based on the characteristics of the host piece, not the DAL, and therefore should avoid potential mismatches. Tr. 9/5494-95. Any dispute, therefore, is not one of principle, but rather of application.

Dr. Haldi's primary dispute regarding application relates to his third purpose, an alternative estimate of the number of DALs. Based on information provided by Advo in response to Valpak discovery, it seems likely that the actual number of DALs in 2004 was neither as low as originally estimated by the Postal Service, nor as high as originally estimated by Dr. Haldi. Indeed, Dr. Haldi actually revised his testimony based on the new Advo responses, and lowered his estimate substantially. See Tr. 9/5555.<sup>61</sup> With neither his original nor his revised alternative estimate of DALs, however, did Dr. Haldi work through to identify for the record the actual costs upon which he believes the Commission should rely. Tr. 9/5690-92. In contrast, in rebuttal to Dr. Haldi, Advo

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<sup>61</sup> Dr. Haldi simultaneously made a revision that increased his estimate of "Others, Independent" DALs, claiming (Tr. 9/5554) that new information "amply" supported this upward revision. Oral cross-examination by Advo, however, effectively destroyed that claim (see, e.g., Tr. 9/5666, 5678). Sticking, therefore, with his original estimate of 0.168 billion "Other, Independent" DALs, rather than his unsupported upward revision to 0.345 billion, the Postal Service submits that a reasonable estimate of 2004 total DALs based on the current record can be derived, based on all of the rest of Dr. Haldi's revised figures as shown at Tr. 9/5555, as 4.323 billion. This figure is actually closer to the Postal Service's estimate of 3.375 billion (Tr. 9/5539) than Dr. Haldi's original estimate of 5.400 billion.

witness Crowder (ADVO-RT-1) took the initiative to conduct a complete analysis exploring the cost ramifications of the higher DAL number. Tr. 10/5737-39. Her testimony convincingly demonstrates that, for a variety of reasons, the settlement rates can easily be reconciled even with cost estimates based on a plausible increase in the number of estimated DALs. Tr. 10/5736-45.

In term of costing issues relating to DALs beyond just the volume of DALs, witness Crowder likewise examines Dr. Haldi's allegations and insinuations, and shows them to be baseless. Tr. 10/5746-55. For example, at Tr. 9/5495-96, Dr. Haldi criticizes a procedure in which a piece estimate for cased flats is developed by multiplying an IOCS estimate of hours spent casing flats, by a flats casing productivity estimate of pieces per hour. His criticism boils down to an observation that, because the IOCS time estimate includes some hours spent casing DALs as well as flats, this multiplication yields a higher estimate of cased flats than it would if any hours spent casing DALs could be (correctly) excluded from the hours term of the equation. Dr. Haldi concludes that overstating the volume of cased flats will underestimate the volume of "uncased" flats taken directly to the street, and hence underestimate the share of street costs of sequenced mail that should be attributed to flats. *Id.* But, as witness Crowder explains, when the effects of the same alleged overstatement of cased flats on the estimated street costs of cased flats is also taken into account, the net result will be *lower* overall (cased plus sequenced) street costs for flats, and a *lower* letter-flat differential, exactly contrary to the conclusion proffered by Dr. Haldi. Tr. 10/5748-49.

Witness Crowder similarly disposes of Dr. Haldi's claims relating to DALs regarding mail processing cost issues (see Tr. 10/5749-52; see also Tr. 9/5605-06) and

transportation cost issues (see Tr. 10/5749; see also Tr. 9/5603-04). She also explains (Tr. 10/5752-55) that the postal data systems are not biased against letters, as Dr. Haldi appears to suggest (Tr. 9/5499-5501). Witness Crowder does agree with Dr. Haldi that better information from the data systems regarding DALs is warranted (Tr. 10/5746), but Dr. Kiefer's rebuttal testimony for the Postal Service observes that Postal Service efforts have been underway to achieve that objective since even before the case was filed (USPS-RT-1 at 31-32). In summary, nothing offered by Dr. Haldi pertaining to the topic of DALs provides any basis to deviate from the settlement rates.

With respect to the other purpose identified by Dr. Haldi for his testimony, the claim that the established methodology yields average cost estimates rather than marginal cost estimates for ECR saturation mail, three witnesses testified to rebut both the factual and theoretical premises of his assertion. Briefly stated, Dr. Haldi submits that persistent capacity constraints preclude the Postal Service from always delivering saturation mail as an extra bundle, that such constraints constitute the reason why saturation flats are handled as extra bundles more than saturation letters, and that the different treatment afforded flats and letters distorts the estimates of marginal costs generated by the prevailing attribution methodology. Tr. 9/5503-34.

On behalf of the Postal Service, witness Lewis (USPS-RT-2) presented operational testimony addressing Dr. Haldi's theories. Mr. Lewis testified that city carrier managers, in instances in which they are forced to choose between a flat or a letter mailing to handle as an extra bundle, will be inclined to case the letter mailing because flats tend to be easier to handle on the street, as well as because letters tend to be easier to case in the office. USPS-RT-2 at 2-4. But witness Lewis also testified

that the incidence of instances in which such conflicts must be resolved based on those criteria appears to be much less common than Dr. Haldi's testimony would suggest.

Based on his experience, and more specifically a field survey he conducted, Mr. Lewis estimates that the constraint on which Dr. Haldi's testimony is focused seems to occur quite infrequently – in the neighborhood of only about 10 percent of the time. *Id.* at 4-8.

Prof. Bradley, also testifying on behalf of the Postal Service (USPS-RT-3), discusses why the established Postal Service/PRC methodology can handle variations in operating procedures such as those caused (relatively rarely) by the extra bundle constraint. USPS-RT-3 at 1-16. He also demonstrates mathematically and intuitively why the resulting cost estimates are truly measures of marginal (and not "average") costs. *Id.* at 16-27. As Prof. Bradley shows, Dr. Haldi's assertions are based on both factual and theoretical flaws. The established costing methodology provides appropriate results for ratemaking, and Dr. Haldi's radical suggestion to abandon those results does not withstand scrutiny.

The portion of Advo witness Crowder's rebuttal testimony addressing this issue (Tr. 10/5756-66) reiterates some of the same points made by witnesses Lewis and Bradley. She also notes that Dr. Haldi's suggested solution to the extra bundle constraint problem he hypothesizes is predicated on an assumption that no further capacity exists to handle *any* additional saturation mail as an extra bundle. Tr. 10/5756-58, 5764-65. She cites data from Dr. Bradley's variability study as evidence to show that this assumption is utterly unrealistic. Tr. 10/5759-61. She states that reasons other than an extra bundle constraint which might lead to a saturation letter mailing being cased include the Postal Service's policy on DPS, and the physical characteristics of

letters. Tr. 10/5762-64. Witness Crowder also makes the telling observation that Dr. Haldi suggests applying his approach (i.e., the assumption that no more saturation mail can be taken directly to the street and that the relevant marginal cost is therefore the in-office and street costs of cased mail) only for purposes of developing the letter-flat differential, but not for other rate making purposes. Tr. 10/5758, 5765-66. Since those marginal cost estimates for ECR Saturation would be greater than those produced by the established costing systems, one understands why Dr. Haldi would not be advocating what would be, from his perspective, the undesirable consequences of consistent application of his approach for all purposes. Witness Crowder provides strong support for her conclusion that Dr. Haldi's contentions and solutions regarding the extra bundle constraint should be rejected.

#### B. Summary

Collectively, the Postal Service's costing witnesses have sponsored testimony and source materials that provide more than sufficient cost information to allow the Commission to evaluate fully the proposed rates and fees. First, the Commission can be assured that the proposed rates for each subclass and service cover the costs of providing the service, and that no cross-subsidies will exist in contravention of subsection (b)(3). Second, the Commission can examine the proposed rate relationships in light of the relevant cost relationships for purposes of applying the other factors of section 3622(b), such as fairness and equity, effects on postal costs of the degree of mailer preparation, etc. As explained above, the testimony of Dr. Haldi on behalf of Valpak offers no material basis to question reliance on the costing materials

provided by the Postal Service for purposes of recommending the settlement rates and fees.

V. THE POSTAL SERVICE'S ACROSS-THE-BOARD RATE AND FEE PROPOSALS REFLECT A FAIR DISTRIBUTION OF THE PUBLIC LAW 108-18 ESCROW BURDEN AND CONFORM TO THE POLICIES OF THE POSTAL REORGANIZATION ACT

A. The Need To Satisfy A Unique Revenue Requirement Justifies the Request for Relatively Uniform Postal Rate And Fee Changes

The central objective of the Postal Service's Request in this docket is to satisfy an extraordinary mandate in the Civil Service Retirement Funding Reform Act of 2003, Public Law 108-18, 117 Stat. 624 (April 23, 2003) (hereinafter, "PL 108-18"). That law requires the Postal Service to generate and put into escrow approximately \$3.1 billion dollars per year that may not be obligated or expended by the Postal Service. In the nearly two and one-half years since the passage of Public Law 108-18, Congress has assigned no purpose (postal or otherwise) to this escrow fund. Nevertheless, PL 108-18 defines the escrow as an "operating expense" of the Postal Service that must be met in FY 2006. PL 108-18, § 3(a)(3), 117 Stat. 627.

The Postal Reorganization Act vests solely in the Board of Governors of the United States Postal Service the authority to make fiscal policy determinations for the nation's postal system. 39 U.S.C. § 205(a). Subject to recommendations of the Postal Rate Commission, which operates under authority of § 3624, the Governors of the Postal Service are granted final authority under §§ 3621 and 3625 to establish postal rates and fees. It is well-settled that the Board of Governors exercises the power to determine (1) what the Postal Service may do with any assets or existing equity, (2) whether the Postal Service should borrow funds within limits set by the Congress, (3) whether to request that postal rates and fees be increased to meet its financial needs, and (4) when to exercise any of these options. See, *Newsweek, Inc. v. United States*

*Postal Service*, 663 F.2d 1186, 1204-05 (2<sup>nd</sup> Cir 1981); *Governors of the United States Postal Service v. United States Postal Rate Commission*, 654 F.2d 108, 114 (DC Cir 1981).

Faced with the need to fulfill the Fiscal Year 2006 escrow obligation, the Board of Governors directed the Postal Service to file a request with the Postal Rate Commission seeking rate changes that, if implemented at the beginning of FY 2006, would generate the necessary \$3.1 billion to cover the expense. To be as transparent as possible about the Board's objectives, Postmaster General John E. Potter took the unprecedented step of becoming the first Postmaster General to testify before the Postal Rate Commission.<sup>62</sup> He testifies that:

If the FY 2006 escrow obligation embodied in Public Law 108-18 did not exist, the Board of Governors would not have directed postal management to file the request now under review. Should legislation be enacted that relieves the Postal Service of this \$3.1 billion obligation before a recommended decision is issued in this docket, we will withdraw this request.

USPS-T-1 at 7.<sup>63</sup> Thus, the record in this docket establishes beyond any doubt that the escrow obligation is both unavoidable and the sole basis for the request in this proceeding.<sup>64</sup> Were the Postal Service not faced with the need to meet the FY 2006

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<sup>62</sup> See, Direct Testimony of John E. Potter On Behalf Of United States Postal Service (USPS-T-1).

<sup>63</sup> See also, Tr. 2/65. Witness Potter further testified that, if legislation to eliminate the escrow which otherwise placed no limitations on the Postal Service were enacted after an affirmative recommended decision by the Commission, but before any action by the Governors under U.S.C. § 3625, he would discourage the Governors from approving the Commission's recommendations, so as to keep the current rates in effect in FY 2006. Tr. 2/57.

<sup>64</sup> The Docket No. R2001-1 rates have been in effect since June 30, 2002. As a result, customers' rates have declined in real terms over the past three years. See, Tr. 3/406.

escrow obligation, the Commission would not now be reviewing a request for rate and fee changes at this time.

In determining to file a rate request to apportion the escrow burden among mailers in the FY 2006 test year, the Postal Service has made what witness Potter describes as “a policy judgment about the most reasonable, practical and effective way to meet an unavoidable financial obligation . . . .” USPS-T-1 at 1. His testimony emphasizes that, however unwelcome the Postal Service regards the escrow obligation to be, responsible stewardship requires that revenues be generated in FY 2006 to cover the expense “through moderate, across-the-board changes in all rates and fees, except for limited exceptions dictated by statute or other extraordinary circumstances.” *Id.* at 2.

The Postal Service’s determination to simplify its rate request by proposing relatively uniform rate and fee changes reflects several important policy objectives. First and foremost, the Postal Service determined that the unique nature of the escrow expense justifies the rate design and pricing approach it has taken in this case. Although PL 108-18 characterizes the escrow as an “operational expense,” it is not an expense that arises from any operation of the Postal Service. *Id.* at 4. *See also*, USPS-T-6 at 12.

The unique character of the escrow burden is obvious. There is no activity or function of the Postal Service (or the Post Office Department) that either has caused or will cause the escrow expense to be incurred in FY 2006. The expense does not arise from the collection, processing or delivery of any mail, or provision of any service to any customer in the past, present, or future. It is not a past, present or future capital or personnel expenditure or obligation. There is no feature of any one mail class or

special service that causes the escrow to be incurred to any degree greater than by any other mail class or special service. In the two and one-half years since its inception, the purpose of the escrow stands apart from the Postal Service's other financial obligations.<sup>65</sup>

In the absence of any specific direction in the Postal Reorganization Act or in Public Law 108-18, the Board of Governors directed the Postal Service to file the instant Request. In the Postal Service's approach, the escrow burden is shared as evenly as practicable among the various mail classes and special services, based on revenue. USPS-T-1 at 4-5.<sup>66</sup> The absence of any proposals for changes in mail classification is another important feature of the Postal Service's Docket No. R2005-1 Request. The Postal Service exercised restraint in this regard in order to prevent such classification issues from complicating the proceeding. *Id.* at 5-6. By proposing that the escrow burden be imposed in a generally uniform manner and without classification changes to add further complexity, the Postal Service has made it possible to expedite the resolution of this docket. From the outset, given the timing of the request in this proceeding, expedition has been a vital objective of the Postal Service. USPS-T-1 at 5. Without it, under the circumstances of its request, the Postal Service would not have the opportunity to receive a recommended decision in time to permit a substantial recovery

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<sup>65</sup> Accordingly, commentators characterized the escrow obligation as the equivalent of a "tax" on the Postal Service. See, Direct Testimony of Maura Robinson On Behalf Of United States Postal Service (USPS-T-27, at 6-7, n.4).

<sup>66</sup> If the escrow obligation were smaller or larger, the Postal Service would have requested that rates and fees be changed by a correspondingly smaller or larger percentage across-the-board. USPS-T-1 at 5.

of the escrow expense through the implementation of rate increases as early as practicable in FY 2006. *Id.*

Given the intensity of the conflicting interests among rate case intervenors, there has rarely been unanimity among the parties on any issue in any omnibus rate case. Still, from the outset, it has been the Postal Service's expectation that a substantial majority of intervenors would examine the financial, costing and forecasting data filed in support of the Postal Service's current request, study the policy rationale for the current across-the-board approach, find the deviations from 5.4 percent warranted, and conclude that the across-the-board request was a reasonable response to the imposition of an extraordinary escrow expense.<sup>67</sup> Witness Potter testifies that the Postal Service's across-the-board "approach creates the prospect of settlement of issues among usually contentious rate case participants." *Id.* at 2-3. His expectation has been borne out by the number of intervenors that are signatories to the July 22, 2005, Stipulation and Agreement.<sup>68</sup> As a result, the Commission has been able to conclude the administrative litigation of this docket in less than six months, compared to

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<sup>67</sup> *Id.* at 5. Any request to meaningfully vary the treatment of the escrow burden among the numerous mail classes and postal services would likely have triggered the usual full-length, robust and cacophonous litigation of conflicting, self-interested counter-proposals.

<sup>68</sup> See Notice of United States Postal Service Filing Signatures For Stipulation And Agreement (September 23, 2005). As explained by Postal Service witness Robinson at Tr. 3/426: "Parties interven[e] before the Commission . . . because they are interested in providing guidance to the Commission on potential rates and classifications that likely would be beneficial to those parties' economic interests." Therefore, it is not unreasonable in the instant docket to infer from the near unanimity of settlement that the Postal Service's across-the-board proposals have appropriately balanced the parties' interests and the statutory requirements. The absence of objections from the settlement parties would imply that these parties have carefully weighed the Postal Service's proposals.

the usual eight and one-half months, creating the opportunity for the issuance of a recommended decision well in advance of the 10-month deadline imposed by § 3624(c)(1).

B. The Across-The-Board Directive Has Resulted In Carefully Designed Rate And Fee Proposals

Working under the general direction of the policy objectives adopted by the Board of Governors, Postal Service economist Altaf H. Taufique was assigned the responsibility for proposing rate and fee changes for the Commission's consideration in this docket.<sup>69</sup> Witness Taufique's starting point was the existing rate and fee schedule, which reflects the Commission's judgments on cost allocation and rate relationships from the most recent general rate proceeding, Docket No. R2001-1. His testimony reflects the application of his experience and expertise to the task of designing rates and fees that are not only consistent with the policies of the Postal Reorganization Act, but which, to the greatest extent practicable, also are faithful to senior postal management's objective of layering the escrow burden relatively evenly over the existing postal rate and fee schedule.

The testimony of witness Taufique demonstrates that the application of a simple policy objective -- across-the-board changes -- to the postal rate and fee schedule is not as simple as it may sound at first blush. Beginning with the fact that the escrow obligation represents approximately a 5.4 percent increase over existing revenues, witness Taufique determined that his goal was to propose that existing rates and fees generally be increased by that percentage. However, in developing the Postal Service's

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<sup>69</sup> See Direct Testimony Of Altaf H. Taufique On Behalf Of United States Postal Service (USPS-T-28).

rate and fee proposals, witness Taufique had to harmonize postal management's objectives with the ratemaking criteria and related policies of the Postal Reorganization Act. As demonstrated by his testimony (USPS-T-28) and his rate design worksheets (USPS Library Reference K-115), witness Taufique's approach to this task is faithful to those objectives.

Using the existing rate and fee schedule as a base, witness Taufique generally proposes across-the-board changes.<sup>70</sup> As necessary, he advocates deviations from an absolutely strict across-the-board approach to:

conform proposed rates and fees to the requirement that each subclass or special service covers its volume-variable costs, as required by § 3622(b)(3);

preserve subclass markup and rate relationship mandates and targets specified by § 3626(a) for various preferred subclasses; or

maintain certain intra- or inter-subclass rate relationships.

As necessary, he also applies standard, rational rounding constraints in designing the rates and fees. The following examples are illustrative of the great care exercised by witness Taufique (at times collaborating with witness Robinson) in the design of the proposed rate and fee schedule.

The current 37-cent initial-ounce First-Class Mail rate is regarded as the flagship postal rate. Witness Taufique proposes that it be increased by 5.4 percent to 39 cents. However, application of the whole-cent rounding constraint to other First-Class Mail

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<sup>70</sup> As noted at page 1, n.1, of the Docket No. R2005-1 Request, and for the reasons articulated in the USPS Notice Regarding Exclusion of Confirm Service From General Rate Case (April 8, 2005), no changes are proposed in the Domestic Mail Classification Schedule 991 fees for the Confirm special service.

rates used by members of the general mailing public leads to several deviations from the 5.4 percent target.<sup>71</sup>

At the two-pound level of Zones 1-3 for Priority Mail, witness Taufique applies an exception to the general convention of rounding down to the next nickel in order to preserve a 10-cent differential between those rates and corresponding rates for Inter-BMC/ASF Parcel Post. USPS-T-28 at 7.

As explained by witness Robinson, § 3626(a)(3) requires that the markup<sup>72</sup> for the Within County Periodicals subclass shall be equivalent to half the markup of for the Outside County subclass. In the context of the instant request, the Postal Service proposal to increase Outside County rates by approximately 5.4 percent requires it to comply with § 3626(a)(3) by proposing a subclass markup for Within County that results in Within County rate decreases. USPS-T-27 at 10. Witness Taufique's rate design complies with this requirement. See, USPS-T-28 at 14; Exhibit USPS-28A, pages 10-15, Table 4.

In contrast to the markup relationship described above, § 3626(a)(4)(A) establishes a slightly more flexible rate design target for corresponding categories within the Media Mail and Library Mail subclasses. Here, the Act requires that the Postal Service, as nearly as practicable, establish rates for Library Mail that are five percent

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<sup>71</sup> For instance, the proposed single-piece nonmachinable surcharge increase (from 12 to 13 cents) is eight percent. The proposed single-piece postcard rate and additional-ounce rate increases (from 23 cents each to 24 cents) are only 4.3 percent. See, Exhibit USPS-28A, page 1, Table 1.

<sup>72</sup> Consistent with prior Commission recommended decisions, the markup for Outside County Periodicals is calculated prior to the application of the five percent rate reduction for Nonprofit Periodicals and Classroom Periodicals. For this purpose, the "markup" is defined as the ratio of adjusted revenue divided by incremental costs less one. Exhibit USPS-27G.

lower than those for corresponding Media Mail. Consistent with this directive and the Postal Service's goal of relatively uniform, across-the-board increases, witness Taufique proposes that Media Mail and Library Mail rates be increased by 5.4 and 5.7 percent, respectively.

In accordance with § 3626(a)(6)(A), the average revenue per piece for each nonprofit Standard Mail subclass is to be established, as nearly as practicable, at a level that is 60 percent of the revenue generated by corresponding regular rate (commercial) Standard Mail subclasses. At page 11 of USPS-T-28, the Commission will observe that, in harmonizing the Postal Service's across-the-board policy goal and the limited flexibility inherent in subsection (a)(6)(A), witness Taufique proposes rates for Nonprofit Regular and Nonprofit Enhanced Carrier Route (ECR) that generate 61 percent and 56 percent, respectively, of the average revenue per piece for their corresponding commercial subclasses.<sup>73</sup> Had witness Taufique applied subsection (a)(6)(A) as if it imposed an inflexibly strict 60 percent mandate, he would have boxed himself into proposing rate increases for Nonprofit ECR in the neighborhood of 13 percent.

The examples above illustrate witness Taufique's faithful application of the across-the-board rate design goal in a manner that abides by statutory pricing and rate design policies directed at specific, preferred subclasses. In one case, he has designed rates to comply with a strict markup relationship requirement applied by witness Robinson. In two other cases, his rate designs harmonize the across-the-board objective with the limited flexibility permitted at the rate cell level.

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<sup>73</sup> See, the responses of witness Taufique to VP/USPS-T28-52 through 55, Tr. 3/676-683; as revised on August 24, 2005, and admitted into evidence by Presiding Officer's Ruling No. R2005-1/79 at 2 (September 13, 2005).

In compliance with the strict § 3622(b)(3) mandate that each subclass or special service generate sufficient revenues to cover its projected test year volume-variable costs, the Postal Service proposes extraordinarily high fee increases -- above 60 percent -- for Registered Mail. Costs for this special service have spiked upward quite substantially since Docket No. R2001-1. See, USPS-T-27 at 24A; USPS-T-28 at 29; Exhibit USPS-28A, at 57, Table 10. Similarly, the proposed average increase for the Periodicals Application fees, in total, also substantially exceeds 5.4 percent because of the need to cover volume variable costs and the applicable five dollar rounding constraint. USPS-T-27 at 16, fn. 9.

Otherwise, in designing rates, witness Taufique takes into account the rounding conventions that traditionally have been applied in postal ratemaking. These include the whole-integer constraint on the initial ounce rate of First-Class Mail, which both the Postal Service and the Commission have consistently observed. See, PRC Op. R2001-1 at ¶3021. Subject to exceptions noted and otherwise explained in his testimony, witness Taufique also applies the nickel rounding constraints which have been used in Priority Mail and Express Mail rate design. For Periodicals and Standard Mail, witness Taufique applies the usual tenth-of-a-cent rounding standard.<sup>74</sup> He continues the whole-cent rounding constraint in his design of rates for the various Package Services. When designing fees for the various special services, witness Taufique generally applies the usual penny, nickel, dime, quarter, dollar, and five-dollar rounding constraints. These outcomes are reflected in witness Taufique's proposed rates and fees. Exhibit USPS-28A.

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<sup>74</sup> With the exception noted for Standard Mail at pages 14-15 of USPS-T-28.

- C. The Proposed Rate and Fee Changes Satisfy the Pricing Criteria of the Act
  - 1. The Postal Service's method of evaluating the pricing criteria is appropriate for this case

Upon review of the testimony of witness Taufique (USPS-T-28), the Commission will find that his careful and sensitive implementation of the Postmaster General's across-the-board policy directive is in accord with all applicable pricing and rate design criteria in the Act and warrants great deference under the circumstances of this proceeding. The testimony of Postal Service economist Maura Robinson (USPS-T-27) demonstrates that the rates and fees proposed by witness Taufique are consistent with the policies of the Act, especially those reflected in § 3622(b).

Witness Robinson's approach to pricing in this Docket departs from the traditional, iterative development of cost coverages. In the instant across-the-board case, Ms. Robinson evaluates the proposals of witness Taufique in light of all of the pricing criteria enumerated in § 3622(b). She incorporates postal management policy objectives as permitted by § 3622(b)(9), and reviews the resulting cost coverages against the remaining criteria, including the "fairness and equity" criterion in § 3622(b)(1). Proposed cost coverages for Registered Mail and Periodicals Application Fees result from deviations from the across-the-board approach that are necessary to meet the § 3622(b)(3) requirement that the fees generate sufficient revenue to cover volume-variable costs. USPS-T-27 at 11-24; Exhibit USPS-27B. Witness Robinson's approach was tailored to meet the unique policy objectives of this request and represents a pragmatic approach to evaluating the institutional cost burden imposed on the Postal Service at a time when postal rates and fees otherwise would not be the

subject of a request for change. Her pricing analysis fully considers all of the applicable pricing criteria, but in a manner that takes into account the unusual circumstances of this proceeding. USPS-T-27 at 7-9.

As the Postal Service's rate policy witness, Ms. Robinson explains how institutional costs are allocated among the subclasses and special services such that total revenues and total costs satisfy the test year breakeven requirement of § 3621. Exhibit USPS-27B. The Postal Service's proposed rate and fee levels are the product of a comprehensive process, covering all postal subclasses and services. Witness Robinson applies her expertise in a manner prescribed by the specific statutory pricing criteria.

When examining proposed rates, the Commission has stated that its primary reference point is the existing rate schedule. The current schedule reflects what postal customers are paying today and any new rates must be viewed in light of what changes they involve from rates recommended by the Commission. See, PRC Op. R2001-1 at ¶¶2082; PRC Op. R2000-1 at ¶¶4013; PRC Op. R97-1 at ¶¶4005; PRC Op. R87-1 at ¶¶4025. The existing rate relationships are presumptively reasonable. They have evolved over the years as a result of extensive analysis, as described in Commission recommended decisions. PRC Op. R87-1 at ¶¶4026.

Reviewing the cost coverages resulting from witness Taufique's rate and fee design, witness Robinson demonstrates that the Postal Service's across-the board policy goal can be reconciled with the principles in subparts (1) through (9) of § 3622(b) to produce a rate and fee schedule that is consistent with the objectives of the Postal

Reorganization Act. USPS-T-27 at 11-24. The highlights of witness Robinson's analysis are discussed below.

2. Fairness and equity are emphasized

Subsection 3622(b)(1), the fairness and equity criterion, is the touchstone for all rates and fees recommended by the Commission. "The Commission considers each criterion, exercising its informed judgment to balance the competing objectives of the Act in a manner that will result in fair and equitable rate recommendations." PRC Op. R2000-1 at ¶4005. *See also*, PRC Op. R2001-1 at ¶2078.

The Postal Service's policy of proposing that as many rates and fees be adjusted by the same percentage reflects an emphasis on the consideration in § 3622(b)(1) that proposed Docket No. R2005-1 rates and fees be fair and equitable. USPS-T-27 at 11-

13. As in past dockets, the Postal Service reiterates its view that

Fairness and equity . . . [are the] most fundamental objectives. Fairness and equity form the framework within which the additional eight criteria are considered, providing a basis upon which to properly balance the sometimes conflicting factors indicated by these other criteria and serving as a check against undue influence by any one of the other criteria.

USPS-T-27 at 11-12. *See also*, Docket No. R2001-1, USPS-T-27 at 4; Docket No. R2000-1, USPS-T-32 at 3-4; Docket No. R97-1, USPS-T-30 at 3.

If existing rates and fees are presumptively fair and equitable, it follows then that modest, across-the-board changes and the resulting cost coverages, as witnesses Taufique and Robinson propose in this Docket, generally preserve those original rate relationships. The resulting rates are no less fair and equitable.<sup>75</sup> One objective

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<sup>75</sup> It should be borne in mind that, in the absence of the escrow requirement the Postal Service would not have filed this request (USPS-T-1 at 2). And that, had the escrow amount been either larger or smaller, the Postal Service would have proposed

measure of the fairness and equity of the Postal Service's proposals is the degree to which the intervenors in this proceeding, whose traditional interests are very diverse and conflicting, have demonstrated widespread support and very little objection.<sup>76</sup>

Witness Robinson readily concedes that other methods of allocating the escrow burden could be considered; however, upon evaluating these options with respect to § 3622(b)(1), she finds that they should not be recommended because they would lead to unfair and inequitable results.<sup>77</sup> USPS-T-27 at 8. For example, possible alternatives could include a *pro rata* allocation based on contribution, a *pro rata* allocation based on attributable costs or a differential allocation based on specific cost, product or market characteristics. In considering these possibilities, witness Robinson concluded that any approach other than an across-the-board increase based on revenue would be unfair and inequitable. For example, in her discussion of these issues, witness Robinson concludes that:

Because the escrow expense does not vary with mail volume, and, in fact, is not related to the provision of postal services, it would be unreasonable to propose that any one customer or group of customers bear a disproportionate share of this expense. The proposal to distribute the escrow cost to the various subclasses and special services through a substantially equal across-the-board, 5.4 percent increase in rates and fees is fair and equitable. This approach does not unreasonably burden any group of customers by imposing

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proportionally larger or smaller across-the board percentage rate and fee changes. USPS-T-1 at 5, n.2.

<sup>76</sup> The Postal Service invites the Commission's attention to the diversity of interests and concerns represented by the numerous signatories to the Stipulation and Agreement.

<sup>77</sup> Valpak witness Mitchell suggests that "fairness has been elevated above all other considerations." Direct Testimony of Robert W. Mitchell On Behalf Of Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association (VP-T-1) at 12; Tr. 9/5278. This statement mistakenly assumes that meeting the requirement of § 3622(b)(1) -- that rates be fair and equitable -- has overridden consideration of all other criteria. As witness Robinson's testimony clearly indicates, she considered all of the § 3622(b) criteria.

a higher-than-average rate increase without corresponding changes in attributable costs or other changed circumstances.

USPS-T-27 at 12. Some changes in costs have occurred since the implementation of the current rates in 2002; however, in the context of a case whose sole goal is to recover a Congressionally-mandated escrow obligation, none of these changes are sufficiently large enough to require an approach other than across-the-board.<sup>78</sup> See, Tr. 3/366-368, 379, 381-383, 407 and 413.

The only party that argued for a reduction in the cost coverage applicable to its mail is Valpak. However, Valpak failed to address the central question posed by its proposal: if one subclass is singled out for separate rate treatment, which subclasses and special services should bear an additional burden? Under the Postal Service's breakeven requirement, ratemaking is a zero-sum game: rates for one type of mail do not decrease without offsetting increases in other rates and fees. Valpak seeks to be relieved of the payment of its proportional share of the escrow burden and asks the Commission to keep Standard ECR rates at existing levels, without identifying the source of the revenue necessary to offset this reduction. The Postal Service and the Commission do not have the luxury of such vague proposals; they must consider the tradeoffs inherent in adjusting rates. Sound policy reasons can lead to the Postal Service proposing relatively high Standard ECR cost coverages that witness Mitchell

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<sup>78</sup> Valpak witness Mitchell agrees that "national policy issues can be associated with fairness." Tr. 9/5323. However, he can "find no basis for concluding that considerations of fairness and equity argue for a cost coverage on ECR that is higher than the coverage on the former third class, or even higher than the average for all mail." *Id.* at 5324. This is a striking assertion, considering that the Commission, based upon its independent evaluation of the record in each docket, has recommended a Standard ECR cost coverage that is higher than average beginning with Docket No. MC95-1 and in each subsequent in each omnibus case. See, PRC Op. R2001-1, App. G at 36.

does not prefer, Tr. 3/405-06, but which the Commission deems fair. As emphasized by witness Robinson, if ECR revenue were reduced via a deviation from an across-the-board distribution of the escrow burden in this docket, that revenue would have to be raised from the rates of customers purchasing First-Class Mail, non-ECR Standard Mail, Periodicals, Package Services or Special Services. *Id* at 407.

3. The volume-variable costs for each subclass and special service are covered

In reviewing the rates and fees proposed by witness Taufique, witness Robinson concludes that resulting revenue for the each subclass and special service covers the applicable volume variable costs. Exhibit USPS-27B. In the limited number of cases where it was necessary to ensure compliance with § 3622(b)(3), the Postal Service has proposed higher-than-standard increases than would otherwise exist under a purely formulaic application of a 5.4 percent across-the-board increase. These proposed deviations demonstrate the Postal Service's recognition of the mandatory nature § 3622(b)(3). USPS-T-27 at 17. *See also*, USPS-T-27 at 24A.<sup>79</sup>

Valpak witness Mitchell extrapolates from § 3622(b)(3) a requirement that rates must be “cost-based.” However, as witness Robinson emphasizes, care should be taken not to assert that § 3622(b)(3) requires that cost *alone* be considered in designing rates. The remaining eight statutory criteria clearly indicate that other factors including

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<sup>79</sup> Following a revision to Registered Mail costs, witness Robinson reviewed the proposed 70 percent increase in Registered Mail fees and concluded: “Had [she] been aware of the correct after-rates cost estimate prior to the filing of this request, management would have recommended that the Governors request a lower percentage fee increase for Registered Mail.” USPS-T-27 at 24A.

social policy considerations, operational requirements, value, and sound policy judgments must be incorporated into any Commission recommendation. Tr. 3/422-24.

4. Consideration of the other statutory factors supports the across-the-board approach

a. Value of service

Value of service to both the sender and recipient of the mail is typically considered from two perspectives. First, the “economic value of service” is measured using estimates of demand elasticity; second, “intrinsic value of service” is evaluated based on the inherent characteristics of the mail service including collection, mode of transportation and priority of delivery. USPS-T-27 at 13-15. In applying § 3622(b)(2), the Commission has considered such variables as the effect of the Private Express Statutes on the measured elasticity and other factors, including but not limited to the collection, mode of transportation, and priority of delivery.

At base, the imposition of the escrow requirement does not change the value of service for any class of mail. As witness Robinson emphasizes, value of service considerations are incorporated into the proposed rates and fees through the cumulative judgments of the Commission implicit in the development of current rates and fees and there is no basis for distributing the escrow burden on the basis of relative value of service among the subclasses and special services. Tr. 3/439.

b. Effect of rate increases

The across-the-board pricing approach shows proper consideration of the effect of the proposed rate and fee increases under § 3622(b)(4). It equitably distributes the burden of rate increases on all mail users and unduly burdens no one. USPS-T-27 at 17-19. In considering the context of an escrow obligation which “does not differentiate

between customers,” USPS-T27 at 18, the across-the-board approach results in an approximately equal effect on all customers. By definition, an across-the-board increase imposes the same relative burden on customers whose alternatives are limited by the Private Express Statutes (39 U.S.C. §§ 601-606; 18 U.S.C. §§ 1693-99) as it imposes on customers who have more market alternatives. *Id.* at 17-19.

No attempt was made to shield competitive services like Express Mail, Priority Mail, or Parcel Post with less-than-standard increases to the detriment of any competitor. The validity of witness Robinson’s assessment of the effect on competitors is bolstered by the willingness of postal competitors engaged in package delivery or newspaper publishing to sign the Stipulation and Agreement.

c. Available alternatives

Subsection 3622(b)(5) calls for consideration of the availability of alternative means of sending letters and other mailable matter at reasonable costs. Like § 3622(b)(2), it allows for consideration of relative demand for alternative services. It also calls for consideration of the effect of the Private Express Statutes on the availability of alternatives for the delivery of letter mail. The Postal Service’s reliance on the existing rate and fee schedule as the basis for the rates it proposes here incorporates the Commission’s past consideration of this factor and the other factors of the Act. USPS-T-27 at 23. Public Law 108-18 does not dictate any differentiation in escrow burden among postal customers on the basis of whether they have available alternatives. *Id.* at 19. In the absence of any evidence that the availability of alternatives has significantly changed since Docket No. R2001-1 for any subclass or special service, there is no

basis for applying § 3622(b)(5) in a manner that shifts the escrow burden among the various mail classes and postal services on any basis other than across-the-board.

d. Degree of preparation

The Postal Service proposes to maintain all existing worksharing discounts and, therefore, will continue to recognize the degree of mail preparation inherent in the current Domestic Mail Classification Schedule. Consistent with its overall policy objective, the Postal Service has “deferred consideration of classification changes that may affect customers’ options to change the degree of preparation of their mail.” USPS-T-27 at 20. As a result, there is no change in the “degree of preparation” as compared to the current rates that would require a re-balancing in the application of § 3622(b)(6) with respect to the other pricing criteria.

e. Simplicity of rate structure

Subsection 3622(b)(7) calls for simplicity of structure for the entire rate and fee schedule and identifiable relationships between rates or fees and services provided. Because proposed rates and fees generally reflect relatively simple arithmetic adjustments from the existing rate schedule, existing rounding conventions are followed, and no classification changes are introduced, the proposed rate and fee schedule is no more complex than the current one and preserves existing rate and fee relationships. USPS-T-27 at 20-22. In fact, witness Taufique makes a minor adjustment to the Priority Mail rate schedule to further simplify that rate schedule and preserve an existing relationship with corresponding Parcel Post rates. USPS-T-28 at 7.

f. Educational, cultural, scientific, and informational value

Witness Robinson proposes no changes in the application of § 3622(b)(8) from that reflected in the Commission's Docket No. R2001-1 recommended decision. The current rate and fee schedule, from which witness Taufique's proposed rate increases are calculated, reflects the Commission's previous consideration of educational, cultural, scientific, and informational value. USPS-T-27 at 22.

g. Other factors the Commission deems appropriate

Subsection 3622(b)(9) grants the Commission broad discretion to consider such factors as it may deem appropriate. Most recently, the Commission used this discretion to recommend rates that took into account the uncertainty resulting from the September 11, 2001 terrorist attacks and the subsequent use of the mail to transmit anthrax.<sup>80</sup> The Postal Service does not suggest that the financial burden imposed by the PL 108-18 escrow obligation can be equated to the tragic loss of life and the disruption to its operations resulting from the horrific events four years ago. Still, the financial burden of the escrow is an urgent matter that must be addressed. In its request, the Postal

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<sup>80</sup> The Commission's reliance on § 3622(b)(9) in Docket No R2001-1 stands in sharp contrast to Valpak witness Mitchell's recollection that "[the Commission] has never used references to [criterion 9] to influence the markups for ECR Standard or Regular Standard [M]ail." He testified that, "[i]n fact, the Commission has made relatively little use of this factor for any purpose." Tr. 9/5337. However, in the most recent omnibus rate case, the Commission, the Commission "elevate[d] criterion 9 . . . to a prominent role in . . . [its] pricing deliberations." PRC Op. R2001-1 at ¶2062. Witness Mitchell's assertion that § 3622(b)(9) has not influence[d] the markups for ECR Standard or Regular Standard [M]ail ignores the Commission's view that its opinions should also be considered as a whole, rather than as a group of separate decisions on individual subclasses and services. PRC Op R87-1 at ¶4004. Thus, criterion 9 has indeed factored in the development of Standard Mail Regular and ECR cost coverages and rates.

Service has crafted pricing, rate, and fee proposals that treat the various mail categories and services in a fair and equitable manner and that are consistent with all requirements of the Postal Reorganization Act.

The Postal Service's Docket No. R2005-1 request clearly differs from more traditional postal ratemaking approaches. In a traditional case, rate design is based on assumptions about the allocation of costs and the relationship of rates to the underlying cost and mail piece characteristics. In the several-year interval typically between rate cases, changes in these relationships can occur each year for various subclasses and services; however these changes, in and of themselves do not instantly trigger a Postal Service omnibus rate request for Commission review each year. See, Tr. 3/381-389. The decision to request rate and fee changes is based on a comprehensive evaluation of the financial circumstances facing the Postal Service, including the revenue requirement, market conditions, operational requirements and the potential effect of proposed changes on customers and competitors. Were it not for the impending escrow requirement, there would currently be no pending omnibus proposal to change rates and fees that would serve as a forum within which to debate such trends and changes. The signatories to the Stipulation and Agreement represent a broad spectrum of mailers who, in the context of a "traditional" omnibus rate case, might advocate a host of non-escrow-related reasons in support of a variety of rate and classification changes. In the context of the current proceeding, however, they have temporarily set aside self-interest for the public interest. Out of regard for the need to expeditiously ensure that FY 2006 escrow obligation does not leave the Postal Service financially hamstrung,

they have agreed to absorb rate and fee changes designed to equalize their shares of the FY 2006 escrow burden.

Throughout the testimony of its pricing and policy witnesses, the Postal Service readily concedes that the escrow obligation is not comparable to any other cost incurred in the ongoing operations of the Postal Service. Tr. 3/434-36. However, the Postal Service emphasizes that the ratemaking structure established by the Postal Reorganization Act is sufficiently flexible to address the escrow requirement. As witness Robinson observes:

Appropriate ratemaking requires that the full context surrounding a rate request be considered and incorporated into the rate proposal. In this case, the Postal Service has considered the full set of circumstances surrounding the rate request including the facts that if the escrow obligation did not exist a change in rates would not have been requested, and rate relationships and cost coverages would not have been changed.

Tr. 3/430-31.

This rate request is unusual; however, the precipitating factor for the rate request – the escrow requirement -- is also unusual. By granting the Commission the discretion under § 3622(b)(9), Congress had the foresight to recognize that the Commission could find it necessary to address matters and circumstances that could not be subsumed in the other specifically enumerated ratemaking criteria. In Public Law 108-18, Congress could have dictated a specific rate treatment for the escrow costs. As witness Robinson observes, it did not. Tr. 3/440-41.

In preparing the instant request, the Postal Service took care to ensure that all the ratemaking criteria of the Act were considered. As a part of that process, witness Robinson analyzed the changes in cost coverages, markups, and relative markups since the Commission's Docket No. R2001-1 recommended decision. While the Postal

Service does not advocate formulaic reliance on markups or markup indices, examination of the markup indices does indicate that most of the relative relationships from the prior docket have been maintained. USPS-T-27 at 24. Some changes have occurred, but these changes must be viewed in the context of successful efforts to control Postal Service costs over the last five years. “One result of the successful efficiency efforts is that, if the escrow obligation did not exist, the Postal Service would have been able to forgo a rate increase at this time.” Tr. 3/357.

However, as witness Robinson emphasizes, care must be taken not to fall into the trap of assuming that any one specific set of markup indices is the only possible set that is “fair and equitable” and that conforms to all the policies of the Act. All the circumstances surrounding a rate request must be considered before any set of rates and fees and the associated cost coverages and markup indices can be recommended. Tr. 3/397. Over time, the Commission has “reassess[ed] and respond[ed] to new circumstances as appropriate. Tr. 3/410-11. The modest changes in the cost coverages and markup indices since the last docket are appropriate once the circumstances surrounding this case are considered.

The Commission has recognized that the Act gives it sufficient discretion to consider “public interest considerations” and to consider potential “tradeoffs designed to address these public interest issues.” PRC Op.R2001-1 at ¶2081. Appropriate ratemaking requires that the full context surrounding a rate request be considered and incorporated into the rate proposal. The across-the-board proposal is not based on a determination that the pricing criteria are inadequate or should be dismissed. To the contrary, it is based on the determination that the Act permits an application of those

criteria to support an across-the-board approach under appropriate circumstances. The instant request provides a sound public policy rationale for across-the-board rate and fee changes.

D. The Current Case Is Distinguishable From Docket No. R94-1

While formulating its Docket No. R2005-1 request that current rates and fees generally be increased across-the-board to cover its FY 2006 escrow expense, the Postal Service was not unmindful of history. Docket No. R94-1 stands out as the only previous omnibus rate proceeding in which the Commission was presented with a request that rates and fees generally be increased on a uniform percentage basis. The Commission summarized the policy goals underlying the Postal Service's Docket No. R94-1 across-the-board proposals as follows:

- (1) satisfying its short-term revenue needs in a manner least disruptive to its customers;
- (2) maintaining and increasing mail volumes in the face of changing technology and competition;
- (3) demonstrating its commitment to customer needs; and
- (4) facilitating a classification reform case (Docket No. MC95-1) that was on the horizon.

PRC Op. R94-1 at ¶4001. In that proceeding, the Commission commended the Postal Service for its commitment to restrain the level of rate increases it sought from mailers, characterizing such restraint as responsive to the standard in § 3621 for "honest, efficient, and economical management." PRC Op. R94-1 at ¶4002. However, the Commission commented that:

Although a number of parties support the Postal Service's request, there is no empirical evidence in the record to suggest that mailers will be less receptive to reform of product lines if rate increases for existing subclasses are not identical.

Without such evidence, there is no classification-related reason for freezing existing inter-class rate relationships, and the across-the-board proposal does

not override the need to insure a balanced application of other factors in the Act, including questions of fairness and equity.

PRC Op. R94-1 at ¶¶1015-16. The Commission also was troubled by what it regarded as a proposal to substantially and unfairly increase the institutional cost burden of First-Class Mail and Priority Mail. *Id* at ¶1017.

The Commission observed what it described as “wide variations in estimated attributable cost changes” since Docket No. R90-1 and “divergent pricing consequences.” *Id.* at ¶¶4005, 4006. Moreover, the Commission was disturbed by the Postal Service’s failure to include intra-subclass and special service cost studies for analysis. *Id.* at ¶¶1031-34. Comparing markup indices, the Commission concluded that the Postal Service’s Docket No. R94-1 across-the-board approach incorporated “drastic departures from the pricing recommendations upon which the pre-existing Docket No. R90-1 rates were based. *Id.* at ¶4006. The Commission opined that:

attributable costs have changed such that any uniform increase of Docket No. R90-1 rates would appreciably alter inter-subclass markup relationships recommended in that case . . . .

*Id* at ¶4007. Accordingly, the Commission found the underlying policy rationale for the Postal Service’s across-the-board approach in that docket unpersuasive. In its Docket No. R94-1 rate and fee recommendations, the Commission deviated substantially from the Postal Service’s proposals.

In Docket No. R94-1, the Commission found there to be no policy basis sufficiently compelling to warrant acceptance of the Postal Service’s proposal that it rely heavily on its § 3622(b)(9) discretion to recommend across-the-board rate and fee increases. However, there is no basis for reaching the same conclusions in Docket No. R2005-1. The policy underlying the Postal Service’s current across-the-board approach

is indisputable and unassailable. The Postal Service would not have filed the current request, had it not been for the legislatively imposed FY 2006 escrow burden. USPS-T-1 at 9. An across-the-board approach is fair, considering the nature of that burden: it does not arise from any operation of policy of the Postal Service, past, present, or future; it is not caused by any one mail class or service to a greater or lesser degree than by any other class or service. An across-the-board filing stripped of complicating classification changes is critical to the goal of expediting this proceeding. The inherent fairness of an across-the board approach to recover this unique cost has muted the usual inter- and intra-class strife among rate case participants and created an opportunity for a substantially expedited conclusion to this proceeding. Such expedition is vital to enhancing the Postal Service's ability to recover as much of the escrow cost through rate and fee changes in a test year that will be well underway by the time any such changes can be implemented.

The Postal Service submits that the Commission's other Docket No. R94-1 concerns must be viewed through the prism of Docket No. MC95-1, which has resulted in significant reform of the mail classification structure, and in light of subsequent omnibus rate case determinations. For instance, the Commission's Docket No. 94-1 concerns about the First-Class Mail markup relative to other subclasses<sup>81</sup> has been addressed from that case onward. The relative relationship of the markup indices for First-Class Mail and what is now Standard ECR has been reversed, with the latter consistently higher as a result of recent omnibus rate case determinations. *Compare*, USPS-T-27 at 24; USPS Library Reference K-114; PRC Op. R2001-1, Appendix G,

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<sup>81</sup> PRC Op. R94-1 at ¶4006.

Schedule 3, pp. 36-37; with PRC Op. R94-1, at IV-3, Table IV-1. Without question, some changes in costs have occurred since the implementation of the current rates in 2002; however, in the context of a case whose central goal is to meet a Congressionally-mandated escrow obligation, none of these changes seem sufficiently large to require an approach other than across-the-board.

Moreover, another critical distinction between the instant request and Docket No. R94-1 cannot be overlooked. The Postal Service would not have filed the current request, had it not been for the imposition of a legislatively imposed fund to which no postal purpose has been assigned. USPS-T-1 at 9. In contrast, the Docket No. R94-1 request sought to change rates and fees to cover ordinary inflation in postal costs through the Docket No. R94-1 test year. In Docket No. R94-1, the Commission found there to be no policy basis sufficiently compelling to warrant acceptance of the Postal Service's proposal that it rely heavily on its § 3622(b)(9) discretion in Docket No. R94-1 to justify an across-the-board approach to raising rates intended to cover what could fairly be described as ordinary postal inflation.

Except where §§ 3622(b)(3) and 3626(a) compel a different result, the controlling principle of the Postal Service's pricing approach in the current docket has been to apply uniform percentage rate increases across-the-board. Witnesses Taufique (USPS-T-28) and Robinson (USPS-T-27) have harmonized these important postal management policy objectives with the statutory ratemaking criteria. The proposed rate and fee levels are the product of a comprehensive process covering all subclasses and services. Accordingly, the Postal Service urges the Commission, through § 3622(b)(9),

to give thoughtful consideration to those objectives, and to concur that the proposed rate and fee changes satisfy all applicable postal ratemaking policies.

In every previous omnibus rate case except Docket No. R94-1, the Postal Service's pricing proposals and Commission recommendations have been based on what can be described as an iterative, judgmental application of the statutory criteria. Under this traditional approach, volume variable costs are identified for each subclass and service. Pricing decisions are then guided by iterative distributions of institutional costs over volume-variable costs (cost coverage) for each subclass or service, so that, after adjustments are made for the volume (and subsequent cost) consequences of the new rate and fee levels, total proposed revenues equal total costs as nearly as practicable.

Judicial review has confirmed the validity of the traditional, iterative approach, but neither the statutory language nor judicial interpretation requires that it be used exclusively. See, *Mail Order Association of America v. United States Postal Service*, 2 F3d 403, 425-27 (DC Cir 1993); *Direct Marketing Association v. United States Postal Service*, 778 F2d at 102 (2d Cir 1985). As these court decisions affirm, the Commission need not demonstrate the effect of every § 3622(b) criterion on each subclass or service, with the exception of § 3622(b)(3), which requires that the revenues generated by each subclass or service be sufficient to cover its attributable costs and make a reasonable contribution to institutional costs.

In the current docket, the Postal Service has generally adjusted current rates and fees across-the-board. Subject to the pricing and rate design requirements in §§ 3622(b)(3) and 3626(a), the Postal Service has evaluated its proposals against the

other statutory postal pricing factors. As the preceding arguments make clear, under the unique circumstances of this request, the Postal Service considers it appropriate for the Commission to use the discretion inherent in assessing the other pricing criteria to recommend relatively uniform adjustments to the current rate and fee schedule in order to generate sufficient FY 2006 revenues to satisfy the impending escrow burden.

E. Valpak's Objections And Alternative Proposals Lack Merit

One intervenor, Valpak, has expressed its disagreement with the Postal Service's request in the form of testimony opposing the Postal Service's across-the-board approach to rate design and pricing. As will be demonstrated below, the testimony of Valpak witness Robert Mitchell (VP-T-1) is based upon a strained reading of the Postal Reorganization Act and irrelevant notions of causation. Witness Mitchell encourages the Commission to intrude upon the prerogatives of the Board of Governors. His testimony shows a preference for ratemaking based on revisionism and nostalgia. He embraces a restricted reading of Commission precedent and sacrifices all non-cost ratemaking factors on the altar of "cost tracking." As an alternative to the Postal Service's comprehensive rate design and application of the statutory pricing criteria, witness Mitchell offers an incomplete proposal for the benefit of the Standard Mail Enhanced Carrier Route (ECR) subclass that does not provide a viable basis for rate design.

1. Valpak's contentions about the escrow are misguided

Valpak witness Mitchell testified that, "as a matter of logic," the Postal Service's test year deficit "is no more caused by the escrow payment than by any other expense component . . . ." Tr. 9/5276-77. Accordingly, contrary to the testimony of the

Postmaster General, he asserted that the escrow is not the cause of the projected FY 2006 deficit that the Postal Service's Docket No. R2005-1 request is designed to recover. But then, upon further reflection, witness Mitchell conceded that a reduction to zero or elimination of the escrow "would bring about a no-deficit projection." Tr. 9/5394-95. Under witness Mitchell's "no escrow = no deficit" scenario, the Postmaster General made clear that there would be no rate request. Thus, in its own way, witness Mitchell's brand of logic establishes a clear nexus between the escrow and the Postal Service's Docket No. R2005-1 request.

Witness Mitchell also proposes an arbitrarily restrictive interpretation of § 3622(b)(9) to limit the Commission's options in response to the Postal Service's request. He rejects the notion that Commission consider the link between the Postal Service's across-the-board approach, the ensuing reduction of contested issues among usually contentious intervenors, the resulting enhanced ability of the Commission to expedite issuance of a recommended decision, and the resulting creation of an opportunity for implementation of rate and fee changes early enough to recover as much of the escrow expense as possible in the test year. Witness Mitchell grouses that such considerations should not hold sway because (1) the Postal Service could have filed its request before April 2005 and (2), in any event, the escrow could be financed through "[b]orrowing options." Tr. 9/5282. See *also*, Tr. 12/6359, 6361.

First, as made clear by the rebuttal testimony of Postal Service witness James M. Kiefer,<sup>82</sup> there is no basis for witness Mitchell's assertion that, under § 3622(b)(9), the Commission either cannot or should not consider the nexus between the inherent

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<sup>82</sup> Rebuttal Testimony Of James M. Kiefer On Behalf Of United States Postal Service (USPS-RT-1).

fairness of the across-the-board approach, its impact on settlement and expedition, and the benefits to the Postal Service's FY 2006 bottom line. Tr. 11/6160-61. As witness Kiefer emphasizes, the Board of Governors is empowered to make the types of policy judgments underlying the Postal Service's request, *Id.* at 6154-55, and the Commission is authorized to consider them, *Id.* at 6157.<sup>83</sup>

2. Witness Mitchell seeks to unduly restrict the scope of the Commission's discretion

Witness Mitchell grumbles that Docket No. R2005-1 has degenerated into a proceeding without a "complete" record and encumbered by a non-unanimous settlement agreement. Tr. 12/6371. In his view, the ratemaking process was established to produce the "best" rates. And, no Postal Service rate request meets this standard if, in designing rates, the Postal Service considered whether parties, in lieu of full-blown, self-interested litigation in pursuit of alternative results, might be willing to stipulate to its rate proposals. *Id.* at 6371-72. Witness Mitchell worries that:

Focusing on settlement as a goal in such a situation introduces a dynamic that may be out of line with appropriate ratemaking. . . . [T]hat the Postal Service, in negotiating with intervening parties . . . will find that it can achieve settlement by proposing rates that it cannot justify as most appropriate, in hopes that the Commission will do little more than certify that the rates in the settlement are within a range allowed by law, instead of best for the nation.

Tr. 9/5283. Contrary to Mr. Mitchell's characterizations, the Postal Service considers the rates that it has requested as the most appropriate under the circumstances of this case. Furthermore, the Postal Service has justified those rates on the basis of

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<sup>83</sup> The Commission should resist the suggestion implicit in Mr. Mitchell's testimony that some lesson be taught the Board for filing its request in April 2005, two years after PL 108-18 was enacted. See, Tr. 9/5282. The Commission is ill-served by advice to revisit circumstances that led the Governors' to challenge the initial recommended decision in Docket No. R80-1. See, *Newsweek, supra*, 663 F.2d 1186, 1204-05.

substantial record evidence. As Congress intended, the Postal Service has requested that the Commission review the evidentiary record developed in this proceeding and opine (on the basis of that record), that the rates and fees referenced in the July 22, 2005, Stipulation and Agreement are in accord with the policies of the Postal Reorganization Act.<sup>84</sup> Should the Commission base its recommendations on substantial record evidence, either to concur with the Stipulation and Agreement or recommend some alternatives, it will have fulfilled its responsibilities under the Act in a manner that serves the public interest.

Discussing rate case procedure, Mr. Mitchell has testified that:

This process requires the Postal Service to present and discuss all bases for the rates proposed. It must be transparent with all of its policy positions. Following the filing, the Commission and interested parties examine the case, explore alternatives, and have the opportunity to supplement the record with information and analyses that might be helpful to the Commission. In the end, the Commission makes a recommendation based on the Act, its judgment, and the record developed.

Tr. 9/ 5285. In Docket No. R2005-1, the Postal Service has presented and discussed all bases for its request. Its policy positions are transparent. Scores of interested parties and the Commission have examined the request. Presumably, various parties have explored alternatives. The record has been supplemented with information and analyses deemed helpful to the Commission.

Postal Service rebuttal witness Kiefer observes:

Aside from the 'no settlements' test, however, it would appear that the process followed in the current case would satisfy even Mr. Mitchell's strict requirements.

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<sup>84</sup> Mr. Mitchell is entitled to his opinion as to whether such rates and fees were "best for the nation" or met some other standard also not implied by the Act.

Tr. 11/6165. Witness Kiefer further notes that:

While the Act prescribes a legal process, as guaranteed under statutory guidelines implemented by Commission rules of procedure, it does not dictate any particular course for any proceeding initiated by the Postal Service; nor does it dictate the form or contents of the record developed to review any particular proposal. . . . [T]he Commission's rules . . . do not . . . require participants to disagree with the Postal Service.

*Id* at 6164. And finally, witness Kiefer concludes that:

Few parties have chosen to attack the Postal Service's proposals, and, if only judged by their failure to conduct discovery, engage in cross-examination, and submit rebuttal, most participants have found the proposals acceptable given the current circumstances. *Id.*

The record in the instant proceeding reflects the provision of all the evidence necessary (and more) to support a recommended decision to approve the rates and fees referenced in the July 22, 2005, Stipulation and Agreement. The Postal Service considers a "complete" record to be one that meets the requirements of both the Postal Reorganization Act and the requirement of substantial evidence in the Administrative Procedure Act. That such a record can be developed in an omnibus postal rate case without scores of parties filing conflicting testimony was demonstrated most recently in Docket No. R2001-1.<sup>85</sup>

Witness Mitchell conceded that the Act permits parties to review a postal rate request and agree not to oppose it. Tr. 9/5281. Presumably, he would still permit the Postal Service, under § 3622(b)(4), to consider the impact of alternative rate and fee designs on mailers before choosing one mix of rates and fees to submit to the Commission for consideration. However, he apparently reads into the Act a prohibition against pre-filing deliberations by the Postal Service that consider whether particular

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<sup>85</sup> In the R2005-1 Valpak Brief, one half-expects a homàge to the late Johnnie Cochran along the lines of: "If there ain't a big fight, the rates ain't right."

rates might actually be acceptable to those same mailers. And, he would forbid the Postal Service to propose rates that were sufficiently acceptable to mailers and supported by such record evidence as to reduce litigation by any degree that might, down the line, result in earlier rate implementation.<sup>86</sup> There is no basis for inferring such a prohibition anywhere in the Act – in § 3622(b)(9) or elsewhere. Moreover, as Postal Service witness Kiefer observes, far from discouraging settlement, the Commission’s rules implementing its authority under § 3624 are constructed to facilitate settlement of issues and cases. Tr. 11/6164. Witness Mitchell’s preference for what *typically* happens in Postal Rate Commission omnibus rate case litigation does not override the broader range of procedural possibilities that the Act and the Commission’s rules allow.

3. Valpak’s “full cost recognition” approach ignores the other pricing factors

At Tr. 12/6361, Valpak witness Mitchell argues that the “ratemaking scheme as implemented by the Commission requires that . . . current costs be fully recognized.” Elsewhere, he claims that the Postal Service’s across-the-board proposal fails to track costs. Tr. 9/5288, 5450-51; Tr. 12/6364. Yet, only one of the nine postal ratemaking pricing criteria can fairly be described as a cost-based requirement -- § 3622(b)(3). This provision mandates that the rates for a subclass or the fees for a special service must generate sufficient revenue for that subclass or service so as to at least cover its volume-variable costs. There is no basis for claiming that any aspect of the Postal Service’s across-the-board proposal fails to meet this requirement.

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<sup>86</sup> The Act directs the Commission to conduct its proceedings with utmost expedition consistent with procedural fairness. 39 U.S.C. §3624(b).

The only other cost-based policy consideration in postal ratemaking is reflected in § 3622(b)(6). This provision allows (but does not require) the Commission to consider the degree of preparation performed by the mailer and its effect upon reducing postal costs. The evidence and circumstances of each case determine the extent to which the Commission finds it appropriate to apply this factor. Otherwise, § 3622(b) specifies six other specific non-cost factors that the Commission can apply and authorizes the Commission to consider such other factors as it may deem appropriate in distributing institutional costs and recommending rates.

Every omnibus rate case presents an opportunity for the Commission to examine cost trends since the establishment of then-current rates and to take those trends into account, to the extent required by subsection (b)(3). The Postal Service is not proposing that the Commission ignore that requirement. The Postal Service deviates from its own across-the-board policy objective, where necessary to ensure compliance with subsection (b)(3). Beyond this cost floor mandate, the Commission is authorized to reflect costs (or not) in rate design on the basis of § 3622(b)(6) or other factors under subsection (b)(9). Under the circumstances of the current docket, the Commission has authority to give weight to the management policies underlying the Postal Service's request. The results of an across-the-board request may be different institutional cost distributions and different rate designs than would be recommended in a "regular" rate case. But, the ratemaking policies of the Act are not violated by such a result when the mandate in subsection (b)(3) is respected and the determinations are based on the record.

The Commission's rejection of the Postal Service's Docket No. R94-1 across-the-board filing reflected the Commission's unwillingness to deviate from rate design principles it enunciated in Docket No. R90-1: (a) on the basis of R94-1 postal policy reasons it found unpersuasive; (b) in the absence of an examination of any changing cost patterns within subclasses and special services; and (c) because the R94-1 request would result in what the Commission regarded as objectionable changes in the allocation of institutional costs among subclasses. PRC Op. R94-1 at ¶1017. Whatever the Commission found wanting in Docket No. R94-1 has been cured in the Postal Service's Docket No. R2005-1 presentation. The policy basis for the current request is even more compelling and is inextricably linked to the proposed outcome. The Postal Service has presented for examination the special intra-subclass and service cost studies that were absent from its Docket No. R94-1 filing. No party can fairly complain in Docket No. R2005-1 that it has been deprived of its usual opportunity to analyze current costs at this level of detail. The testimony of witness Robinson (USPS-T-27 at 23-24) demonstrates that the Commission need not be concerned as it was a decade ago that the inter-class markup relationships resulting from the implementation of across-the-board rates are impermissibly skewed.

On the basis of hypothetical future rate case scenarios he has constructed, witness Mitchell worries that across-the-board rates coming out of Docket No. R2005-1 could "disrupt normal rate case trends and cause excess effects on mailers" Tr. 9/5295. However, Postal Service witness Kiefer's testimony reminds the Commission that there is no basis for concluding that witness Mitchell's negative speculation about future "rate shock" has any basis in probability. Tr. 11/6173. In any event, on the basis of actual

evidence in future omnibus rate cases, the Commission will be poised to assess future rate case requests and assertions of “rate shock” from offended intervenors. There is no basis for offering these hypothetical future intervenors relief in Docket No. R2005-1 before they make their claims in the next rate case.<sup>87</sup>

4. Witness Mitchell’s isolated Standard ECR cost coverage proposal should not be recommended

As an alternative to the Postal Service’s comprehensive rate design and pricing analysis, Valpak witness Mitchell proposed that the Commission reduce the Standard Mail ECR subclass cost coverage by 10 percentage points below the cost coverage proposed by the Postal Service. Witness Mitchell also asked the Commission to commit now to reducing the Standard ECR cost coverage by 10 additional percentage points in each of the next two successive rate cases. Tr. 9/5346. Witness Mitchell then granted the Commission permission to consider further Standard ECR cost coverage level changes after fulfilling these commitments. *Id.*

Casting aside the reality of the determinations of the Commission and the Governors in Docket Nos. R97-1, R2000-1, and R2001-1, witness Mitchell’s testimony offered the Commission a revisionist rate and classification history -- apparently based on observations from his own version of Mr. Peabody’s WayBack Machine. After re-visiting and correcting for past decisions of the Commission and the Governors, Mr. Mitchell declared that, if the Standard ECR subclass had not been created in Docket No. MC95-1, the letter/flat differential introduced in Docket No. R90-1 for third-class mail

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<sup>87</sup> A case described by the Postmaster General on June 27<sup>th</sup> as coming on the heels of Docket No. R2005-1, Tr. 2/80, and confirmed by witness Kiefer on September 15<sup>th</sup> as a work-in-progress, Tr. 11/6230.

would surely now have moved to 100 percent. His paranormal powers of hindsight also informed him that the average per –piece contributions for the categories now in Standard ECR would be approximately the same as the average per-piece contribution of the categories now in Standard Regular. Tr. 9/5311-12. Based upon these revisionist observations, witness Mitchell proclaimed that fairness and equity required that the cost coverage for Standard ECR be set no higher than either the currently proposed systemwide average or the cost coverage recommended by the Commission for third-class mail in Docket No. R90-1. Tr. 9/5324.<sup>88</sup>

Postal Service witness Kiefer’s testimony acknowledges that, as he did not accompany Mr. Mitchell on his time-travel escapade, he cannot prove that Mr. Mitchell revisionist historical observations are false. Tr. 11/6176. However, the Postal Service encourages the Commission to conclude, as witness Kiefer does, that there is “no way to know with any reasonable certainty how saturation mail’s history would have evolved had certain events not taken place.” *Id.* Witness Kiefer emphasizes that:

Witness Mitchell has provided no evidence that the Postal Service or the Commission would have viewed the trajectory of saturation mail rates (beyond the rate relief obtained in Docket No. MC95-1 and subsequent rate cases) any differently if the ECR subclass had not been created and saturation mail rates could only be lowered by making certain passthroughs closer to 100%.

*Id.* at 6177. In the zero-sum game of postal ratemaking, Mr. Mitchell offered no clue as to the impact that his proposed reduction Standard ECR institutional cost burden would

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<sup>88</sup> In a similar vein, Mr. Mitchell asserted, at Tr. 9/5300, that the current and proposed rates are based upon costs that were not the result of “full Commission deliberation.” If that is witness Mitchell’s belief, he would do well to acquaint himself with PRC Op. R2001-1 at ¶¶2014-15. There, the Commission emphasized that its recommendations in that case were the result of an appraisal of “the extent to which the record evidence indicates that the agreed-upon rates are compatible with applicable statutory considerations, such as the § 3622(b) ratemaking factors.”

have on the rates and fees paid by postal customers who use other subclasses and special services. *Id.* Absent evidence of what might constitute a fair and equitable redistribution of so large a share of the institutional cost burden, the Commission should decline to adopt Mr. Mitchell's recommendations.

5. Valpak's Standard ECR rate design principles should be rejected

Witness Mitchell offered the Commission two options regarding Standard ECR rate design: it can propose rates consistent with his cost coverage proposal "if it finds that the record allows meaningful estimates of ECR rate category costs" or it can agree with him that his cost coverage proposal justifies leaving Standard ECR rates unchanged. Tr. 9/5346.

If, after embracing witness Mitchell's cost coverage reduction proposal, the Commission is inclined to recommend Standard ECR rate changes, witness Mitchell dashes off several rate design notions, the principal ones being: (1) the letter-flat cost differential passthrough for ECR should be at least 100 percent and (2) the rates for ECR Basic letters be "decoupled" from the rates for 5-digit Standard Mail Regular Automation letters. Tr. 9/5346-52. *See also, Id.* at 5353-54.

Postal Service witness Kiefer concedes that these proposals are not frivolous, but cautions the Commission to reject them as inadequately supported alternatives to the results implied by application of the Postal Service witness Taufique's across-the-board approach to Standard Mail ECR rate design. Tr. 11/6178. Witness Mitchell failed to provide the record with the necessary evidentiary basis upon which to form a considered opinion about the appropriateness of permanently recommending his Standard ECR rate design ideals. It is safe to assume that, if Mr. Mitchell's ideals were

implemented, Valpak would pay lower rates than proposed by the Postal Service. But, beyond that, very little is known, given the dearth of evidence offered in support of his notions. Moreover, ADVO rebuttal witness Antoinette Crowder amply demonstrates that implementation of witness Mitchell's proposals would result in a double-counting of weight-related flats costs, as recognized by the Commission in Docket No. R2001-1. See, Rebuttal Testimony of Antoinette Crowder On Behalf Of ADVO, Inc (ADVO-RT-1); Tr. 10/5735-39.

Witness Mitchell characterized the two most important participants in the ratemaking process—the Postal Service and the Postal Rate Commission – as “impartial reviewers in the sense that they are not users of specific categories of rates.” At Tr. 9/5282. He went on to observe that, “[o]n the other hand, intervening parties generally do use specific categories of rates and do stand to gain if the rates of those categories are reduced. *Id.*

The Commission had the benefit in this proceeding of receiving testimony from Mr. Godfrey Otuteye, President and CEO of Money Mailer, a saturation coupon envelope distributor that often uses a flat size envelope and that happens to be Valpak's biggest competitor. Rebuttal Testimony of Godfrey Otuteye On Behalf Of ADVO, Inc., ADVO-RT-2. On the broader issue of the Postal Service's across-the-board filing, Mr. Otuteye, was asked about its impact on Money Mailer and whether he would prefer rate proposals that improved his ability to compete against Valpak. He expressed that he:

[did] . . . not like paying 5.4 percent more postage, but [he was] . . . willing to live with it, and to accept it, because it retains the relevant difference [of] the postage that [Money Mailer pays] . . . and what Valpak pays today. If you increase the [letter/flat] rate differential, then that puts us at a competitive disadvantage, and that is what I am objecting to.

Tr. 10/5919-20. Money Mailer desires to see rate design and cost coverage issues revisited in a future proceeding, but “do[es] not object to the Postal Service's proposed rates in this case . . . .” Tr. 9/5896.

In this regard, Mr. Otuteye is representative of so many parties in this proceeding who support deferral of the examination of potentially beneficial rate and classification changes in order to allow the Postal Service to secure the revenues necessary to meet its escrow obligation through a fair and equitable across-the-board rate request.

CONCLUSION

For the reasons stated above, the rates for postal services and the fees for special services contained in the Stipulation and Agreement are supported by the evidentiary record and are in accord with the applicable provisions of the Postal Reorganization Act.

WHEREFORE, the Postal Service requests that the Postal Rate Commission recommend under 39 U.S.C. 3624(d) the rates and fees contained in the Stipulation and Agreement.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

\_\_\_\_\_  
Daniel J. Foucheaux, Jr.  
Chief Counsel, Ratemaking

\_\_\_\_\_  
Kenneth N. Hollies

\_\_\_\_\_  
Eric P. Koetting

\_\_\_\_\_  
Nan K. McKenzie

\_\_\_\_\_  
Sheela A. Portonovo

\_\_\_\_\_  
Brian M. Reimer

\_\_\_\_\_  
Scott L. Reiter

\_\_\_\_\_  
David H. Rubin

\_\_\_\_\_  
Michael T. Tidwell

\_\_\_\_\_  
Keith E. Weidner

475 L'Enfant Plaza West, S.W  
Washington, D.C. 20260-1137  
September 26, 2005

## CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

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Daniel J. Foucheaux, Jr.

475 L'Enfant Plaza West, S.W.  
Washington, D.C. 20260-1137  
September 26, 2005