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**I. VALPAK'S PROPOSAL TO INCREASE THE SATURATION LETTER-FLAT PASSTHROUGH MUST BE REJECTED.**

Witness Crowder, both in her rebuttal testimony and in cross-examination by Valpak's counsel, clearly explained that, because the saturation letter-flat cost differential reflects not only shape-related costs but also weight-related costs that are already recovered through the separate pound rate, a 100-percent passthrough of that cost differential would double-charge flats for weight-related costs.<sup>1</sup>

On brief, Valpak tries to distort this issue through convoluted comparisons of the *average* unit costs to specific rates for letters and flats at various points in the weight spectrum. VP Br. at VII-7-11. These are the same faulty comparisons that Valpak's counsel posed to Crowder during cross-examination. There, Crowder fully explained why these comparisons were meaningless. Tr. 10/5808-32.

Nevertheless, we will address these in some detail here, because they reveal Valpak's fundamental misconceptions of the nature of that cost differential (or, more likely, its desire to cloud this clear-cut issue). More importantly, they highlight Valpak's impossible dilemma: How to minimize the magnitude and significance of weight-related

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<sup>1</sup> Valpak takes exception to Crowder's use of the term "double-charging" in explaining why a 100 percent passthrough of the letter-flat difference, coupled with the high pound rate, will cause flat mailers to pay too much. Following a confused discourse on which flat mailers might be "double-charged," Valpak concludes by saying that "it is simply an issue that some weight-related costs *might* be reflected in the letter-flat cost differential. . . ." VP Br. at VII-8 (emphasis added). That is wrong. If there is any weight-related cost difference between the average unit costs of letters and flats, then a 100 percent passthrough of that difference necessarily charges all flat mailers for 100 percent of that weight-related cost – a cost that is also charged through the pound rate. "Double-charging" is a correct description. Moreover, the impact ("double-charging") would fall on the entire flat mail rate category whose rates cover the weight-related cost twice.

costs reflected in the letter-flat cost differential and increase the passthrough, while at the same time still claiming that the pound rate should not be reduced correspondingly.

A. Valpak's Error-Filled "Analyses" Of The Letter-Flat Cost Differential On Brief Were Previously Addressed And Refuted By Crowder At The Hearing, And In Any Event Undermine Its Position

Starting at page VII-9 of its brief, Valpak throws out a confusing and complicated two-part "analysis" that attempts to minimize the extent of weight-related cost in the letter-flat cost differential, without coming right out and saying that there is little weight-related cost in the differential. Despite that analysis, however, Valpak ultimately is forced to admit that "the letter-flat cost difference *may need some correction for weight,*" but then it erroneously claims that "once this correction is made, an increase in the [letter-flat piece] rate difference to the appropriate level would not have implications for the pound rate." *Id.* at VII-10.

Valpak's two-part on-brief "analysis" demonstrates its willingness to bend the truth, depending upon its current pursuit. In the first part (at VII-9-10), Valpak notes that the average ECR flat weighs 3.43 ounces, just slightly over the 3.3-ounce breakpoint.<sup>2</sup> From this, Valpak presupposes that there is little difference between (1) the weight-related costs for a flat that weighs between zero and 3.3 ounces and (2) the average flat that weighs 3.43 ounces. According to Valpak, this supposedly implies that the *average* weight and weight-related cost for *all* flats (both above and below the 3.3-ounce

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<sup>2</sup> Valpak states that the combined ECR plus NECR Basic-Rate letters average 0.95 ounces while flats average 3.43 ounces, leading to a 2.48-ounce weight difference. Per USPS-LR-K-77, however, the ECR plus NECR Basic-Rate letter average is 0.80 ounces, leading to a 2.63-ounce letter-flat weight difference. This is a large difference in piece weights.

breakpoint) is representative of just those piece-rated flats that weigh less than 3.3 ounces, and that therefore, this somehow justifies passing through the entirety of the average letter-flat cost differential. But as Crowder explained, if that were the case, then there would no need for the pound rate because *all* the weight-related cost would be recovered in the piece rate. Tr. 10/5820-28.

In the second part of its strained analysis, Valpak continues with its faulty assumption that the *average* weight-related cost for *all* flats (both above and below the breakpoint) is representative of the weight-related cost for *just* that portion of flats weighing less than the 3.3-ounce breakpoint. Valpak then estimates (incorrectly) the average purchased transportation plus vehicle service costs for ECR letters (0.23 cents) and flats (0.32 cents).<sup>3</sup> These are acknowledged as weight-related costs. Valpak then argues that if the 0.32-cent average cost were passed-through 100 percent, minimum-per-piece rated flats under 3.3 ounces would be covering the *average* weight-related cost associated with *all* flats that weigh on average 3.43 ounces – a cost which Valpak claims “might not be much higher than the cost for flats weighing from zero to 3.33 ounces.” Following this gibberish, Valpak then adds that it does *not* intend to suggest that (average) weight-related costs for minimum-per-piece rated flats under the breakpoint (apparently based on a 100 percent letter-flat passthrough) are substantial.

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<sup>3</sup> These specific unit costs have no meaning for Valpak’s purported analysis as they were derived from a simple weight-related allocation of ECR attributable costs (to determine the flat-parcel cost/rate differential), rather than either a cost-causative allocation of costs reflecting relative degrees of dropshipment or a dropship-neutral set of costs. In any case, a check of USPS-LR-K-119 shows that Valpak did not accurately quantify those costs – the sum of those two costs for letters is 0.16 cents (vs. 0.23 cents in the Valpak Brief) and for flats it is 0.55 cents (vs. 0.32 cents in the Valpak Brief).

Again, Valpak ducks a key question: If the average flat cost has so little weight-related cost, then why is the pound rate so high?

Unfortunately for Valpak, its “analysis” conveniently ignores facts. First, the *average* unit cost of flats is just that: an average of both flats that weigh less than the breakpoint and those that weigh more. Using Valpak’s own example of ECR plus NECR Basic-Rate flats that average 3.43 ounces, flats below the breakpoint weigh only 1.9 ounces while those above the breakpoint weigh 5.1 ounces (USPS LR-K-77, Sheets G-5 page 2 and G-5 page 4). Thus, there is a very large weight difference between the *average minimum-per-piece* rate flat and the *overall average* flat. To the extent there are weight-related costs, that large weight difference is associated with a comparably large weight-related cost difference. Passing through all of the average weight-related cost, as Valpak proposes, would cause flats to recover too much cost (and contribute too much institutional cost relative to letters). Compounding this problem, when the pound rate also is designed to recover that same weight-related cost (for pieces over the breakpoint), then flats in *total* recover way too much cost (and contribute too much institutional cost relative to letters).

All of this was explained by Crowder, extensively and repeatedly, during cross-examination by Valpak’s counsel. Tr. 10/5820-32. Either Valpak simply doesn’t understand it, or Valpak just doesn’t want to hear it.

Further, in the second part of its analysis, Valpak appears to be suggesting that purchased transportation plus vehicle service driver costs are either (1) the only weight-related costs or (2) the principal weight-related costs. On a per-piece basis, these costs are relatively small due to extensive ECR dropshipping. Thus, Valpak seems to be

suggesting that flats have very little weight-related costs, on average. But yet again, this leads to the inevitable logical conclusion that, for the entire range of ECR flat weights – both below and above the breakpoint -- weight-related flat costs are relatively small, and the pound rate is therefore too high.

B. In A Subtle But Significant Departure From Its Testimony, Valpak On Brief Finally Acknowledges The Interrelationship Between The ECR Letter-Flat Rate Differential And The Pound Rate, But Still Proposes To Worsen The Overcharging Of Flats

In the R2000-1 rate case, Valpak vigorously opposed any reduction in the ECR pound rate, arguing that there are substantial weight-related costs within ECR.<sup>4</sup> If that were true, then the letter-flat cost differential would necessarily include significant weight-related costs. Yet here, where it is urging an increased letter-flat rate differential, Valpak argues the opposite: that weight-related costs included in the cost differential “may be quite small.” At page VII-10 of its brief, Valpak says:

“Valpak does not take the position that the weight effects described by witness Crowder are nonexistent, only that they may be quite small.”

What Valpak ignores is the logical corollary of this conclusion: If weight-related costs are “quite small,” then the current high pound rate is clearly excessive. And furthermore, any proposal to further increase the letter-flat passthrough would only make matters worse.

Valpak’s refusal to confront this reality is seen in its very selective, truncated quotation from Crowder’s cross-examination. At page VII-10 of its brief, Valpak states:

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<sup>4</sup> See, e.g., Appendix B of VP/CW-T-1 in Docket R2000-1. See also Appendix D of VP/CW-T1-1 in Docket R97-1.

“On oral cross examination, witness Crowder addressed whether the weight-related costs are large, and concluded essentially that they probably are not. She said:

‘My speculation is that the majority of the difference between unit letter cost and unit flat cost, at least at the high-density saturation level, is based on the piece and shape characteristics and not on weight, which means that it’s not really the letter-flat differential that’s the problem.’

“Tr. 10/5824 [sic], ll. 5-11.”

What Valpak carefully omits is the telling last sentence of Crowder’s response (Tr. 10/5822):

“What it means is the pound rate is a big problem, and that’s really where I think the problem is.

“Q: The pound rate is too high?

“A: The pound rate is too high.”

Tellingly, Valpak also omits the key point of Crowder’s discussion of the interrelationship between the letter-flat cost differential and the pound rate: that *any* further increase in the letter-flat passthrough as Valpak advocates would exacerbate this problem. Try as it might, Valpak cannot have it both ways.

Yet that is exactly what Valpak is seeking here. Ultimately, Valpak is forced to admit that “the letter-flat cost difference *may need some correction for weight*,” but then it erroneously claims that “*once* this correction is made, an increase in the [letter-flat piece] rate difference to the appropriate level would not have implications for the pound rate.” VP Br. at VII-10 (emphasis added). Valpak assiduously avoids addressing what should happen to the pound rate *when* that correction is made: the pound rate would have to be reduced. Instead, Valpak not-so-subtly sidesteps the issue of the excessive pound rate, claiming the letter-flat passthrough should nevertheless be increased now, without making any other (necessary offsetting) changes in the rate structure. This is

not just simply self-serving and internally inconsistent with Valpak's present and past positions on ECR rate structure issues. It is wrong.

C. Valpak's Criticisms Of Crowder's Saturation Letter-Flat Cost Coverages Misrepresent The Purpose Of Her Analysis, And Do Not In Any Event Change The Conclusion That The Existing Higher Coverage For Saturation Flats Would Be Exacerbated By Valpak's Proposal

Valpak suggests that Crowder, in her comparison of cost coverages for saturation/high-density letters and flats, has injected a "subclass issue" that was not raised in Valpak's testimony. That is nonsense.

Valpak witness Mitchell is the one who introduced the concept of pricing letters and flats as though they were separate products, with a substantial "cost coverage markup" on the letter-flat cost differential ostensibly for the purpose of curing what Mitchell erroneously believed was an excessive cost coverage for letters relative to flats. He is the one who claimed (again, erroneously) that his remedy would produce the same result as though letters and flats were separate subclasses. Tr. 9/5415.

Crowder's analysis – using the correct approach to calculating cost coverages for separate products – rebutted and demonstrated the errors in Mitchell's conceptual analysis, as well as the error in his conclusion that letters bear a disproportional cost coverage burden.

Valpak's complaint that Crowder "subtly shifts" the analysis away from total letter and flat products to saturation/high-density letter and flat subclasses is likewise misplaced. Crowder did not call saturation/high-density letters and flats separate subclasses. She simply noted that Mitchell's description of a separate "product" was comparable to the PRC's description of a separate subclass. Moreover, she explained

clearly and logically why basic-rate letters and flats were excluded. (ADVO-RT-1, pages 14-15, lines 19 ff). Clearly, under Commission procedures, if a “product’s” costs are separately determined and separately marked-up on the basis of market characteristics, as described by Mitchell, it is being treated as a separate subclass. Crowder was simply adopting Mitchell’s concepts and took them to their logical and most relevant conclusion – rebutting Mitchell’s contention that saturation letters pay a disproportionate contribution compared to saturation flats.<sup>5</sup>

Valpak also mischaracterizes Crowder as treating saturation/high-density letters and flats as workshare variants. Indeed, she agreed with Mitchell that saturation/high-density letters and flats are more appropriately treated as different products. Moreover, contrary to Valpak’s contention, Crowder did not need to consider the differences as worksharing to explain why the letter-flat passthrough should be less than 100 percent. She demonstrated this by treating letters and flats as different products, just as Mitchell maintained. Valpak’s argument would have the Commission ignore the fact that saturation/high-density flats have a greater cost coverage than comparable letters. This occurs even if those costs are adjusted to be dropship-neutral and revenues are adjusted to eliminate dropship discounts.

Valpak is the one that has distorted the true picture. It continues to focus myopically on “passthroughs” of dropship-neutral costs without taking into consideration the fact that flats pay not only a piece rate but also the pound rate. If there were no

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<sup>5</sup> Valpak criticizes Crowder’s commercial saturation/high-density letter and flat product coverages on the ground that she excluded non-profit revenues. This criticism is gratuitous and trivial since non-profit rates are simply scaled-down from commercial rates, and their inclusion would not change the relative cost coverage relationships identified by Crowder.

pound rate but only letter and flat piece rates, the Commission could pass through 100 percent of the letter-flat cost differential and be assured that letter and flat cost coverages were relatively equal. But, with the current per-piece/per-pound rate structure, if 100 percent of the cost difference were passed through, then the pound rate paid by flats for weight over the breakpoint would represent an excessive percentage contribution paid by flats over that paid by letters.

Finally, contrary to Valpak's implication, Crowder has not proposed that letter and flat piece and pound rates make no contribution to institutional costs. Rather, she demonstrated that saturation/high-density flats and letters both have substantial cost coverages that come from the piece and pound rates. Her point was not that the already-larger saturation/high-density flat coverage should be reduced, but that it should not be increased further in order to further reduce the lower saturation/high-density letter coverage. If the letter-flat *piece*-rate passthroughs were to be increased, as Valpak proposes, that worsening of the burden on flats is precisely what would occur.<sup>6</sup>

Although Valpak (through witness Mitchell) piously claims that it is trying to accomplish the PRC's "markup" goals, the way in which it proposes to apply the markup percentage will simply expand the disparity between the implicit markups in

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<sup>6</sup> At pages III-16-20, Valpak implies that there may be other problems with the costing of DAL mailings that may result in overstatement of saturation letter costs relative to flats. These points were, in fact, addressed by Crowder. ADV0-RT-1 at 20-29. The most significant of these is the underestimate of "sequenced" saturation flats. But as Crowder explained, Haldi did not take this point to its logical conclusion: the underestimate results in saturation flats being charged too much "cased" delivery cost, which if corrected would *overstate* total flat costs compared to letters. *Id.* at 20-23, Tr. 10/5746-49.

saturation/high-density letter and flat rates. See ADVO-RT-1, page 14, lines 9-13; page 16, lines 12-16; page 18, lines 22-25.

## **II. VALPAK'S CAPACITY CONSTRAINT AND MODELED "MARGINAL" COST THEORIES ARE CONTRARY TO OPERATIONAL REALITIES**

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

- Valpak witness Haldi ignored (or was unaware of) the policy and operational reasons -- unrelated to flats -- why the Postal Service generally prefers to DPS saturation letters rather than handle them as extra-bundles/trays;
- He ignored the mail characteristics and makeup of most saturation letter mail, and the differences from flats, that make letters better and more efficient candidates for DPS-processing than for delivery as third bundles;
- He ignored the fact that city carriers have a variety of ways to expand their extra-bundle/tray capacity;
- He did not review available evidence on the subject that shows ample capacity in the city carrier system;
- He ignored the fact that the USPS cost data already reflect conditions where some saturation mail is DPSed or cased rather than treated as extra-bundles/trays; and
- His proposed solution -- to use casing costs as the "marginal" delivery cost for all saturation letters and flats -- preposterously presumes that there is no capacity on *any* city route on *any* day to handle an additional saturation mailing as an extra-bundle/tray.

See Advo/SMC Initial Br. at 4-5, 14-29, and the record evidence cited therein.

In its initial brief, Valpak rehashes Haldi's (misguided) view of the ideal world for handling saturation letters and his ensuing (faulty) conclusions. These are addressed

fully in our initial brief, detailing the many reasons why Haldi is wrong. Nothing in Valpak's brief undermines our discussion or necessitates reply.

If anything, Valpak's arguments on brief further underscore the weaknesses of its case. Valpak's primary evidence of "bumping" is the fact that most saturation letters are DPSed and some are cased, whereas it believes that the only "rational" way to process letters would be to bypass the DPS operation and be carried directly to the street as third bundles. Valpak repeatedly characterizes the Postal Service's sound preference to DPS saturation letters rather than carry them to the street as third bundles as "irrationally pursuing a dysfunctional" objective. VP Br. at IV-18; see also IV-14 and IV-20 (a policy to DPS letters in the absence of a constraint is "totally dysfunctional and irrational"). This hyperbole stems from Haldi's faulty conception of the "ideal" world for processing saturation letters, where in his view letters would always be carried directly to the street, and never be DPSed or cased absent a capacity constraint.

As fully explained in our initial brief, USPS witness Lewis and Advo witness Crowder have destroyed Haldi's key contentions. Because of the ergonomic difficulty of handling two bundles of letters on the street (a DPS bundle and a sequenced letter bundle), the Postal Service prefers *not* to carry letters as third bundles *even on days when there are no saturation flat mailings*. Tr. 11/5973-74 (Lewis). See also USPS-RT-2 at 3-4 (Lewis); Tr. 11/5940-41, 5992-93 (Lewis); ADVO-RT-1 at 37-38 (Crowder); Tr. 10/5763-64 (Crowder). It is not flats, but the characteristics of letters that act as the constraint on third-bundle letters. This, in fact, is a major reason why the Postal Service prefers to DPS as many letters as possible. See Advo/SMC Initial Br. at 14-23, 25-28, and the citations to the record evidence therein.

Moreover, these same considerations cause the Postal Service to prefer to DPS even those portions of a saturation letter mailing going to non-walking route segments. The DPS operation is necessarily an “all or nothing” proposition, because it is impossible to split a mailing by route segment at the DPS plant. *Advo/SMC Initial Br.* at 17-22, and the record citations therein. This dispels Valpak’s wild and baseless contention on brief that “on every day and every route where the Postal Service is not faced with a capacity constraint, ergonomic problems provide no rational reason for failing to minimize costs by giving bypass treatment to saturation letters.” *VP Br.* at IV-20. The Postal Service’s policy to DPS as much saturation letter mail as possible -- independent of the existence of capacity constraints or flats – is most certainly rational. This policy is driven not by concern about potential conflicts with flats, but by the broader objective of optimizing system efficiency in the handling of *letters*.

For the same reasons, Valpak is wrong in its assertion that witnesses Lewis and Crowder “have a dilemma which they attempt, but fail, to resolve.” *VP Br.* at IV-20. Valpak, for example, claims that witness Crowder “makes no effort to reconcile this policy [to DPS saturation letters whenever possible] with (i) her assumption that the Postal Service acts rationally in a manner designed to minimize costs, and (ii) the fact that so many saturation pieces are either cased, collated or DPS’s.” *Id.* at 20-21. Valpak’s claim is preposterous; Crowder fully and clearly reconciled these facts, demonstrating that the Postal Service’s DPS policy is not (as Valpak contends) dictated by capacity concerns or flats. *ADVO-RT-1* at 36-38, *Tr.* 10/5762-64. *See also* *Advo/SMC Initial Br.* at 14-27.

It is Valpak, not Crowder or the Postal Service, that misunderstands the nature and reasons for the USPS DPS policy. The hypothetical world that Valpak constructs, and that underlies its case, is disconnected from the reality of Postal Service mail characteristics and operations.

**III. OCA’S ARGUMENTS AND IMPROPER “TESTIMONY” ON BRIEF PROVIDE NO BASIS TO REJECT THE POSTAL SERVICE’S NEW AND MUCH IMPROVED CITY CARRIER STREET TIME STUDY**

A. The Perverse Standard By Which The OCA’s Judges The New CCSTS Study Ignores That, Even Under The OCA’s Own Criteria, The CCSTS Is Far Superior To The Existing Outdated Carrier Cost Studies

The only proper standard for the Commission to employ in deciding whether to adopt the Postal Service’s new City Carrier Street Time Study, in place of the current outdated and disjointed studies, is whether the CCSTS represents an improvement over those old studies. The OCA would turn this proper standard on its head. The OCA does not really even compare the old studies with the much-improved new study. Instead, using hyper-stringent, hyper-technical (and faulty) non-record analyses applied only to the new method, it would reject the new study as “less than ideal” even though that study performs far better under OCA’s criteria than the current methodology.

In our initial brief, we explained at length the many features of the new CCSTS that make it far superior to the outdated and fractionated studies that underlie the Commission’s so-called “current” methodology. Advo/SMC Br. at 36-47. The OCA, in its single-minded and result-oriented attack on the CCSTS, hardly mentions the myriad

problems with the old studies. More importantly, in its strained technical criticisms of the new CCSTS, the OCA never puts the existing methodology to the same tests. Had it done so, the OCA would have found that the new CCSTS represents a clear and decisive improvement over the old studies and methodologies *even under the its own stringent tests*.

This is akin to the manager of a football team deciding whether to replace its old, decrepit “current” quarterback who is way past his prime with a new, much improved quarterback. If OCA were the manager, it would reject the new, improved quarterback on the ground that he does not meet OCA’s stringent criteria for the “ideal” quarterback, even though the old current quarterback falls far shorter of meeting the same criteria.

In July, the OCA entered into an agreement with the Postal Service which provided that, in exchange for certain concessions from the Postal Service, the OCA would not file direct testimony in this proceeding. Now, OCA is attempting to circumvent this by filing its direct testimony in its initial brief, unleashing numerous highly technical criticisms that should have been presented in testimony on the record. This is more than a technical shortcoming. Its ploy denies the Postal Service and other parties their due process rights to conduct discovery and cross-examination, and to submit rebuttal testimony with respect to the OCA’s allegations.

The OCA, on brief, presents considerable non-record technical testimony on what it regards as a multitude of inadequacies in the CCSTS database and its use by USPS witness Bradley to develop city delivery econometric models. However, in virtually every case where OCA argues the CCSTS results are inadequate, its criticisms are clearly even more relevant to the older city street-time variability data and models.

This is nowhere clearer or more relevant than in the case of the OCA's major cost arguments against the assumption of "separability" of cost pool variabilities (OCA Br. at 38-39). The old city street-time variability studies certainly depended heavily on those assumptions, so much so that they have generated considerable controversy. Now, the new CCSTS analysis has made a giant step in eliminating the separability assumptions inherent in the old street time cost studies, but the OCA simply ignores that significant improvement.

Indeed, the new CCSTS data and analysis are tremendous improvements over the old studies.<sup>7</sup> Even the OCA does not deny the improvement. It does not even try to defend the use of the old variability studies but simply describes them as a default alternative. Instead, it curiously takes no position on the validity of those old studies, stating that if the old studies are as unsound as the Postal Service contends, then the only solution may be to assume that city street costs are 100 percent volume variable. OCA Br. at 87.

The OCA's "default" solution is, of course, preposterous. It simply highlights the extremes to which the OCA would be willing to go to sidetrack the CCSTS, sticking its head in the sand to the obvious improvements that the CCSTS offers over the old, outdated studies that even the OCA is unwilling to defend.

In this proceeding, the OCA cannot have what it wants – its own preferred approach using the DOIS/DSIS data plus possibly other data that may not even be available. So, it prefers to make the Commission, the Postal Service, and the mailers

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<sup>7</sup> For the benefit of those that did not participate in Dockets R87-1 and R90-1, where the old studies were first introduced and adopted by the Commission, we provide brief descriptions of the old studies in Attachment 1 to this reply brief.

do without a much-improved set of attributable city delivery costs. Amazingly, it even prefers to assume 100 percent variability – known even on a conceptual basis to be terribly wrong – rather than use the much-improved data. Clearly, the OCA is the classic dog in the manger and the Commission should not permit such tactics to succeed in derailing needed improvements in carrier street costing.<sup>8</sup>

The CCSTS has been well-conceived and carefully implemented. Its overall variability results are reasonably close to past estimates used by the Commission (36.6 percent vs. the old variability of 29.9 percent; USPS-T-14 at 63). As Crowder explained in response to Commissioner Goldway, no cost study can ever be “perfect,” particularly one that deals with such a complex topic as carrier street time; and any study can always be “criticized” on some basis by opponents. Tr. 10/5887-90. Although the CCSTS is not perfect, it is unquestionably far better than either of the OCA’s alternatives. Further, as noted in our Initial Brief, with the CCSTS design, further updating and expansion of the database is feasible (thus producing more panel data) and a number of costing enhancements can now be considered that could never be considered with the old studies. These expected future improvements will surely address some of the OCA’s concerns.

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<sup>8</sup> The OCA apparently fails to realize that, in the future, it can still pursue its preferred alternative approach to developing city carrier costs even if the Commission were to now adopt the CCSTS as an acceptable basis for approving the settlement agreement. The OCA now has the data requested from the USPS, it can acquire other zip-code level data, and it should be encouraged to work on its concepts. Just because the CCSTS is used in this case does not mean that further improvements or changes cannot be made in the future.

The Commission should adopt the CCSTS study, not only because it is a vast improvement over the alternatives offered by OCA but also because it is the result of thoughtful, careful, substantial, and appropriate Postal Service efforts to continue costing improvements.

B. The OCA's Highly Technical Testimony On Brief Does Not Provide A Legitimate Basis To Reject The CCSTS Study Or Results

The OCA's tactical decision to postpone submission of its direct testimony until the briefing stage places the other parties in an impossible and unacceptable quandary. Having been deprived of their due process rights to confront the OCA's arguments on the hearing record – through discovery, cross-examination, and the filing of rebuttal testimony – those parties face the possibility that the Commission might, directly or indirectly, consider or be influenced by the OCA's improper arguments in assessing whether to adopt or reject to new study. For these reasons, the Commission cannot give any consideration to the OCA's untested, non-record arguments.

The Commission should not be misled by the array of technical arguments (testimony) provided in the OCA's Initial Brief. Most of these are simply complaints that certain issues were not *fully* explored in the data collection – e.g., sample size and seasonality (OCA Br. at 62, 65-67, etc.), individualized zip-level demographic and other characteristics (*id.* at 69-70, 83-85), treatment of “sequenced” and DAL mail (*id.* at 70-72, 85-86), impacts of route restructuring (*id.* at 74-75, 85), impacts from street-time overtime and use of non-permanent carriers on a route (*id.* at 85), and integration of in-office with out-of-office analysis (*id.* at 86). What OCA intentionally fails to mention is that the old studies are far more deficient in these same areas than the CCSTS. Those outdated studies were even smaller and less representative than the CCSTS, leading to

high coefficients of variation. Most telling of all, the other issues that OCA criticizes with respect to the CCSTS *were not even addressed, much less explored in the old studies.*

The OCA may be correct that exploration of some of the issues it identifies will improve results, but those improvements can be made as the CCSTS data are expanded and more fully explored.<sup>9</sup> The fact that the CCSTS study (like any costing study) could be improved upon in the future does not mean the improvements already at hand should be rejected. Surely the Commission should not reject a good study that is superior to the existing studies merely because it can be made even better in the future.

Ironically, what most bothers the OCA is that the results of the new CCSTS differ from those produced by the old studies. The OCA has fallen into the trap of presuming the validity of the old results, and then using those outdated results as a benchmark to evaluate the results from the new study. In fact, one would fully expect that the new study -- reflecting the Postal Service's *current* delivery network, mail handling and delivery methods, and mail characteristics -- would necessarily produce different delivery cost results than the old studies that reflected the dramatically different environment from 15-plus years ago. These different results are a virtue of the new CCSTS, not a vice as presumed by OCA.

With respect to some of the other of OCA arguments, especially those concerning the CCSTS econometric model results, it is always easy to offer interpretations and casual explanations. It is not always so easy to defend them "on the

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<sup>9</sup> Moreover, there is no way to know before-hand the general direction these improvements will take the CCSTS model results. Thus, there are no known or even suggested biases in those results.

record.” The OCA’s arguments on brief are not record evidence, and have not been subjected to discovery, cross-examination, or opportunity for rebuttal on the record. Its interpretations of record evidence should be viewed with considerable suspicion. Appearances are often misleading and one should investigate in-depth before finalizing interpretations and conclusions.<sup>10</sup>

It would be extremely difficult (and patently unnecessary) to even try to address all the OCA’s arguments in the extremely short time allowed for reply briefs. Although OCA’s tactic has deprived us of the opportunity to rebut its arguments on the record, in Attachment 2 to this brief, we lay out some of the points we would have addressed on the record had we been given the chance. The material in the attachment, like OCA’s arguments on brief, is, of course, neither testimony nor part of the evidentiary record. We offer it solely to demonstrate some of the many reasons why the OCA’s contentions do not undermine the validity of the new CCSTS study, and why they should not and must not be considered by the Commission.

WHEREFORE, for the reasons stated herein and in our initial brief, Advo and the Saturation Mailers Coalition respectfully request the Commission to (1) approve the nearly-unanimous Settlement Agreement; (2) recommend to the Governors the rates

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<sup>10</sup> A clear example is the OCA’s comment that Valpak witness Haldi has presented testimony showing how volume in one cost pool can affect cost in another pool. OCA Br. at 39. This apparently refers to Haldi’s contention that city carriers do not carry out saturation letters as extra bundles (“sequenced”) mail because they have only enough capacity to carry out saturation flats in that manner. Thus OCA implies that the presence of saturation flats in the city delivery cost pool impacts the cost of saturation letters in the mail-processing and city in-office cost pools. USPS rebuttal witness Lewis and Advo rebuttal witness Crowder have clearly and unequivocally explained that the mail-processing and casing of saturation letters is independent of the presence of saturation flats.

proposed by the Postal Service; (2) reject Valpak's proposals; and (4) adopt the Postal Service's new City Carrier Street Time Study.

Respectfully submitted,

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The Saturation Mailers Coalition

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## **DESCRIPTION OF THE OLD CITY STREET-TIME STUDIES**

For the benefit of the Commission, the following provides a brief description of the old city street-time studies.

### **The Street Time Sampling System (STS)**

The Street Time Sampling System (STS) is the data collection and database introduced by USPS witness Hume in Docket R87-1 (USPS-T-7) to disaggregate city letter carrier street time costs into the major cost pools: Foot Run Time, Curblineline Run Time, Load Time, Street Support, and Travel. A pilot test of the STS was carried out over a three-month period ending October 1986. It involved about 2,400 routes at 91 offices. Significantly, for each route, only three sample readings or tallies were taken (using a beeper system that asked the carrier to record what he or she was doing at the time of the beep). Consequently, the STS generated only 7,103 total tallies (trimmed down to roughly 6,000 usable tallies after missed-call and lunch tallies were eliminated) that covered all eight letter route categories.

Further, the number of tallies among route categories varied considerably: from 3,458 tallies for the residential park-and-loop category to 109 tallies for the business motorized category. Even for the 1986 period, the STS street-times by route type were not consistent with those estimated by subtracting in-office time from total carrier time. For example, roughly 5,300 out of the 7,100 tallies or nearly 75% fell within two of the eight route types (residential curb and mixed curb) that today comprise only about 24% of letter routes.

These disparities alone did not necessarily make the STS results invalid since those results were not used to allocate total street time across route types. However, the STS results by route type were used to allocate total route type costs to the various cost pools (e.g., the residential curblane STS results allocated the residential curblane street time among cost pools). And, for some route types, the number of tallies was very small or even zero, creating very large confidence intervals. Even Hume recognized that the STS confidence intervals were large.

Another problem with the STS was the treatment of tallies that were not taken because the beeper calls were not placed or were missed by the carrier, or something else occurred (e.g., the carrier was doing in-office activities). These tallies were assigned to Margin, Missed Time, and Lunch/No Call components, and then a strange, complicated processing of all tallies occurred whereby nearly 1,100 tallies were eliminated from the analysis and the remainder were proportioned so that each represented the same amount of carrier street time.

Because the STS was only a pilot test and was expected to be revised and upgraded to a full-scale data collection program, it received relatively little attention in Docket R87-1. Unfortunately, it never was revised and upgraded and has since become embedded in the USPS/PRC costing methodology.

### **The Load Time Variability (LTV) Data**

The Load Time Variability (LTV) study was also introduced in Docket R87-1 by USPS witness Hume (USPS-T-7). The LTV data are used to develop the load time models used to identify the elemental and coverage-related load time proportions of the total STS load time cost pool. The LTV data were collected in a pilot test implemented

on a nationwide sample of 400 routes over the September-December 1985 time period. The collected LTV data consisted of a time study of delivery activities over a sequence of stops in combination with the mail volumes and physical characteristics of the same stops. These data were then used to develop three load time models (single-delivery residential stops, multiple-delivery residential stops, and business & mixed stops) used to estimate volume variability by delivered piece shapes, by delivered accountable pieces, and by collected pieces. The LTV test collected data from over 20,000 stops but some of the data were eliminated and the LTV models only used data from 18,861 stops from 369 routes. Because the LTV was only a pilot test, there was the expectation that the LTV would be revised and expanded in the future. Unfortunately, it never was.

The LTV models remain a reflection of the city route volumes and carrier delivery characteristics of the 1985 time period when the original time, volume, and other data were collected. To use the models now requires that current annual CCS volumes be used with the old models' coefficients to provide "current" estimates of load time variability (i.e., estimates of elemental and coverage-related load time).

### **The Foot and Curblin Access Tests (FAT/CAT)**

The most recent versions of the Foot and Curblin Access Tests (FAT/CAT) were introduced in Docket R90-1 by USPS witness Colvin (USPS-T-7). Run time is the portion of the carrier's time associated with traveling the route and accessing stops where deliveries are made. Since route time is considered fixed while access time is considered variable with volume, the USPS developed the Foot Access Test (FAT) and Curblin Access Test (CAT) analyses to determine the proportions of STS foot and

curbline run time cost pools represented by route and access, under different stop coverage conditions. The FAT/CAT tests were conducted in the late 1980s and collected data from 446 city carrier routes (78 foot, 161 curbline, and 199 park and loop routes).

Essentially the FAT and CAT were time-and-motion studies. They entailed a regular carrier making five runs over the same segment of a test route – without carrying mail. On each run, the carrier (either walking or driving) made a pattern of stops that corresponded to a particular level of stop coverage (e.g., 100%, 90%, 80%, 70%, or 60%). When the carrier reached each designated stop, he paused long enough to mark a data collection sheet but he delivered no mail. The time to cover the segment and the coverage level was recorded for each run. With this information, the USPS could then (1) match stop coverage percentages with run times, (2) identify the change in run time with the change in coverage and access time, and (3) identify the unchanged run time as route time. Accomplishing this feat, however, involved extremely complex econometric models that have been associated with a number of so-far unresolved statistical problems. (See, e.g., USPS-T-14, pages 4-6). The CAT/FAT proportions of route and access time were then applied to the STS curbline and foot run time cost pools.

Interestingly, in Docket R90-1 when the new FAT/CAT data were introduced, the PRC recognized some of the shortcomings of the time-and-motion studies and supported the recommendation that the LTV sample frame (which everyone thought was going to be updated) be modified to include a time series of observations encompassing a range of volume/coverage conditions on a representative cross-section

of sampled routes. (R90-1 Opinion, page III-22, para. 3051) *This recommendation sounds very close to what the USPS now offers in the CCSTS.*

Finally, it should be noted that, like the use of the LTV model, the CAT/FAT models remain a reflection of the city route delivery technology characteristics of the late-1980s time period when the original time and coverage data were collected. So, using the models now requires that current stop coverage data from the annual CCS volume and deliveries data be used with the old models' coefficients to provide "current" estimates of run time variability (i.e., estimates of route and access time).

**PROBLEMS WITH OCA'S NON-RECORD TECHNICAL CRITICISMS OF THE CCSTS**

1. The Results Of The CCSTS Model Do Not Contain “Wrong Signs” On Volume Variables, And Are Acceptable

The OCA criticizes the results of the CCSTS study on the peculiar ground that several of the coefficients for squared volume terms (letters, sequenced, and collection volumes) are negative. OCA Br. at 78-79. This “criticism” reveals the OCA’s lack of understanding on how to properly interpret the model results. These negative coefficients indicate declining but positive marginal costs, an indicator of scale economies for postal volume. Marginal costs are calculated using both first and second order terms. All first order terms are positive and therefore all marginal costs are positive (as shown on page 65 of OCA’s Brief).

This is a good example of why the OCA’s technical criticism (and all the others discussed below) *should have been presented in the form of testimony*, on the record, subject to discovery, cross-examination, and rebuttal. Interpretations of complex models and their results, as well as questions of bias due to model specifications or data collection, and also determinations of the nature or significance of alleged shortcomings or errors, are highly technical topics that can be easily misconstrued or distorted by the commentator. It is why these kinds of assertions *must* be made subject to due process scrutiny by other parties, *on the record*.

2. The “T-Values” For Variables Under The CCSTS Regular Delivery Restricted Quadratic Are Not Problematic, Particularly Compared To The Results Under The Old LTV Models

The OCA argues that the results of the CCSTS regular delivery restricted quadratic contain variables with insignificant t-values that may indicate a problem. This alleged “problem” is greatly overblown – particularly compared to the worse results under the old LTV model -- and does not provide reason to reject the CCSTS model results. With the lone exception of small parcels, all volume variables in the delivery restricted quadratic model contain at least one coefficient with an HC-corrected t-value that is significant at least to the 10 percent level (i.e., there is only a 10 percent chance that the coefficient value, but not the estimate calculated from the regression, is zero).<sup>11</sup> Further, all volume variables contain coefficients with the correct signs (first order term must be positive but second order term can be positive, zero or negative).

When all signs are correct, and certainly when multicollinearity is present, it is common practice to include all regressors in the estimating equation. This is because multicollinearity causes the standard errors for the individual coefficients to vary more widely than if there were no multicollinearity. Hence, there is a greater chance to reject a term as statistically insignificant (when viewed in isolation) when in fact it is significant (the true coefficient is non-zero). By including *all* coefficients with high and low t-values (first and second order volume terms), the effects from these wide variations in the estimated coefficients tend to cancel out (when some are higher than expected, the others are lower than expected). Therefore, total cost estimates and individual shape marginal costs are *more precise* when all terms are included. Selectively eliminating any

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<sup>11</sup> For all variables, the t-statistics can be interpreted at the 5 percent level of significance (t value - 1.96) and/or 10 percent level of significance (t value - 1.645).

of the volume terms included in the equation would bias not only the total estimate, but one or more of the shape variability estimates as well.

Indeed, multicollinearity is expected whenever a model contains separate volume variables for each shape. This is because most deliveries contain pieces of different shapes; and the more pieces of one shape, the more pieces of another. Significantly, the results of the current (but severely outdated) LTV model that generates the largest chunk of volume-variable delivery costs fares far worse on this score than the new CCSTS model. The LTV model likewise exhibited (1) multicollinearity, (2) some negative second order and cross-effect terms, and (3) some low t-statistics – all of which the OCA quite conveniently ignores. In fact, the  $R^2$  value produced by the old LTV single-delivery-residential-stop model (which encompasses the vast majority of load time) has always been extremely low (35.2% in the R90-1 Commission model), in sharp contrast to the much higher  $R^2$  values produced by the CCSTS (81.7% for the regular delivery model and 70.6% for the parcel/accountable model).

3. The Slightly Lower Marginal Cost For Flats Than Letters Is Not Counter-Intuitive In Current Operations, And Is Not Evidence Of Bias In The Model.

The OCA focuses on the slightly lower marginal delivery cost for flats than for letters (1.39 vs. 1.36 seconds) as counter-intuitive and evidence of bias. OCA Br. at 81. The OCA implicitly assumes that all delivery time is load time (time spent loading mail into receptacles), and that letters cost less to load than flats. Even if viewed as principally the result of load time, one cannot assume that the letter-flat cost relationship exists for load time that *used to exist* for in-office casing time. At one time, letters cost substantially less to case than did flats. With the advent of DPS and vertical flat cases,

however, their casing times are much more comparable. Not surprisingly, the same has occurred for receptacle loading on the street.

Because there are more delivered letters than flats, “fingering” of the mail is likely more time consuming for carriers on a per piece basis for letters than for flats – especially now that most letters are DPSed. Unlike cased flats that the carrier has sorted into walk sequence in the office, DPS bundles are not touched by the carrier until leaving the office for the street. Carriers are known to “finger” their DPS letters on the street (even moreso than their cased mail) to guard against DPS mis-sorts and ensure proper address order. This effect on delivery time is likely even greater at the increasing number of multiple delivery stops where carriers essentially have to “case” the mail into multiple receptacles. These effects are evidenced by the fact that, when witness Bradley separated out DPSed letters from cased letters, the marginal cost for DPSed letters was much higher. Finally, flats are often used by carriers to “wrap” the rest of the mail, making all the mail easier to load into the receptacle. All these effects are picked up in the model’s shape coefficients.

4. The Lower Marginal Cost For Sequenced Mail Compared To Letters And Flats Is Expected, And Is Not Evidence Of Model Bias Or Data Problems.

The OCA claims that the lower marginal cost for sequenced mail compared to letters and flats is evidence of model bias and data problems in the CCSTS. OCA Br. at 82. Again, the OCA incorrectly assumes that all delivery time is load time. Sequenced mail, however, is more often found on curblines and centralized route segments. Both segments are very high-productivity (i.e., more pieces per delivery time than for foot and park-and-loop), and the “sequenced” mail marginal cost reflects that. Moreover, on the growing number of centralized deliveries, letter and flat

mail must still be “fingered” and sorted to some extent while “sequenced mail” is already sorted to delivery point sequence. The lower marginal delivery cost for “sequenced” mail is to be expected.

It also appears that the OCA, when discussing delivery models, misunderstands precisely what “sequenced” mail is. In trying to persuade the Commission that the CCSTS may not include a representative amount of “sequenced” mail, the OCA confuses “sequenced” mail (as the term is used in the delivery model) with walk-sequenced saturation mail that is cased in-office. See OCA Br. at 71, discussing DAL mailings. The model’s sequenced mail is only that saturation mail that is actually carried to the street as extra bundles or trays.

5. The CCSTS’s Bifurcation Of Total Carrier Time Into Regular And Parcel/Accountable Portions Does Not Result In Meaningful Misallocation Or Understatement Of Flat Delivery Cost, And Removal Of This Bifurcation Would Likely Result In Lower Flat Costs.

The OCA claims that Bradley’s bifurcation of total carrier time into regular and parcel/accountable portions causes some extra door delivery time for flats to be incorrectly imputed to parcels/accountables. OCA Br. at 63-64. This assertion is speculative simply because there is no evidence that this is happening on any meaningful scale, or even that the CCSTS carriers would have treated such flats in the same way as they treat large parcels. Further, it ignores the fact that many multiple-delivery and some small single-delivery points have other means to receive large flats – e.g., nooks, large cubbies, and J-hooks where the carrier can place a rolled flat.

However, to avoid any potential problem from this situation, one relatively simple solution would be to estimate all delivery time (regular and extra time caused by parcels/accountables) against all volume variables (parcels/accountables included).

Such a modification would most likely *reduce* both flat and letter marginal costs, rather than increase it as OCA implies.

This is because parcel/accountable deviation and parking times decline as regular mail volume increases – i.e., as total volume rises, the need for added vehicle time for parcel/accountable deliveries alone decreases because more delivery points and parking locations are accessed for delivery of regular volume. The added time for the latter is captured by regular delivery time under CCSTS, but the resulting lower deviation parking point time is included in the parcel/accountables pool. If, however, both pools were combined, some of the parking/deviation time reduction resulting from greater letter/flat volume would be attributed to letter/flat volume (lowering their coefficients) rather than to the parcel/accountable volume. Therefore the resulting overstatement of flat/letter marginal costs is systematic by design.

6. OCA's Criticisms That Bradley's Model Does Not Capture Long-Term Variability And Seasonal Influences Are Incorrect, And Its Proposed Remedy Is Unnecessary Overkill

The OCA argues that Bradley's cross-sectional model does not capture long-term variability because of its use of short-term data by zip-code. It further claims that seasonal influences are completely missed because data collection occurred over only a two-week period. The OCA concludes that what is needed is long-term panel data reflecting a continuous collection effort at regular intervals at the zip-code level. OCA Br. 72-75.

The underlying premise behind OCA's attack is that collection of continuous data over the long term by zip-code is the only way to accurately measure system level volume variable costs. This is wrong. The Service has employed an equally valid and

certainly less costly approach.<sup>12</sup> Moreover, the OCA misunderstands what Bradley accomplishes through his cross-sectional approach for capturing long-term variability effects. Lack of seasonality in the data is not a concern as long as volumes and costs are properly matched by time.

The key to understanding how permanent volume changes cause permanent cost changes is to consider that delivery managers staff based on expected volume over an entire seasonal cycle. The average level of volume plus the extent of seasonal volume variation relative to the average determines the efficient mix of permanent and seasonal/temporary staff, and how much overtime to use. Once the seasonal cycle ends, if there is an expected change in the average volume level over the next seasonal cycle, it is this change and the precipitated cost response that should be considered permanent and therefore subject to volume variable measurement.

Managers can be expected to adjust all labor elements proportionately based on expected increases in average volume. This keeps the staffing mix and the relative use

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<sup>12</sup> OCA appears to have in mind a continuous data collection process at regular intervals for designated zip-codes so that both seasonal influences and long-term delivery network changes to sustained volume changes are adequately captured by zip-code. Its proposal is gross overkill. That might satisfy the basic requirement for capturing long-term volume variability effects, but it is certainly unnecessary and far from being the most cost efficient way to accomplish this feat. In particular, the OCA claims that collecting biweekly data by zip-code over a four-year period would be sufficient for model development and analysis. However, this effort would yield 104 data points for each of the 145 sampled zip-codes used by witness Bradley in his analyses for a grand total of 15,080 observations, not the 160,680 observations claimed by OCA (OCA, page 75). In its example, OCA confuses the 1,545 zip/day observations with the 145 sampled zips that are the basis for Bradley's zip-day analysis. It uses the former to obtain its number of observations estimate. From the example, the OCA appears to lack basic understanding of how many observations are required to obtain reliable econometric estimates. Apart from taxing computer processing and storage capabilities to the limit, the figure is certainly not the 160,680 observations claimed through their example.

of regular/overtime labor the same, given the same level of seasonal volume variation at the new higher average volume level. If the initial condition is optimal (cost minimizing), then the new adjusted condition at the higher volume level will also be optimal and therefore expected from the judicious use of carrier resources by postal managers. This is exactly the response captured by Bradley's models through his cross-sectional analysis.

Accordingly, witness Bradley's cross-sectional approach is perfectly consistent with the described long-term measurement approach. In particular, his model development scheme involves zip-code to zip-code data comparisons for the same two-week periods of time. The underlying premise is that once the proper zip-code specific control variables are in place for purposes of cost-volume analysis, zip codes are largely substitutable for one another in determining long-term volume-cost relationships.

Bradley's cross-sectional approach is tantamount to observing cost-volume data from one zip code, not with the same zip code at a later point in time but with another zip-code that already has higher volumes and costs at the same point in time. The response in the second zip-code acts as a proxy for the eventual response in the first zip-code, once it reaches the indicated higher volume level. Differences in zip-code level characteristics that can account for non-volume related cost responses are already accounted for in Bradley's restricted quadratic through the inclusion of density and possible delivery control variables. Also, the fact that the same two-week period for the zip-code data is used to develop the models means that data are already de-seasonalized for purposes of analysis as already described

Therefore, contrary to the OCA's misinformed comments, Bradley's cross-sectional approach is a perfectly acceptable procedure for measuring long-term variabilities. His control variables properly account for the different non-volume cost causing characteristics across zip-codes. And, the volume variability estimates from the restricted quadratic properly measure the long-term cost-volume relationships both by zip-code across time and across zip-codes at the same point in time.<sup>13</sup>

Finally, OCA's claim that Bradley's control variables are insufficient to account for all zip-code level differences is entirely speculative. It offers no proof for such assertions. To the contrary, inclusion of a "shopping list" of zip-code level non-volume variables to control for zip-code level differences (the approach OCA appears to advocate) can easily cause spurious correlations among the data and bias the measured cost-volume connection. Any determination to include additional control variables beyond those used by witness Bradley must be carefully studied beforehand. Most importantly, such variables should be theoretically justified and fit the overall conceptual scheme for developed model structures.

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<sup>13</sup> OCA makes much of the fact that the short time period represented by the CCSTS panel data prevents it from being used to develop fixed-effects models. Having a fixed-effects model is desirable because it would provide information on how *each individual* zip-code's costs change as volume changes over time. However, this information should be considered a luxury, not an absolute necessity. The current Bradley models provide the absolute necessity – accurate information on how, on a system-wide basis, zip-code costs change as volume changes. At some future time, the CCSTS may be sufficiently enhanced (or the OCA may develop its own models) such that fixed-effects may also be identified.