

Before the
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

Postal Rate and Fee Changes, 2006)

Docket No. R2006-1

OFFICE OF THE CONSUMER ADVOCATE
TRIAL BRIEF
(September 6, 2006)

The Office of the Consumer Advocate (OCA) hereby presents its Trial Brief which contains OCA's endorsement of the Postal Service's Forever Stamp proposal, as well as synopses of the five pieces of testimony filed this date as OCA's direct case.

OCA Supports the Proposal of the Postal Service to Establish
A New Classification for the Forever Stamp

Postal Service witness Taufique presents the Postal Service's proposal for a Forever Stamp that would be purchased at the prevailing rate for the first ounce of a single-piece letter but could be used "forever," without additional postage, even when rates go up in the future. This proposal provides an important new convenience to mailers of single-piece First Class letters. OCA gives its full support to this new classification.

The details of how the stamp may be used have been presented in responses to a series of interrogatories by intervenors David Popkin and Douglas Carlson. The Postal Service wants to proceed with caution in the early years that the stamp is made available to the public so as to limit financial exposure. This a reasonable position to take at this time, and OCA is hopeful that successful use of this stamp over a period of years may eventually lead to opportunities to use the stamp on a wider variety of

mailpieces. Stamps of this type have been in circulation in the United Kingdom and France for decades. Public convenience and costs saved have led to very liberal usage rules in these countries, and there is reason to believe that the U.S. Postal Service may be willing to relax the mailing rules following successful use over the next several years. In short, OCA gives its unqualified endorsement to the Postal Service's Forever Stamp proposal.

OCA's Direct Case

OCA also files its direct case, consisting of five pieces of testimony from four witnesses: OCA-T-1, witness Mark J. Roberts; OCA-T-2 and OCA-T-3, witness J. Edward Smith; OCA -T-4, witness Pamela A. Thompson; and OCA-T-5, witness James F. Callow.

OCA-T-1, Testimony of Mark J. Roberts (Volume Variability of Mail Processing Costs)

Witness Roberts presents the results of his econometric estimation of labor demand in mail processing. This testimony constitutes a third refinement of the modeling approach presented in two earlier papers: *An Empirical Model of Labor Demand in Mail Sorting Operations* (May 2002) and *An Economic Framework for Modeling Mail Processing Costs* (March 2006). The new findings presented in OCA-T-1 include empirical refutation of the "proportionality" assumption that Postal Service witness Bozzo must make in order to characterize his elasticity estimates as the *bona fide* marginal cost estimates that the Commission requires for the attribution of costs. Using the MODS data provided by the Postal Service, witness Roberts shows that the

number of pieces that are identified in mail processing operations (called “Total Pieces Fed” or “TPF”) are rarely proportional to the correct volume measure that witness Roberts uses in his econometric analysis, i.e., “First Handled Pieces” or “FHP.” On numerous occasions, both in testimony and academic papers, the Postal Service has attempted to defend its failure to use actual mail volumes in the estimation of volume variable costs. Witness Roberts finally lays this matter to rest by presenting empirical proof that TPF is not in fixed proportion to the volume of mail in the plant (FHP).

In demonstrating the failure of the Postal Service’s proportionality assumption, witness Roberts is able to show that, when the Postal Service’s elasticity estimates are augmented with the empirical relationship between TPF and FHP, they crudely approximate the correct volume elasticities that are needed to estimate marginal cost and that are estimated directly in the Roberts analysis.

As in the March 2006 paper, witness Roberts makes use of the quarterly variations of labor hours with volumes to isolate the volume variability of mail processing costs by shape. Witness Roberts’ current testimony contains another innovation regarding how to exploit the quarterly variation in mail volume to estimate volume elasticities – the use of quarterly dummy variables as additional instrumental variables to control for the endogeneity of output.

Elasticities for letters, flats and Priority Mail are presented, with small standard errors for letters and Priority Mail. Witness Roberts is confident in the letters and Priority Mail results, but has reservations about the flats estimates (because of the standard error problem). He believes that there is significant instability in the MODS

flats data for the last several years because this is the period in which there is extensive displacement of the manual sortation of flats by AFSM technology.

OCA-T-2; Testimony of J. Edward Smith
(Supply Side Transaction Variability of Window Service Costs)

Witness Smith critiques a new study of the transaction supply side volume variability of window service costs that is presented in the testimony of two Postal Service witnesses: Nieto (USPS-T-24) and Bradley (USPS-T-17).

Witness Nieto designed and managed the collection of data on window transaction volumes by type, as well as the clerk time consumed in conducting the observed transactions. OCA witness Smith concludes that the data collection effort is deficient in several respects:

Sampling theory was not employed to determine the sampling plan.

The transactions observed were not shown to be representative of the population of window transactions, nor were they shown to be representative of seasonal patterns throughout the year.

There appears to be an insufficient amount of data for most transaction types; therefore, the statistical validity of the sample is questionable.

A large amount of data was dropped from consideration; these dropped observations may have biased the results.

Witness Smith improves the transaction analysis by taking into account customer walk-time and recommends that the Commission use his, rather than witness Bradley's, transaction variability results.

OCA-T-3; Testimony of J. Edward Smith
(Volume Variability of City Carrier Delivery Costs)

Witness Smith critiques the volume variability testimony presented by witness Bradley in Docket No. R2005-1, which was not updated for the current proceeding. Witness Smith finds that the database underlying the City Carrier Street Time Study (CCSTS) is flawed. Of equal importance is that witness Bradley has not properly specified the estimation equations – he has included density as a control variable. A proper specification of the model treats mail volumes and service to delivery points as cost drivers, but density is an output of the cost minimization process. It is not a cost driver. The Postal Service “sells” delivery of mailpieces to particular delivery points as its fundamental service; however, it does not “sell” density. The density variable must be removed from the equations. Witness Smith re-runs the model using the proper specification.

An important new development in the estimation of the volume variability of City Carrier delivery costs is the availability of data from the Delivery Operations Information System (DOIS) over a four-year period, FY 2002- 2005. The DOIS database is superior to the CCSTS database because it contains nearly 500,000 useable observations over 16 quarters, as contrasted with the CCSTS database, which contains only 30,000 useable observations for a single quarter. Although these data have been available to OCA for a very short period of time (a little over a month), witness Smith has been able to prepare the database and run several reasonable alternatives, finally settling upon a set of elasticities that result from using data on delivery point technology (i.e., delivery point type).

OCA-T-4; Testimony of Pamela A. Thompson
(Rate Design Proposal for First-Class Letters and Sealed Parcels Subclass)

Witness Thompson proposes a greatly simplified First-Class rate schedule that eliminates additional-ounce rate cells (with one exception for business parcels). In lieu of single-ounce rates, witness Thompson recommends quarter-pound rates, i.e., a single rate for all First-Class single piece letters (up to 4 ounces); only three rate cells for single-piece flats; and only three rate cells for single-piece parcels. In almost all cases, Witness Thompson has set the rate levels at 42-cent increments, so as to make stamp purchases more convenient than they have ever been in recent memory.

Specifically, all single piece First-Class letters would pay 42 cents. Flats would pay 2 x 42 cents (84 cents) for 0 – 4 ounces; 4 x 42 cents (\$1.68) for 4 – 8 ounces; and 6 x 42 cents (\$2.52) for 8 – 13 ounces. The rates proposed for single-piece parcels are \$1.68 for 0 – 4 ounces, \$2.52 for 4 – 8 ounces, and \$2.79 for 8 – 13 ounces.

Witness Thompson opposes the “de-linking” contained in the Postal Service’s proposal and employs the bulk metered mail (BMM) benchmark in setting presort rates. She agrees with the oft-expressed views of the Commission that discounts should be based on the costs avoided by the worksharing activities of mailers, not incidental cost differences that are wholly unrelated to worksharing. Discount levels set by the Commission send correct price signals, while those resulting from the uncritical application of all CRA cost differences will simply produce unwarranted cost shifts to single-piece mail. Rate discounts set in such an uneconomic manner create an inequitable rate schedule. By means of the BMM benchmark, witness Thompson develops workshared rates using the Commission’s accepted methodology. Witness

Thompson extends the benefits of a simplified, quarter-pound, rate schedule to workshared letters, flats, and parcels. (Business parcels are the single exception).

It is the view of the OCA that this is the ideal time to make all desirable changes to the First-Class rate schedule, since the introduction of shape-based rates already will cause the public to have to learn a new system of rates. A distinct virtue of the quarter-pound structure is that considerable mailer time will be saved by not having to weigh every piece to see whether it is just over or under the next ounce. Such determinations will only need to be made for pieces that are close to the four-ounce breakpoint. Many mailpieces (perhaps most) used by both consumer and business mailers will obviously fall well within a four-ounce increment and will not need to be weighed at all.

OCA-T-5; Testimony of James F. Callow
(Confirm Service Fee Proposal)

Witness Callow opposes the classification changes proposed by the Postal Service for Confirm. By eliminating the “start the clock” electronic notice requirement currently in the DMCS and abandoning the unlimited scan pricing design (for Platinum subscribers) currently in place, the Postal Service is retreating from any program to measure its provision of services to First-Class workshared mail, Standard Mail, and Periodicals mail. It is ironic that the Postal Service is attempting to dismantle the nascent Confirm program after being harshly criticized by the Government Accountability Office (GAO) for precisely this failure.

In “Delivery Performance Standards, Measurement, and Reporting Need Improvement,” GAO-06-733, July 2006, “Highlights page”, (emphasis added), GAO concludes:

USPS does not measure and report its delivery performance for most types of mail. Therefore, transparency with regard to its overall performance in timely mail delivery is limited. As shown in the table below, representative measures cover less than one-fifth of mail volume and *do not include Standard Mail, bulk First-Class Mail, Periodicals, and most Package Services.*

GAO recognizes that tracking data and establishing other performance measures will result in processing, transportation, and delivery service improvements only if “this information is actually used by managers to make decisions.” Report at 9. The accuracy of this insight is reinforced repeatedly by the statements of the Postal Service’s Confirm witness, Drew Mitchum. Witness Mitchum states:

“Confirm service itself was not and is not intended to be a performance measurement tool.” Tr. 14/3966.

“The Postal Service does not view Confirm service as a tool for evaluating processing and delivery system performance” Id.

“[T]he Postal Service does not use customer scan data for its purposes” Id. at 3981.

Since the Postal Service has refused to develop a sampling system that can be used to measure the performance of the majority of its mail, i.e., workshared First Class, Standard Mail, and Periodicals, it is inexcusable that it is attempting to impose lethal changes on the one tracking/performance tool (imperfect as it may be) that is operable today – the Confirm system.

The testimony first presented by witness Kiefer (USPS-T-5), in Docket No. MC2002-1, manifested an optimistic spirit of trying to build a system that encouraged as much use of Confirm as possible, culminating in a performance measurement tool that

would give mailers a clear idea of the level of service they could expect. In the current proceeding, witness Mitchum attempts to rewrite the history of Confirm, characterizing the statements of postal officials in the early years of Confirm as having an intent exactly the opposite of their explicit meaning.

OCA has long had an interest in promoting systemwide measurement of service performance for business customers as well as consumers. In an effort to protect Confirm from the Postal Service's proposal to impose destructive changes, witness Callow proposes Confirm prices that retain the current Confirm rate design. He recommends:

Retaining the Silver, Gold, and Platinum service levels;

Preserving the subscription-based "internet" pricing model;

Maintaining Silver prices at current levels; increase Gold subscription fees by 16 percent; and increase Platinum subscription fees by 95 percent;

Producing a cost coverage for Confirm that is slightly higher than that proposed by the Postal Service;

Retaining the "start the clock" electronic notice requirement.

Respectfully submitted,

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