

USPS-RT-10

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

REBUTTAL TESTIMONY
OF
MAURA ROBINSON
ON BEHALF OF
UNITED STATES POSTAL SERVICE

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1 AUTOBIOGRAPHICAL SKETCH

2 My name is Maura Robinson. I am the Manager, Pricing Systems and
3 Analysis in Pricing and Classification. My office provides technical pricing and
4 business management support, enabling the development of pricing and product
5 initiatives. Earlier this year, I served as Manager, Transformation in the Strategic
6 Planning Department with responsibility for the development of strategic
7 marketing and finance transformation initiatives. I have been employed by the
8 United States Postal Service since 1998. Through January 2006, I served as an
9 Economist in Pricing and Classification. During that time, I worked on issues
10 relating to Priority Mail, First-Class Mail, rate policy, and legislative reform.

11 I have previously testified before the Postal Rate Commission in three
12 dockets. In Docket No. R2005-1, I testified in support of the Postal Service's
13 policy decision to request an "across-the-board" increase in rates and fees to
14 fund the escrow requirement established by the Postal Civil Service Retirement
15 System Funding Reform Act of 2003 (P. L. 108-18). In Docket No. R2001-1, I
16 presented testimony on First-Class Mail rate design, and in Docket No. R2000-1,
17 I testified on the Postal Service's Priority Mail rate proposal.

18 Prior to joining the Postal Service, I worked for the Baltimore Gas and
19 Electric Company from 1992 through 1998. I graduated from the University of
20 Maryland at College Park with a Master's of Arts degree in Economics. I also
21 hold a Bachelor of Science degree in Economics and a Bachelor of Arts degree
22 in French from Iowa State University.

1 I. PURPOSE AND SCOPE OF TESTIMONY

2 Witnesses for several intervenors¹ have proposed prices or pricing
3 approaches different from those proposed in the Postal Service's direct case.
4 These intervenor proposals have at least one element in common: they arise
5 from, or result in, a flawed assessment of what would constitute acceptable
6 allocation of institutional costs among classes of mail, in accordance with
7 applicable statutory ratemaking criteria. The alternative First-Class Mail letter
8 price proposals would also have significant revenue consequences that would
9 cause a distortion of rate policy decisions spreading beyond First-Class Mail.

10 My testimony responds to these alternative proposals and explains why
11 the allocation of institutional costs proposed by Postal Service witness O'Hara
12 (USPS-T-31) in this case is most faithful to the pricing criteria of the Postal
13 Reorganization Act and why it should be recommended by the Commission.

14 Various intervenor witnesses in this docket have suggested modifications
15 to the Postal Service's proposal based on their application of specific pricing
16 principles such as Efficient Component Pricing (ECP). However, no intervenor
17 has appropriately balanced the economic efficiency goal which underlies ECP
18 with a full consideration of the context in which postal rates are established. As
19 a result, these proposals typically meet one narrow policy objective rather than

¹ American Postal Workers Union, AFL-CIO witness Kobe (APWU-T-1),
Newspaper Association of American witness Sidak (NAA-T-1), Pitney Bowes
witness Panzar (PB-T-1), and ValPak witness Mitchell (VP-T-1).

- 1 address the full spectrum of issues that the Postal Service balances in its
- 2 proposal and that the Commission must consider in its recommended decision.

1 II. POSTAL PRICING IS NOT THE MECHANISTIC APPLICATION OF
2 THEORETICAL PRICING RULES

3 Considerable discussion in this docket has surrounded the mechanics of
4 rate design and how “efficient” discounts should be set. In general, the
5 testimonies of American Postal Workers Union, AFL-CIO witness Kobe (APWU-
6 T-1), Newspaper Association of America witness Sidak (NAA-T-1), Pitney Bowes
7 witness Panzar (PB-T-1), and ValPak witness Mitchell (VP-T-1) imply that, if the
8 theory of Efficient Component Pricing is not strictly adhered to, then the resulting
9 prices will not be economically efficient, and therefore, in some sense, they
10 would be inappropriate for the Commission to recommend. I disagree.

11 In developing its pricing proposals, the Postal Service has been guided by
12 the Commission’s prior interpretations of the Postal Reorganization Act which
13 recognize the variety of factors that must be appropriately considered and
14 balanced to arrive at a reasonable, comprehensive pricing structure. In its
15 discussion of the Act, the Commission has noted:

16 The language of the Act is quite broad. The objectives of the Act suggest,
17 in one form or another, virtually every standard for equity and efficiency
18 found in economic theory. Many of the objectives of the Act can conflict;
19 thus, the Act assigns to the Commission the judgments that are needed to
20 apply them. It is the Commission’s understanding that it has an obligation
21 to evaluate evidence and to recommend rates in consideration of *all* the
22 objectives of the Act. The Commission does not ignore any of them, nor
23 does it adopt rules for attributing and assigning costs that constructively
24 waive any of them.

25 PRC Op. R97-1 at 228 [emphasis in original].

26 This guidance illustrates the delicate balance that the Commission must
27 strike between numerous, often conflicting goals. This balance must weigh not
28 only the merits of each proposal, but must also address the implicit goals of

1 various pricing theories to determine which aspects of each option should be
2 included in the recommended pricing structure.

3 Clearly, encouraging economic efficiency has been an important goal of
4 the Commission's pricing recommendations in prior dockets and has informed
5 the Commission's decisions. However, the Commission has recognized that
6 "[e]conomic efficiency is neither the exclusive nor even the paramount
7 ratemaking objective under the Act." PRC Op. R2000-1 at 210. Consequently,
8 any pricing proposal which suggests that the Commission should adopt an
9 economic theory whose sole purpose is to drive economic efficiency not only
10 overlooks the nine statutory pricing criteria, but also seeks to eliminate the
11 discretion to address the requirements of a given circumstance inherent in the
12 Commission's statutory pricing obligations.

13 A careful reading of intervenors' testimonies suggests that they recognize
14 the tension between economic efficiency and other statutory goals. For
15 example, APWU witness Kobe asserts:

16 For an agency that must weigh efficiency against its public policy
17 responsibilities to the American public at large, I recognize that [providing
18 the correct economic signals] may not be the only criterion for a decision.

19 Tr. 20/7131; response to NAPM/APWU-T1-1. Similarly, Pitney Bowes witness
20 Panzar agreed that:

21 there may be demand side reasons or reasons in accordance with the
22 Postal Statute for deviating from that efficient discount policy.

23 Tr. 26/9155; response to USPS/PB-T1-2, referencing Docket No. R97-1, Tr.
24 34/18465-66. However, these distinctions are often lost in the rhetoric

1 surrounding the value of economically efficient rates and are absent from the
2 proposals that intervenor witnesses have put forth.

3 To evaluate the arguments underlying the merits of economically efficient
4 rates or discounts, it may be useful to begin by considering the role of the
5 statutory postal pricing criteria in establishing rates and fees. These section
6 3622(b) pricing criteria are applied at the subclass level to evaluate and establish
7 the appropriate markups over institutional costs as discussed in the testimony of
8 Postal Service witness O'Hara (USPS-T-31). However, once markups are
9 established, the factors enumerated in the pricing criteria do not cease to be
10 relevant in rate design. At every step, the Commission must consider not only
11 the cost justification for a given price, but also the entire context within which the
12 price was developed. For example, in its Docket No. R2000-1 discussion of
13 single-piece First-Class Mail rates, the Commission considered the effect of the
14 rate on the Postal Service's revenue, the relative growth rates of single-piece
15 and workshared First-Class Mail, relative rate increases, rate increases
16 compared to the rate of inflation, rate changes as compared to those of other
17 classes of mail, as well as simplicity. PRC Op. R2000-1 at 233-235. A
18 mechanistic assertion that "discounts should always equal costs avoided" or that
19 "only economically efficient rates should be adopted" fails to consider the myriad
20

- 1 of factors that must be considered in constructing postal rates that are both fair
- 2 and equitable and consistent with the Act.²

² Pitney Bowes witness Panzar makes an interesting point, acknowledging that his

testimony sets forth the arguments in favor of instituting a system of cost-based discounts at the subclass level. It does not specifically address the issue of how one makes changes from an existing system of discounts that are less than avoided costs.

Tr. 26/9159, response to USPS/PB-T1-5.

1 III. THE PROPOSED FIRST-CLASS MAIL RATES ARE REASONABLE AND
2 CONSISTENT WITH THE ACT

3 In evaluating any postal rate proposal, the basic (single-piece, first-ounce)
4 First-Class Mail rate (in this docket proposed to be 42 cents) is a keystone rate
5 which is inextricably tied to the Postal Service's revenue requirement and policy
6 goals. In the base year, this rate was the largest single contributor to postal
7 revenues, accounting for \$15.9 billion, or 22.8 percent of the Postal Service's
8 total postage and fee revenue. In FY 2005, the basic First-Class Mail rate alone
9 provided almost \$2 billion more revenue than the combined revenue from
10 Express Mail, Priority Mail, Periodicals, Parcel Post, Bound Printed Matter, Media
11 Mail, Library Mail, International Mail, and Special Services. USPS-LR-L-77.

12 In Docket R2000-1, the Commission noted several factors that the Postal
13 Service also has considered in developing the proposed 42-cent First-Class Mail
14 basic rate in this docket:

15 Recommending the single-piece First-Class rate entails balancing several
16 unpleasant choices. . . .[E]ach penny of this rate affects hundreds of
17 millions of dollars in Postal Service revenue that would otherwise be
18 assessed to other mail classes. Balancing this is the already high
19 institutional cost contribution of First-Class mailers. On the other hand,
20 the [Postal Service's proposed Docket No. R2000-1] rate increase for
21 First-Class Mail is in line with inflation, and is lower on a percentage basis
22 than the system wide rate increase.

23 PRC Op. R2000-1 at 235.

24 The process of developing the basic First-Class Mail rate is unique given
25 its importance in meeting the revenue requirement of the Postal Service. In my
26 experience, the initial steps of rate design focus on what the test year revenue
27 requirement is, and how that revenue requirement will affect the proposed basic

1 First-Class Mail rate. The policy implications of no other proposed rate are as
2 carefully considered as those surrounding the basic First-Class Mail rate.

3 In this docket, Postal Service witness Taufique (USPS-T-32) has
4 proposed that the basic First-Class Mail rate increase from 39 cents to 42 cents,
5 a 7.7 percent change, which is less than the average percentage change for the
6 system as a whole. Exhibit USPS-31D. In fact, the basic First-Class Mail rate
7 will have increased by less than the rate of inflation over the period since Docket
8 No. R94-1,³ a modest increase which is consistent with the Postal Service's
9 policy goals.

10 In discussing the Postal Service's proposals, intervenor witnesses Kobe
11 (APWU-T-1), and Clifton (GCA-T-1)⁴ propose changes to the basic First-Class
12 Mail rate which they "finance" by either reducing the proposed discounts for --
13 and thus further increasing the rates of -- presorted First-Class Mail (APWU-T-1
14 at Table 2) or by increasing Standard Mail rates (GCA-T-1 at 60).⁵ In each case,

³ Beginning with the Docket No. R94-1 rates implemented in January 1995, the basic First-Class Mail rate will have increased from 32 cents to the proposed 42 cents, or 31.3 percent. USPS-LR-L-73. Over the period January 1995 to October 2006 (approximately 7 months short of the expected Docket No. R2006-1 May 2007 implementation date), the CPI-U has increased 34.0 percent. Bureau of Labor Statistics, www.bls.gov, Series ID: CUSR0000SA0.

⁴ GCA witness Clifton's revision of the Postal Service's elasticity estimates is discussed by witness Thress. USPS-RT-2.

⁵ While OCA witness Thompson accepts the Postal Service's proposed 42-cent rate, the revenue effect of her proposal to eliminate the additional ounce rate structure is offset by an increase in presorted First-Class Mail rates. OCA-T-1 at 3, line 7. In rebuttal, Postal Service witness Taufique (USPS-RT-18) discusses the Postal Service's concerns about OCA witness Thompson's proposal and its potential effect on First-Class Mail rates. In addition, OCA witness Thompson's proposal fails to recognize the increased value of service that a customer receives when they send heavier weight First-Class Mail pieces.

1 these proposals fail to recognize the dynamics that support the Postal Service's
2 proposal and the policy implications of deviations from that proposal.

3 If the Postal Service's proposed increase in the First-Class Mail basic rate
4 from 39 to 42 cents were to be reduced, the Postal Service would have to
5 recover substantial additional revenue from other customer groups. APWU
6 witness Kobe has chosen to recover this revenue shortfall entirely from presorted
7 First-Class Mail. She rationalizes this decision by initially invoking a rate design
8 based on Efficient Component Pricing, as indicated by 100% passthroughs of
9 avoided cost estimates based on the Bulk Meter Mail benchmark. APWU-T-1 at
10 9. While this use of ECP may, at first blush, be appealing, it fails to recognize a
11 number of factors which underlie the Postal Service's initial policy decision to
12 propose presorted First-Class Mail price increases that are slightly less than the
13 average percent change.⁶

14 Economic efficiency,⁷ or ECP as used by APWU witness Kobe and
15 applied to presorted First-Class Mail rates, is not a static concept and cannot be
16 evaluated without considering the underlying changes in unit costs over time.
17 From FY 1997 to FY 2005, the Postal Service's unit costs for presorted First-
18 Class Mail have increased from 9.8 cents to 10.1 cents in base year 2005.
19 USPS-RT-18 at Table 2. This is a unit cost increase of only 3.6 percent over a

⁶ Interestingly, despite her arguments supporting 100 percent passthroughs, by choosing greater than 100 percent passthroughs to mitigate "rate shock", APWU witness Kobe recognizes that rate design is not a simple exercise of calculating would-be economically efficient rates. APWU-T-1 at 10, lines 9-10.

⁷ ECP is not the sole determinant of efficiency. In prior dockets, intervenors have invoked Ramsey pricing or similar rate design approaches in the name of economic efficiency. See, for instance, PRC Op. R97-1 at 239.

1 period during which the unit cost for single-piece First-Class Mail increased 21.1
2 percent.⁸ Id. This cost trend reflects several factors, including the Postal
3 Service's decision in the early 1990's to target its automation program at letter-
4 shaped mail, with the result of considerable success in slowing the increase in
5 processing costs not only for workshared mail but also for single-piece First-
6 Class Mail. While some credit for this is due to increased worksharing
7 encouraged by the classification reform discounts implemented in 1996, this
8 trend has continued. From FY 2000 to FY 2005, unit volume variable costs have
9 increased 10 percent for single-piece First-Class Mail while presorted First-Class
10 Mail costs have increased only 3 percent. Id. In comparison, average revenue
11 has increased 9 percent for single-piece and 11 percent for presorted First-Class
12 Mail.⁹ As a result, the implicit cost coverage and per-unit contribution for
13 presorted First-Class Mail continue to rise. Tr. 16/4915; response to
14 MMA/USPS-T32-2. This has resulted in a high relative contribution to the Postal
15 Service's institutional costs with an implicit cost coverage exceeding 300 percent
16 for presorted First-Class Mail. See Exhibit USPS-31B. In effect, by applying a
17 single concept and effectively ignoring the statutory criteria, APWU witness Kobe

⁸ FY 1997 was chosen as a starting point because this is the first full fiscal year following the implementation of the Docket No. MC95-1 reclassification rates.

⁹ The increase in presorted revenue per piece is greater than the increase in single-piece revenue per piece despite an increase in the degree of customer worksharing. In FY 2005, 84.8 percent of all presorted mail was entered as 3-digit, 5-digit, or carrier route automation presorted letters and flats. USPS-LR-L-77. In FY 2000, 78.8 percent of all presorted mail was entered as 3-digit, 5-digit, 3/5-digit, or carrier-route automation presorted letters and flats. USPS-LR-J-98.

1 is asking the Commission to penalize presorted First-Class Mail – the mail
2 category with the most stable costs – with a higher-than-average increase.

3 As has been discussed in previous dockets, the Postal Service is
4 concerned about the potential impact on these First-Class Mail customers,
5 whose mail preparation activities have played a large part in the success of our
6 automation program. In addition, the Postal Service is concerned about the
7 equity implications of imposing higher-than-average price increases on a
8 customer group whose costs in recent years have been substantially stable.
9 While theories based on economic efficiency often inform Commission decisions
10 “[t]he language of the Act does not specifically identify the pursuit of economic
11 efficiency as a policy objective.” PRC Op. R97-1 at 237. Section 3622(b)(1)
12 does, however, require that the Commission recommend fair and equitable rates.
13 In contrast, APWU witness Kobe, while discussing the results of Efficient
14 Component Pricing at length, does not determine whether her price proposal to
15 shift the revenue burden to presorted First-Class Mail is “fair and equitable.” The
16 following interrogatory response is telling:

17 NAPM/APWU-T1-1

18 . . .

19 a. Please confirm that discounts set at 100 percent of avoided costs are
20 both fair and equitable. If you cannot confirm, please explain why.

21 . . .

22 Response:

23 a. Fair and equitable as used in postal rate proceedings is, as I
24 understand it, a legal concept contained in the PRA and I am not a lawyer.
25 As I stated in my testimony, setting discounts equal to costs avoided

1 provides a basis for ensuring that a piece of mail would pay the same
2 contribution to overhead whether or not it is workshared.

3 Tr. 20/7131. The Commission does not have the luxury of applying a theory
4 without considering its consistency with the policies of the Act.

5 Witness Clifton (GCA~~T~~- 1) also testifies in support of reducing the Postal
6 Service's proposed increase in the basic First-Class Mail rate to 41 cents. In
7 contrast to APWU witness Kobe, GCA witness Clifton proposes that Standard
8 Mail would be the appropriate target to finance his proposal. GCA-T-1 at 59.
9 However, a review of witness Clifton's proposal does not provide the
10 Commission with any reasoned guidance about the relative merits of his
11 proposal versus any alternative. First, it is unclear what witness Clifton's
12 proposal is. It could be to limit the increase in the basic single-piece First-Class
13 Mail rate for letter-shaped mail to 41 cents (hereinafter, "Clifton Option 1"). GCA-
14 T-1 at 59, lines 18-21. It could be to reduce all single-piece and presorted, First-
15 Class Mail, first-ounce rates for letter-shaped mail by one cent from the Postal
16 Service's proposal (hereinafter, "Clifton Option 2").¹⁰ GCA-T-1 at 59 (line 21) –
17 60 (line 2).

18 Second, it appears that GCA witness Clifton may have substantially
19 understated the revenue effect of Clifton Option 2. Given the assumption that

¹⁰ The assumption that GCA witness Clifton's proposal would apply only to letter-shaped mail appears to be most consistent with his oral testimony:

Q. [Mr. Levy] Is it your intention to apply the broader version of your proposal to parcels and flats as well?

A. [Mr. Clifton] It's not my intention to do that.

Tr. 29/9961, lines 1-3.

1 the proposed rate for each First-Class Mail piece (both single-piece and
2 presorted) would be reduced by one-cent, a net First-Class Mail revenue loss of
3 only \$519 million (Tr.29/9799, response to DMA/GCA-T1-7) cannot be correct.
4 In my Appendix below, I estimate that the First-Class Mail revenue reduction
5 from Clifton Option 2 is approximately \$812 million.¹¹

6 Third, GCA witness Clifton's intended target for recovering this revenue is
7 also unclear. He proposes that the Commission "raise rates on Standard A
8 Regular mail to maintain revenue neutrality;" (GCA-T-1 at 60, lines 15-16);
9 however, his calculations presented in the response to DMA/GCA-T1-7 (Tr.
10 29/9799) seem to indicate that both Standard Mail Regular and Standard Mail
11 Nonprofit would bear the burden. While "Standard A Regular" may have been
12 merely a shorthand description of the affected subclasses, the policy implications
13 are not trivial. The requirements of § 3626 tie Standard Mail Nonprofit revenue
14 per piece to Standard Mail Regular revenue per piece. Therefore, witness
15 Clifton's proposal would also place upward pressure on Standard Mail Nonprofit
16 rates.

17 Under the Postal Service's proposal, Standard Mail Regular rates
18 increase by an average of 9.6 percent which is more than the system average.,
19 The proposed 8.9 percent Standard Mail Nonprofit average rate increase is also
20 above the system average. Exhibit USPS-31D, revised 8/25/2006. Clifton

¹¹ For the sake of simplicity, I have assumed no volume effect in either Standard Mail or First-Class Mail. This is consistent with the hypothetical proposed in DMA/GCA-T1-7. Tr. 29/9794-9799. Consider also that a strict focus on revenue neutrality may not highlight potential contribution issues inherent in such a proposal.

1 Option 1 would reduce single-piece First-Class Mail revenue by approximately
2 \$337 million (Tr. 29/9796; response to DMA/GCA-T1-7) and result in an average
3 Standard Mail Regular rate increase of 11.8 percent and an average Standard
4 Mail Nonprofit rate increase of 11.0 percent. Clifton Option 2 would reduce First-
5 Class Mail revenue by approximately \$813 million and result in an average
6 Standard Mail Regular increase of 14.8 percent and an average Standard Mail
7 Nonprofit rate increase of 14.0 percent. See my Appendix below. Apparently, in
8 GCA witness Clifton's view, either option is reasonable, and it is not necessary to
9 reconsider whether his revision results in rates that are still consistent with the
10 pricing criteria.

11 In addition to determining what cost coverages and associated rate
12 increases should be recommended, the Commission must recommend rates and
13 determine which of many smaller rate categories will bear the burden of the rate
14 increase. In his direct testimony, Postal Service witness Kiefer (USPS-T-36) has
15 carefully developed a rate proposal that balances many competing criteria. In
16 contrast, GCA witness Clifton provides the Commission with no guidance on how
17 it should impose the additional rate and revenue burden arising from his
18 proposals. Should relatively efficient automation letters pay higher rates? Or will
19 the additional increase be imposed on flats and parcels for which the Postal
20 Service already has proposed greater-than-average rate increases? All of these
21 decisions have policy implications that GCA witness Clifton chooses to ignore.

22 In his discussion of the application of the pricing criteria to Standard Mail,
23 Postal Service witness O'Hara justifies his proposed greater-than-average rate

1 increase by carefully examining the characteristics of Standard Mail Regular
2 service and assessing how the statutory pricing criteria inform his determination
3 that the proposed rate increase and cost coverage are reasonable and
4 consistent with the Act. USPS-T-31 at 27-28. GCA witness Clifton simply
5 asserts his result is appropriate, based on a flawed elasticity model which is
6 discredited by witness Thress. USPS-RT-2.

1 IV. UPS WITNESS GEDDES' PROPOSED PRIORITY MAIL RATE
2 INCREASE IS UNREASONABLE

3 UPS witness Geddes (UPS-T-3) proposes an unreasonable 23.6 percent
4 increase in Priority Mail rates. UPS-T-3 at 12. While witness Geddes discusses
5 the pricing criteria at length, his analysis is seriously flawed by his failure to
6 address a fundamental fact of rate design – customers pay prices, not markups,
7 not cost coverages, nor markup indices. Therefore, while he discusses markups
8 and markup indices at length, witness Geddes fails to provide the market and
9 rate context needed to inform the Commission's recommended decision.

10 Postal Service witness O'Hara has proposed a 13.6 percent increase in
11 Priority Mail rates based on his assessment of the pricing criteria. Exhibit USPS-
12 31D, revised 8/25/2006. This increase is substantially above the system-
13 average increase of 8.5 percent and, in light of recent Priority Mail rate history, a
14 further increase is not warranted. Assuming implementation of the Postal
15 Service's proposal, Priority Mail rates will have increased 19.7 percent over
16 eighteen months, and 59.3 percent¹² in this decade. Rate increases of this
17 magnitude raise serious concerns about the impact on customers of the Postal
18 Service and the need to mitigate Priority Mail rate increases, to the extent
19 possible, given cost trends.

¹² This is the cumulative effect of the currently proposed 13.6 percent rate increase, the 5.4 percent Docket R2005-1 rate increase, the 13.5 percent Docket No. R2001-1 increase and the 17.2 percent Docket No. R2000-1 rate increase. See, Exhibit USPS-31D; Dockets R2005-1, R2001-1, PRC Op. Appendix G at 1; and Decision of the Governors of the United States Postal Service on the Recommended Decision on Further Reconsideration of the Postal Rate Commission on Postal Rate and Fee Changes, Docket No. R2000-1.

1 Despite the substantial increase in Priority Mail rates, UPS witness
2 Geddes suggests that Priority Mail volume “can recover from a series of
3 unfortunate events and rate increases.” UPS-T-3 at 17. This argument is based
4 on a Priority Mail growth rate of 5 percent in FY 2005 and preliminary data for FY
5 2006 that suggest continued growth. He further states that,

6 Because Priority Mail volume growth rates are approaching the historical
7 growth rate after seven quarters, I do not believe that permanent or
8 systemic factors have reduced the long-term competitiveness of Priority
9 Mail.

10 Tr. 26/9121, response to USPS/UPS-T3-5. Once again, context is lacking in this
11 analysis. From FY 2000 to FY 2005, Priority Mail volume fell from 1,222 million
12 to 887 million pieces – a reduction of 27 percent. USPS-LR-L-77. Despite UPS
13 witness Geddes’ assertion that “Priority Mail volumes have recovered” (Tr.
14 26/9120; response to USPS-UPS-T3-4); assuming that the very recent 5 percent
15 average annual growth rate persists, Priority Mail volumes will not reach the FY
16 2000 level for almost another seven years.¹³ In contrast, from 2000 through
17 2004, UPS combined deferred and ground volume grew by 2.1 percent .
18 Response to USPS/UPS-T3-7, redirected to UPS.

19 The Postal Service’s market share has dropped from “over 70 percent of
20 the second-day delivery market” (PRC Op. R94-1 at ¶5116) to 53.1 percent in FY
21 2004 (USPS-T-33 at 8).¹⁴ UPS witness Geddes generally argues that cost

¹³ From a FY 2005 volume of 887 million pieces, volume will not exceed FY2000 volume (1,222 million pieces) for 6.6 years. That is, $(887 \text{ million pieces}) * (1+5\%) ^ 6.6 \text{ years} = 1,224 \text{ million pieces}$.

¹⁴ As Postal Service witness Scherer indicates, these data overstate the Postal Service’s true market position. USPS-T-33 at 8.

1 coverage should not be lowered in order to protect the Postal Service’s market
2 share. UPS-T-3 at Section III.D. However, the principles that the Commission
3 used in its Docket No. R2000-1 decision still hold today:

4 The Commission finds it appropriate to moderate Priority Mail’s coverage
5 to this level in order to protect its users – especially those users whose
6 mail falls within the monopoly segment of Priority Mail – from the impact of
7 even higher rate levels. It is also the Commission’s opinion that
8 restraining coverage to this level is appropriate under § 3622(b)(5) to
9 avoid the harm that higher rate levels may cause the Postal Service’s
10 position as a competitor in the market in which Priority Mail competes.
11 The Commission rejects the suggestion of United Parcel Service that this
12 is an impermissible or negligible consideration in formulating pricing
13 recommendations.

14 PRC Op. R2000-1 at 313 [footnote omitted]. These principles do not argue for
15 the adoption of the Docket No. R2000-1 cost coverage in the current case, but
16 rather a careful consideration of the competitive conditions surrounding every
17 rate request, as well as the importance of considering the effect of any price
18 increase on the Postal Service’s customers.

19 UPS witness Geddes suggests that the Commission recommend a cost
20 coverage for Priority Mail of 163 percent because (1) it is close to that
21 recommended by the Commission in Docket No. R2000-1; and (2) it is that
22 proposed by the Postal Service in this docket. UPS-T-3 at 12. UPS witness
23 Geddes further suggests that “the best recommended cost coverage is not
24 dependent upon the cost basis utilized.” Tr. 26/9122; response to USPS/UPS-
25 T3-6. While asserting that he has assessed his proposed coverages in light of
26 the pricing criteria, witness Geddes does not appear to understand that cost
27 coverages can be evaluated using the pricing criteria only within the entire
28 context of the resulting rate proposal. If the underlying costing methodologies

1 are not consistent, then comparing resulting cost coverage “numbers” is of little
2 value. As has been discussed at length, the costing methodology proposed by
3 the Postal Service in this case differs from the costing methodology used by the
4 Commission in prior Recommended Decisions. As a result, the same rate
5 increase when compared to each of the two different cost methodologies will
6 result in different cost coverages without changing the underlying rates.¹⁵
7 Although cost coverages, and the many factors that underlie them, provide
8 useful guidance to the Commission, the Commission’s obligation is not simply to
9 recommend cost coverages.

¹⁵ This is most readily illustrated by the results of Docket No. R2005-1. For Priority Mail, the Commission recommended rates identical to those proposed by the Postal Service. PRC Op. R2005-1 at 122. However, the calculated Priority Mail cost coverage based on the PRC costing methodology was 140.1 percent (PRC Op. R2005-1, Appendix G at 1) as compared to the calculated Priority Mail cost coverage of 156.5 percent (Docket No. R2005-1, Exhibit USPS-27B, revised 6/10/2005) based on the Postal Service’s costing methodology

1 V. VALPAK WITNESS MITCHELL'S STANDARD MAIL PROPOSALS ARE
2 ILL-CONCEIVED

3 In this docket, a number of intervenor witnesses have suggested rate
4 designs which rely heavily on the theory of Efficient Component Pricing. The
5 Commission has long recognized the value of postal rates and fees that reflect
6 cost-causative characteristics and encourage economic efficiency. As I discuss
7 above, the Postal Service has generally agreed with the Commission's
8 conclusions about the value of economically efficient rates as well as the need to
9 temper recommendations based on economic efficiency with a reasoned
10 assessment of all of the pricing criteria. Valpak witness Mitchell's proposals
11 highlight the danger of an overly narrow focus on economic efficiency at the
12 expense of considerations of all other factors¹⁶.

13 Witness Mitchell (VP-T-1) begins his discussion of Standard Mail rates
14 and rate design with an assessment of changes in the postal market over the last
15 eight years.

16 During this period [since Docket No. R2000-1], postal operations have
17 changed, mail preparation has changed, and the capabilities of the Postal
18 Service and mailers have changed, not to mention changes in markets
19 and the competitive environment. One would expect recognition of these
20 changes, particularly in costs, to require numerous and significant rate
21 adjustments.

22 VP-T-1 at 6 (line 15) – 7 (line 4). Despite his assessment that the postal
23 landscape has changed, Valpak witness Mitchell continues to contend that the
24 Commission should:

¹⁶ Postal Service rebuttal witness Kiefer discusses numerous flaws with witness Mitchell's Standard Mail rate proposals. USPS-RT-11.

1 take the steps understood at the time the two [commercial Standard Mail]
2 subclasses were created and adjust the markups and the rates
3 accordingly.

4 VP-T-1 at 12, lines 12-14. In other words, witness Mitchell believes that the
5 Commission should return to a view of Standard Mail pricing that may (or may
6 not) have existed in 1996.

7 Valpak witness Mitchell does not appreciate that theoretical arguments
8 about what the “perfect” cost coverage should be must be tempered with a
9 realistic assessment of how changes in cost coverage affect not only the rates
10 and cost coverages recommended for Standard Mail ECR, but also those
11 recommended for other subclasses, and the revenue requirements of the Postal
12 Service as a whole. The Commission, in its recommended decisions, has
13 repeatedly considered the Postal Service’s proposals, Valpak’s proposals, and
14 the proposals of numerous other intervenors, and determined that the
15 recommended rates, including Standard Mail ECR rates, are fully consistent with
16 the pricing criteria and other provisions of the Act. To quote witness Mitchell,

17 The Commission has clearly given weight to ECP, notions of lowest
18 combined cost, worksharing, the signal sent to mailers, how competition
19 should be recognized, how products should be defined, the capabilities of
20 mailers, elasticity, issues of resource allocation, costing theory long run
21 vs. short run, notions of cross subsidy, questions of when mailers are
22 similarly situated, ease of administration, and others, none of which is
23 addressed specifically in the Act. . . . The practice of giving weight to such
24 concerns should continue.

25 VP-T-1 at 55. The Postal Service’s rate proposal does exactly that, it balances
26 all of the pricing criteria to develop rates which meet the Postal Service’s
27 revenue requirement. See USPS-T-31 at 29-30.

1 Valpak witness Mitchell proposes that Standard Mail ECR rates should
2 decrease by 8.47 percent while Standard Mail Regular rates should increase by
3 17.56 percent. VP-T-1 at 97. Witness Mitchell also suggests an alternate set of
4 cost coverages in the event that Congress does not enact legislative changes to
5 the current postal price-setting system embodied in Title 39. VP-T-1 at 97.
6 Witness Mitchell seems to leave the Commission with an odd choice. The
7 Commission could choose the (unspecified) rates that witness Mitchell would
8 recommend if everything were just as it is today, or it could speculate, and
9 prejudge how it might implement a yet-to-be-enacted legislative proposal.
10 Witness Mitchell presumes, with little foundation, that this speculation would lead
11 to the rates he has designed.

12 More reasonably, the Postal Service's proposal offers the Commission a
13 balanced assessment of the pricing criteria and presents a comprehensive
14 pricing proposal that not only considers how prices for Standard Mail ECR
15 should be developed but also how the Standard Mail ECR price proposal fits
16 within the context of rate proposals for all mail subclasses. Valpak witness
17 Mitchell's proposal raises fundamental questions about why Standard Mail ECR
18 should be granted preferential price treatment as compared to all other
19 subclasses of mail.¹⁷ Under the Postal Service's proposals, only First-Class Mail
20 Letters and Sealed Parcels has a lower rate increase (7.1 percent) than
21 Standard Mail ECR (8.9 percent). This is despite the fact that Standard Mail

¹⁷ Valpak witness Mitchell does not propose changes to the Postal Service's proposal for any class of mail other than Standard Mail. Tr. 25/8936, response to USPS/VP-T1-28(f).

1 ECR pays lower rates than any non-preferred mail; and, in comparison to
2 Standard Mail Regular, Standard Mail ECR pays approximately the same per-
3 piece contribution to institutional costs as Standard Mail Regular. See USPS-T-
4 31 at 30.

5 Valpak witness Mitchell continues to assert that, somehow, the goals of
6 Docket No. MC95-1 have not been achieved, because the cost coverage for
7 Standard Mail ECR has not been reduced below that of Standard Mail Regular.
8 He cites the Commission's paraphrasing of Postal Service witness Moeller's
9 Docket No. MC95-1 argument that ECR cost coverage should be lower (see, for
10 example, VP-T-1 at 29 lines 6-12); however, witness Mitchell does not provide
11 any direct evidence that the Commission has established a long-term policy
12 aimed at reducing Standard Mail ECR cost coverages to the levels he
13 suggests.¹⁸ In fact, in its first opportunity to adjust Standard Mail ECR cost
14 coverages following Docket No. MC95-1:

15 [t]he Commission . . . [agreed] with the Service that even though several
16 of the statutory factors might indicate a low ECR cost coverage, on
17 balance the record supports an ECR cost coverage that is well above
18 average.

19 PRC Op. R97-1 at 447. In its Docket No. R97-1 recommended decision, and in
20 each subsequent recommended decision, the Commission has balanced the

¹⁸ However, the Commission has recommended relatively small rate increases for Standard Mail ECR since Docket No. MC95-1. Over this period, Standard Mail ECR rates have increased 21.1 percent, less than the system average 23.6 percent. In contrast, Standard Mail Regular rates have increased 26.8 percent. See Dockets R2005-1, R2001-1, PRC Op. Appendix G at 1; and Decision of the Governors of the United States Postal Service on the Recommended Decision on Further Reconsideration of the Postal Rate Commission on Postal Rate and Fee Changes, Docket No. R2000-1.

1 often conflicting factors embodied in the pricing criteria and reached the
2 conclusion that a greater-than-average Standard Mail ECR cost coverage is
3 consistent with the Act. In its current proposal, the Postal Service has carefully
4 weighed the statutory pricing criteria and provided substantial evidence
5 supporting the conclusion that a greater-than-average Standard Mail ECR cost
6 coverage is justified. This proposal should be accepted.

Appendix to USPS-RT- 10

<u>First-Class Mail</u>		TYAR	TYAR (Clifton 1)	TYAR (Clifton 2)
Letter-shaped mail pieces				
(a)	Single-piece, excl. QBRM	33,401,815	33,401,815	33,401,815
(b)	QBRM	322,989	322,989	322,989
(c) = (a) + (b)	Total Single-piece letter-shaped	33,724,804	33,724,804	33,724,804
(d)	Nonautomation presort	840,022		840,022
(e)	Mixed AADC	2,918,778		2,918,778
(f)	AADC	2,538,198		2,538,198
(g)	3-Digit	23,024,390		23,024,390
(h)	5-Digit	18,233,989		18,233,989
(i) = (d) + (e) + (f) + (g) + (h)	Total Presorted Letter-shap	47,555,377		47,555,377
(j) = (c) + (i)	Total letter -shape	81,280,181		81,280,181
(k)	Assumption Reduction in rate		\$ 0.01	\$ 0.01
(l)	Assumption Volume Affected		33,724,804	81,280,181
(m) = (k) * (l)	Reduction in revenue		337,248	812,802
 <u>Standard Mail</u>				
Revenue				
(n)	Standard Mail Regular	14,062,934	15,525,041	15,826,678
(o)	Standard Mail Nonprofit	1,695,666	1,832,884	1,868,496
(p) = (n) + (o)	Total Standard Regular & Nonprofit	15,758,600	17,357,926	17,695,174
Volume				
(q)	Standard Mail Regular	62,380,254	62,815,558	62,815,558
(r)	Standard Mail Nonprofit	12,464,101	12,372,554	12,372,554
(s) = (q) + (r)	Total Standard Regular & Nonprofit	74,844,355	75,188,113	75,188,113
Revenue per piece				
(t) = (n) / (q)	Standard Mail Regular	\$ 0.225	\$ 0.247	\$ 0.252
(u) = (o) / (r)	Standard Mail Nonprofit	\$ 0.136	\$ 0.148	\$ 0.151
(v) = (p) / (s)	Total Standard Regular & Nonprofit	\$ 0.211	\$ 0.231	\$ 0.235
Percentage Change Revenue Per piece				
(w)	Standard Mail Regular		9.6%	11.8%
(x)	Standard Mail Nonprofit		8.9%	11.0%
(y)	Average percentage change		9.6%	11.8%

Notes:

Rows (a) - (j)	USPS-LR-L-129 revised 8/24/2006
Row (l) column (3)	Assumption that rate reduced for single-piece FCM letter shape only
Row (l) column (4)	Assumption that rate reduced for all FCM letter-shape
Rows (n) column (1) - (2)	USPS-LR-L-36, revised 6/21/2006
Row (n), column (3) - (4)	[Row (n) column (2) + row (m)] * row (n) col (2) / row (p) col (2)
Rows (o) column (1) - (2)	USPS-LR-L-36, revised 6/21/2006
Row (o), column (3) - (4)	[Row (o) column (2) + row (m)] * row (o) col (2) / row (p) col (2)
Note: row (n) - (o) assume that	revenue is collected pro rata on revenue from Std Reg and NP
Rows (q) - (r)	USPS-LR-L-36, revised 6/21/2006