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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D. C. 20268-0001

POSTAL RATE AND FEE CHANGES, 2006	Docket No. R2006–1

REBUTTAL TESTIMONY
OF
ABDULKADIR M. ABDIRAHMAN
ON BEHALF OF THE
UNITED STATES POSTAL SERVICE

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AUTOBIOGRAPHICAL SKETCH

My name is Abdulkadir M. Abdirahman. I am an Economist in Special Studies at the United States Postal Service. Special Studies is part of Corporate Financial Planning at Headquarters.

In this docket, I testified as a direct witness (USPS-T-22) concerning the total mail processing unit costs for First-Class Mail presort letters, First-Class Mail presort cards, and Standard Mail Regular presort letters. In addition, my testimony included the cost study supporting the Qualified Business Reply Mail (QBRM) cost avoidance estimates and the additional cost estimates associated with the various Business Reply Mail (BRM) fees.

I. PURPOSE AND SCOPE OF TESTIMONY

This testimony offers rebuttal evidence concerning several proposals submitted by First-Class Mail intervenors.

First, my testimony contests the Metered Mail Letters (MML) benchmark submitted by the Major Mailers Association (MMA) and Pitney Bowes Inc (PB). The Postal Service believes that the Commission has already and repeatedly rejected MML as the benchmark for presort letter costs, and MMA and PB have added nothing to the current discussion that would merit reconsideration of MML as a benchmark.

Second, my testimony rebuts the use of unreliable delivery unit cost estimates by MMA, PB and the American Postal Workers Union, AFL-CIO (APWU). The Postal Service believes that there are no reliable data which indicate that delivery unit costs differ by presort rate category. Therefore, any cost analyses which rely upon the use of these delivery cost differences are immediately suspect.

Third, my testimony rebuts the cost pool classifications proposed by several of the same intervenors. The Postal Service believes that its cost pool classifications in this docket are consistent with past "Commission-approved" cost pool classifications and accurately reflect the costs that may be modeled to reflect differences in costs among presort levels.

Fourth, my testimony rebuts the MMA and Time Warner, Inc (TW) proposals to expand the scope of the QBRM cost study.

Finally, my testimony rebuts the MMA's unfounded criticisms concerning the Remote Bar Code System (RBCS). Postal Service data show that RBCS has consistently improved over time.

II. FIRST-CLASS MAIL LETTER COST METHODOLOGIES AND RELATED ISSUES

The Postal Service and First-Class Mail intervenors have, in the past, disagreed about aspects of the methods used to measure worksharing related cost savings for purposes of setting presort and automation rates. In the instant proceeding, the Postal Service has presented an alternative methodology that involves "de-linking" the rates for First-Class Mail workshared letters from single-piece letters.

Many of the traditional intervenors in the First-Class Mail arena have congratulated the Postal Service for these methodological improvements. MMA witness Bentley called this change "a welcome relief from the considerable controversy generated in recent omnibus rate cases. I applaud the Postal Service for bringing the long and unduly complicated conflict to an end."[1]

Pitney Bowes (PB) witness Buc stated the following:

> The Postal Service has made some improvements to its model in this case. Specifically, the Postal Service has improved the model's handling of estimated costs and cost avoidances in three ways: (1) combining Automation with non-Automation tallies in the cost pools; (2) changing the classification of three cost pools from fixed to the proportional category; (3) delinking the Presort letters cost avoidance from a single piece benchmark.[2]

My testimony (USPS-T-22, pages 5 and 6) in this docket discussed several improvements to the methodology used to estimate First-Class Mail

[1] Docket No. R2006-1, MMA-T-1, page 6.
[2] Docket No. R2006-1, PB-T-2, page 10.

worksharing-related cost avoidances.[3] It also presented the rationale behind those improvements.

The changes include:

- The elimination of the Bulk Metered Mail (BMM) benchmark
- The use of a single CRA-derived mail processing unit cost estimate for presort letters (as opposed to the use of separate, unreliable, CRA-derived estimates for nonautomation presort and automation presort letters)
- The elimination of the distinction between worksharing-related fixed and nonworksharing-related fixed cost pools (no longer necessary in a de-linking scenario in which the worksharing mail processing unit cost ties directly back to a CRA-derived estimate); and
- The elimination of unreliable, rate category-specific delivery unit cost estimates.

A. Intervenor Comments Concerning the Historic BMM Letters Benchmark

In this docket, the Postal Service is proposing a change in the approach used to develop the rates for First-Class Mail workshared letters. The Postal Service's delinking proposal is a superior approach for determining the rates for First-Class Mail workshared letters. MMA witness Bentley first salutes the delinking proposal, but then, hedging his bets, rejects the "Commission-approved" BMM letters benchmark in favor of his own Metered Mail Letters

[3] Docket No. R2005-1, USPS-LR-K-48.

(MML) benchmark. His position that BMM letters do not exist has not been substantiated by any current field observations.[4] While the new delinking approach does not require the use of a BMM letters benchmark, it is worth noting that the Commission-approved benchmark for First-Class Mail letters has been BMM letters in each of the past three litigated dockets (PRC Op. R2000-1 at para. 5089; PRC Op. R97-1 at para. 5089; and PRC Op. MC95-1 at para. 4302). In Docket No. R2000-1, the Commission categorically stated the following in its Opinion and Recommended Decision.

> The Commission continues to accept bulk metered mail as the appropriate benchmark for determining the worksharing cost savings for First Class Mail. The Postal Service provides evidence that at least some BMM does exist in the mailstream. The Commission also views a benchmark as a "two-way street". It represents not only that mail most likely to convert to worksharing, but also, to what category current worksharing mail would be most likely to revert if the discounts no longer outweigh the cost of performing the worksharing activities.[5]

In the face of such conclusions by the Commission, and in the face of repeated observations by postal witnesses confirming the existence of BMM in prior cases, it is surprising that witness Bentley could continue to hold his view. In fact, in September 2006 I personally observed hundreds of trays of BMM at the Southern Maryland processing plant.

Unlike witness Bentley, Pitney Bowes Inc witnesses Panzar (PB-T-1) and Buc (PB-T-3) both reject the BMM letter benchmark from a theoretical perspective. Neither Witness Panzar's nor Witness Buc's positions, however, have been substantiated by any current field observations.[6] In my opinion, the

[4] Docket No. R2006-1, MMA-T-1, Appendix 1 pages 3, lines 11-13.
[5] PRC Op. R2000-1, para. 5089.
[6] Docket No. R2006-1, PB-T-3, page 12, lines 1-7.

Commission should adopt the Postal Service's delinking methodology as the superior approach in this proceeding. Even if the Commission does not adopt the delinking methodology, these unsubstantiated views should not warrant departure from Commission findings in past cases supporting BMM benchmark.[7]

B. Delivery Unit Cost Estimates By Rate Category

In the instant proceeding, the Postal Service revised the way rate category delivery unit cost estimates were produced. After further consideration, it was determined that machinability is the one characteristic of a mail-piece that has a quantifiable impact on delivery unit costs. Machinable mail pieces would be dispatched to delivery units as part of the Delivery Point Sequence (DPS) mail, while the nonmachinable mail pieces would be dispatched with the residual (non-DPS) mail that required manual processing. Separate delivery unit cost estimates are therefore provided for machinable and nonmachinable mail pieces only. Separate delivery unit cost estimates by rate category are no longer provided because there is no conclusive evidence to suggest that the DPS percentages actually vary among the machinable rate categories. Furthermore, because the presort letters that fail to be DPSed are not individually marked to indicate their specific presort level, it would not be possible to conduct a field study to estimate those percentages.

[7] In Docket Nos. R2001-1 and R2005-1, the Postal Service used Nonautomation Machinable Mixed AADC presort letters as the proxy for the delivery cost for BMM benchmark. In Docket No. R2000-1 the Commission used the average delivery cost of all nonautomation presort letters as the delivery proxy. The Postal Service chose the Nonautomation Machinable Mixed AADC presort letters as the appropriate delivery benchmark because they share similar characteristics to BMM. See USPS-LR-K-48.

The DPS percentages that were calculated in the past were a byproduct of the fact that acceptance rates were assigned to each automation operation in the letter cost models. The cost models were based on a premise that mail processed through a larger number of steps had lower DPS percentages than mail processed through fewer steps. In reality, mail pieces that have been successfully processed (i.e., accepted) in an "upstream" automation operation can be successfully processed in a "downstream" operation as well. Furthermore, no studies have been conducted in which the same mail pieces are processed through machines multiple times in order to determine if the total number of pieces that are ultimately rejected increases as the number of automation handlings increases.

Moving from upstream to downstream operations, the acceptance rates tend to increase. Part of the reason this occurs is that the upstream operations contain more single-piece mail. If there are problematic single-piece mail pieces upstream, once they are rejected they would be processed manually. This is part of the reason why downstream acceptance rates are higher. Given that the cost models rely on aggregate acceptance rates (single-piece and bulk combined), less finely presorted bulk mail pieces appear to have lower DPS percentages, even though we have no data to indicate that this is actually true. In other words, it is a byproduct of our data limitations.

While the letter cost models are adequate for estimating mail processing unit costs by rate category, they are not likely to be an effective tool for estimating DPS percentages by rate category. Hence, the disaggregated DPS

percentages by presort category are not meaningful and should not be used to determine cost differences by presort level for letters.

In their testimonies, MMA, PB, and APWU all rely on these DPS percentages of highly questionable accuracy. The Postal Service has, on numerous occasions in this docket, testified that the differences in DPS percentages by rate category for machinable letters are spurious.[8] MMA witness Bentley, on page 21 of his Appendix 1, does not rely solely on the cost model derived DPS percentages. Instead he derives the percentages and then claims to reconcile them to the DPS% reported by USPS witness Kelley from the carrier data system. Witness Bentley's delivery costs savings methodology, nevertheless, uses unreliable DPS percentages as the starting point in his analysis, before this reconciliation is performed and therefore, his delivery cost savings calculation is similarly unreliable.

PB witness Buc criticizes the Postal Service's reluctance to continue using the meaningless DPS percentage differentiations, saying that it "substantially degrades the integrity of the cost model" by not using these flawed data.[9] To the contrary, the exclusion of the flawed data has improved the cost model. DPS percentages are not inputs to the mail processing cost models – and never were -- and there are no data indicating that DPS percentages actually differ among the presort rate categories. It is ironic that the same parties that have complained in the past that the model produced DPS percentages that were inaccurate are now criticizing the Postal Service for not producing them. Again, this shows that

[8] Docket No. R2006-1 MMA/USPS-T42-7. Tr.11/2850.
[9] Docket No. R2006-1, PB-T-2, page 12.

their criticism is not based on improving the accuracy of the methodology. Therefore, their use of these flawed data in their cost analyses should be rejected.

Despite the repeated objections by the USPS regarding the use of such data, APWU witness Kobe makes the same mistake. She also uses these flawed data as the basis for her cost analyses of worksharing cost avoidances.[10] Indeed, witness Kobe's BMM-benchmark based cost model relies heavily on the DPS percentage differences in order to drive the outcome of the model. In my opnion, the inability of the BMM-benchmark to operate in the absence of the meaningless DPS percentage differences reinforces the advantages of the Postal Service's de-linking proposal.[11]

C. Cost Pool Classifications

My testimony, USPS-T-22, at page 6, lines 10-21, explains the rationale for eliminating the distinction between worksharing-related cost pools and nonworksharing-related cost pools: "All analyses of workshare-related activities are constrained within the self-contained CRA set of costs associated with Presort letters." In this docket, the distinction between worksharing-related and nonworksharing-related cost pools is eliminated solely because the use of a single CRA set of costs makes any such distinction moot in the computation of cost avoidances. Nevertheless, the Postal Service's approach to cost pool

[10] Docket No.R2006-1, APWU-LR-1.
[11] Office of Consumer Advocate witness Thompson, OCA-T-4 relies on USPS-LR-L-141, which uses DPS percentages for delivery cost savings calculations. Her use of delivery cost savings by rate category should also be rejected.

classifications in this docket is consistent with the approaches adopted by the Commission in previous dockets.[12]

PB witness Buc proposes cost pool classifications in PB-LR-L-1 that differ from those relied upon by the Postal Service and the Commission in past dockets. Witness Buc classifies the vast majority of cost pools as proportional, even though the tasks represented by many of those cost pools are not included in the mail flow models. He arbitrarily classifies the majority of the cost pools as modeled/proportional without presenting any supporting evidence. Witness Buc acknowledges that he relies on his so called "Thought Experiment" for the cost pool changes. When the Postal Service inquired whether witness Buc had, in fact, attempted to model the costs for the cost pools that he proposes to shift to the "proportional" classifications, witness Buc replied, "I have not modeled them but I have provided multiple reasons why they are proportional".[13]

In fact, witness Buc provided no justification for classifying these cost pools as proportional, despite the Postal Service's inquiries.[14] Instead, he has chosen to use the costs that are modeled as distribution keys for the costs he has not modeled; an activity that he, himself, stated was inappropriate. (Tr. 20/7349).

Witness Buc's cost pool reclassification proposal misses the point of why the cost pool classifications in the letter models were necessary in the first place. Cost pools are classified as proportional because the activities, and the costs thereof, captured within those cost pools ***are understood to vary in known***

[12] Docket No. R2000-1, PRC-LT-12 Part B and Docket No.R2005-1, PRC-LR-9.
[13] Docket R2006-1, Tr. 20/7314
[14] Docket No.R2006-1, Tr. 20/7290

ways with the presort level, *i.e.* the more finely presorted a piece is, the less the cost of processing in a given cost pool. Witness Buc's "thought experiment" neither presents a mail flow model depicting these extraordinary changes, nor does it provide reasons why these cost pools are proportional **and vary within each presort level.**

MMA witness Bentley relies on a similar approach, but separates the modeled proportional costs from the nonmodeled proportional costs. The end result, however, is the same. Most cost pools that were previously treated as fixed are now classified as proportional cost pools, such that the cost relationships between rate categories are distorted. In fact, the classifications used by witness Bentley do not even correspond to those he has relied upon as an MMA witness in past dockets. He now states "[T]here are no nonworkshared related cost pools," but provides no evidence to substantiate that claim.[15] He therefore presents no factual basis for shifting large sums of costs from the nonmodeled fixed classification to the nonmodeled proportional classification. Witness Bentley also admits that his analysis was somewhat arbitrary, because the mail flow model presented in my testimony in this docket did not allow him to perform the cost pool shifts.[16]

The Commission's analysis in Docket No.R2000-1, where cost pool classifications were debated at length, support the Postal Service's approach, rather than the flawed approaches advocated by witnesses Buc and Bentley. While it is no longer necessary to maintain three separate cost pool

[15] Docket No. R2006-1, MMA-T-1, Appendix 1, p. 10.
[16] Docket No. R2006-1, MMA-T-1, Appendix 1, pp. 9-10.

classifications, the Commission's analysis from Docket No. R2000-1 can easily be used to determine which cost pools should be classified as proportional and which cost pools should be classified as fixed. If a given cost pool contains tasks that are included in the mail flow models, that cost pool is classified as proportional. If not, that cost pool is classified as fixed.

I also note that the Office of Consumer Advocate witness Thompson, OCA-T-4 inappropriately relies on USPS-LR-L-141 which uses separate auto and non-auto cost pool classifications to support her calculations of First-Class Mail workshare related savings. She does not provide any justification for separating auto and not auto costs, nor does she address the problems related to auto and non-auto cost identification as discussed by the Postal Service in its response to POIR No.1, Question 1a in Docket No. R2005-1.

The Postal Service therefore recommends that the Commission adopt the USPS cost pool classifications as presented in USPS-LR-L-48 and reject the convoluted cost pool classification proposals described above.

D. Expansion of the QBRM Cost Analysis.

MMA witness Bentley and TW witness Mitchell both present testimonies which recommend expanding the scope of the QBRM cost analysis. Both criticize the Postal Service's determination to limit the derived QBRM cost savings to costs incurred up to the point where each piece -- the QBRM and handwritten First-Class reply mail pieces--receives its first barcoded sortation on a BCS. MMA witness Bentley further argues that the Postal Service's approach

"represents an unjustified departure from the cost savings methodology employed by the Postal Service and relied upon by the Commission in R2000-1".[17] Both witnesses fail to tell the whole story regarding the previous positions of the Postal Service and Commission regarding QBRM cost saving estimates.

In Docket No. R97-1, the Postal Service proposed that a 3-cent discount be extended to QBRM letters and cards.[18] This discount was based on an analysis presented in witness Miller's testimony (USPS-T-23) that measured a 4.016-cent savings.[19] The savings were calculated to be the difference in mail processing costs between a preapproved, prebarcoded First-Class Mail reply mail piece and a handwritten First-Class Mail reply mail piece.[20] Cost models were developed that captured mail processing costs up to the point where each mail piece received its first sortation on a BCS.[21] The worksharing related savings measured between the two mail pieces was driven by the fact that handwritten mail pieces incurred additional costs as they were processed through the RBCS.[22]

In Docket No. R2000-1, witness Campbell updated this cost study, expanding the analysis beyond the incoming primary operation and including incoming secondary costs as well.[23] In Docket No. R2001-1, the Postal Service reconsidered the R2000-1 approach, and the R2001-1 QBRM analysis was revised to follow the methodology originally presented and approved in Docket

[17] Docket No. R2006-1, MMA-T-1, Appendix II, p.1 at lines 23 -24.
[18] Docket No. R97-1, USPS-T-32, p. 7 at 2-4.
[19] Docket No. R97-1, USPS-T-23, Exhibit USPS-T-23D.
[20] Docket No. R97-1, USPS-T-23, p. 2 at lines 12-14.
[21] Docket No. R97-1, USPS-T-23, p. 3 at lines 8-10.
[22] Docket No. R97-1, USPS-T-23, p. 11 at lines 5-6.
[23] Docket No. R2000-1, USPS-T-29, pp. 38-40.

No. R97-1.[24] This same methodology was followed in R2005-1.[25] The reasons for this reversion are explained below.

Mail volume dictates how much processing is required before QBRM is isolated from the residual cards and letter mail volume. Large volumes of QBRM are likely to be held out in upstream operations. Smaller volumes are likely to be isolated in downstream operations. If a given mailer did not provide QBRM mail pieces to its customers, and those customers had to rely on handwritten reply mail pieces, the volume would still be the same, *ceteris paribus*. The point at which the mail is isolated would also be the same. The only avoided costs that would be associated with the presence of a barcode on a QBRM mail piece would be the RBCS-related costs required to apply a POSTNET barcode to a handwritten reply mail piece.

As an example, a large volume BRM recipient would be more likely to have its mail isolated in the automation outgoing primary ("FIM") operation. If that mailer no longer provided BRM envelopes to its customers and they had to rely on handwritten reply envelopes, that mail would no longer be isolated in the automation outgoing primary operation. Instead, the Advanced Facer Canceler System (AFCS) would lift the image and the mail piece would be processed through RBCS. A barcode would ultimately be applied to that mail piece by the Output Sub System (OSS). Given that the volume for this recipient would still be large, the sort plan for the OSS would be modified to accommodate a separation

[24] Docket No. R2001-1, USPS-T-22, pp. 26-27.
[25] Docket No. R2005-1, USPS-T-22, pp. 4-5.

for that recipient. In this example, the cost difference between the two mail pieces would consist solely of RBCS-related costs.

For low volume recipients, the result would still be the same. The mail for low volume recipients is likely to be processed all the way through the system and would not be isolated until all the mail for the delivery unit serving that recipient was being processed in an incoming secondary operation. Given that the volume would be low, this method would occur, whether or not the mail piece was a QBRM mail piece or a handwritten reply mail piece. In this example, the cost difference between the two mail pieces again would consist solely of RBCS-related costs.

When an "exact piece comparison" is performed, it is clear that there are no cost differences beyond the RBCS-related costs as described above. The proposals to expand the scope of the QBRM cost study should therefore be ignored.

III. WITNESS BENTLEY'S RBCS COMPLAINTS

MMA witness Bentley does not present any new RBCS-related data on the record, but instead, throughout his testimony and library references, relies on USPS supplied data.[26] Nevertheless, he repeatedly criticizes the accuracy of that data which he has chosen to use in his analysis. Witness Bentley often talks about how the Postal Service data overstate or understate certain RBCS costs.

[26] Docket No. R2006-1, MMA-T-1 and MMA-LR-1, 2 and 3.

His analysis, however, inappropriately relies on dissecting RBCS costs at the component level.

An examination of costs at the operations level reveals that the results are not as clear cut with regard to the direction of the model's overstatement or understatement of costs.

Table 1

First-Class Metered Mail Letters costs

Operation - Cost Pool	Cost Sheet Value	Cost Pool Value	Difference
ISS/OCR	1.162	1.146	0.016
RCR, REC, LMLM/LD15	0.134	0.378	(0.245)
OSS-BCS/DBCS	0.097	????	????

MMA-LR-1, pages 4 and 5

Table 1 compares the values shown for the relevant CRA derived cost pools (MMA-LR-1, p. 4) to the model derived costs shown in the cost sheet (MMA-LR-1, p. 5). As the models are structured, RBCS is defined to include the ISS, RCR, REC, OSS, and LMLM operations. As shown above, the ISS cost pool value is fairly close to the modeled cost sheet value. The LD 15 operations (RCR, REC, and LMLM) appear to understate the cost pool value. As has been stated on many occasions, however, the cost pool values are for all single-piece metered letters, not just BMM letters, which are considered to be homogenous trays of mail with machine printed addresses. Metered letters in general, however, could have handwritten addresses, which could explain the discrepancy between the cost sheet and cost pool values. Finally, the OSS costs

are imbedded in the BCS/DBCS cost pool such that those costs cannot be compared and there is not a separate OSS cost pool value. Since OSS is part of RBCS, it is not possible to conclude that the model as currently is structured, understates or overstates the RBCS costs.

The RCR finalization rate, however, can be used to illustrate the benefits of RBCS. The finalization rate, the rate at which the Postal Service successfully reads the address in order to apply a barcode to single-piece letter mail was initially 25 percent when RBCS was first deployed in 1992 and is now approaching 80 percent. Table 2, clearly demonstrates how the Postal Service and the mailing community continue to reap the benefits of the RBCS investment.

Table 2

Summary of Historical USPS RCR Finalization Rates

Years	RCR Finalization Rates
2002	68.30%
2003	70.50%
2004	75.57%
2005	78.40%

USPS RBCS DATA

The Postal Service has traditionally used two separate CRA adjustments factors in the unit calculations, one for auto costs and another for nonauto costs. The CRA adjustment factors were applied to the models to bring the modeled costs into alignment with the two separate CRA automation and nonautomation

costs. In this docket, the Postal Service presented automation and nonautomation costs as one set of costs by shape. A single CRA adjustment factor was developed to tie the modeled costs to the single CRA First-Class presort letter cost.

Witness Bentley supports the combining of auto and nonauto costs and uses the combined costs in his cost sheet.[27] He also agrees that the modeled costs should be tied back to the CRA costs, but he proposes a tortuous and unsupported methodology to make the CRA adjustments. He uses BMM CRA unit cost data to make adjustments to the nonautomation model costs, and then he uses a separate adjustment factor for the automation costs. His justification for using separate adjustment factors is because he assumes there are errors in the RBCS costs.

Neither the Postal Service nor the Commission has ever used the BMM CRA unit cost data to make such adjustments to nonautomation presort letters costs. Moreover, his methodology is flawed because it relies on his unsupported assumption that RBCS costs are unreliable. Moreover , the modeled costs, which are based on combined auto and nonauto costs, should be tied to a single CRA cost number, as I have explained throughout this docket.

[27] Docket No. R2006-1, MMA-T-1, Appendix 1, p.10.