OFFICIAL TRANSCRIPT OF PROCEEDINGS BEFORE THE POSTAL RATE COMMISSION

In the Matter of:)
) Docket No.: R2006-1
POSTAL RATE AND FEE CHANGES)

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POSTAL RATE COMMISSION

In the Matter of:)
) Docket No.: R2006-1
POSTAL RATE AND FEE CHANGES)

Suite 200
Postal Rate Commission
901 New York Avenue, N.W
Washington, D.C.

volume 33
Thursday, November 30, 2006

The above-entitled matter came on for hearing pursuant to notice, at 9:35 a.m.

BEFORE:

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HON. DAWN A. TISDALE, VICE-CHAIRMAN
HON. RUTH Y. GOLDWAY, COMMISSIONER
HON. TONY HAMMOND, COMMISSIONER
HON. MARK ACTON, COMMISSIONER

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WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS	VOIR DIRE
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C O N T E N T S

DOCUMENTS TRANSCRIBED INTO THE RECORD

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1 P R O C E E D I N G S

2 (9:35 a.m.)

3 CHAIRMAN OMAS: Good morning, everybody with
4 their nice, smiling faces. Good morning and welcome.
5 Today we continue hearings to receive testimony in
6 rebuttal to participants' direct testimony on Docket
7 NO. R2006-1.
8 Six witnesses are scheduled to appear today:
9 Michael W. Miller, James M. Kiefer, Sander A. Glick,
10 Steve Zwieg, Drew Mitchum and Cameron Bellamy.
11 Does anyone have any procedural matter that
12 we need to discuss before we begin this morning?
13 (No response.)
14 CHAIRMAN OMAS: There being none, counsel,
15 Mr. Weidner?
16 MR. WEIDNER: The Postal Service calls
17 Michael W. Miller to the stand.
18 CHAIRMAN OMAS: Please stand.
19 Whereupon,
20 MICHAEL W. MILLER
21 having been previously duly sworn, was
22 recalled as a witness herein and was examined and
23 testified further as follows:
24 CHAIRMAN OMAS: I think you were already
25 sworn.

1 (The document referred to was
2 marked for identification as
3 Exhibit No. USPS-RT-8.)
4 DIRECT EXAMINATION
5 BY MR. WEIDNER:
6 Q Mr. Miller, before you are two documents
7 entitled Rebuttal Testimony of Michael W. Miller on
8 Behalf of the United States Postal Service designated
9 as USPS-RT-8.
10 Was that prepared by you or under your
11 supervision?
12 A Yes, it was.
13 Q And if you were to give the contents today
14 as your oral testimony, would it be the same?
15 A Yes, with the minor exception that I would
16 have put a modification in to Attachment 2 based on a
17 cross-examination exhibit we received from MPA, but at
18 this point I'm not really sure what that modification
19 would have been. However, it doesn't change the
20 substance of what was in my testimony.
21 MR. WEIDNER: Okay. With that
22 understanding, Mr. Chairman, I would like to move that
23 Mr. Miller's testimony be entered into evidence.
24 CHAIRMAN OMAS: Is there any objection?
25 (No response.)

1 CHAIRMAN OMAS: Hearing none, I will direct
2 counsel to provide the reporter with two copies of the
3 corrected rebuttal testimony of Michael W. Miller.
4 That testimony is received into evidence and
5 is to be transcribed into the record.
6 (The document referred to,
7 previously identified as
8 Exhibit No. USPS-RT-8, was
9 received in evidence.)
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Postal Rate Commission
Submitted 11/20/2006 3:52 pm
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Accepted 11/20/2006

USPS-RT-8

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

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

REBUTTAL TESTIMONY
OF
MICHAEL W. MILLER
ON BEHALF OF THE
UNITED STATES POSTAL SERVICE

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REBUTTAL TESTIMONY
OF
MICHAEL W. MILLER

AUTOBIOGRAPHICAL SKETCH

My name is Michael W. Miller. I am an Economist in Special Studies at the United States Postal Service. Special Studies is a unit of Corporate Financial Planning in Finance at Headquarters. I have testified before the Postal Rate Commission on twelve previous occasions.

Most recently, I was the direct flats cost witness (USPS-T-20) and parcels cost witness (USPS-T-21) in Docket No. R2006-1.

In Docket No. MC2006-1, I testified as the Parcel Return Service (PRS) cost witness (USPS-T-2).

In Docket No. R2005-1, I presented two direct testimonies on behalf of the Postal Service. The first testimony covered First-class Mail, Periodicals, and Standard Mail flats mail processing unit cost estimates (USPS-T-19). The second testimony presented Parcel Post, Bound Printed Matter, and Media Mail/ Library Mail non-transportation cost estimates (USPS-T-20).

In Docket No. C2004-1, I testified as a rebuttal witness in opposition to the Time Warner, et al. complaint case (USPS-RT-1).

In Docket No. R2001-1, I sponsored two separate testimonies as a direct witness on behalf of the Postal Service. The first testimony presented First-class Mail letters/cards and Standard Mail letters mail processing unit cost estimates and worksharing related savings estimates, the Qualified Business Reply Mail (QBRM) worksharing related savings estimate, the nonstandard surcharge/nonmachinable surcharge cost studies, and the Business Reply Mail (BRM) fee cost studies (USPS-T-22). The second testimony presented First-class Mail, Periodicals, and Standard Mail flats mail processing unit cost estimates (USPS-T-24).

In Docket No. R2000-1, I testified as the direct witness presenting First-class Mail letters/cards and Standard Mail letters mail processing unit cost estimates and

worksharing related savings estimates (USPS-T-24). My testimony also included the cost study supporting the nonstandard surcharge. In that same docket, I also testified as a rebuttal witness (USPS-RT-15). My rebuttal testimony contested key elements of the worksharing discount proposals presented by several First-class Mail intervenors, as well as the Office of the Consumer Advocate (OCA).

In Docket No. R97-1, I testified as a direct witness concerning Prepaid Reply Mail (PRM) and QBRM mail processing cost avoidance estimates (USPS-T-23). In that same docket, I also testified as a rebuttal witness concerning the Courtesy Envelope Mail (CEM) proposal presented by the **OCA** (USPS-RT-17).

Prior to joining the Special Studies unit in January 1997, I served as an Industrial Engineer at the Margaret L. Sellers Processing and Distribution Center in San Diego, California. In that capacity, I worked on field implementation projects. For example, I was the local coordinator for automation programs in San Diego such as the Remote Bar Coding System (RBCS) and the Delivery Bar Code Sorter (DBCS). I was also responsible for planning the operations for a new Processing and Distribution Center (P&DC) that was activated in 1993. In addition to field work, I have completed detail assignments within the Systems/Process Integration group in Engineering. My primary responsibility during those assignments was the development of Operating System Layouts (OSL) for new facilities.

Prior to joining the Postal Service, I worked as an Industrial Engineer at General Dynamics Space Systems Division, where I developed labor and material cost estimates for new business proposals. These estimates were submitted as part of the formal bidding process used to solicit government contracts.

I was awarded a Bachelor of Science degree in Industrial Engineering from Iowa State University in 1984 and a Master of Business Administration from San Diego State University in 1990. I also earned a Professional Engineer registration in the State of California in 1990 and a Methods Time Measurement (MTM) "blue card" certification in 2004.

I. PURPOSE AND SCOPE OF TESTIMONY

This testimony is divided into two sections. The purpose of Section II is to present rebuttal evidence concerning the proposed modifications to the Periodicals Outside County flats cost model (USPS-LR-L-43). These modifications have been recommended by witnesses Glick (MPNANM-T-2) and Stralberg (TW-T-2). Section III addresses witness Luciani's (UPS-T-2) proposal that the Parcel Post cost avoidance passthroughs be reduced based on concerns he has with the cost model (USPS-LR-L-46).

II. THE PROPOSED FLATS COST MODEL MODIFICATIONS ARE NOT APPROPRIATE

MPA/ANM witness Glick (MPNANM-T-2) and Time Warner witness Stralberg (TW-T-2) both propose modifications to the Periodicals Outside County flats cost model (USPS-LR-L-43).[1] As described below, I believe their proposed changes should be rejected. There is no evidence which leads me to believe that these modifications would result in more accurate mail processing unit cost estimates by rate category. There is thus no evidence which leads me to believe that the modifications would improve the Commission's ability to gauge the value of mailer prebarcoding and/or presorting activities.

A. RESULTS-DRIVEN COST STUDIES SHOULD BE REJECTED

On page 14 of his testimony, witness Glick proposes that automation 5-digit presort flats be the cost benchmark for the nonautomation carrier route presort flats rate category.' Attachment 1 shows the incremental impact of the cost model changes proposed by witness Glick, including the impact of using the revised benchmark.[3] Column 1 contains my flats cost model results from USPS-LR-L-43. Columns 2 though 7 show the impact of each successive change proposed by witness Glick. The Column 7 figures are also identical to the final estimates contained in MPNANM-LR-2.

Regardless of whether the nonautomation 5-digit presort flats rate category or the automation 5-digit presort flats rate category is chosen as the cost benchmark for the nonautomation carrier route presort flats rate category, each successive change proposed by witness Glick expands the cost difference: In fact, the first five changes

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[1] *See* MPA/ANM-T-2, Section III.A.2; TW-T-2, Section III.

[2] While witness Glick dismisses the fact that nonautomation carrier route flats are not required to bear barcodes, I urge the Commission to take this into consideration when evaluating the appropriate benchmark. It should also be pointed out that nonautomation and automation rates are administered in different ways. Automation flats are always assessed bundle-based rates, regardless of the container type (pallets or sacks) in which they are contained. Nonautomation flats, on the other hand, are only assessed bundle-based rates when the mail pieces are entered on pallets. This issue should also be considered when evaluating whether an automation rate category is an appropriate benchmark for a nonautomation rate category.

[3] While a similar analysis has not been developed using witness Stralberg's cost model data, the end result is the same. The 4.326-cent cost difference between 5-digit nonauto flats and nonauto carrier route flats derived in USPS-LR-L-43 expands to a 9.750-cent cost difference as shown in TW-LR-2.

[4] Cost difference figures are contained within the boxed areas for the actual and presort adjusted versions of the model.

inflate the cost difference even though they have no bearing whatsoever on the model cost estimates. It is interesting that witness Glick's proposed changes are completely one-sided. Common sense tells us that if there are estimating errors within any cost model they would also, on occasion, result in overstated **cost** difference measurements. Results-driven analyses such as that presented by witness Glick should be rejected.

B. THE INCOMING SECONDARY COVERAGE FACTORS SHOULD NOT BE INCLUDED

Several of the modifications proposed by witness Glick are also proposed by witness Stralberg, although their specific methods for implementing these modifications differ on occasion. One such modification concerns the addition of manual incoming secondary coverage factors. I do not believe it is appropriate to include these factors in the flats cost models. Witnesses Glick and Stralberg disagree. The main focus of this disagreement concerns witness McCrery's response to MPA/USPS-T42-1(a) (Tr. 11/2853), in which it was estimated that 44.7 percent of flats are finalized in manual incoming secondary operations.

1. THE MPA/USPS-T42-1(A) ESTIMATE HAS BEEN MISUSED

The information provided in response to MPA/ANM-T42-1(a) was taken from an analysis produced annually as a means to gauge incoming secondary flats processing improvement. The figures represent estimates of the percentage of <u>all</u> (mostly non-carrier route) flats that are <u>finalized</u> in the various incoming secondary operations. While these data are appropriate for measuring performance, they are not appropriate for cost modeling purposes. These data are not available by class of mail and cannot be used as cost model inputs. If cost models were developed for all classes of flats. these figures could possibly be compared to the aggregate finalization rates from all the cost models. In the instant proceeding, however, cost models have not been developed for all flats.

Due to the limitations of these data, both witness Glick and witness Stralberg again rely on results-driven approaches. Witness Glick incorporates arbitrary incoming secondary factors which estimate that 80 percent of flats are processed on machines

and 20 percent of flats are processed manually.[5] He provides no empirical basis for these estimates, as he admits that they are not an output from any postal data collection system! Instead, he claims that his cost model results are more reasonable than those found in USPS-LR-L-43 because the percentage of manual incoming secondary flats derived from his factors is 36 percent, a value closer to the 44.7 percent figure cited in the response *to* MPA/USPS-T42-1(a).[7]

In similar fashion, witness Stralberg incorporates arbitrary incoming secondary factors which estimate that 85 percent of flats are processed on machines and 15 percent of flats are processed manually.' Witness Stralberg also provided no empirical basis for those estimates. Instead, like witness Glick he implies that his results are more reasonable because the manual incoming secondary percentage derived from his model's use of the factors is 40 percent, a value closer to the 44.7 percent figure cited in the response to MPA/USPS-T42-1(a).[9]

The fact of the matter is that no one knows the true percentage of total non-carrier route flats that are finalized in manual incoming secondary operations. The percentage of non-carrier route flats finalized in manual incoming secondary operations for each class is therefore also unknown. Consequently, no evidence has been offered which clearly demonstrates that the inclusion of these factors results in more accurate Periodicals Outside County mail processing unit cost estimates by rate category.

2. THE ORIGINAL FINALIZATION RATES ARE NOT ACCURATE

In fact, there is evidence *to* the contrary. As witness Stralberg stated, "Given a modeling task where the available data are not perfect (they hardly ever are), someone charged with producing a mail flow model to be used as a guide for rate setting still has an obligation to strive to find the best solution possible with the available data."[8] I could not agree more. The fact that some "data" may exist, however, does not necessarily mean that they should be incorporated into a cost model. The data must be evaluated

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[5] See MPA/ANM-T-2, page 19, lines 2 to 6.
[6] See responses to USPS/MPA/ANM-T2-4(a) (Tr. 30/10315) and USPS/MPA/ANM-T2-40(a) (Tr. 30/10367-68).
'See MPNANM-T-2, page 19, lines 6 to 11; response to USPS/MPA/ANM-T2-4(a) (Tr. 30/10315).
[8] See TW-T-2, page 13, lines 15 to 18.
[9] See TW-T-2, page 13, line 24; response to USPS/TW-T2-7 (Tr. 31/10580); response to USPS/TW-T2-19 (Tr. 31/10600).

on a case-by-case basis. A close evaluation of the 44.7 percent estimate from the response to MPA/USPS-T42-1(a) demonstrates its inappropriateness for use in the flats cost model. Apparently, however, witness Stralberg felt that he was unable to perform such an evaluation of the 44.7 percent figure." Witness Glick also made no attempt to evaluate this figure."

The results of such an evaluation are contained in Attachment 2. Part A contains an estimate of the candidate incoming secondary volume. This estimate is based on FY 2005 RPW flats volumes for all non-carrier mail pieces, as well as the portion of Periodicals Outside County nonautomation carrier route presort flats that are estimated *to* be processed through incoming secondary operations due **to** bundle **breakage.**[13]

Part B contains the figures used as the basis for the response to MPA/USPS-T42-1(a). The Automated Flat Sorting Machine Model 100 (AFSM100) and Upgraded Flat Sorting Machine Model 1000 (UFSM1000) volumes shown in Part **B** have been obtained from the Management Operating Data System (MODS), which collects the actual machine piece counts from End-Of-Run (EOR) reports. Consequently, those figures should be precise. The manual volumes, however, have been obtained from "flash reports, which are not based on machine piece counts and which I generally regard as overstating volume figures.

After comparing these figures, it is clear that the total incoming secondary flat volume provided in response to MPA/USPS-T42-1(a) should have been viewed as suspect for cost modeling purposes. That volume estimate (29,501,659,000 pieces[14]) exceeds the total FY 2005 incoming secondary candidate RPW volume estimate (23,632,029,575) by roughly six billion pieces.

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[10] See response to **USPS/TW-T2-8(b)** (Tr. 31/10581).

[11] See response to **USPS/TW-T2-6(a),** where he states, "I don't know in which sense you would have expected me to 'evaluate' this empirical basis...." (Tr. 31/10576) While witness Stralberg briefly reviews the overall volume figure underlying the 44.7 percent figure (Tr. 31/10577), this review is cursory and inadequate.

[12] See response to **USPS/MPA/ANM-T2-1(a)** (Tr. 30/10311).

[13] According to the estimates found in USPS-LR-L-43, page 49, 9.54 percent of nonautornation carrier route flats are processed through incoming secondary operations. The figure shown in Part A is therefore 9.54 percent of the total FY 2005 nonautomation carrier route volume. On page 22 of his testimony, witness Stralberg expresses his view that some bundle breakage data are excessive. To the extent that his hypothesis is correct, it should be noted that the nonautomation carrier mute volume in Part A of Attachment 2 would decrease.

Part C contains revised estimates of the finalization percentages found in Part B. These estimates have been developed using the assumption that the discrepancy of six billion pieces is due solely to the manual volume estimate.

Part D contains a further modification. These estimates have been developed with the Parcel Post and Media Mail / Library Mail volumes removed from the analysis.[15]

The finalization percentages shown in Part D of Attachment 2 differ substantially from those provided in the response to MPA/USPS-T42-1(a). The AFSMIOO finalization rate has increased by 13 percentage points, while the manual incoming secondary finalization rate has decreased by 14 percentage points.

3. THE REVISED FINALIZATION RATES DEMONSTRATE THAT THE USPS-LR-L-43 RESULTS ARE REASONABLE

As stated above, finalization rates are not available by class of mail. I therefore do not view these data as particularly meaningful when it comes to class-specific evaluations. These data can be used, however, to evaluate flats in total. All things considered, I think these data demonstrate that the USPS-LR-L-43 cost model results are reasonable. Attachment 3 compares the USPS-LR-L-43, MPNANM-LR-2, and TW-LR-2 results to the revised finalization rates calculated in Part D of Attachment 2.

The top portion of Attachment 3 contains the results from the USPS-LR-L-43 cost models. The boxed area in the middle shows the aggregate finalization rates for all three cost models in USPS-LR-L-43 and compares it to the revised finalization rates calculated in Part D of Attachment 2. The bottom portion of Attachment 3 shows the results from MPNANM-LR-2 and TW-LR-2.[16]

The revised finalization rates indicate that roughly 65 percent of flat-shaped mail pieces are finalized in AFSMIOO incoming secondary operations. The results from the USPS-LR-L-43 aggregate cost models show that 70 percent of flat-shaped mail pieces are processed through those operations. Given that First-class Mail single-piece flats

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[14] The figure provided in response to MPA/USPS-T42-1(a) was 29,501,658,000. The difference is due to rounding error.

[15] It is assumed that these mail pieces would be processed through Bulk Mail Centers (BMCs) with parcel-shaped mail pieces of the same subclass.

[16] Due to witness Stralberg's assumption concerning firm bundles, the nonautomation basic presort flats percentages from TW-LR-2 were calculated by dividing the percentage of flats finalized in a given incoming secondary operation by the total flats finalized in all incoming secondary operations.

have not been modeled and included in Attachment 3, it is likely that the aggregate percentage would have decreased somewhat had that flats mail stream been modeled."

When comparing the revised UFSM100 and manual finalization rates from Attachment 2 to the USPS-LR-L-43 results in Attachment 3, it appears that the cost models overstate the percentage of flats finalized in UFSMlOO incoming secondary operations and understate the percentage of flats finalized in manual operations. As stated above, the manual percentage would likely have increased had a cost model for First-Class Mail single-piece flats been developed and incorporated into Attachment 3.

It is also likely that the incorporation of the revised UFSMlOOO strategy into the cost models has resulted in overstated UFSMlOOO costs.[17] Unfortunately, the last flats density and acceptance rate study was conducted in 2001 and presented in Docket No. R2001-1, a time period that preceded the implementation of the revised UFSMlOOO strategy.[18] Consequently, there are no data that can be used to adequately determine how the UFSM1000 assumptions in the cost model should be changed. While witness Stralberg attempted to modify the UFSMlOOO assumptions,[19] the basis for making those modifications is not adequate. He uses a results-driven approach that focuses on the "scrubbed FY 2005 MODS values from USPS-LR-L-56. Those data are used to develop productivity estimates in the USPS-LR-L-43 cost models. It would have been preferable to conduct a study that focuses on UFSM1000 processing methods.[20] As stated above, no such study has been conducted at this time. Witness Stralberg's modifications are therefore inappropriate.

Although I do not believe that the aggregate revised finalization rates can be used to evaluate class-specific finalization rates, I do think Attachment 3 contains some additional interesting information pertaining to class. Witness Glick indicates (citing witness McCrery) that the percentage of Periodicals Outside County flats that are

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[17] Unlike the First-class Mail presort flats, Periodicals Outside County flats, and Standard Mail Regular flats represented by the USPS-LR-L-43 cost models, First-class Mail single-piece flats are not required to have machine-printed addresses, nor are they required to be presorted and/or prebarcoded. Thus, I would expect them to be processed manually more frequently than presort flats.

[18] See Docket No. R2005-1, USPS-T-19, page 5, lines 19 to 22. and page 7, lines 10 to 22.

[19] See Docket No. R2001-1, USPS-LR-J-63.

[20] See TW-T-2, Section 1113.

processed manually may be higher than the system wide average." The USPS-LR-L-43 results shown in Attachment 3 do indicate that the manual incoming secondary finalization rate for Periodicals Outside County is higher than the same rate for either First-class Mail presort flats or Standard Mail Regular flats. This result is not surprising given that the mail characteristics data show that fewer Periodicals Outside County flats are AFSMIOO compatible. Witness Stralberg also hypothesizes that the manual incoming secondary finalization rate for Periodicals Outside County flats could be higher than the average values because zones with only a few carrier routes would receive manual incoming secondary processing.[22] In reality, this issue would apply to all classes of flats and is not something that solely affects Periodicals.

4. ALL FLATS COST MODELS WOULD HAVE TO BE MODIFIED

One final issue should be mentioned concerning the coverage factors modifications proposed by witness Glick and witness Stralberg. To the extent the Commission views this modification as necessary, it is not a modification that affects Periodicals Outside County flats only. This modification should, theoretically, be incorporated into the First-class Mail presort flats and Standard Mail Regular flats cost models as well. Witness Glick and witness Stralberg provide no explanation as to why this change would be appropriate for the Periodicals Outside County flats cost model only.[23]

Based on the information presented in Attachments 2 and 3, I am confident that the cost models in USPS-LR-L-43 accomplish the purpose for which they were originally intended: to isolate the cost differences by rate category related to the presorting and prebarcoding activities performed by mailers, given the data that are available. I therefore urge the Commission to reject any attempt to incorporate arbitrary incoming secondary coverage factors into any of the flats cost models, including the Periodicals Outside County cost model, on the basis of a mis-used estimate.

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[21] See response to USPS/MPA/ANM-T2-3(b) (Tr. 30/10312).
[22] See TW-T-2, page 13, lines 4 to 6.
[23] In the event that such changes are deemed appropriate, it should be noted that other intervenors who might be affected have not been litigating this issue.

C. COST BY SHAPE ESTIMATES SHOULD NOT BE MANIPULATED TO EXPAND RATE CATEGORY COST DIFFERENCES

Mail processing unit cost by shape estimates can be found in USPS-LR-L-53. These estimates consist of separately estimated "cost pools." It is my understanding that the cost pool estimates are calculated using a combination of accounting and MODS data, distribution key estimates, cost pool specific piggyback factor estimates, and cost pool specific volume variability factor estimates. In the instant proceeding, witness Glick and witness Stralberg propose several cost model changes that affect the cost by shape and cost pool estimates. These proposed changes include: reliance on the aggregate cost by shape estimate for Periodicals Outside County flats / parcels, revised cost pool classifications, a "1FLATPRP" cost pool modification, an "ALLIED cost pool modification, and a "1SUPP_F1" cost pool modification. These proposed modifications should be rejected for the reasons outlined below.

1. AGGREGATE COST BY SHAPE ESTIMATES SHOULD NOT BE USED

In USPS-LR-L-43, I developed model cost estimates by rate category that were weighted together using base year volumes and compared to the Periodicals Outside County flats mail processing unit cost by shape estimate from USPS-LR-L-53. Both witness Glick and witness Stralberg propose that the aggregate Periodicals Outside County mail processing unit cost by shape estimate for flats and parcels should be used as an alternative.

Witness Glick attempts to justify this change based on anomalous parcels cost estimates that he admits have not been studied.[24] Witness Stralberg summarizes his conclusion in the following statement: "Whatever these 'parcels' are, they are probably more like non-machinable flats than letters."[25]

To the extent any errors, like those they hypothesize, affect the cost by shape estimates, they are not likely to always overstate the actual values. In the realm of cost estimating, any estimate could understate, accurately state, or overstate the actual value. The Commission should also consider that this modification is not something that

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[24] See MPA/ANM-T-2, page 20, lines 9 to 19.

solely affects Periodicals Outside County flats. Similar modifications could be incorporated into the other flats cost studies. In fact, it is my understanding that adjustments have been made to the flats cost by shape estimates to account for differences related to how flats are categorized in Postal Service data collection systems. While these adjustments may be needed, the averaging of flats and parcels cost by shape estimates leads to an overstatement of flats unit costs. Witness Glick and witness Stralberg have therefore gone too far.

2. TASK-BASED COST POOL CLASSIFICATIONS SHOULD BE USED

Cost pool classifications can have a big impact on the cost differences between rate categories. Consequently, these classifications have been debated a great deal in past rate cases. In my USPS-T-20 testimony, I describe how I classify cost pools as proportional or fixed.[26] Cost pools are classified as proportional if they contain costs for piece or bundle distribution operations that are related to the tasks actually modeled. Both witness Glick and witness Stralberg propose expanding the number of proportional cost pools to include those representing tasks that are unrelated to the tasks actually modeled. Their proposed cost pool classifications are not appropriate and should therefore be rejected.

Witness Glick attempts to justify his proposal by citing an interrogatory response I made concerning my parcel cost testimony (USPS-T-21).[27] In that interrogatory, I was asked to explain why I classified the 1MECPARC cost pool as proportional in the Parcel Post cost model. That cost pool represents mechanized operations that are used to sort Non Machinable Outsides (NMO) parcels at non-BMC MODS facilities. To the best of my knowledge, there are no data that could be used to estimate the percent of NMOs processed on this equipment at MODS facilities. Consequently, these operations were not explicitly included in the cost models. Instead, the models rely on the assumption that all NMOs are processed manually at plants. Despite this fact, this cost pool clearly represents tasks in which Parcel Post NMOs are sorted from the 3-digit level to the 5-

[25] See TW-T-2, page 24, lines 14 to 15.
[26] See USPS-T-20, page 6, lines 14 to 20.
[27] See MPA/ANM-T-2, page 21, line 22, to page 22, line 10.

digit level at plants. Those operations have been specifically established for that purpose. Witness Glick's comparison is therefore misguided, because the additional cost pools he attempts to classify as proportional do not represent operations that have been specifically established to sort Periodicals Outside County flats (*e.g.*, BCS, MANL).

Witness Stralberg and witness Glick also make the point that sampled employees may be clocked into the wrong operation when attempting to justify their cost pool classifications.[28] While circumstances such as those described could occur, it is difficult to imagine that any such problems would always result in a situation where the proportional costs are understated. In fact, some cost pools are classified as proportional even though they represent tasks that are not actually included in the mail flow models (a point that is discussed in more detail below). When using a hybrid costing approach like that relied upon for the past several cases, there is a continuum of cost results that could be obtained. The "clearly capturable" cost avoidance and full cost difference approaches lie at opposite ends of that continuum.[29] In my opinion, it is best to use a conservative approach in classifying cost pools as proportional. I would note that the Commission has also relied on a conservative approach in the past.

Finally, as with the other changes proposed by witness Glick and witness Stralberg, they have provided no explanation as to why this modification should only affect Periodicals Outside County flats. If the Commission were to determine that more liberal cost pool classifications were appropriate, these classifications should affect the cost studies for all shapes and classes of mail.[30]

Witness Glick and witness Stralberg have offered no data that in my mind substantiate the claims that they make concerning cost pool classifications. Their rationale consists of nothing but conjecture. I therefore believe that their proposals to classify additional cost pools as proportional should be rejected.

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[28] *See* TW-T-2, page 24, lines 20 to 25; MPNANM-T-2, page 21, lines 7 to 21.
[29] See PRC Op. MC95-1, Section IV.D.I.
[30] In the event that such changes are deemed appropriate, it should be noted that other intervenors who might be affected have not been litigating this issue.

3. FLAT PREPARATION COSTS SHOULD NOT AFFECT RATE CATEGORY COST DIFFERENCES

All flat-shaped mail pieces are entered in bundles and/or containers such that the mail pieces must be "prepped before being processed in piece distribution operations, whether those mail pieces are processed on equipment or not. The method of piece distribution, however, has historically affected the amount of prepping required. When the **AFSMIOO** program was first implemented, Flat Mail Carts **(FMC)** were deployed with the machines and were used as a preparation tool. Mail handlers removed the flats from containers, opened the bundles, disposed of the packaging, and loaded the mail pieces onto those carts. The carts were then secured and staged for later processing. In piece distribution operations, **AFSM100** clerks then unloaded those mail pieces and placed them on the feeding modules. The carts are also now used to prep mail for **UFSM1000** operations to some extent. In contrast, mail pieces that are sorted manually do not have to be loaded and unloaded from FMC carts. They do, however, still have to be removed from the original containers and unbundled, if required.

When the **AFSMIOO** program was implemented, **MODS** operation number 035 was established. This operation is used to collect the costs related to FMC prepping activities. In the USPS-LR-L-53 cost by shape estimates, 035 costs are mapped to the "1FLATPRP" cost pool. In fact, that is the only operation mapped to that cost pool. In USPS-LR-L-43, I classified this cost pool as fixed because the costs do not generally vary for the non-carrier route rate categories; in addition, future **AFSMIOO** modifications are likely to reduce the flats preparation cost differences between carrier route and non-carrier route mail. Because this cost pool is fixed, it had no impact on the cost differences by rate category.

Both witness Glick and witness Stralberg have proposed that a percentage of this cost pool should be classified as proportional in a manner that affects the cost differences by rate category. Witness Glick believes this change is warranted because Periodicals nonautomation carrier route presort flats are being "double charged" for preparation activities.[31] He applies a completely arbitrary factor of 50 percent to the cost

[31] See MPA/ANM-T-2, page 23, lines 9 to 14. At the very least this is an oversimplification. The In-office Cost System (IOCS) cannot be used to isolate a Periodicals Outside County nonautomation carrier route

pool such that half of it is attributed to non-carrier route flats only, and the other half is attributed to all flats.[32] Witness Glick admits that this factor was judgmental and lacks any empirical basis.[33]

Witness Stralberg claims that operation 035 costs are part of the cost of using flats sorting machines.[34] He makes cost model adjustments based on the extent to which carrier route and non-carrier route flats are processed through FSM operations.[35]

If there was ever a time when it might have been appropriate to classify flats preparation costs as "proportional" costs, it certainly is not now. Like the cards / letters automation program before it, the flats automation program continues to evolve. One such modification concerns the Automatic Induction (AI) retrofits to the AFSMIOO. As witness McCrery states, and witness Glick and witness Stralberg confirm, two-thirds of the AFSMIOO machines will have been retrofitted with the AI system by the test year.[36] As the Decision Analysis Report (DAR) for this program states:

> AFSM-ai improves the Flat Mail Preparation operation, by relocating the prep operation adjacent to the AFSM 100, and by replacing the arrangement of Flat Mail Carts (FMC) and other containers with a state of the art preparation operation and transport system. The prep system consists of a container unloader, at which bundles of mail are placed onto a transport belt, which in turn distributes the bundles of flats among several ergonomically designed workstations. The transport belt also can be used to distribute flat mail trays to the prep workstations.
>
> Each workstation is staffed by one Mail Handler. The employee opens each bundle of flat mail and stacks the flats into an empty Automation Compatible Tray (ACT). Debris such as plastic wrap, strapping, string, and rubber bands is taken away by an integrated pneumatic tube collection system. When the ACT is fully loaded, the employee releases it for transport to the feed end of the AFSM 100 and the system places another empty ACT onto the workstation shelf.[37]

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presort flats delivery unit cost estimate. Consequently, the Standard Mail ECR delivery unit cost estimate has been used as a proxy. The extent to which the actual delivery cost might differ from the proxy is unknown.

[32] See MPA/ANM-T-2, page 23, lines 15 to 18.

[33] See responses to USPS/MPA/ANM-T2-7(a) (Tr. 30/10321) and USPS/MPA/ANM-T2-41 (Tr. 30110369).

[34] See TW-T-2, page 10, lines 8 to 10.

[35] See TW-T-2, page 10, line 17, to page 11, line 15.

[36] See responses to USPS/MPA/ANM-T2-7(b) (Tr. 30/10321) and USPS/TW-T2-5(a) (Tr. 31110574). respectively.

Based on this task description, mail handlers will no longer have to load, secure, and position FMCs in staging areas. In fact, the tasks that mail handlers will perform in an AI environment do not appear to be significantly different from those tasks required to prepare carrier route bundles at Delivery Units. At the very least, it would appear that the prepping cost differences would shrink.[38]

Although the Postal Service has not currently approved funding for retrofitting all the machines with AI, my past experience is that virtually all machines are eventually modified.[39] It is also my understanding that it is not possible to specifically extract the flats preparation cost savings from the AI DAR. Consequently, the 1FLATPRP cost pool was not modified in any way to reflect test year flat preparation savings. Given this fact, it is likely that the value of that cost pool has been overstated. Regardless, this cost pool should not influence rate category cost differences because the AI system is going to ultimately reduce flats preparation cost differences between carrier route and non-carrier route mail.

Finally, as with the other changes proposed by witness Glick and witness Stralberg, they have provided no explanation as to why this modification should only affect Periodicals Outside County flats. If the Commission were to determine that this modification were appropriate, it should be incorporated into all the cost models found in USPS-LR-L-43.[40] As explained above, however, this change is not appropriate at this time. The proposal to modify the IFLATPRP cost pool should therefore be rejected.

4. INTERVENOR PROPOSALS TO DISAGGREGATE THE NON-MODS ALLIED COST POOL ARE INAPPROPRIATE

Another cost pool which has received considerable attention in this case is the non-MODS "ALLIED cost pool. In USPS-LR-L-43, I classified this cost pool as fixed. Witness Glick and witness Stralberg attempt to classify a fraction of that cost pool as proportional. The basis that they use for doing so is an interrogatory response from

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[37] See *USPS-LR-L-194,* page 3 (internal citation omitted).

[38] These costs would still be incurred, regardless of whether the costs are considered to be "mail processing" or "delivery" costs.

[39] It is my understanding that some facilities currently have problems accommodating these retrofits due to space limitations. However, these problems tend to work themselves out over the long run.

[40] In the event that such changes are deemed appropriate, it should be noted that other intervenors who might be affected have not been litigating this issue

Postal Service witness Van-Ty-Smith in which it was estimated that 37 percent of the tallies associated with that cost pool were related to bundle sorting operation. After making this adjustment, 0.393 cents were shifted from the fixed to the proportional classification.

Selective attempts to disaggregate costs below the cost pool level should be discouraged. The comparison of weighted cost model results *to* cost **pools** is not a perfect comparison. While every proportional cost pool contains at least some costs bearing a relationship to the tasks actually represented in the ***cost*** models, there are also costs in some cost pools that have not been modeled.

The "1OPBULK" and "1OPPREF" cost pools are examples of such cost pools. These cost pools represent opening unit activities. Bundle sorting operations are often performed using these operation numbers. Given that bundle sorting operations are included in the mail flow models, these cost pools have been classified as proportional in USPS-LR-L-43. The opening units are often the first stop for containers when they enter a facility. Postal employees then sort these containers based on the next operation to which they should be directed based on the specific sortation level associated with that container. In other words, the opening unit cost pools contain costs beyond those related to bundle sorting. Despite this fact, the entire values of these cost pools were classified as being proportional.

A tally analysis was conducted on these two cost pools using the same framework as that relied upon to develop the 37-percent figure for the ALLIED cost pool described above. The results of this analysis showed that bundle sorting costs represent an estimated 56-percent and 47-percent of the IOPBULK and 1OPPREF cost pool values, respectively. Using the logic employed by both witness Glick and witness Stralberg, 44-percent and 53-percent of the 1OPBULK and 1OPPREF *cost* pool values should be shifted from a proportional classification to a fixed classification. If this modification were to be made using the cost pool values relied upon by both witness Glick and witness Stralberg, 0.103 cents and 0.236 cents, or a total of 0.339 cents, would be shifted from the proportional classification to the fixed classification. This change would almost completely counterbalance the ALLIED adjustment proposed by witness Glick and witness Stralberg. When asked why this adjustment was not

performed, witness Glick assumed the non-bundle sorting costs associated with these cost pools were small and therefore made no attempt to adjust the cost pool. Witness Stralberg also made no attempt to modify this cost pool.[42]

I am not suggesting that this modification should actually be performed. I do not believe such analyses below the cost pool level should be conducted because volume variability factors and piggyback factors are developed at the cost pool level, not at a task level below the cost pool level. A proper analysis would have to consider the extent to which these factors need to be de-averaged for component activities. The multiplication of task-related tallies by an overall cost pool value may therefore not be an accurate method for disaggregating those costs. Furthermore, if one cost pool is analyzed at this level of detail, all cost pools should be analyzed at this level of detail. I imagine that such modifications would, if they were typically performed, probably balance out.

Finally, as with the other changes proposed by witness Glick and witness Stralberg, they provide no explanation as to why this modification should only affect Periodicals Outside County flats. If the Commission were to determine that analyses below the cost pool level were appropriate, they would affect the cost studies for all shapes and classes of mail.[43] As explained above, however, these analyses are not appropriate. The proposal to modify the ALLIED cost pool should therefore be rejected.

5. THE COMMISSION HAS ALREADY DETERMINED THAT THE 1SUPP_F1 COST POOL IS FIXED

In the **USPS-LR-L-43** cost models, the **"1SUPP_F1"** cost pool has been classified as a fixed cost pool. Witness Glick proposes classifying a percentage of the **costs** from this cost pool as proportional, using a methodology similar to that used to develop piggyback factors.[44] First of all, the fact that a cost pool could be impacted by worksharing does not necessarily mean that those costs would vary by rate category such that the cost pool should be classified as proportional. For example, the Business

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[41] See response to USPS/MPA/ANM-T2-12(a) and (b) (Tr. 30/10328-29).
[42] See response to USPS/TW-T2-14(b) (Tr. 31110594).
[43] In the event that such changes are deemed appropriate, it should be noted that other intervenors who might be affected have not been litigating this issue.
[44] See MPNANM-T-2, page 22. lines 14 to 20.

Mail Entry Unit (BMEU) activities related to the acceptance and verification of mailings obviously are affected by mailer worksharing activities. The costs related to the LD79 cost pool, however, have not been classified as proportional in USPS-LR-L-43. In addition, neither witness Glick nor witness Stralberg proposed that they should be classified as proportional

This is not the first time that the classification for the 1SUPP_F1 cost pool has been called into question. The classification for several cost pools was scrutinized by the Cornmission in Docket No. R2000-1. In that docket, the Commission stated:

> Postal Service witness Miller confirms that worksharing could affect the costs in platform, support, and non-MODS allied pools. The Commission finds these pools are affected by worksharing activities (including mail preparation), and treats them as worksharing related (fixed) in the calculation of First-class Mail worksharing savings.[45]

These classification recommendations pertained to the presort letters cost models. There is no reason, however, that the 1SUPP_F1 classification should differ for the cost models supporting other shapes of mail. Finally, as with the other changes proposed by witness Glick, he has provided no explanation as to why this modification should only affect Periodicals Outside County flats. If the Commission were to determine that his cost pool adjustment were appropriate, it would affect the cost studies for all shapes and classes of mail.[46] As explained above, however, the Commission has already spoken on this issue. The proposal to modify the 1SUPPF1 cost pool should therefore be rejected.

O. WITNESS STRALBERG'S BUNDLE BREAKAGE COMMENTS SHOULD BE IGNORED

Data related to bundle breakage are very difficult to obtain. The same flats bundle breakage assumptions have been used in the past three dockets. These data were obtained from two studies presented in Docket No. R2000-1.[47] While witness

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[45] P [illegible] Op. 2[illegible] [illegible] reg [illegible] [illegible] 1] (i t r [illegible] it [illegible] o [illegible] omitted).

[46] In the event that such cha[illegible] s ar[illegible] deemed approp ri[illegible] it should be [illegible]ted that otner intervenors who [illegible]ig[illegible]t be affected have not been litigating this issue.

[47] [illegible] D[illegible] et N[illegible] R20[illegible] -1 US[illegible]S [illegible] F [illegible]-8[illegible] and [illegible] -297

Stralberg is quite critical *of* the bundle breakage data and assumptions, he offers little in the way of alternatives. It is true that a IO-percent bundle breakage factor that is used in the cost models was derived from a qualitative survey. There are, however, no other data, empirical or otherwise, that can be used instead. When asked for an empirical basis for his statement that this factor is "excessive,"[48] witness Stralberg responded, "It follows that just as there is no empirical basis for fixing it at 10%, there also is no empirical basis for concluding that 10% is too high or too low."[49]

The one modification that witness Stralberg does rely upon concerns a manual bundle sorting assumption. He assumes that manually sorted bundles cannot break until after they are sorted into a specific container.[50] In reality, manual bundle sorting operations can be conducted by more than one person. In such instances, mail is dumped onto belts, and the employees sort the mail into the appropriate container. Manually sorted bundles therefore can break before they are sorted into containers.

Finally, as with the other changes proposed by witness Stralberg, he has provided no explanation as to why this modification should only affect Periodicals Outside County flats. If the Commission were to determine that the bundle breakage assumptions and factors should be changed, the same assumptions and factors for all flats cost studies should also be changed.[51] I believe that witness Stralberg's bundle breakage comments are not helpful in any way and should therefore be ignored.

E. THE DOCKET NO. C2004-1 TESTIMONY IS STILL RELEVANT

In his testimony, witness Stralberg proposes an "extended" flats cost model that could be used to support rate design proposals similar to the proposals Time Warner, et al., championed in Docket No. C2004-1. In the instant proceeding, witness Mitchell (TW-T-1) again presents container, bundle, and piece-specific rates.

I was a rebuttal witness in Docket No. C2004-1.[52] One point I made in my testimony concerned the level to which available cost modeling data allow us to precisely estimate separate and distinct container, bundle, and piece distribution costs.

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[48] See TW-T-2, page 22, line 19.
[49] See response to USPS/TW-T2-12 (Tr. 31/10590)
[50] See TW-T-2, page 21, lines 3 to 7.
[51] In the event that such changes are deemed appropriate, it should be noted that intervenors who might be affected have not been litigating this issue,

As was the case then, I believe that the data allow us to effectively de-average a CRA cost by shape estimate into rate category estimates using the hybrid cost methodology I describe in my USPS-T-20 testimony. I do not believe, however, that these data can be used to precisely estimate separate and distinct container, bundle, and piece distribution costs. In fact, I would contend that several of witness Stralberg's comments and actions, as described above, serve to underscore this point.

It is my understanding that the Presiding Officer has allowed my rebuttal testimony in Docket No. C2004-1 to be entered into the record of this proceeding in its entirety, subject to affirmation of its continued applicability.[53] Because of this, I will simply state that the issues I raised in Docket No. C2004-1 are still applicable and accurate today, rather than rehashing the points discussed in that testimony.

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[52] See Docket No. C2004-1, USPS-RT-1.
[53] See Presiding Officer's Ruling No. R2006-1/75, at 8.

III. THE PARCEL POST COST MODEL SHOULD NOT BE USED TO JUSTIFY LOWER PASSTHROUGH VALUES

Witness Luciani (UPS-T-2) proposes that the passthroughs for the estimated Parcel Post cost avoidances be decreased from 100 percent to 90 percent, based in part on what he perceives to be defects in the Postal Service's cost model.[54] He feels the cost model has not improved, but has gotten worse.[55] In reality, the cost model has been modified in each of the past two cases to reflect operation changes.[56] In addition, updated test year cost model inputs that were developed by other witnesses were, as always, incorporated into the cost model.

Witness Luciani makes three primary claims: the cost model data are old or include unsupported assumptions, the CRA adjustment factor is unstable, and the Delivery Unit (DU) parcel sorting cost estimate is not accurate. Rather than sponsoring an alternative cost model of his own, he lists unhelpful criticisms in the hope that the Commission will use them as justification for reducing Parcel Post cost avoidance passthroughs. The reason witness Luciani provided no alternative cost model is simple: he could not do so because there are no better data with which to develop an alternative cost model.

In fact, as confirmed by witness Luciani, any cost model could generate one of three results: (1) an overstated savings estimate, (2) an accurate savings estimate, (3) or an understated savings estimate.[57] To the extent that any model is viewed to contain errors, it does not necessarily follow that passthroughs should be reduced to compensate for those errors. It is possible that some cost avoidance estimates could be understated as well. The Parcel Post cost model should therefore not be used to justify lower cost avoidance passthrough values. I urge the Commission to disregard witness Luciani's comments regarding the cost model when developing its Parcel Post rate design.

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[54] See UPS-T-2, page 3, lines 1 to 6.
[55] See UPS-T-2. page 7, lines 6 to 9.
[56] See Docket No. R2006-1, USPS-T-21, Section III.B, and Docket No. R2005-1, USPS-T-20, Section III.B.
[57] See response to USPS/UPS-T2-9 (Tr. 27/9434).

A. THE AGE OF A STUDY DOES NOT NECESSARILY MEAN THE RESULTS ARE INVALID

In his testimony, witness Luciani states, "The underlying data sources used in the Parcel Post cost model are often dated."[58] He then proceeds to list several cost model inputs that he feels are problematic in that regard.[59] Witness Luciani confirms, however, that he has conducted no studies of his own which invalidate any of the cost model inputs.[60] Furthermore, he also confirms that the age of a study does not necessarily invalidate the results.[61] Recognizing this, I do not believe that one can credibly challenge the adequacy of the model without closely examining the supposedly "outdated" inputs, and determining whether they are still valid or, if they may have changed somewhat, whether any such changes would materially affect the cost model results. Witness Luciani did not, however, perform such an evaluation. I perform such an evaluation below.

Pieces Per Container: The number of pieces per container at DUs is a concern to witness Luciani because as little as one Destination Delivery Unit (DDU) piece can be entered at a DU.[62] Witness Luciani was unable to provide any insight as to how often such an unlikely event occurs.[63]

The number of pieces per container in the USPS-LR-L-46 cost model are calculated by applying base year average cubic feet per piece data to results from a 1984 study.[64] The base year average cubic feet per piece estimates for the benchmark cost models are the same values used for the rate category cost models. To the extent any of the original 1984 figures have changed over time, it would likely be due to changes in the cubic volume per piece values. Consequently, updated values would not significantly affect the cost model results.

The impact can be illustrated by revising the figures in USPS-LR-L-46, page 8, cells C34:C38. If it is assumed that each container can hold 20 percent more parcels

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[58] See UPS-T-2, page 7, lines 11 to 12.
[59] See UPS-T-2, pages 7 to 9.
[60] See response to USPS/UPS-T2-8 (Tr. 2719433).
[61] See response to USPS/UPS-T2-4 (Tr. 27/9429).
[62] See UPS-T-2, page 7, lines 18 to 19.
[63] See response to USPS/UPS-T2-5 (Tr. 27/9430).
[64] See USPS-LR-L-46. page 8.

compared to 1984 (i.e., the values are multiplied by 1.2), the DDU savings estimate from USPS-LR-L-46 increases from its original value of $1.058 to $1.078 (a 1.89-percent increase). If it is assumed that each container can hold 20 percent less parcels compared to 1984, the DDU savings estimate decreases from $1.058 cents to $1.034 cents (a 2.27-percent decrease). Given the magnitude of Parcel Post unit costs, these changes do not have a significant impact on the results.

DU Parcel **Sorting** Productivity: The USPS-LR-L-46 Parcel Post cost model relies on a DU parcel sorting productivity obtained from a 1982 study involving Bound Printed Matter (BPM).[65] Based on that fact alone, witness Luciani appears to draw the conclusion that this figure is not correct.

Witness Luciani correctly describes the methods used to perform this operation, with the exception that clerks, rather than mail handlers, perform the sortation. He also acknowledges that the basic operation has not changed since 1982.[66] I observed DU parcel sorting operations on my second day of employment with the Postal Service in February 1991 and can confirm that the operations I observed then are identical to those described by witness Luciani. Furthermore, they are identical to those I observed in recent field observations at DUs.

If the methods used to sort the mail are the same, the only other reason the productivity value might have changed is if related factors, such as the number of carrier routes per delivery unit or the types of containers, have changed. Witness Luciani was unable to demonstrate that any such factors have appreciably changed since 1982.[67] Given these facts, it is unclear why witness Luciani hypothesizes that the productivity value is incorrect.

BMC Crossdock Productivity: The productivity value for moving containers from the dock to the parcel sorting operation at delivery units has been estimated to be four times a BMC crossdock productivity value. This crossdock productivity value was originally developed in a 1996 study. Witness Luciani is concerned about the age of the data, as well as what he perceives to be the arbitrary nature of the assumption.

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[65] See USPS-LR-L-46, page 4.
[66] See response to USPS/UPS-T2-7 (Tr. 2719431).
[67] See response to USPS/UPS-T2-15 (Tr. 27/9440-42).

While I have continued to use this value in the past two rate cases, I did not develop the initial assumption and am therefore unsure as to the original basis for using it beyond the information provided by witness Eggleston in her response to UPS/USPS-T25-9 in Docket No. R2001-1.[68] I can state, however, based on my experience developing facility layouts and observing both delivery unit and BMC operations, that the amount of dock space at an average BMC dwarfs the amount of dock space at an average delivery unit. Consequently, if dock space square footage were used as the original basis to revise this figure, and from witness Eggleston's response to UPS/USPS-T25-9 it appears that this played a role, then this assumption has, to the extent it is inaccurate, likely resulted in overstated delivery unit costs. This point is moot, however, because the same assumption is used in all of the Parcel Post cost models such that it has no effect on the cost avoidance estimates.

Unloading productivities: Witness Luciani's concern with the unloading productivities also appears to be focused on the age of the data only. The unloading productivity values in the USPS-LR-L-46 cost model were developed in a 1996 study. These values would change if the containers, the unloading methods, or the facilities were to have changed since 1996. The containers and methods shown in USPS-LR-L-46 are still used today. Most recent BMC modifications concern sorting equipment. It is my understanding that some BMC facilities have been expanded since 1996, but the additional floor space is most often used for staging mail. Consequently, it is unlikely that there have been significant or material changes to the unloading productivities since 1996.

Arrival and Dispatch Profiles: Witness Luciani's concern regarding the arrival and dispatch profiles appears to be related to the age of the data as well, since he provides no specific explanation of how the values may have changed. The arrival and dispatch profile data in USPS-LR-L-46 were also developed in a 1996 study.

The impact of any potential changes to these values can be assessed by observing the data in USPS-LR-L-46, page 9. The arrival profile percentages are used to estimate loading costs at the SCF and are contained in cells B11:B17. The costs per operation are shown in cells F11:F17. If the arrival profile were to have changed since

[68] This R2001-1 interrogatoty response can be found in the transcript of this docket at Tr. 3/318-19.

1996, it would likely show that less mail is bedloaded and more mail is containerized upon entry, leading to a decrease in costs. The loose bedloaded mail has a much higher cost per operation than the other arrival / entry methods. Mail entered in pallets and pallet boxes have the lowest per operation cost of the methods. The arrival profile percentages are also used to estimate unloading costs at the BMC, and are contained in cells B19:B25. The costs per operation are shown in cells F19:F25. If less mail were to be bedloaded and more mail were to be entered in rolling stock, the costs would again decrease.

When the dispatch profile data are considered, however, it appears that any change to the arrival and dispatch profiles would, at the very least, be offsetting. The dispatch profile percentages from USPS-LR-L-46, page 9 are contained in cells B39:B43. The costs per operation are shown in cells F39:F43. In this instance, the costs associated with bedloading sacks are lower than those associated with loading Over The Road (OTR) containers and other rolling stock. If the Postal Service were to have relied less on bedloading and more on rolling stock over time, the loading costs would have increased to some extent. Overall, the inclusion of revised arrival and dispatch profile data would have resulted in a situation where some costs decrease while other costs increase.

Direct Transportation to DU: The USPS-LR-L-46 cost model relies on an estimate that 12.3 percent of parcels are dispatched directly to the DU from the BMC.[69] This estimate was developed in 1998. Witness Luciani is concerned that it is no longer valid. As he indicated throughout his testimony, the percentage of Parcel Post comprised of DDU parcels has increased a great deal over the last several years. With this change in mail mix, it is likely that the percentage of mail transported directly to DUs from BMCs has decreased. If the 12.3-percent estimate is reduced in the cost model, the end result is that some cost avoidances, like those related to DDU parcels, would increase.

Other Inputs: Witness Luciani is also concerned about various other cost model inputs. He specifically cites the percentage of mail sorted to 5-digits by the Primary Parcel Sorting Machine (PPSM), the percent of mail fed directly to the Secondary Parcel

[69] See USPS-LR-L-46, page 6.

Sorting Machine (SPSM), and the percentage of nonmachinable mail pieces inducted on conveyor systems. All three values were based on data collected in 1998.

The cost model currently relies on an estimate that 20.1 percent of the parcels processed on the PPSM are sorted to the 5-digit level.[70] The amount of mail sorted to 5-digits on PPSMs would be affected by the number of ZIP Codes and the number of separations that are possible on PPSMs. It is my understanding that the number of ZIP Codes and therefore the number of separations performed at BMCs have not changed appreciably since 1998. Assuming that this percentage had actually increased to 30 percent and the cost model input were changed accordingly, the InterBMC machinable mail processing unit cost estimate would change from $ 2.541 to $2.545 (a 0.16-percent increase) and the IntraBMC machinable mail processing unit cost estimate would change from $2.230 to $2.222 (a 0.36-percent decrease). Given the magnitude of the parcels cost estimates, the cost model does not appear to be appreciably sensitive to this input value.

The cost model currently relies on an estimate that 20.8 percent of parcels are inducted directly to the SPSM.[71] If this percentage were to have changed in any way since 1998, it would likely have increased?' If the 20.8 percent value is increased to 30 percent, the InterBMC machinable mail processing unit cost estimate changes from $2.541 to $2.544 (a 0.12-percent increase) and the IntraBMC machinable mail processing unit cost estimate changes from $2.230 to $2.228 (a 0.09-percent decrease). Given the magnitude of the parcels cost estimates, the cost model also does not appear to be appreciably sensitive to the input value.

The cost model currently relies on an estimate that 41.2 percent of parcels are inducted using a conveyor system.[73] If it were determined that this value were actually 30 percent and the input value were changed accordingly, the InterBMC NMO mail processing unit cost estimate would change from $6.390 to $6.354 (a 0.56-percent decrease) and the IntraBMC NMO mail processing unit cost estimate would change from $5.066 to $5.047 (a 0.38-percent decrease). If it were determined that this value

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[70] See USPS-LR-L-46, page 6.
[71] See USPS-LR-L-46, page 6.
[72] It is my understanding that more mailers are preparing their parcels so that they can be inducted directly into the secondary operation because they believe it has improved their service.

were actually 50 percent and the input value were changed accordingly, the InterBMC NMO mail processing unit cost estimate would change from **$6.390** to $ **6.418** (a 0.44-percent increase) and the IntraBMC NMO mail processing unit cost estimate would change from **$5.066** to **$5.081** (0.30-percent increase). Given the magnitude of the parcels cost estimates, the cost model does not appear to be appreciably sensitive to the input value.

Parcel Keying Productivity: Finally, witness Luciani is concerned about data related to PSM keying operations. By definition, these data are fairly old because parcel keying activities are oflen not required now, given that many parcels are prebarcoded. Productivity data from the **1990s** are therefore relied upon in the cost study that is used as the basis for the parcel barcode discount.[74] In order to evaluate the accuracy level of the keying task estimate, I have estimated the additional tasks required to key a parcel using a Methods Time Measurement (MTM-4M) analysis, as shown below:

Task	Measurement Units **(MUs)**
Regrasp parcel	56
Turn parcel to read	**89**
Read Parcel	**146**
Key parcel using 5 keystrokes	100
Total Normal Time	**391**
Standard Time **(15%** PFD)	**450**

With Personal, Fatigue and Delay allowances of **15** percent, the standard time estimate for keying a parcel to 5 digits is **450** MUs. A measurement unit is equal to **0.000001** hours. The parcel keying estimate is therefore equal to **0.00045** hours per piece. The inverse of this number is the productivity estimate, which is **2,223.952** pieces per hour. Given that the volume variability factor for the PSM operation is **0.85,** the marginal productivity value is calculated to be **2,616.414** pieces per hour (the actual productivity divided by the volume variability factor). When the premium pay adjusted test year wage rate of **$37.992** is divided by the marginal productivity value, the direct

[73] See USPS-LR-L-46, page 6.
[74] The input values are contained in USPS-LR-L-46, page 4. The cost study is contained in USPS-LR-L-46, page 33.

cost per piece is calculated to be $0.015. The total direct and indirect cost per piece value can be obtained by multiplying this figure by the PSM piggyback factor of 1.756. The result from this analysis is therefore a test year cost estimate of $0.025 per piece. This figure is not significantly different than the $0.027 estimate in USPS-LR-L-46.

In summary, witness Luciani criticizes the cost model input data, but has not provided any evidence demonstrating that any of the figures are incorrect. He has also confirmed that the age of the data do not necessarily mean that they are invalid. Furthermore, as I have demonstrated above, if any of the data inputs have changed, they likely have (1) changed in a way that does not justify the use of less-than-100-percent passthroughs, or (2) changed in a manner that would not significantly impact the cost avoidance estimates. Consequently, witness Luciani's criticisms should not be used as a basis for reducing the *cost* avoidance estimate passthroughs for Parcel Post.

B. CRA ADJUSTMENT FACTORS CANNOT NECESSARILY BE USED TO ASSESS COST MODEL VALIDITY

In his testimony, witness Luciani states that the CRA proportional adjustment factor "suggests that something is wrong with the Postal Service's Parcel Post mail processing cost model."[75] In reality, CRA proportional adjustment factors are not very effective when used as a tool to gauge model accuracy and reliability. Witness Luciani's comments concerning CRA adjustment factors should therefore not be used as a basis for decreasing the Parcel Post cost avoidance passthroughs.

In Table 2 of his testimony witness Luciani lists the proportional adjustment factors that have been used in past rate cases, beginning with Docket No. R97-1. It is unclear what purpose Table 2 serves. The methodologies used to develop the CRA *costs* by shape estimates and the methodologies used to develop the Parcel Post cost models have both changed over time. One would therefore not expect CRA proportional adjustment factors to remain static over time.

[75] See UPS-T-2, page 9, lines 13 to 16.

In Witness Luciani's view, the current factor of 1.194 "inflate[s]" the model cost estimates and "suffers from severe instability."[76] It appears that this claim is being made as a result of revised cost models being filed in this docket.[77] While I personally do not enjoy making errors, cost model errata are going to have to be filed on occasion, whether it is a result of something I have done or it is related to another witness' work upon which I rely. Errors are often pointed out by the Commission, or other intervening parties like United Parcel Service (UPS). In the instant proceeding, UPS has pointed out some problems with data. In that regard, I appreciate their contributions. To the extent there are errors in anyone's work, I view this circumstance as a necessary part of the process that results in the Commission having the best data with which to work before issuing their Opinion and Recommended Decision. Changes to CRA proportional adjustment factors *as* a result of errata being filed, however, are not necessarily a sign of "instability."

As witness Luciani has confirmed, CRA adjustment factors have been relied upon by rate case participants, including the Commission, for several years.[78] Witness Luciani also confirms that the models are simplified representations of reality and that some cost pools may contain costs which are not actually included in the cost models.[79] An example of a task that would be represented in the proportional cost pool cost estimates, but not in the model cost estimates, is the additional processing costs required to process barcoded mail pieces that are rejected by PSMs. When mail pieces are rejected, mail processing clerks can manually print and apply a label with a correct barcode on the mail piece and then re-induct the mail piece into the PSM system. This task is not currently included in the cost models, but is imbedded in the BMC cost pools, which are all classified *as* proportional in USPS-LR-L-46.

Due to the fact that the tasks being modeled and the tasks represented by the proportional cost pools do not always exactly correspond to each other, it would be meaningless *to* aim for a cost model which results in a CRA proportional adjustment factor of *1.000*. In fact, it is unclear what an acceptable range would be. Despite

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[76] See UPS-T-2, page 10, lines 6 to *8.*
[77] See UPS-T-2, page 11, lines 12 to 15.
[78] *See* response to USPS/UPS-T2-10(c) Tr. 27/943
[79] *See* responses to USPS/UPS-T2-11 (Tr. 27/9436) [illegible] (Tr 27/9443)

witness Luciani's complaint that the factors are not stable, he was unwilling to provide an acceptable range of accuracy." In this instance, witness Luciani's comments are again unavailing and should not be used as justification for reducing the passthroughs for the Parcel Post cost avoidance estimates.

C. SELECTIVE COST POOL ADJUSTMENTS SHOULD NOT BE INCLUDED

Although he did not provide his own version of the cost model, witness Luciani did recommend that one modification be made to the cost model. This modification concerns the parcel sorting operation at DUs. As described above, the productivity estimate for that operation was developed in a 1982 study. The parcel sorting methods have not changed since that time. The cost pool to which the parcel sorting operation at DUs should be mapped is the non-MODS "MANP" cost pool. The test year value of that cost pool is *26.029* cents. The model cost estimate for this task is 10.745 cents. Witness Luciani believes that the current modeling method skews the results and inflates the DDU cost avoidance estimate." To solve this problem, he recommends that 24 cents be used as the model cost estimate for the parcel sorting operation at DUs. The basis for this estimate is a tally analysis indicating that 92.3 percent of the cost pool value represents incoming costs."

Theoretically, the basis that witness Luciani has used for his analysis could be applied to every single cost pool. If such an analysis were to be performed, it is likely that some adjustments would increase the DDU cost avoidance while others would decrease the DDU cost avoidance. As witness Luciani confirms, there are several tasks in the fixed cost pools that would not be incurred at all by DDU.[83] For example, some of the fixed mail processing costs incurred at MODS plants would not be incurred by DDU. Using witness Luciani's approach, these cost pool values should be set to 0.000 for DDU mail pieces, which would expand the cost avoidance estimates. Currently, these cost pools are classified as fixed for both DDU and non-DDU mail and therefore do not contribute to the cost avoidance estimates.

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[80] See response to USPS/UPS-T2-12 (Tr. 27/9437).
[81] See UPS-T-2. pages *13* to *15.*
[82] See USPS-LR-L-144.
[83] See response to USPS/UPS-T2-17(a) (Tr. 27/9444).

Witness Luciani proposes that his modification be included until more is known about why this cost discrepancy has occurred.[84] I believe that, in order to be fair and avoid a biased model, this modification should not be implemented unless each cost pool is assessed in a similar manner. I therefore recommend that the Commission disregard witness Luciani's proposed modification when developing the Parcel Post rate design.

[84] *See* UPS-T-2, page 14, lines 13 to 17.

ATTACHMENT 1: INCREMENTAL IMPACT OF WITNESS GLICK'S COST MODEL CHANGES

ACTUAL MAIL PROCESSING UNIT COST ESTIMATES (CENTS)

Rate Category	(1) USPS-LR-L-43	(2) Cost By Shape Modification	(3) 1FLATPRP Cost Pool Modification	(4) ALLIED Cost Pool Modification	(5) Cost Pool Classification Modification	(6) 1SUPP_F1 Cost Pool Modification	(7) Man Inc Sec Coverage Factor Modification
Basic Nonauto	29.605	30.677	31.134	32.057	32.967	33.604	32.355
3-Digit Nonauto	22.157	22.981	23.438	23.929	24.413	24.763	24.269
5-Digit Nonauto	14.161	14.719	15.176	15.204	15.230	15.273	15.725
Carrier Route Nonauto	9.835	10.248	9.753	9.530	9.309	9.134	8.947
Basic Auto	25.212	26.137	26.595	27.263	27.922	28.389	27.580
3-Digit Auto	21.078	21.866	22.323	22.751	23.174	23.482	23.146
5-Digit Auto	14.314	14.876	15.334	15.370	15.405	15.454	16.012
Benchmark:							
5-Digit Nonauto	4.326	4.471	5.423	5.674	5.921	6.139	6.778
5-Digit Auto	4.479	4.628	5.581	5.840	6.096	6.320	7.065

PRESORT ADJUSTED MAIL PROCESSING UNIT COST ESTIMATES (CENTS)

Rate Category	(1) USPS-LR-L-43	(2) Cost By Shape Modification	(3) 1FLATPRP Cost Pool Modification	(4) ALLIED cost Pool Modification	(5) Cost Pool Classification Modification	(6) 1SUPP_F1 Cost Pad Modification	(7) Manlnc Sec Coverage Factor Modification
Basic Nonauto	29.605	30.677	31.134	32.057	32.967	33.604	32.355
3-Digit Nonauto	22.157	22.981	23.436	23.929	24.413	24.763	21.269
5-Digit Nonauto	14.161	14.718	15.176	15.204	15.230	15.273	15.725
Carrier Route Nonauto	9.635	10.248	9.753	9.530	9.309	9.134	8.947
Basic Auto	28.321	29.350	29.807	30.655	31.493	32.079	30.987
3-Digit Auto	20.936	21.719	22.177	22.597	23.011	23.314	22.959
5-Digit Auto	13.860	14.407	14.855	14.874	14.864	14.915	16.460
5-Digit Nonauto	4.326	1.411	5.423	5.614	6921	6.119	6.778
5-Digit Auto	4.026	4.159	5.112	5.344	5.575	5.781	6.513

(1) USPS-LR-L-43
(2) Values based on witness Glick's cost by shape modification
(3) Values based on witness Glick's 1FLATPRP cost pool modification
(4) Values based on witness Glick's ALLIED cost pool modification
(5) Values based on witness Glick's cost pool classification changes
(6) Values based on witness Glick's 1SUPP_F1 cost pool modification
(7) MPA/ANM-LR-2

ATTACHMENT 2: FY 2005 FLATS MAIL VOLUMES AND ESTIMATED INCOMING SECONDARY FINALIZATION RATES

A. Flats Category	FY 2005 RPW Pieces		Source
First-Class Mail single-piece	3,572,195,284	15.12%	USPS-LR-L-87
First-Class Mail presort	909,625,881	3.85%	USPS-LR-L-32
Periodicals Outside County (Non-CR)	4,265,346,527	18.05%	USPS-LR-L-91
Periodicals Outside County (CR)	376,064,469	1.59%	USPS-LR-L-91 (* 0.0954)
Periodicals Inside County (Non-CR)	180,028,444	0.76%	USPS-LR-L-87
Standard Mail Regular (Non-ECR)	14,025,889,177	59.35%	USPS-LR-L-92
Parcel Post	3,157,972	0.01%	USPS-LR-L-87
Bound Printed Matter	269,142,744	1.14%	USPS-LR-L-87
Media Mail / Library Mail	30,579,077	0.13%	USPS-LR-L-87
Total	**23,632,029,575**	**100.00%**	

B. Finalization Rate (Original)	FY 2005 Estimated Pieces	Percent	Source
AFSM100	15,275,731,000	51.78%	MODS/EOR
UFSM1000	1,037,685,000	3.52%	MODS/EOR
Manual	13,188,243,000	44.70%	FLASH
Total	**29,501,659,000**	**100.00%**	

C. Finalization Rate (Adjusted)	FY 2005 Estimated Pieces	Percent	Source
AFSM100	15,275,731,000	64.64%	MODS/EOR
UFSM1000	1,037,685,000	4.39%	MODS/EOR
Manual	7,318,613,575	30.97%	ADJUSTED VALUE
Total	**23,632,029,575**	**100.00%**	

D. Finalization Rate (Adjusted - No PP & MM/LM)	FY 2005 Estimated Pieces	Percent	Source
AFSM100	15,275,731,000	64.73%	MODS/EOR
UFSM1000	1,037,685,000	4.40%	MODS/EOR
Manual	7,284,876,526	30.87%	ADJUSTED VALUE
Total	**23,598,292,526**	**100.00%**	

ATTACHMENT 3: USPS-LR-L-43 FLATS COST MODEL DATA COMPARISONS

Class	Flats Rate Category	BY 2005 RPW Volume	Class Percent	Non-CR Flats Percent	AFSM100 Compatible Percent	Incoming Secondary Percent Finalized AFSM100	UFSM1000	Manual	Total
FCM	Nonauto	176,370,081	19.39%	0.92%	56.12%	41.25%	32.78%	25.99%	100.00%
	MADC Auto	42,965,539	4.72%	0.22%	86.20%	58.62%	17.52%	23.87%	100.00%
	ADC Auto	102,738,851	11.29%	0.54%	91.05%	6538%	14.95%	19.69%	100.00%
	3D Auto	288,821,078	28.45%	1.35%	88.08%	86.47%	15.69%	15.64%	100.00%
	5D Auto	328,730,334	38.14%	1.71%	97.54%	82.96%	7.83%	9.21%	100.00%
	Class Total / Aggregate	909,625,881	100.00%		85.55%	67.61%	16.16%	16.23%	100.00%
PERIODICALS	Basic Nonauto	168,214,698	3.94%	0.88%	79.85%	50.18%	19.99%	29.86%	100.00%
	3D Nonauto	172,270,322	4.04%	0.90%	64.93%	41.64%	26.94%	31.42%	100.00%
	5D Nonauto	223,586,748	5.24%	1.16%	62.14%	49.27%	32.59%	16.13%	100.00%
	Basic Auto	151,367,760	3.55%	0.79%	82.39%	49.79%	18.41%	31.80%	100.00%
	3D Auto	1,038,021,663	24.34%	5.41%	81.19%	51.56%	19.60%	28.84%	100.00%
	5D Auto	2,511,885,335	58.89%	13.06%	63.31%	86.39%	17.74%	15.87%	100.00%
	Class Total / Aggregate	4,265,346,527	100.00%		80.77%	59.65%	19.46%	20.89%	100.00%
STANDARD	MADC Nonauto	215,020,175	1.53%	1.12%	94.75%	60.27%	14.12%	25.62%	100.00%
	ADC Nonauto	141,457,414	1.01%	0.74%	86.16%	60.50%	16.35%	23.15%	100.00%
	3D Nonauto	421,057,344	3.00%	2.19%	61.93%	58.76%	19.57%	21.66%	100.00%
	5D Nonauto	358,931,019	2.56%	1.87%	79.86%	85.83%	20.78%	13.41%	100.00%
	MADC Auto	85.590.082	0.61%	0.45%	92.14%	55.44%	15.69%	28.87%	100.00%
	ADC Auto	334,618,618	2.39%	1.74%	94.04%	62.47%	13.78%	23.75%	100.00%
	3D Auto	4,470,785,082	31.88%	23.28%	96.18%	66.16%	12.73%	21.10%	100.00%
	5D Auto	7,998,429,444	57.03%	41.68%	97.08%	80.58%	8.72%	10.70%	100.00%
	Class Total / Aggregate	14,025,889,177	100.00%		95.87%	73.86%	10.95%	15.19%	100.00%
	Flats Total IAggregate	19,200,861,585		100.00%	91.86%	70.41%	13.09%	16.50%	100.00%
	Modified FY 2005 Incoming Secondary Data (Attachment 2)					64.73%	4.40%	30.87%	100.00%
MPA/ANM-LR-2	Basic Nonauto	168,214,698	3.94%	0.88%	79.85%	40.12%	15.99%	43.89%	100.00%
	3D Nonauto	172,270,322	4.04%	0.90%	64.93%	33.31%	21.55%	45.14%	100.00%
	5D Nonauto	223,586,748	5.24%	118%	62.14%	39.42%	26.07%	34.51%	100.00%
	Basic Auto	151,367,760	3.55%	0.79%	82.39%	39.83%	14.73%	45.44%	100.00%
	30 Auto	1,038,021,663	24.34%	5.41%	81.19%	41.25%	15.68%	43.07%	100.00%
	5D Auto	2,511,885,335	58.89%	13.06%	83.31%	53.11%	14.19%	32.70%	100.00%
	Class Total IAggregate	4,265,346,527	100.00%		80.77%	47.72%	15.56%	36.71%	100.00%
TW-LR-2	Basic Nonauto	168,214,698	3.94%	0.68%	79.85%	41.81%	11.83%	46.35%	100.00%
	3D Nonauto	172,270,322	4.04%	0.90%	64.93%	35.39%	15.46%	49.15%	100.00%
	5D Nonauto	223,586,748	5.24%	1.16%	62.14%	41.88%	2.99%	55.13%	100.00%
	Basic Auto	151,367,760	3.55%	0.79%	82.39%	42.32%	14.69%	42.99%	100.00%
	3D Auto	1,038,021,663	24.34%	5.41%	81.19%	43.83%	15.64%	40.53%	100.00%
	5D Auto	2,511,885,335	56.89%	13 08%	83.31%	56.43%	5.27%	38.30%	100.00%
	Class Total / Aggregate	4,265,346,527	100.00%		80.77%	50.67%	8.68%	40.65%	100.00%

1 CHAIRMAN OMAS: This now bring us to oral
2 cross-examination. There have been three requests for
3 oral cross-examination.
4 We will begin with Mr. Levy, the Alliance of
5 Non-Profit Mailers and Magazine Publishers of America.
6 Mr. Levy, you may begin.
7 MR. LEVY: Thank you, Mr. Chairman. Please
8 let me know if I'm too far or too close to the mic.
9 CROSS-EXAMINATION
10 BY MR. LEVY:
11 Q Good morning, Mr. Miller.
12 A Good morning.
13 CHAIRMAN OMAS: I think you need to bring it
14 a little closer.
15 MR. LEVY: Thank you.
16 CHAIRMAN OMAS: You got real soft there for
17 a minute.
18 BY MR. LEVY:
19 Q My questions will cover Section (2)(B) of
20 your testimony. Now, that section concerns incoming
21 secondary coverage factors? That section concerns
22 incoming secondary coverage factors?
23 A Yes.
24 Q And in that section you're rebutting Mr.
25 Glick and Mr. Stralberg?

A Yes, I am.

Q You disagree with them about the cost of sorting flat-shaped periodical mail. Is that correct?

A I disagree with the use of those factors.

Q And your disagreement concerns the estimated cost of the incoming secondary distribution?

A My disagreement doesn't stem from the actual cost for the operation. It stems from using these factors in the cost model.

Q Your disagreement involves the use of those factors to estimate the cost of the incoming secondary distribution?

A In total, yes.

Q Now, the incoming secondary distribution involves the sorting of flats from five-digit zip codes to the carrier route levels. Is that correct?

A Yes.

Q And you disagree with Witnesses Glick and Stralberg over how much of this sorting is done manually?

A I don't know if that's the way I'd phrase it. I disagree with their use of these factors in estimating those costs, but I don't think anybody knows how much is processed in any operation.

Q You disagree with their use of those factors

1 to estimate how much of the sorting is done manually,
2 correct?
3 A Yes.
4 Q And you would have the Commission assume
5 that a smaller percentage of the sorting is done
6 manually than Glick and Stralberg have assumed. Is
7 that correct?
8 A I believe my recommendation was not to
9 include these factors in the model. I didn't
10 specifically say there should be more or less sorting.
11 I just had an issue with the actual use of the data.
12 Q You can't tell the Commission directionally
13 what is the effect of your disagreement with the other
14 two witnesses?
15 A I think I just said that. I don't think
16 that those factors should be used in the cost model.
17 That was the extent of my disagreement.
18 Q Well, Mr. Stralberg's cost model assumes
19 that 40 percent of incoming secondary flats are
20 manually sorted. Isn't that right?
21 A No, that's not correct. That's the result
22 of the assumptions and the factors that are in his
23 model.
24 He doesn't make an assumption that 40
25 percent are processed in that operation. That's a

1 result of all the inputs in the cost model such as the
2 fact that he put those arbitrary factors in, which I
3 didn't use in mine.
4 Q The result of Mr. Stralberg's factors is to
5 assume that 40 percent of the incoming secondary flats
6 are manually sorted, correct?
7 A Well, that's the result. I wouldn't call it
8 an assumption.
9 Q But the answer to my question is yes?
10 A The 40 percent was the result.
11 Q And with Mr. Glick's model the result is 36
12 percent?
13 A I believe that was the result from his
14 model, yes.
15 Q And in your rebuttal testimony the result is
16 slightly less than 31 percent?
17 A Are you referring to Attachment 2?
18 Q Yes, the next to the last line.
19 A Well, you're comparing the results from
20 their models to something that's not the cost model,
21 but the number that was in Attachment 2 is slightly
22 less than 31 percent.
23 Q And that number represents an estimate of
24 the incoming secondary flats that are manually sorted?
25 A It's not an estimate that I use anywhere.

1 Attachment 2 was something I provided to show the
2 figures that both Witness Glick and Witness Stralberg
3 had been citing were incorrect.
4 Q But if the Commission adopted the inputs and
5 assumptions that you recommend they would get a value
6 of slightly under 31 percent?
7 A No, because I didn't use these factors in my
8 cost model.
9 Q Are you testifying that the factors in
10 Attachment 2 are the best available estimate of those
11 factors?
12 A I don't know if I would describe it that
13 way. Attachment 2 was something I provided to show
14 that a figure that Witness McCrery provided in
15 response to MPA/USPS-T42-1(a), to show that that
16 number was not correct.
17 Q And 30.87 is your best estimate of the
18 correct value?
19 A If someone wanted to use this data for any
20 purpose I would say that is a better estimate, but, as
21 I said in my testimony, I don't think anybody really
22 knows what the percentages actually are.
23 Q Now let's go to Mr. McCrery. He's testified
24 in this case that in fiscal year 2005 44.7 percent of
25 incoming secondary flats were finalized in manual

1 operations in the field. Is that correct?
2 A That was his response to the interrogatory I
3 just mentioned.
4 Q And that response became his testimony when
5 he adopted the interrogatory on the witness stand?
6 A I assume so.
7 Q And both Mr. Glick and Mr. Stralberg relied
8 to some extent on that interrogatory answer in
9 defending their values of 40 and 36 percent, correct?
10 A I think they used it as justification for
11 putting these factors into their models, but they
12 didn't actually use those data for anything.
13 Q Now, you've criticized Glick and Stralberg
14 for relying on the 44.1 percent figure. Is that
15 correct?
16 A Well, I think I made it known that I didn't
17 agree. I disagreed as far as using these sorts of
18 factors when it comes to including those in a cost
19 model, but I did criticize them for using that value
20 when it should have been obvious that there's
21 something wrong with that data.
22 Q You've labeled their reliance on the 44.1
23 percent value a results-driven approach?
24 A Yes. I think when you put arbitrary factors
25 in a cost model and then gauge the results and compare

it to a figure like the 44.7 percent that I've shown as wrong, I think that's results-driven.

Q At the risk of belaboring the obvious, your testimony is that's a bad thing to do?

A It's not what I would have done. I just disagree with their use of those factors.

Q Well, in fact you've testified that it should be rejected for that reason, haven't you?

A Yes.

Q Now, the Postal Service doesn't use results-driven approaches to its cost modeling in the same sense?

A I can't think of any instances similar to this one, no.

Q Let me give you a definition of results-driven which I will then follow up with a question.

The definition of results-driven is to defend the reasonableness of an intermediate step in a cost model on the ground that the end result is reasonable by some outside measure.

Do you understand that definition?

A Could you repeat that?

Q Yes. The definition of results-driven: To defend the intermediate step in a cost model on the ground that the end result produces a reasonable

value.

A I guess that's one interpretation.

Q If the Postal Service or any other party were to follow a results-driven approach in that sense would you urge the Commission to reject it?

A I think you'd have to look at that at a case-by-case basis.

I mean, if the factors that both witnesses have put in their cost models, if there was something you could look at to say those were reasonable in terms of what they're supposed to represent that would be one thing, but I'm not aware of any data that you could use for that purpose.

Q So if there are no data to defend the reasonableness of the intermediate value you would urge the Commission to reject the use of those values if they were defended solely on the basis of the reasonableness of the end result?

A I think I lost you on that question.

Q All right. In any event, your criticism of Glick and Stralberg's reliance on the 44.7 percent value is the main focus of your disagreement with their proposed values?

A Well, that in conjunction with putting the factors in the model in the first place.

1 Q Will you turn to your rebuttal testimony at
2 page 3? Would you go to line 12 and let me know when
3 you're there?
4 A I'm there.
5 Q I'm going to read it. "The main focus of
6 this disagreement concerns Witness McCrery's response
7 to MPA/USPS-T42-1(a)," transcript citation," in which
8 it was estimated that 44.7 percent of flats are
9 finalized in manual incoming secondary operations."
10 Did I read that correctly?
11 A Yes.
12 Q And that's still your testimony?
13 A Yes.
14 Q Beginning on page 4 of your rebuttal
15 testimony you try to discredit the 44.7 percent
16 figure?
17 A Yes.
18 Q And that effort continues from page 4
19 through page 8?
20 A Yes.
21 Q And you're also rebutting the 44.7 percent
22 value in Attachment 2 to your testimony?
23 A Yes.
24 Q And in Attachment 3?
25 A Yes, the results were in Attachment 3 as

1 well.

2 Q So when you're rebutting Glick and Stralberg

3 you're also rebutting another Postal Service witness,

4 aren't you?

5 A I don't know what you're referring to.

6 Q You're rebutting Mr. McCrery, aren't you,

7 too?

8 A Because of the 44.7 percent?

9 Q Yes.

10 A I don't really know how to respond to that

11 other than to say that that figure is not accurate.

12 Q But that figure was sponsored by your fellow

13 witness, wasn't it?

14 A Yes.

15 MR. LEVY: I'd like to if I may approach the

16 witness?

17 (Pause.)

18 MR. LEVY: For the record, Mr. Chairman,

19 I've handed the witness a copy of the Postal Service's

20 response to MPA/USPS-T42-1 as reproduced in the

21 transcript at page 2853.

22 I had put a cross-examination exhibit

23 marking on it this morning, but since it's already in

24 the record unless there's a desire I am not going to

25 mark it separately as an exhibit.

1 CHAIRMAN OMAS: Without objection.
2 BY MR. LEVY:
3 Q You recognize this interrogatory response?
4 A Yes.
5 Q And this is the source of the 44.7 percent
6 value, correct?
7 A Yes.
8 Q Now, is there anything on this response at
9 again page 2853 of the transcript that puts
10 Intervenors on notice that the 44.7 percent figure
11 overstates the percentage of all flats that are
12 finalized manually?
13 A Yes. The 29 billion total pieces that are
14 processed through incoming secondary flat volumes.
15 Q The people who read it should have realized
16 that that was anomalous because it was at odds with
17 other data? Is that your point?
18 A Yes.
19 Q But page 3853, the interrogatory answer,
20 doesn't point that out, does it?
21 A No.
22 Q And there was nothing in the Postal Service
23 file at the time that pointed that out, was there?
24 A Not that I'm aware of.
25 Q In fact, the Postal Service didn't point it

1 out until your rebuttal testimony, did it?
2 A Not that I'm aware of. All I know is that I
3 put it in my testimony.
4 Q Now would you go to page 3 of your rebuttal
5 testimony? I'm going to focus on line 17. Again,
6 page 3, line 17. Let me know when you're there.
7 A I'm there.
8 Q There you state, "The information provided
9 in response to MPA/ANM-T42-1(a) was taken from an
10 analysis produced annually as a means to gauge
11 incoming secondary flats processing improvement."
12 Did I read that correctly?
13 A Yes.
14 Q Now, in fact there is a typo in what I just
15 read in that the actual interrogatory was MPA/USPS
16 rather than MPA/ANM?
17 A Yes, that's correct.
18 Q In any event, we're talking about the same
19 interrogatory answer that's reproduced on page 2853 of
20 the transcript?
21 A Yes.
22 Q I want to focus on the analysis, the annual
23 analysis to which you refer. Who at the Postal
24 Service receives these annual analyses?
25 A I have no idea. That would be something

1 someone in Operations would have to ask or answer.
2 Q Do you know what departments receive the
3 analyses?
4 A No.
5 Q Do you know what the Postal Service does
6 with the analyses?
7 A No.
8 Q But you believe that they're used in some
9 way to help the Postal Service run its business?
10 A It's my understanding it's used to evaluate
11 year-to-year what percent of mail are processed on the
12 machines.
13 Q Why would the Postal Service management want
14 to know that?
15 A That's all my understanding is of what the
16 report is developed for. I can't answer for
17 management.
18 Q Did you try to find out?
19 A That wasn't really a point I was making in
20 my testimony. I was just trying to explain what the
21 data are used for.
22 Q So you didn't ask?
23 A I didn't conduct an in-depth study of trying
24 to find out what the data were used for, no.
25 Q You didn't pick up the phone and ask anyone?

1 A No.

2 Q Now I'm going to introduce another document,

3 again a page from a transcript, page 2888.

4 Mr. Miller, do you recognize the document

5 I've just handed you?

6 A Yes.

7 Q And for the record, it's page 2888 of the

8 hearing transcript which reproduced Witness McCrery's

9 answer to MPA/USPS-T42-20.

10 Now, the answer to part (c) states that,

11 "The national FLASH system (FLASH) is a weekly

12 operating reporting management system. FLASH combines

13 critical data from all functions and produces a one-

14 page overview of the status of an organization."

15 Do you see that?

16 A Yes.

17 Q Do you know who at the Postal Service

18 receives these weekly reports?

19 A No. No, I don't.

20 Q Do you know why the data are considered

21 critical?

22 A No.

23 Q Do you know what use the Postal Service

24 makes with the information in the reports?

25 A I personally don't know.

1 Q Do you have any reason to doubt that the
2 Postal Service uses the reports in the management of
3 its business?
4 A I don't know what the reports are actually
5 used for.
6 Q Did you try to find out?
7 A No.
8 Q Now would you go to Attachment 2 of your
9 testimony?
10 Now, according to the information used by
11 the Postal Service to gauge incoming secondary flats
12 processing improvement and obtain a status of the
13 organization, 13.2 billion flats were finalized
14 manually in fiscal year 2005. Is that correct?
15 I'm sorry, Mr. Miller. I think I'm
16 misleading you. That number I just read comes from
17 page 2853 of the transcript, the third line of the
18 response to (a). Do you see that?
19 A Could you repeat the question?
20 Q Okay. Approximately 13.2 billion flats were
21 finalized manually in fiscal year 2005. Isn't that
22 correct?
23 A That's what the response says.
24 Q And in your Attachment A it also appears in
25 the middle column or the second column?

1 A I'm sorry? Which attachment was that?
2 Q Your attachment to Group B Finalization Rate
3 Original. Do you see that? Do you see the Group B
4 Finalization Rate Original on the left-hand column?
5 A Yes.
6 Q And if you go to the second column in that
7 row opposite the word Manual you'll see a number
8 that's about 13.2 billion.
9 A Yes.
10 Q And that's the same number as appeared in
11 transcript page 2853?
12 A Yes.
13 Q And that number of 13.2 billion represents
14 the number of flats that were finalized manually in
15 fiscal year 2005?
16 A That section of Attachment 2 was to show
17 where the actual figures were derived from Witness
18 McCrery's response.
19 Q Okay.
20 A And that figure is from the FLASH report as
21 it says.
22 Q You believe, however, that only 7.3 billion
23 flats were finalized manually in that year, correct?
24 A Well, again the function of this attachment
25 was to show that the numbers that had frequently been

1 cited were not correct, and I think as I said in my
2 testimony no one really knows what the percentages
3 are.
4 I don't know if the way you described it is
5 what I would say, but I think it's generally believed
6 that the FLASH volumes are high. The extent to which
7 they are I don't know.
8 Q Would you go to Group D of your Attachment
9 2, which is the bunch of lines at the bottom? Do you
10 see that?
11 A Yes.
12 Q And that has a caption Finalized Rate
13 Adjusted No PP and MM/LM. Do you see that?
14 A Yes.
15 Q And if you go to the volume numbers in the
16 second column there is a volume for Manual. Do you
17 see that?
18 A Yes.
19 Q And the volume is approximately 7.3 billion
20 pieces?
21 A Yes.
22 Q And that represents a volume of flats that
23 were sorted manually?
24 A It was the last series in the adjustments I
25 made in this attachment to show that the original 44.7

1 percent figure was not correct, and that would have
2 been after the two adjustments I made.
3 That would have been manual volume if you
4 make those adjustments and assume they're right.
5 Q But it's your testimony that the 7.3 billion
6 figure that results from those adjustments is a more
7 reasonable value than the 13.2 billion figure used by
8 McCrery, correct?
9 A I think in this attachment I'm really saying
10 it could be, but no one knows.
11 Q But your best testimony is 7.3 billion and
12 not --
13 A Well, I'm not trying to use, you know, this
14 estimate for anything really in my own testimony or in
15 the cost models that I sponsor.
16 I was just trying to show that there were
17 issues with the figure they used. That's what the
18 purpose of this attachment was.
19 Q My question isn't whether you were using it,
20 but whether you were offering it as a more reasonable
21 value than the 13.2 billion.
22 A If someone were going to use this for any
23 purpose I would say it's a more reasonable value.
24 Q And it's a value that is slightly more than
25 half of the 13 billion figure, correct?

1 A I'm sorry. Could you repeat that?
2 Q The 7.3 billion is a little more than half
3 of 13.2 billion, correct?
4 A Yes.
5 Q So it's your testimony that if Postal
6 Service management relies on the 13.2 billion figure
7 for internal reporting purposes the Postal Service is
8 relying on a figure that's about 80 percent
9 overstated?
10 A I don't believe that's what I'm saying in
11 this attachment.
12 I'm saying that there's some issue with this
13 data, and therefore I don't think it should be used
14 for the purpose that Witness Glick and Witness
15 Stralberg were trying to use it. What the
16 discrepancies really are, no one knows.
17 Q When was Attachment 2 created?
18 A When I was preparing my rebuttal testimony.
19 Q So that would have been some point after
20 September 6?
21 A I'm not sure exactly what date I did it. It
22 was sometime this fall. I'm not really sure exactly
23 when.
24 Q Well, would it help if it turned out that
25 Intervenor testimony was filed on September 6?

1 A Well, it would have been after that, yes.
2 Q And Attachment 2 was created for use in this
3 case, wasn't it?
4 A Yes.
5 Q It's not used for internal management of the
6 Postal Service, is it?
7 A NO.
8 Q The same is true of Attachment 3?
9 A That was just created to support my
10 testimony.
11 Q And again is not used for management of the
12 Postal Service's business, is it?
13 A No.
14 Q Now go to Section A if you would of
15 Attachment 2. That's the one entitled Flats Category.
16 Do you see that?
17 A Yes.
18 Q One of the rows on the left-hand column is
19 called Periodicals Outside County (CR). Do you see
20 that?
21 A Yes.
22 Q CR is an acronym standing for carrier route?
23 A Yes.
24 Q And the volume figure corresponding to that
25 row is 376 million and change?

A Yes.

Q And you calculated that 376 million figure by multiplying two numbers. One of them was the total number of periodicals outside county carrier route flats. Is that correct?

A Yes.

Q And the other number is the percentage of those flats that will require an incoming secondary sort, correct?

A No, that's not correct.

Q What is the second number?

A It was taken from the cost model for that specific rate category, and it represents basically the number of pieces that were in broken bundles and therefore ended up in piece distribution operations at plants.

Q Okay. So flats that are sorted to the carrier routes sometimes require an incoming secondary sort because the bundles break?

A Yes.

Q And once the bundles break the individual pieces have to be sorted?

A Yes.

Q Now, Attachment 2 includes no volume for standard mail enhanced carrier route or ECR flats. IS

1 that correct?

2 A That's correct, and I believe that's what I

3 stated when I first came up to the stand; that it

4 should have been in there.

5 Q Let's try to get a sense of what should have

6 been in there. In fiscal year 2005, the Postal

7 Service carried about 24 billion pieces of standard

8 mail commercial ECR flats. Does that sound right?

9 A I don't know the exact figure.

10 MR. LEVY: If I may approach the witness?

11 (Pause.)

12 MR. LEVY: Let me first identify the

13 exhibit, which I would like to have marked as MPA-X-1,

14 and then I'll explain to the witness the purpose of

15 this.

16 CHAIRMAN OMAS: Without objection.

17 (The document referred to was

18 marked for identification as

19 Exhibit No. MPA-X-1.)

20 BY MR. LEVY:

21 Q I'll represent that MPA-X-1 is a page from

22 Postal Service Library Reference LR-L-36 entitled

23 WP-STD ECR-8.

24 I'm going to walk you through this, Mr.

25 Miller to try to convince you that about 12 billion

1 pieces of standard mail ECR flats processed by the
2 Postal Service in 2005 were ECR basic flats. That's
3 the purpose of this line of questioning.
4 Now, this exhibit, MPA-X-1, shows base year
5 2005 commercial ECR flat volumes by shape and rate
6 category. Is that correct?
7 A Yes, that's correct.
8 Q And you see the Total Pieces column that's
9 about four columns or five columns from the right?
10 A Yes.
11 Q Order of magnitude, if you sum up the volume
12 figures for flats, which are in the middle rows -- let
13 me walk you through that.
14 You see there are three volume numbers in
15 that column for flats. The first one is 11, almost 12
16 billion pieces. Do you see that?
17 A Yes.
18 Q And the second one is about 1.8 billion
19 pieces. Do you see that?
20 A Yes.
21 Q And the third one is about 10.5 billion
22 pieces. Do you see that?
23 A Yes.
24 Q And they sum up to roughly 24 billion?
25 A Yes.

Q And the same page shows that about 12 billion of those pieces were commercial ECR basic flats. That's the first of the three numbers.

A Yes.

Q And you've agreed a moment ago that standard mail commercial ECR flats can break?

A Yes.

Q And that when they break they require an incoming secondary piece sort?

A I should say standard ECR flats that are in bundles that need to be sorted can break.

Q Thank you. Attachment 2, besides including standard mail commercial ECR flats, should have included some volumes for standard mail nonprofit ECR flats because their bundles can break too?

A You said nonprofit?

Q Yes.

A I believe the nonprofit and commercial are both part of regular, standard mail regular.

Q Look at the top line of Exhibit MPA-X-1, the left-hand side. It says Standard Mail Commercial. Do you see the word commercial?

A Yes.

Q So that would not include nonprofit, would it?

1 A No.

2 Q But there should be some volumes

3 representing nonprofit ECR flats whose bundles break?

4 A Yes.

5 Q And likewise, Attachment 2 should have

6 included some volumes for periodicals within county

7 carrier route flats that have broken bundles?

8 A To the extent there are any that require

9 bundle processing, yes.

10 Q Would you go back to Attachment 2, Section

11 C? Do you see the row labeled Manual?

12 A Yes.

13 Q And likewise in Group D there is a row

14 labeled Manual?

15 A Yes.

16 Q In the right-hand column of each of those

17 rows is the legend Adjusted Value. Do you see that?

18 A Yes.

19 Q You estimated the adjusted value for manual

20 by subtracting the difference between the total rows

21 in Section A and B from the manual volume shown in

22 Section B?

23 A I'm sorry. What specific figure are you

24 talking about?

25 Q Sure. You start with the 30.97 percent

1 figure. I'm sorry. You start with the 13.2 billion
2 figure, and then from that you would subtract the
3 difference between the 29.5 billion figure and the
4 23.6 billion figure at the bottom of Group A?
5 A Yes.
6 Q So to the extent that the total fiscal year
7 2005 RPW pieces figure is understated for the reasons
8 we've just discussed, the manual figures in Sections C
9 and D are also understated?
10 A If you revise Attachment 2 they would
11 increase, those percentages.
12 Q And if I understand your last answer, the
13 percentage of flats that are finalized in manual
14 operations is also understated?
15 A That's what I was referring to.
16 MR. LEVY: Thank you.
17 For the record, I've handed the witness a
18 one-page page of numbers that I would like to have
19 marked as MPA-X-2.
20 CHAIRMAN OMAS: Without objection.
21 (The document referred to was
22 marked for identification as
23 Exhibit No. MPA-X-2.)
24 BY MR. LEVY:
25 Q Mr. Miller, you first saw a document with

1 these numbers a couple of days ago?

2 A Yes.

3 Q And this is a cross-examination exhibit that

4 you obtained from me through your lawyer?

5 A I assume so, yes.

6 Q Have you had a chance to look at it?

7 A Yes.

8 Q Now, MPA-X-2 is an adjusted version of your

9 Attachment 2, isn't it?

10 A There have been modifications made to it

11 yes.

12 Q Let's walk through those modifications. In

13 MPA-X-2 there is a line marked Standard Mail

14 Commercial ECR Basic within Group A, correct?

15 A Yes.

16 Q That is about the seventh line in Category

17 A, the seventh or eighth, correct?

18 A Yes.

19 Q And the volume in that line is a little more

20 than 1.1 billion pieces. Do you see that?

21 A Yes.

22 Q And the percentage associated with that is

23 4.61 percent?

24 A Yes.

25 Q And one would obtain these values by

1 assuming that 9.54 percent of commercial ECR basic
2 flats required an incoming secondary source, correct?
3 A I don't know. I didn't complete this
4 analysis.
5 Q Will you accept that subject to check?
6 A Yes.
7 Q And in fact you did assume for periodicals
8 outside county carrier route flats that 9.54 percent
9 of the flats required an incoming secondary sort?
10 A Well, in that case there is an actual cost
11 model for that rate category, and that was the percent
12 of mail pieces that ended up being processed through
13 piece distribution operations. I don't believe we
14 have any ECR comparable model.
15 Q The value for periodicals appears in the
16 parentheses as the very right-hand number in the line
17 for periodicals outside county CR?
18 A Yes.
19 Q Have you seen any evidence to indicate that
20 for standard mail commercial ECR basic the rate of
21 bundle breakage is lower than the one that produced
22 the 9.54 value?
23 A We have very limited bundle breakage data
24 that are used in the cost models, and they're used for
25 all classes.

However, the mail characteristics also have an impact on how much is processed through piece distribution operations.

Q But you've seen no data to indicate that the value for standard mail commercial ECR basic is lower than the rate for periodicals outside county carrier route?

A Not bundle breakage factors, no.

Q Adopting the 9.54 percent value for standard mail commercial ECR basic increases the percentage of flats that are finalized manually from 3.87 percent to 34.2 percent? 34.06 percent. Excuse me.

A I'm sorry. Could you repeat that question?

Q Let me state it differently. Adding that one line in Group A, the flats category, with a 9.54 percent value has the effect of raising the percent figure in the manual line for Group D up to 34.06 percent, correct?

A If you make the adjustments in that exhibit you provided me, the manual percentage in Section D of Attachment 2 increases from 30.87 percent to 34.06 percent.

Q And the manual percentage would increase further if one were to make a further adjustment for periodicals within county carrier route flats?

1 A It could possibly, but the volume is much
2 smaller.
3 Q But the direction of the change would be to
4 increase the percentage?
5 A It would increase it, but I believe it would
6 increase it a much smaller amount.
7 Q And the manual percentage would also
8 increase if standard mail nonprofit ECR flats were
9 included in the calculations?
10 A I would assume so, yes.
11 Q And likewise if standard mail commercial ECR
12 high density flats were included in the calculation?
13 A To the extent any of those mail pieces or
14 any of those mailings have bundles that need to get
15 processed and then the bundles break, that would be
16 true.
17 Q Do those mail come in bundles for
18 processing?
19 A The reason I said what I did is because I
20 haven't seen the mail characteristics data.
21 Q So you don't know?
22 A It would depend on the container and bundle
23 presort level, and I haven't seen ECR.
24 Q You don't know whether they come in bundles?
25 A Well, they come in bundles, but I don't know

1 whether it would be something that would require
2 sorting.
3 To the extent they require any sorting at
4 the plants and the bundles break and the mail pieces
5 end up being processed in piece distribution
6 operations, what you're saying is true.
7 Q And the same is true if one were to include
8 standard mail commercial ECR saturation flats in the
9 calculations?
10 A Well, I would repeat what I just said
11 before. The same thing would apply.
12 Q Thank you. Now, I have one more question
13 about your Attachment 2. Early in the questioning did
14 I give you a copy of transcript page 2888? I can't
15 remember whether I did or not.
16 A Yes, you did.
17 Q Now, that for the record is Mr. McCrery's
18 response to MPA/USPS-T42-20.
19 In answer to parts (a) and (b) of that
20 interrogatory Mr. McCrery confirmed that the 44.7
21 percent figure was calculated by dividing the total
22 number of manual incoming secondary sorts by the total
23 number of all incoming secondary sorts.
24 Do you agree with how the 44.7 percent
25 figure was derived?

1 A Which part of this interrogatory response?
2 Q (a) and (b).
3 A I believe he confirmed that those are the
4 values. He didn't confirm arithmetic calculation.
5 Q Well, just looking at it if you divided 13.1
6 billion into 29.5 billion you would get about 45
7 percent, wouldn't you? I'm not holding you to the
8 precise number.
9 A You can see that on Attachment 2, Section B.
10 Q Okay.
11 A Yes, that's true.
12 Q That's the ratio of those two numbers?
13 A Yes.
14 Q Now, in fact a given flat may require
15 sometimes more than one incoming secondary sort.
16 Isn't that true? For instance, when the flat is
17 rejected by the machine during the first attempted
18 sort.
19 A Yes, that's possible.
20 Q So the number of incoming secondary sorts
21 could exceed the number of flats that require an
22 incoming secondary sort. Isn't that right?
23 A I'm sorry. Could you repeat that question?
24 Q Sure. Because a given flat may require more
25 than one incoming secondary sort, the total number of

1 incoming secondary sorts would exceed the number of
2 flats that get an incoming secondary sort, correct?
3 A Yes, that's true.
4 Q Thank you. Now would you go to Attachment 3
5 to your testimony?
6 Now, in this attachment you show
7 finalization rates from USPS Library Reference L-43,
8 your cost model, or the Postal Service's cost model,
9 and finalization rates from Mr. Glick's cost model and
10 the finalization rates for Mr. Stralberg's cost model
11 and also from your Attachment 2 analysis. Is that
12 correct?
13 A Yes.
14 Q Now I'd like you to look at the column that
15 is marked Manual, which is the second column from the
16 right. Do you see that?
17 A Yes.
18 Q Now, according to the analysis you performed
19 in Attachment 2, slightly under 31 percent of all
20 flats that require an incoming secondary sort will be
21 finalized manually. That's what the number means,
22 correct?
23 A Yes.
24 Q And according to the calculations in Cross-
25 Examination Exhibit MPA-X-2, the figure would be about

34 percent, right?

A Yes, that's correct.

Q And even this figure doesn't include all of the carrier route flats that will require an incoming secondary sort because of bundle breakage, correct?

A That's correct.

Q The percent of flats that require an incoming secondary sort for periodicals outside county mail is higher than the overall average, isn't it?

A Did you say an incoming secondary manual sort?

Q If I didn't, I should have.

A Yes, that's correct.

Q I left one page out. Would you go to page 12 of your rebuttal testimony? I direct your attention to line 16.

There you describe something called MODS, M-O-D-S, Operation No. 035. Do you see that?

A Yes.

Q Now, that refers to the flats preparation cost pool, correct?

A Yes.

Q And that cost pool covers the cost of flat mail carts prepping activities, correct?

A Yes.

1 Q And beginning on line 20 of page 12 you
2 state:
3 "I classified this cost pool as fixed
4 because the costs do not generally vary for the
5 noncarrier route rate categories. In addition, future
6 modifications are likely to reduce the flats
7 preparation cost differences between carrier route and
8 noncarrier route mail."
9 Do you see that?
10 A Yes.
11 Q So today there is a difference between the
12 flats preparation costs for carrier route and
13 noncarrier route mail, correct?
14 A Correct.
15 Q And the flats preparation cost for
16 noncarrier route mail is higher than for carrier route
17 mail?
18 A That's true.
19 Q Is that correct?
20 A That's true.
21 MR. LEVY: Thank you. That's all I have,
22 Mr. Miller.
23 I would move Cross-Examination Exhibits 1
24 and 2 into evidence.
25 CHAIRMAN OMAS: Thank you. I was going to

1 ask if you wanted them.

2 We will move MPA Exhibit 1 and 2 into

3 evidence.

4 MR. LEVY: Thank you.

5 CHAIRMAN OMAS: Thank you, Mr. Levy.

6 (The documents referred to,

7 previously identified as

8 Exhibit Nos. MPA-X-1 and

9 MPA-X-2, were received in

10 evidence.)

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MPA-X-1

USPS-T-36
WP-STDECR-8

Standard Mail Commercial ECR Pieces and Pounds--Base Year

	Piece-Rated Pieces				Pound-Rated Pieces				Total Pieces	Pound-Rated Pounds			
	Origin	DBMC	DSCF	DDU	Origin	DBMC	DSCF	DDU		Origin	DBMC	DSCF	DDU
Letters[1]													
Basic	297,003,239	295,429,418	1,049,115,084	156,140,111		4	1,703,062	1,310,209	1,797,687,852	249,701	100,805	505,050	408,301
Automation Basic	234,730,138	563,089,568	1,191,493,068	43,825,825	791,120	389,4	7,432,583	4,927,698	2,037,332,764	45,480	3,959	1,911,355	1,797,651
High Density	29,435,417	54,758,368	391,256,201	51,788,857	179,944	13,5	86,294,947	17,810,833	539,792,529	371,526	43,206	20,462,868	5,273,743
Saturation	204,274,935	267,074,666	2,079,304,683	628,386,949	1,356,877	113,			3,284,617,045				
Flats[2]													
Basic	313,335,414	922,983,999	4,648,106,438	142,755,102	164,242,924	651,080,1	5,008,560,728	116,735,417	11,967,800,422	55,810,221	201,603,910	1,584,017,092	43,044,633
High Density	17,975,675	24,036,917	503,210,053	284,869,561	4,603,235	9,650,1	363,246,876	590,482,687	1,798,075,746	1,520,168	2,435,393	131,865,346	225,948,221
Saturation	187,154,355	157,291,830	2,728,030,241	3,896,948,921	41,827,460	6,975,	723,497,298	2,798,759,974	10,540,485,658	13,814,168	2,175,665	216,639,602	882,489,672
Parcels[3]													
Basic	158,170	14,744	42,208	4,994	198,916	5	37,099	18,957	489,033	102,012	4,004	12,030	11,565
High Density	37	-	5,237	1,836	1,307		3,096	6,195	17,707	323	-	1,077	3,333
Saturation	7,269	28	22,938	2,523	19,710	13,14	20,013	53,119	125,613	10,369	4	16,511	33,187

Total ECR Commercial Pieces	31,966,424,371
Total ECR Commercial Pound-Rated Pounds	3,392,732,152

Notes

[1] Pieces and pounds from billing determinants: from ECR Commercial BDs Sheet

[2] Piece-Rated Pieces: (Nonletters volumes by density level from ECR Commercial BDs Sheet) minus
(RSS-piece volumes by density Level from ECR Commercial BDs Sheet)
Pound-Rated Pieces, Pound-Rated Pounds: (Nonletters volumes (or pounds) by density level from ECR Commercial BDs Sheet) minus
(Pound-Rated Letters volumes (or pounds) by density Level from ECR Commercial BDs Sheet) minus
(RSS-piece volumes (or pounds) by density Level from ECR Commercial BDs Sheet)

[3] Pieces and pounds from billing determinants (for RSS pieces): from ECR Commercial BDs Sheet

"USPS-RT-8 ATTACHMENT 2" (MODIFIED): FY 2005 FLATS MAIL VOLUMES AND ESTIMATED INCOMING SECONDARY FINALIZATION RATES

Flats Category	FY 2005 RPW Pieces		Source
First-Class Mail single-piece	3,572,195,284	14.42%	USPS-LR-L-87
First-Class Mail presort	909,625,881	3.67%	USPS-LR-L-32
Periodicals Outside County (Non-CR)	4,265,346,527	17.22%	USPS-LR-L-91
Periodicals Outside County (CR)	376,064,469	1.52%	USPS-LR-L-91 (* 0.0954)
Periodicals Inside County (Non-CR)	180,028,444	0.73%	USPS-LR-L-87
Standard Mail Regular (Non-ECR)	14,025,889,177	56.62%	USPS-LR-L-92
Standard Mail Commercial ECR Basic	1,141,728,160	4.61%	USPS-LR-L-36, WP-STDECR-8 (*.0954)
Parcel Post	3,157,972	0.01%	USPS-LR-L-87
Bound Printed Matter	269,142,744	1.09%	USPS-LR-L-87
Media Mail / Library Mail	30,579,077	0.12%	USPS-LR-L-87
Total	**24,773,757,735**	**100.00%**	

B. Finalization Rate (Original)	FY 2005 Estimated Pieces	Percent	Source
AFSM100	15,275,731,000	51.78%	MODS/EOR
UFSM1000	1,037,685,000	3.52%	MODS/EOR
Manual	13,188,243,000	44.70%	FLASH
Total	**29,501,659,000**	**100.00%**	

C. Finalization Rate (Adjusted)	FY 2005 Estimated Pieces	Percent	Source
AFSM100	15,275,731,000	61.66%	MODS/EOR
UFSM1000	1,037,685,000	4.19%	MODS/EOR
Manual	8,460,341,735	34.15%	ADJUSTED VALUE
Total	**24,773,757,735**	**100.00%**	

D. Finalization Rate (Adjusted - No PP & MM/LM)	FY 2005 Estimated Pieces	Percent	Source
AFSM100	15,275,731,000	61.75%	MODS/EOR
UFSM1000	1,037,685,000	4.19%	MODS/EOR
Manual	8,426,604,686	34.06%	ADJUSTED VALUE
Total	**24,740,020,686**	**100.00%**	

1 CHAIRMAN OMAS: Mr. Burzio, would you
2 introduce yourself, please, for the record?
3 MR. KEEGAN: It's Mr. Keegan who's going to
4 be doing the work today, Mr. Chairman.
5 CHAIRMAN OMAS: I'm sorry, sir.
6 MR. KEEGAN: Mr. Burzio is sitting here to
7 protect me from myself.
8 CHAIRMAN OMAS: Well, it's good that you
9 have someone to protect you.
10 **CROSS-EXAMINATION**
11 BY MR. KEEGAN:
12 Q Mr. Miller, I'd like to begin by just
13 picking up on a couple of things that Mr. Levy was
14 pursuing with you.
15 I don't know if Priority Mail was mentioned
16 among all of those categories, but I assume that that
17 would also be a category in which you would expect to
18 find some volume in the incoming secondary, the flats
19 incoming secondary?
20 A That I'm not really sure about because
21 Priority Mail is often separated and kept isolated
22 from the rest of the mail, but it's possible that some
23 could be processed on flats machines.
24 Q And I'm sure that Mr. Levy did not mention
25 international mail, penalty mail? Would you expect

1 the same in those cases?

2 A Those I don't know about. I'm not really

3 sure.

4 Q And how about parcel post and media mail?

5 A Parcel post and media mail? I in Attachment

6 2 assume that they would be processed with the rest of

7 the mail in that mail stream since they go through

8 generally different facilities.

9 Q Was that yes, they would be found in the

10 income secondary flats?

11 A No.

12 Q No? Okay. Do you have with you Mr.

13 Stralberg's interrogatory responses?

14 A Yes, I do.

15 Q And would you take a look at the response to

16 USPS/TW-T2-6? I'm referring especially to page 3 of

17 that response. Do you see a table there headed AFSM

18 Incoming Secondary Tallies by Subclass?

19 A Yes.

20 Q Does that table purport to be a

21 representation of IOCS tallies that were observed in

22 the incoming secondary operation for flats?

23 A Yes.

24 Q And does it show volumes for parcel post,

25 media mail, Free for the Blind, international mail?

1 A It shows tallies.

2 Q Well, would you expect there to be tallies

3 with zero volumes?

4 A I'm not an expert on tallies. All I know is

5 it shows tallies.

6 MR. KEEGAN: Okay. Mr. Chairman, I'm going

7 to be spending a lot of time as well on Attachments 2

8 and 3 to Mr. Miller's testimony.

9 I'd like to suggest that it might be

10 appropriate to make that a cross-examination exhibit

11 and transcribe it in the record at this point because

12 I think it would make it easier for people who resort

13 to the transcript later.

14 CHAIRMAN OMAS: Without objection.

15 MR. KEEGAN: Mr. Chairman, all this is that

16 I've handed out is a photocopy of Attachments 2 and 3

17 to Mr. Miller's testimony marked as TW-XE-1.

18 (The document referred to was

19 marked for identification as

20 Exhibit No. TW-XE-1 and was

21 received in evidence.)

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ATTACHMENT 2: FY 2005 FLATS MAIL VOLUMES AND ESTIMATED INCOMING SECONDARY FINALIZATION RATES

A. Flats Category	FY 2005 RPW Pieces		Source
First-Class Mail single-piece	3,572,195,284	15.12%	USPS-LR-L-87
First-Class Mail presort	909,625,881	3.85%	USPS-LR-L-32
Periodicals Outside County (Non-CR)	4,265,346,527	18.05%	USPS-LR-L-91
Periodicals Outside County (CR)	376,064,469	1.59%	USPS-LR-L-91 (* 0.0954)
Periodicals Inside County (Non-CR)	180,028,444	0.76%	USPS-LR-L-87
Standard Mail Regular (Non-ECR)	14,025,889,177	59.35%	USPS-LR-L-92
Parcel Post	3,157,972	0.01%	USPS-LR-L-87
Bound Printed Matter	269,142,744	1.14%	USPS-LR-L-87
Media Mail / Library Mail	30,579,077	0.13%	USPS-LR-L-87
Total	**23,632,029,575**	**100.00%**	

B. Finalization Rate (Original)	FY 2005 Estimated Pieces	Percent	Source
AFSM100	15,275,731,000	51.78%	MODS/EOR
UFSM1000	1,037,685,000	3.52%	MODS/EOR
Manual	13,188,243,000	44.70%	FLASH
Total	**29,501,659,000**	**100.00%**	

C. Finalization Rate (Adjusted)	FY 2005 Estimated Pieces	Percent	Source
AFSM100	15,275,731,000	64.64%	MODS/EOR
UFSM1000	1,037,685,000	4.39%	MODS/EOR
Manual	7,318,613,575	30.97%	ADJUSTED VALUE
Total	**23,632,029,575**	**100.00%**	

D. Finalization Rate (Adjusted - No PP & MM/LM)	FY 2005 Estimated Pieces	Percent	Source
AFSM100	15,275,731,000	64.73%	MODS/EOR
UFSM1000	1,037,685,000	4.40%	MODS/EOR
Manual	7,284,876,526	30.87%	ADJUSTED VALUE
Total	**23,598,292,526**	**100.00%**	

ATTACHMENT 3: USPS-LR-L-43 FLATS *COST* MODEL DATA COMPARISONS

Class	Flats Rate Category	BY 2005 RPW Volume	Class Percent	Non-CR Flats Percent	AFSM100 Compatible Percent	Incoming Secondary Percent Finalized AFSM100	UFSM1000	Manual	Total
FCM	Nonauto	176,370,081	19.39%	0.92%	56.12%	41.25%	32.76%	25.99%	100.00%
	MADC Auto	42,965,539	4.72%	0.22%	86.20%	58.62%	17.52%	23.87%	100.00%
	ADC Auto	102,738,851	11.29%	0 54%	91.05%	65.36%	14.95%	19.69%	100.00%
	3D Auto	258,821,076	28.45%	1.35%	all 08%	68.47%	15.69%	15.84%	100.00%
	5D Auto	328,730,334	36.14%	171%	97 54%	82.96%	7.83%	9.21%	100.00%
	Class Total / Aggregate	**909,625,881**	**100.00%**		**85.55%**	**67.61%**	**16.16%**	**16.23%**	**100.00%**
PERIODICALS	Basic Nonauto	168,214,698	3.94%	0.88%	79 85%	50.16%	19.99%	29.86%	100.00%
	3D Nonauto	172,270,322	4.04%	0.90%	64 93%	41.64%	26.94%	31.42%	100.00%
	5D Nonauto	223,586,748	5.24%	1.16%	62.14%	49.27%	32.59%	18.13%	100.00%
	Basic Auto	151,367,760	3.55%	0.79%	82.39%	49.79%	18.41%	31.80%	100.00%
	3D Auto	1,038,021,663	24.34%	541%	81 19%	51.56%	19.60%	28.84%	100.00%
	5D Auto	2,511,885,335	58.89%	13 08%	8331%	66.39%	17.74%	15.87%	100.00%
	Class Total / Aggregate	**4,265,346,527**	**100.00%**		**80.77%**	**59.65%**	**19.46%**	**20.89%**	**100.00%**
STANDARD	MADC Nonauto	215,020,175	1.53%	1 12%	94 75%	60.27%	14.12%	2562%	100.00%
	ADC Nonauto	141,457,414	1.01%	0.74%	88.16%	60.50%	16.35%	23.15%	100.00%
	3D Nonauto	421,057,344	3.00%	2.19%	81.93%	58.76%	19.57%	21.66%	100.00%
	5D Nonauto	358,931,019	2.56%	1.87%	79.86%	65.83%	20.76%	13.41%	100.00%
	MADC Auto	85,590,082	0.61%	0.45%	92.14%	55.44%	15.69%	28.87%	100.00%
	ADC Auto	334,618,618	2.39%	ii 74%	94 04%	62.47%	13.78%	23.75%	100.00%
	3D Auto	4,470,785,082	31.88%	23.28%	96.18%	66.18%	12.73%	21.10%	100.00%
	5D Auto	7,998,429,444	57.03%	41 66%	97.08%	80.58%	8.72%	r a m	100.00%
	Class Total / Aggregate	**14,025,889,177**	**100.00%**		**95.67%**	**73.86%**	**10.95%**	**15.19%**	**100.00%**
	Flats Total / Aggregate	**19,200,861,585**		**100.00%**	**91.88%**	**70.41%**	**13.09%**	**16.50%**	**100.00%**
	Modified FY 2005 Incoming Secondary Data (Attachment 2)					**64.73%**	**4.40%**	**30.87%**	**100.00%**
MPA/ANM-LR-2	Basic Nonauto	168,214,698	3.94%	0.88%	79.85%	40.12%	15.99%	43.89%	100.00%
	3D Nonauto	172,270,322	4.04%	0.90%	64.93%	33.31%	21.55%	45.14%	100.00%
	5D Nonauto	223,586,748	5.24%	1.16%	62.14%	39.42%	26.07%	34.51%	100.00%
	Basic Auto	151,367,760	3.55%	o m	82.39%	39.83%	14.73%	45.44%	100.00%
	3D Auto	1,038,021,663	24.34%	5.41%	81 19%	41.25%	15.68%	43.07%	100.00%
	5D Auto	2,511,885,335	58.89%	13.08%	83.31%	53.11%	14.19%	32.70%	100.00%
	Class Total / Aggregate	**4,265,346,527**	**100.00%**		**80.77%**	**47.72%**	**15.56%**	**36.71%**	**100.00%**
TW-LR-2	Basic Nonauto	168,214,698	3.94%	0.88%	79.85%	41.81%	11.83%	46.35%	100.00%
	3D Nonauto	172,270,322	4.04%	0.90%	64 93%	35.39%	15.46%	49.15%	100.00%
	5D Nonauto	223,586,748	5.24%	116%	62.14%	41.88%	2.99%	55.13%	100.00%
	Basic Auto	151,367,760	3.55%	a m	82.39%	42.32%	14.69%	42.99%	100.00%
	3D Auto	1,038,021,663	24.34%	5.41%	81 19%	43.83%	15.64%	40.53%	100.00%
	5D Auto	2,511,885,335	58.89%	13 08%	83.31%	56.43%	5.27%	38.30%	100.00%
	Class Total / Aggregate	**4,265,346,527**	**100.00%**		**80.77%**	**50.67%**	**8.68%**	**40.65%**	**100.00%**

1 BY MR. KEEGAN:

2 Q I want to go back over some of the ground

3 that Mr. Levy went over, but from a slightly different

4 perspective and try to get clear to begin with on how

5 you developed your assumptions as to what flats are

6 manually sorted.

7 Let's turn first to your analysis and

8 specifically how you categorize manually sorted flats

9 for the purpose of your model. We asked you about

10 that in our Interrogatory T20-8. I think you might

11 want to refer to that.

12 We asked you there to confirm that in your

13 model a noncarrier route flat will undergo a manual

14 sortation in the incoming secondary if and only if one

15 of four specific conditions are met, and you confirmed

16 that that was the case.

17 Take your time. T20-8. Can you just

18 confirm that I have accurately described?

19 A Yes.

20 Q If one were to add up those four

21 circumstances or specifications and try to come up

22 with one generalization as to how you define the

23 category of manually sorted flats for your model,

24 would it be accurate to say that you assume that flats

25 are always machine sorted unless they are in a

1 facility that does not have a suitable machine?

2 A Yes, that's true.

3 Q So if a five-digit bundle comes into a

4 plant, a destinating SCF for example, and that plant

5 has a single AFSM 100 your model assumes those flats

6 will always be sorted carrier route on that machine

7 rather than manually?

8 A Yes, the models being simplified

9 representations of reality. That is what happens in

10 the model.

11 Q And the same is true with respect to flats

12 that are machineable on the UFSM 1000, is it not? You

13 assume that if the machine is in the plant all flats

14 in that category, irrespective of capacity

15 limitations, will be sorted on the machine?

16 A Yes, that's true.

17 Q I'd like to look at the interrogatory

18 immediately after the one that we were just looking

19 at. That was redirected to Mr. McCrery. This is

20 TW/USPS-T20-9. Do you happen to have that?

21 A No, I don't.

22 MR. KEEGAN: May I provide a copy to the

23 witness, Mr. Chairman?

24 (Pause.)

25 //

1 BY MR. KEEGAN:

2 Q Now, in the interrogatory we were just
3 discussing we asked you to confirm that in your model
4 a flat would enter a manual sort in the incoming
5 secondary only if one of four conditions were met.
6 In this interrogatory we asked whether in
7 reality certain noncarrier route flats do undergo
8 manual incoming secondary sorting even if none of
9 those conditions are met. Is that correct?
10 A Yes.
11 Q And is it fair to assume that this was
12 redirected to Mr. McCrery because it was taken to be a
13 question about operations?
14 A Yes, that's correct.
15 Q The question provides two examples of
16 circumstances in which you would expect flats to be
17 manually sorted that don't meet your conditions.
18 Did Mr. McCrery confirm that those two
19 examples were in fact examples that actually occur?
20 A His response to part (a) was confirmed.
21 Q Yes. If you look at his response to part
22 (b), did he in fact, in addition to agreeing to our
23 two scenarios, list eight additional scenarios in
24 which he could imagine flats being manually sorted
25 that did not meet any of your conditions?

1 There are eight, if you will accept it
2 subject to check.
3 A Yes.
4 Q Okay. Do you agree with his response? It's
5 a question not about your model, but simply about
6 reality.
7 A I agree with his response, but some of these
8 issues apply to more than just the incoming secondary
9 operation.
10 Q Certainly. Do some of them apply uniquely
11 to periodicals; the first two, for example?
12 A Yes, but again it could be beyond just the
13 incoming secondary operation.
14 Q I understand. I'm happy to say Mr. Levy
15 covered a lot of the ground I had on this line of
16 cross-examination, but that's not the only line I had.
17 Let's take a look at your Attachment 2,
18 which I seem to have lost. Let me begin by asking. I
19 didn't quite understand your explanation of the
20 purpose of this exercise. Why did you develop the
21 revised finalization rates?
22 A I provided this attachment to demonstrate
23 that the figure that both Witness Glick and Witness
24 Stralberg had been citing so frequently was suspect.
25 Q I take it that means you didn't feel that

1 the figure in your model sufficiently demonstrated
2 that?
3 A I don't use these figures in my model.
4 Q No, no. I'm saying that I take it the fact
5 that you developed this exhibit to try to demonstrate
6 that there was something wrong with their estimate
7 means that you didn't believe that your model
8 demonstrates that.
9 A My model doesn't demonstrate it because I
10 don't use any of these data.
11 Q Well, you use some data, and you reach a --
12 A In fact, the data that we're talking about,
13 neither Witness Glick nor Witness Stralberg used it in
14 their models either. They're using it as a gauge of
15 the arbitrary factors they put in their model what the
16 result was. That's what they were comparing it to.
17 My whole point in providing this attachment
18 was to show that the figures they were so frequently
19 citing as a point of comparison were likely suspect.
20 Q Well, they used data that produced results
21 in their models.
22 A Right.
23 Q You used data that produced a result in your
24 model.
25 A Yes, and there's --

1 Q My question is simply whether the data that
2 produced a result in your model was insufficient for
3 your own purposes in discrediting what they had done.
4 A Well, it wouldn't have been a comparison I
5 could make because I don't have any incoming secondary
6 factors in my model.
7 Q Okay. Very well. I believe you did confirm
8 for Mr. Levy that Part D of Attachment 2, Finalization
9 Rate Adjusted, does represent your best estimate of
10 what in reality is the likely incidence of flats
11 sorting, secondary flat sorting?
12 A I don't know if I would have described it as
13 reality. I said that there were some adjustments you
14 could make, and then after you make those adjustments
15 you end up with the result in Part D, but we also
16 talked about how there are some line items that
17 probably should have been included that weren't
18 included.
19 Q Well, they should be included because
20 there's real volume for those items, correct?
21 A Well, assuming that any of that mail
22 requires bundle processing and those bundles break,
23 yes, and assuming the bundle breakage factors are
24 correct, which Witness Stralberg thinks are
25 overstated, yes.

1 Q Does not that imply that what you're trying
2 to get here is the representation of reality? It's
3 not an arbitrary exercise, is it?
4 A Well, it's not something that I actually use
5 for anything in my library references.
6 Q Well, you use it in your rebuttal testimony.
7 A I don't use it in my library references. I
8 use it --
9 Q You use it in your rebuttal testimony. This
10 is your exhibit.
11 A It's in my rebuttal testimony to demonstrate
12 that the figure they were using was suspect.
13 Q All right. Can you demonstrate that without
14 demonstrating that someone else is more correct, more
15 correct as a matter of fact?
16 A I believe I said in my testimony that the
17 reality is that no one actually knows what these
18 percentages are.
19 Q If that's the case, what is this exhibit
20 doing here? If the only answer is no one knows, what
21 is your revised finalization rate representing?
22 A I think I already answered that. This
23 attachment was to show that 44.7 percent was a suspect
24 figure.
25 Q Well, how can you show that one figure is

1 suspect with another figure without showing that the
2 other figure is less suspect; that is, that it
3 corresponds more closely to reality?
4 A All I can say is in my opinion this
5 Attachment 2 shows that the original figure was
6 suspect.
7 Q All right. Let's look at your Attachment 3.
8 That attachment is entitled USPS-LR-L-43, Flats Cost
9 Model Data Comparisons, is it not?
10 A That's true.
11 Q And if you look at the far left-hand column
12 titled Class, what that attachment compares -- perhaps
13 I should say makes possible to compare or facilitates
14 a comparison of -- are your models for first class
15 presort, standard regular and periodicals flats, in
16 addition to Mr. Glick's model and Mr. Stralberg's
17 model for periodicals flats only. Is that right?
18 A Yes.
19 Q And if we go over one column to the second
20 column entitled Flats Rate Category, about halfway
21 down the page in boldface there's an item called Flats
22 Total Aggregate.
23 Is that category a volume weighted average
24 of the three class specific models from LR-43?
25 A Yes, it is.

1 Q And is it all right for convenience if I
2 just refer to that as the aggregate model?
3 A Yes.
4 Q Just beneath that item you have the Modified
5 FY 2005 Incoming Secondary Data (Attachment 2). That
6 is the Column D or the Part D from the previous
7 exhibit, is it not, the revised finalization rate?
8 A Yes, it is.
9 Q Okay. Now, on the right-hand side of that
10 page you have three boxes. Is it fair to say that the
11 numbers in those boxes illustrate or show the -- I'm
12 sorry. I lost my --
13 Well, let me ask you what the purpose of the
14 boxes is. Let's do it that way.
15 A I'm sorry. You were asking me?
16 Q The purpose of the three boxes.
17 A I was just comparing the results from the
18 Attachment 2 analysis to the aggregate results from
19 the USPS-LR-L-43 cost model.
20 Q So it's to highlight the comparison down
21 those columns?
22 A Yes.
23 Q So if we look, for example, under the Manual
24 column we see that the aggregate estimate of flats
25 sorted manually is 16.5 percent, and the revised

1 finalization rate is 30.87 percent. Is that right?
2 A Yes.
3 Q And Mr. Glick has 36.71 percent, and Mr.
4 Stralberg's model is 40.65 percent?
5 A Yes, but those are only for periodicals.
6 Q That's right. The 16.5 percent and the
7 30.87 percent both represent an estimate for the
8 overall flats category. Is that right?
9 A No, that's not true because it doesn't
10 include first class single piece or I guess at this
11 point even anything that would have been processed in
12 bundles and broken.
13 Q All right.
14 A That should have been on Attachment 2 that
15 wasn't on Attachment 2.
16 Q Now if you would look at your testimony on
17 page 6? You have a section that is entitled The
18 Revised Finalization Rates Demonstrate That The
19 USPS-LR-43 Results Are Reasonable. Is that right?
20 A Yes.
21 Q Why didn't you mention that purpose when I
22 asked you what the purpose of Exhibit 2 was?
23 I'm just curious. You said it was to
24 discredit Mr. McCrery's figure, but here you say it
25 shows that your L-43 results are reasonable.

1 A Well, the primary purpose of Attachment 2
2 was to discredit that figure, but since I did
3 calculate it this section was just showing what those
4 values were compared to the cost model results.
5 Q Okay. Beginning at line 23 on that page you
6 say, and I'll just read this and you can tell me if I
7 misquote you. On line 23:
8 "The revised finalization rates indicate
9 that roughly 65 percent of flat-shaped mail pieces are
10 finalized in AFSM 100 incoming secondary operations.
11 The results from the USPS-LR-43 aggregate cost models
12 show that 70 percent of flat-shaped mail pieces are
13 processed through those operations."
14 Did I read that correctly?
15 A Yes.
16 Q If we refer back to Attachment 3, what that
17 statement is referring to is the first column in the
18 first box, is it not, under the heading --
19 A I'm sorry. Could you repeat that?
20 Q The statement I just read corresponds to the
21 first box and the first column in that box, is that
22 correct, in Attachment 3?
23 A Yes, that's true.
24 Q That's where you show the percentages for
25 AFSM 100 processing, and you show the 70.41 percent

1 for the LR-43 aggregate model and the 64.73 for the
2 revised finalization rate that you mention in your
3 testimony. Is that right?
4 A That's true.
5 Q Is it then a correct summary of what you're
6 saying in the passage I read from your testimony that
7 the revised finalization rate shows the reasonableness
8 of your aggregate model because your aggregate model's
9 percentage of AFSM 100 sortation is much closer to the
10 revised finalization rate than Glick's and Stralberg's
11 models are?
12 A Well, I also said more than just what you
13 cited. I also --
14 Q Can you start by telling me whether you said
15 what I asked you?
16 A I'm sorry?
17 Q Can you begin by telling me whether indeed
18 what I just described to you is what --
19 A I'm sorry. Can you repeat what you just
20 said?
21 Q Surely. It was a complicated sentence. Is
22 it a correct summary of what you are saying in the
23 passage I read, the passage from that section, The
24 Revised Finalization Rates Demonstrate That The
25 USPS-LR-L-43 Results Are Reasonable?

1 Is it a correct summary of that passage that
2 the revised finalization rate shows the reasonableness
3 of your **LR-L-43** aggregate model because your aggregate
4 model's percentage of AFSM 100 processing is much
5 closer to that of the revised finalization rate than
6 are Glick's and Stralberg's?
7 A I don't think I specifically stated that
8 anywhere. I just said that my result was 65 percent
9 and --
10 Q No, you did not. I'll stipulate that you
11 did not state it. My question was is it a correct
12 summary of the argument you are making there?
13 A The AFSM 100 estimate from the three cost
14 models is closer to the revised Attachment 2 value
15 than either Witness Glick or Witness Stralberg's
16 result.
17 Q That's a statement of fact?
18 A Yes.
19 Q And my question is what is that statement of
20 fact intended to signify? How does that fact
21 demonstrate that your **LR-L-43** results are reasonable?
22 A What I was saying was all things considered
23 of what isn't involved in these figures, the results,
24 the aggregate results from the cost models, in my
25 opinion looked reasonable.

1 Q Why do you mention the revised finalization
2 rates at all then? What is their relevance?
3 A You could take that line out, and then I
4 would say I think my results are reasonable.
5 Q But then your section would not be entitled
6 the revised finalization rates demonstrate that your
7 results are reasonable, would it?
8 A If you took it out I guess it wouldn't have
9 been, no.
10 Q We'll stay inside that box, and let's go
11 over to the column Manual, the second to the last
12 column, where the figure for manual sorting that you
13 show for your aggregate model is 16.5 percent. Is
14 that correct?
15 A Yes.
16 Q Now, hypothetically if you were to adjust
17 that figure upward for whatever reason and suppose you
18 were to adjust it upward to reach the same level as
19 the revised finalization rate, which is 30.87 percent.
20 wouldn't the percentages for AFSM 100 and UFSM 1 00
21 processing have to come down by an equal amount?
22 A Yes.
23 Q And to reach the same level as the rev sed
24 standard finalization rate, would you have to make up
25 a little over 14 percentage points to equalize those

1 two?

2 A If you were trying to get those two lines to

3 match, yes.

4 Q Right. Okay. And you couldn't do that just

5 with the UFSM 1000s, could you? You would have to get

6 it below zero.

7 A I'm not sure what you're asking.

8 Q Well, if you have to push down those other

9 two either individually or severally in order to push

10 up the manual figure and you have to push the manual

11 figure up 14 points, what does your figure for UFSM

12 1000 --

13 A Yes. I see what you're saying.

14 Q It's 13 points.

15 A Yes. Well, if you're trying to get the

16 length to match, yes.

17 Q Yes. That was just the hypothesis. Since

18 Stralberg's and Glick's models are for periodicals

19 flats only, why do you compare the finalization rates

20 here with your aggregate model and not with your

21 periodicals flats model?

22 A Well, I provided their data because they

23 both seemed to want to compare these data to their

24 results, and one of my points has been that it is the

25 percent finalization for all flats, not just for

1 periodicals outside county flats.

2 MR. KEEGAN: Mr. Chairman, may I hand the

3 witness a copy of a document that I've marked as

4 TW-XE-2? What this is is simply an altered version of

5 his Attachment No. 3.

6 CHAIRMAN OMAS: Without objection.

7 (The document referred to was

8 marked for identification as

9 Exhibit No. TW-XE-2.)

10 BY MR. KEEGAN:

11 Q Mr. Miller, take a moment to look at what

12 I've handed you. I would represent to you that it is

13 a photocopy of your Attachment 3 on which I have made

14 two alterations.

15 First, on the lines where you have a box

16 I've just extended underlining under that entire row.

17 Secondly, I've added an additional box around your

18 figures for your periodicals flats model.

19 Does that appear to be right?

20 A Yes.

21 MR. KEEGAN: Mr. Chairman, the substance of

22 this is already in evidence, but I would ask that it

23 be transcribed for reference purposes at this point in

24 the transcript.

25 CHAIRMAN OMAS: And you're marking it as?

1 MR. KEEGAN: TW-XE-2.

2 CHAIRMAN OMAS: Without objection.

3 (The document referred to,

4 previously identified as

5 Exhibit No. TW-XE-2, was

6 received in evidence.)

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ATTACHMENT 3: USPS-LR-L-43 FLATS COST MODEL DATA COMPARISONS

Class	Flats Rate Category	BY 2005 RPW Volume	Class Percent	Non-CR Flats Percent	AFSM100 Compatible Percent	Incoming Secondary Percent Finalized AFSM100	UFSM1000	Manual	Total
FCM	Nonauto	176,370,081	19.39%	0.92%	56.12%	41.25%	32.76%	25.99%	100.00%
	MADC Auto	42,965,539	4.72%	0.22%	86.20%	58.62%	17.52%	23.87%	100.00%
	ADC Auto	102,738,851	11.29%	0.54%	91.05%	65.36%	14.95%	19.69%	100.00%
	3D Auto	258,821,076	28.45%	1.35%	88.08%	68.47%	15.69%	15.84%	100.00%
	5D Auto	328,730,334	36.14%	1.71%	97.54%	82.96%	7.83%	9.21%	100.00%
	Class Total / Aggregate	**909,625,881**	**100.00%**		**85.55%**	**67.61%**	**16.16%**	**16.23%**	**100.00%**
PERIODICALS	Basic Nonauto	168,214,698	3.94%	0.88%	79.85%	50.16%	19.99%	29.86%	100.00%
	3D Nonauto	172,270,322	4.04%	0.90%	64.93%	41.61%	26.94%	31.42%	100.00%
	5D Nonauto	223,586,748	5.24%	1.16%	62.14%	49.27%	32.59%	18.13%	100.00%
	Basic Auto	151,367,760	3.55%	0.79%	82.39%	49.79%	18.41%	31.80%	100.00%
	3D Auto	1,038,021,663	24.34%	541%	81.19%	51.56%	19.60%	28.84%	100.00%
	5D Auto	2,511,885,335	58.89%	13.08%	83.31%	66.39%	17.74%	15.87%	100.00%
	Class Total / Aggregate	**4,265,346,527**	**100.00%**		**80.77%**	**59.65%**	**19.46%**	**20.89%**	**100.00%**
STANDARD	MADC Nonauto	215,020,175	1.53%	1.12%	94.75%	60.27%	14.12%	25.62%	100.00%
	ADC Nonauto	141,457,414	1.01%	0.74%	88.16%	60.50%	16.35%	23.15%	100.00%
	3D Nonauto	421,057,344	3.00%	2.19%	81.93%	58.76%	19.57%	21.66%	100.00%
	5D Nonauto	358,931,019	2.56%	1.87%	79.86%	65.83%	20.76%	13.41%	100.00%
	MADC Auto	85,590,082	0.61%	0.45%	92.14%	55.44%	15.69%	28.87%	100.00%
	ADC Auto	334,618,618	2.39%	1.74%	94.04%	62.47%	13.78%	23.75%	100.00%
	3D Auto	4,470,785,082	31.88%	23.28%	96.18%	66.18%	12.73%	21.10%	100.00%
	5D Auto	7,998,429,444	57.03%	41.66%	97.08%	80.58%	8.72%	10.70%	100.00%
	Class Total / Aggregate	**14,025,689,177**	**100.00%**		**95.57%**	**73.86%**	**10.95%**	**15.19%**	**100.00%**
	Flats Total / Aggregate	**19,200,861,585**		**100.00%**	**91.88%**	**70.41%**	**13.09%**	**16.50%**	**100.00%**
	Modified FY 2005 Incoming Secondary Data (Attachment 2)					**64.73%**	**4.40%**	**30.87%**	**100.00%**
MPA/ANM-LR-2	Basic Nonauto	168,214,698	3.94%	0.88%	79.85%	40.12%	15.99%	43.89%	100.00%
	3D Nonauto	172,270,322	4.04%	0.90%	64.93%	33.31%	21.55%	45.14%	100.00%
	5D Nonauto	223,586,748	5.24%	1.16%	62.14%	39.42%	26.07%	34.51%	100.00%
	Basic Auto	151,367,760	3.55%	0.79%	82.39%	39.83%	14.73%	45.44%	100.00%
	3D Auto	1,038,021,663	24.34%	5.41%	81.19%	41.25%	15.68%	43.07%	100.00%
	5D Auto	2,511,885,335	58.89%	13.08%	83.31%	53.11%	14.19%	32.70%	100.00%
	Class Total / Aggregate	**4,265,346,527**	**100.00%**		**80.77%**	**47.72%**	**15.56%**	**36.71%**	**100.00%**
TW-LR-2	Basic Nonauto	168,214,698	3.94%	0.88%	79.85%	41.81%	11.83%	46.35%	100.00%
	3D Nonauto	172,270,322	4.04%	0.90%	64.93%	35.39%	15.46%	49.15%	100.00%
	5D Nonauto	223,586,748	5.24%	1.16%	62.14%	41.88%	2.99%	55.13%	100.00%
	Basic Auto	151,367,760	3.55%	0.79%	82.39%	42.32%	14.69%	42.99%	100.00%
	3D Auto	1,038,021,663	24.34%	5.41%	81.19%	43.83%	15.64%	40.53%	100.00%
	5D Auto	2,511,885,335	58.89%	13.08%	83.31%	56.43%	5.27%	38.30%	100.00%
	Class Total / Aggregate	**4,265,346,527**	**100.00%**		**80.77%**	**50.67%**	**8.68%**	**40.65%**	**100.00%**

1 BY MR. KEEGAN:

2 Q Would you look at Mr. Stralberg's TW-LR-2

3 model on this attachment and confirm that if you read

4 across the line for that model you see Class Total/

5 Aggregate and then Volume, 4.265 billion, and then

6 80.77 percent AFSM 100 Compatible, and then the rest

7 of the line is in a box? Would you confirm that?

8 A Yes.

9 Q And would you confirm that if you read

10 across the line for Mr. Glick's model, which is

11 MPA/ANM-LR-2, you also read Class Total/Aggregate,

12 Volume, 4.265 billion, 80.77 percent AFSM 100

13 Compatibility, and then the rest is in a box?

14 A Yes.

15 Q And if you read across the line for your

16 periodicals flats model it's identical to those two,

17 is it not?

18 A Yes.

19 Q Until you get to the box, of course. If you

20 read the line for your aggregate model, what you see

21 is Flats Total/Aggregate, Volume, 19.2 billion, 91.88

22 percent AFSM 100 Compatible. Is that right?

23 A I'm sorry. Where is this at again?

24 Q The line for your Flats Total/Aggregate

25 model. Your aggregate model.

1 A Yes.

2 Q Okay. I want to explore for just a minute

3 how the comparison looks when we substitute your

4 periodicals flats model for your aggregate model.

5 Let's start outside the box. You would

6 confirm, I would assume, from what I've just read that

7 your model, Glick's model and Stralberg's model are

8 all equally distant from or close to the revised

9 finalization rates with respect to volume, AFSM 100

10 compatibility?

11 A I'm not sure I'm understanding what question

12 you're asking.

13 Q I'm saying the figures are identical.

14 Therefore, they must be the same distance from some

15 other figure if they're identical.

16 CHAIRMAN OMAS: Excuse me, Mr. Keegan. If I

17 could interrupt?

18 MR. KEEGAN: Yes.

19 CHAIRMAN OMAS: About how much longer do you

20 have with this witness?

21 MR. KEEGAN: A good deal of time I'm afraid,

22 Mr. Chairman.

23 CHAIRMAN OMAS: All right. Why don't we

24 take our midmorning break and come back at 11:15?

25 Thank you.

1 (Whereupon, a short recess was taken.)
2 CHAIRMAN OMAS: Mr. Keegan, you may proceed.
3 MR. KEEGAN: Thank you, Mr. Chairman.
4 BY MR. KEEGAN:
5 Q We were talking about the figures in my
6 Cross-Examination Exhibit No. 2, and we've been
7 talking about the figures outside the boxes. Now I
8 want to talk about the ones inside the boxes.
9 Would you agree that the analytical
10 differences of opinion between you and Stralberg and
11 Glick are represented by the figures that are inside
12 the boxes?
13 A I would say yes, in the sense that they
14 included factors that I did not include in my cost
15 model.
16 Q And if you would look at the row for AFSM --
17 where is that coming from?
18 CHAIRMAN OMAS: I don't know. Commissioner
19 Goldway, I think your computer has gone on the --
20 Is it your cell phone, Mr. Keegan?
21 MR. KEEGAN: No. It is Mr. McLaughlin's
22 cell phone, Mr. Chairman.
23 CHAIRMAN OMAS: I guess I'm going to have to
24 start telling everyone to shut their cell phones off
25 before we begin.

1 MR. KEEGAN: I suggest that discipline
2 against Mr. McLaughlin might be in order.
3 (Laughter.)
4 CHAIRMAN OMAS: Mr. Keegan, is your phone
5 turned off now?
6 MR. KEEGAN: No, Mr. Chairman. It's not my
7 phone.
8 It appears not to be. Does anyone know how
9 to turn this off? Would anyone like to buy it?
10 CHAIRMAN OMAS: Mr. Keegan, you may proceed.
11 MR. KEEGAN: Thank you, Mr. Chairman.
12 BY MR. KEEGAN:
13 Q If we look at the columns for AFSM 100
14 Processing, the percentages of flats processed in the
15 incoming secondary on AFSM 100s, I'm going to read you
16 the figures for the models inside the boxes in
17 ascending order.
18 Mr. Glick has 47.72 percent; Stralberg,
19 50.67; your periodicals flats model, 59.67. The
20 revised finalization rate is 64.73, and your aggregate
21 model is 70.41 percent. Did I read those right?
22 A Yes.
23 Q And would you agree that the percentage for
24 your periodicals flats model is much closer to
25 Stralberg's percentage than is the percentage for your

1 aggregate model?

2 A Yes.

3 Q Is your periodicals model's percentage,

4 which is 59.65, also a little bit closer to the

5 revised finalization percentage than is your aggregate

6 model's?

7 A Yes.

8 Q I'm going to deal later with UFSM 1000

9 processing, so let's skip to the second to the last

10 column, which is the source of most of the contention

11 in this case, the column for manual sortation.

12 Again, I'm just going to read the numbers in

13 ascending order. For Percentage of Flats Sorted

14 Manually, the aggregate model shows 16.5 percent; your

15 periodicals flats model shows 20.89 percent; the

16 revised finalization figure is 30.87 percent; Mr.

17 Glick has 36.71 percent; and Mr. Stralberg has 40.65

18 percent.

19 Is that correct?

20 A Yes.

21 Q And that means, does it not, that the

22 percentage for your aggregate model is the most

23 distant from the revised finalization rate?

24 A Yes, that's true.

25 Q And that your periodicals flats model figure

1 is closer both to the revised finalization rate and to
2 Mr. Stralberg's model than your aggregate model is?
3 A Yes.
4 Q If you would refer now to page 6 of your
5 testimony? I'm sorry. I just lost the reference
6 because I wasn't looking at your testimony. I'd better
7 go on. I'm sorry. Mr. Burzio has rescued me.
8 Starting on the last line of page 6, you say, "Given
9 that first-class mail, single-piece flats, have not
10 been modeled and included in Attachment 3, it is
11 likely that the aggregate percentage would have
12 decreased somewhat had the flats mail stream been
13 modeled."
14 Is what you're saying here that the 70.4
15 percent of your aggregate model for AFSM-100
16 processing would likely have declined and been closer
17 to the 64.73 finalization rates, if you had included
18 first-class, single-piece mail, as you do in
19 Attachment 2?
20 A Yes.
21 Q And would that decline produce a
22 corresponding increase in the figure for manual
23 sortation?
24 A Yes.
25 Q And I take it, you are assuming that first-

1 class, single-piece mail flats receive less machine
2 sorting and more manual sorting than the flats that
3 are covered in your models.
4 A I would assume so, yes.
5 Q And what's your basis for that assumption?
6 A Because I believe I addressed in footnote
7 17, when I said, "Unlike the various categories of
8 presort flats, first-class mail, single-piece flats
9 are not required to have machine-printed addresses,
10 nor are they required to be presorted and/or prebar
11 coded."
12 Q The optical character readers on the AFSM-
13 100 do have the capability to correctly read
14 handwritten addresses, don't they?
15 A I don't know the extent to which they can or
16 cannot read handwritten addresses at this time.
17 Q Do you know whether they can at all?
18 A I don't believe that the OCR machine
19 actually can.
20 Q All right. And do you know whether the
21 AFSM-100s are connected to remote encoding centers?
22 A Yes, they are.
23 Q And that, I assume, would allow a number of
24 addresses to be read and encoded directly.
25 A Yes.

1 Q Do you happen to know the average reject
2 rate for first-class, single-piece flat on the AFSM-
3 100?
4 A No, I don't know that.
5 Q Do you know the reject rate for first-class,
6 single-piece flats on the AFSM-100 in the outgoing
7 primary sort schemes which sort mostly first-class,
8 single-piece flats?
9 A No.
10 Q You said that the reason that you assumed
11 that first-class, single-piece flats receive less
12 machine sorting than other flats had to do with their
13 address quality, based on the fact that they don't
14 meet the same addressing standards. They are
15 relatively small volume, aren't they, compared to,
16 say, standard flats?
17 A They are smaller than standard flats.
18 Q I seem to recollect -- this came up earlier
19 in your colloquy with Mr. Levy. Well, it's not
20 important.
21 So adding those to the mail stream that you
22 modeled couldn't have very much effect on the average
23 manual rate, could it?
24 A It depends on what the percentages would be
25 for single-piece. I don't know.

1 Q Okay. Do you know whether most first-class,
2 single-piece flats consist of sealed envelopes that
3 are machineable on the AFSM-100?
4 A I don't know. I've never conducted a first-
5 class, single-piece flats mail characteristics study.
6 Q And you don't know whether their
7 machinability is greater, say, than periodicals.
8 A I don't know.
9 Q All right. If you go back to where we left
10 off, at line 4 on page 7, do you indicate there that,
11 for the same reason, that is, the absence of first-
12 class, single-piece flats from the mail stream you're
13 looking at, that a similar downward adjustment would
14 be appropriate in the second column on your Attachment
15 3? That is the column, "UFSM-1000.
16 A To the extent that the revised finalization
17 percentages are close to what the actual figures would
18 be, it does appear that the UFSM-1000 operation
19 overstates the cost.
20 Q And if such an adjustment were made, it
21 would also produce a corresponding increase in the
22 figure for manual sortation. Is that right?
23 A Yes.
24 Q To sum up what I think we've been saying,
25 you've been saying it is the case, is it not, that

1 your model probably overstates the percentage of flats
2 sorted on both the AFSM-100 and the UFSM-1000?
3 A If you believe that the numbers that were
4 developed in Attachment 2 are close to what the actual
5 figures should be, that would be true.
6 Q And -- said that it does not address first-
7 class, single-piece flats.
8 A Yes.
9 Q Now, still on page 7, at line 10, you
10 indicate an additional reason why you think it's
11 likely that your cost models overstate UFSM-1000
12 costs, namely that a revised UFSM-1000 strategy was
13 implemented subsequent to the last flats density and
14 acceptance rate study, which was conducted in 2001.
15 Is that correct?
16 A Yes.
17 Q And you conclude, on lines 14 and 15, that
18 nothing can be done about this because "there are no
19 data that can be used to adequately determine how the
20 UFSM-1000 assumptions in the cost model should be
21 changed." Is that right?
22 A There are no data that I would use to make
23 that adjustment.
24 Q Mr. Stralberg does propose changing the cost
25 assumptions in the model, does he not?

1 A Yes.

2 Q And still on page 7, at line 15, I want to

3 ask you several questions about this, so I want to

4 read it first. You delivered this judgment of Mr.

5 Stralberg's adjustments: "While Witness Stralberg

6 attempted to modify UFSM-1000 assumptions --" and, at

7 that point, you have a footnote referring to Section

8 3.3 of his testimony "-- the basis for making those

9 modifications is not adequate. He uses a results-

10 driven approach that focuses on the scrubbed FY 2005

11 MODS values from USPS-LRL-56. Those data are used to

12 develop productivity estimates in the USPS-LRL-43 cost

13 models. It would have been preferable to conduct a

14 study that focuses on UFSM-1000 processing models."

15 Did I read that --

16 A Yes.

17 Q Do you have Stralberg's direct testimony

18 with you?

19 A Yes, I do.

20 Q And would you please refer to page 14, where

21 the section that you cite there begins? That section

22 is entitled, is it not, "A Realistic Model of the

23 UFSM-1000 Must Recognize the Different Uses of its TwO

24 Sorting Modes"?

25 A Yes.

1 Q And if you go down to the last line on that
2 page, Stralberg says, does he not, "Table 1 summarizes
3 the MODS hours and TPH, i.e., total pieces handled, as
4 provided by Bozzo for the major sorting modes used on
5 the FSM-UFSM-1000 machines." Is that right?
6 A Yes.
7 Q And immediately following, on the top of the
8 next page, there is Table 1, "Utilization and
9 Productivity of Different UFSM-1000 Operations." Do
10 you see that?
11 A Yes.
12 Q Now, I'm not going to try to go through the
13 details of Mr. Stralberg's analysis, but I do want to
14 verify that at least we have the same understanding of
15 the basic thrust of his argument. So I'll just ask if
16 you agree that his testimony argues, based on the data
17 in this table, that there is a great difference
18 between the way the UFSM-1000 machines are used to
19 perform incoming secondary distribution and the way
20 that they are used in earlier sorting steps, such as
21 outgoing and incoming primary sorts. Do you agree
22 that that is his argument?
23 A Yes. I believe that was his conclusion.
24 Q And does he say that what the difference is
25 that in the incoming secondary almost all of the

1 volume sorted on the UFSMs is sorted in the fast
2 automated mode rather than the slower keying mode?
3 A Yes. That's true.
4 Q And is this table and the analysis connected
5 with it that I summarized what you were referring to
6 when you say, "Stralberg attempted to modify the UFSM-
7 1000 assumptions using a results-driven approach that
8 focuses on scrubbed FY 2005 MODS values"?
9 A Yes.
10 MR. KEEGAN: Mr. Chairman, may I approach
11 the witness and hand him a copy of an interrogatory
12 response from Mr. Bozzo?
13 CHAIRMAN OMAS: Without objection.
14 (Pause.)
15 BY MR. KEEGAN:
16 Q Mr. Miller, can you confirm, or will you
17 accept, that what I just handed you is a response from
18 Mr. Bozzo to TW/USPS-T-11-1, redirected from Witness
19 Van-Ty-Smith?
20 A Yes, it is.
21 MR. KEEGAN: And just for the record, Mr.
22 Chairman, that response appears in the transcript at
23 page 2562, and what I have given to the witness is the
24 first page of the answer plus two pages from an
25 attachment to the response, which appear at pages 2569

1 and 2570 in the transcript.

2 If you want a moment to review that, please

3 take it. I'm going to look at the pages from the

4 attachment.

5 (Pause.)

6 BY MR. KEEGAN:

7 Q Can you confirm that those pages contain

8 MODS data for the FSM, UFSM, and the various MODS

9 numbers that are used for different types of

10 processing on those machines --

11 A That's correct.

12 Q -- along with the corresponding hours and

13 volumes?

14 A That's correct.

15 Q And if you would look back at page 14 of Mr.

16 Stralberg's testimony in footnote 12, do you see that

17 he cites this response from Mr. Bozzo?

18 A Was that on page 12?

19 Q Footnote No. 12, page 14, fourth line in the

20 footnote: "See Bozzo response to," et cetera.

21 A Yes. That's correct.

22 Q And if you turn, again, to Mr. Stralberg's

23 Table 1 on the following page, can you confirm, or

24 will you accept, subject to check, that that table

25 summarizes data from this interrogatory response from

1 Mr. Bozzo?

2 A I would accept that, subject to check.

3 Q And can you confirm, or will you accept,

4 subject to check, that the data provided in Mr.

5 Bozzo's response is, as Time Warner requested,

6 unscrubbed data and that these data consist of the

7 complete annual figures for FY 2005 and that the

8 volumes show the sum of all machine readings taken on

9 all such machines for the year 2005?

10 A I don't know the answer to that question.

11 Witness Bozzo would have to answer that.

12 MR. KEEGAN: Mr. Chairman, I wonder if the

13 Postal Service would be willing to provide an answer

14 from Mr. Bozzo. It's a simple question confirmation.

15 A one-word answer would suffice.

16 MR. WEIDNER: That's fine, Mr. Chairman.

17 CHAIRMAN OMAS: Mr. Weidner, would you speak

18 up?

19 MR. WEIDNER: Yes. We will provide that

20 answer, Mr. Chairman.

21 CHAIRMAN OMAS: Thank you.

22 BY MR. KEEGAN:

23 Q Now, if you would turn to page 7 of your

24 testimony -- that's the page we've been looking at

25 that contains your criticism of Mr. Stralberg's

1 adjustment for the UFSM-1000, is it not?

2 A Yes.

3 Q And at the end of that passage, you say --

4 this is line 19: "It would have been preferable to

5 conduct a study that focuses on UFSM-1000 processing

6 methods." Is that correct?

7 A Yes.

8 Q Given the questions Mr. Stralberg was

9 seeking to answer, namely, the relative use of the

10 manual and the automated UFSM-1000 sorting modes for

11 different schemes, is it your view that conducting a

12 study would have been preferable to relying on the

13 national annual MODS data, which incorporate around-

14 the-clock observations for all such machines for an

15 entire year?

16 A In Witness Stralberg's testimony on page 14,

17 starting at line 5, he says, "In my model,

18 nonmachinable flats from five-digit bundles are not

19 processed on the UFSM-1000, even at facilities where

20 such machines exist, but are sent directly to manual,

21 incoming secondary sorting. The MODS data you provided

22 me; they don't tell you whether the mail that's

23 processed through these operations are machineable or

24 nonmachinable."

25 So that's what I was referring to when I

1 said it would have been preferable to do some sort of
2 study.
3 Q All right. I'll let that be the end of that
4 line.
5 Would you turn to page 17 of Mr. Stralberg's
6 testimony? Do you see on that page a table entitled,
7 "Table 2, UFSM-1000 Productivities, Rates, According
8 to LRL-56, Bozzo, and LRL-43, Miller"?
9 A Yes. I see the table.
10 Q And can you confirm that that table contains
11 or employs scrubbed MODS data?
12 A If it's the figures from the two library
13 references cited, then it would be scrub MODS data.
14 Q Okay. On page 16, the page before that
15 table, at line 11, Mr. Stralberg introduces the table.
16 What he says is, "Having, in fact, combined the flows
17 of machineable and nonmachinable flats on the UFSM-
18 1000, Miller compensates by using productivity rates
19 in the automated mode that are weighted averages of
20 the productivities in the keying and automated modes.
21 This is illustrated in Table 2 below, which compares
22 the two sets of productivity rates extracted from LRL-
23 56, Bozzo, with the rates Miller uses." Is that an
24 accurate description of what you do?
25 A Yes.

1 Q Okay. Is there any place that you could
2 point to where Mr. Stralberg relies on scrubbed data
3 other than in performing a tabulation of your data for
4 your model?
5 A I'm not sure what's your --
6 Q Well, you said he relied on scrubbed data,
7 and I just clearly --
8 A Well, I thought, when I wrote that in my
9 testimony, I thought he had used the MODS data that we
10 had used in Library Reference L-56. If it ends up
11 being that it wasn't scrubbed data, then I was
12 incorrect when I said that.
13 Q And, finally, for this line -- it's not the
14 last, but it's the longest -- if you would go back
15 again to your Attachment 3, just to close the circle,
16 and refer to the various finalization rates you've
17 tabulated there, and I want to focus now on the UFSM-
18 1000.
19 Would you confirm that the revised
20 finalization rate, which is your estimate of the most
21 realistic percentage -- I think you did agree to
22 that -- for the UFSM-1000 is 4.4 percent?
23 A The figure from Attachment 2 is 4.4
24 percent --
25 Q Yes, and you take it from Attachment 2, and

1 it appears on Attachment 3, under the --

2 A Yes.

3 Q Okay. And that the rate from Mr.

4 Stralberg's outside-county model is 8.68 percent, and

5 Glick's outside-county model, 15.56 percent, and your

6 outside-county model, 19.46 percent. Is that right?

7 A That's true.

8 Q So with respect to UFSM-1000 sortation, Mr.

9 Stralberg's model is the closest to the revised

10 finalization rate.

11 A Yes. That's true.

12 Q And to the extent that it has significance

13 at all, the revised finalization rate would strongly

14 support your own view that you have overstated UFSM-

15 1000 costs.

16 A Yes, to the extent that you believe those

17 values are close to what the actual values are, and

18 considering the fact that some other mail isn't

19 included in this table.

20 Q Okay. I would like to change the subject

21 now. If you would look at your testimony, page 8,

22 line 13, you state there, "One final issue should be

23 mentioned concerning the coverage factors

24 modifications proposed by Witnesses Glick and

25 Stralberg. To the extent the Commission views this

1 modification as necessary, it is not a modification
2 that affects periodicals, outside- county, flats only.
3 This modification should theoretically be incorporated
4 into the first-class mail presort flats and standard
5 mail regular flats cost models as well. Witness Glick
6 and Witness Stralberg provide no explanation as to why
7 this change would be appropriate for the periodicals
8 outside- county flat cost model only."
9 To start with, would you indicate where
10 either Mr. Glick or Mr. Stralberg has argued that this
11 change would be appropriate for the periodicals
12 outside-county flats cost model only?
13 A I'm not sure, in their interrogatory
14 responses. I did ask some questions, but I'm not sure
15 if there was something actually in there, but what I
16 was saying is that they just basically didn't say why
17 it would only be applicable to periodicals outside
18 county.
19 Q I'm sorry. Could you repeat the very end?
20 A They didn't have anything in their testimony
21 that said, "This change should only be made in
22 periodicals, outside-county cost model only." I just
23 wanted to point out, to the extent you believe in
24 these factors, then you should probably put them in
25 the other two cost models as well.

1 Q And did they anywhere express disagreement
2 with that?
3 A I can't recall off the top of my head.
4 Q Would it be possible to put them in the
5 other cost models for them?
6 A Yes.
7 Q Well, I'll tell Mr. Stralberg he is not busy
8 enough.
9 Is it your view, based on what I just read,
10 that whenever a way is shown to improve a particular
11 cost model, that if that improvement has some
12 theoretical application to other cost models, and that
13 theoretical application has not been studied or
14 documented sufficiently to permit its use in practice,
15 that the Commission is obliged to refrain from
16 adopting the improvement for the model from which it
17 has been satisfactory analyzed and documented?
18 A I think it would be best to analyze it and
19 document it in the general sense and then apply it to
20 the cost models, if it was determined that this was
21 something that should be included.
22 Q That's interesting, but my question
23 hypothesized that you can do it for one but not for
24 all and asked what you believe the Commission is
25 obliged to do in that circumstance.

1 A Well, the Commission will do what they feel
2 they need to do --
3 Q Well, of course.
4 A -- but I would think that it would be best
5 to determine whether they should be included at all
6 and then put them in all of the cost models.
7 Q All right. So you're suggesting, then, I
8 take it, that the adoption of an improvement in any
9 model must be foregone until the Postal Service
10 collects the data and performs the analysis that will
11 permit it to be applied to all of the models to which
12 it may have application.
13 A I'm not really sure what you asked. I just
14 think, when you make these changes, and it could
15 affect other cost models in the same way, that you
16 should make a determination whether a certain
17 methodology makes sense and then make changes to all
18 of the cost models.
19 Q The passage I read has a footnote, footnote
20 23, which says: "In the event that such changes are
21 deemed appropriate, it should be noted that other
22 intervenors who might be affected have not been
23 litigating this issue." What point are you making
24 there?
25 A That if a certain change were made that

1 maybe it was determined that it was worthwhile, if the
2 Commission made that decision, it could also affect
3 somebody in another class of mail, and it could either
4 lead to larger savings estimates or smaller savings
5 estimates, and that should be considered.
6 Q Okay. It should be considered. And what is
7 the significance of saying that other parties have not
8 been litigating this issue?
9 A Well, to my knowledge, I don't think they
10 have been litigating some of these issues concerning
11 incoming secondary factors or revising cost pools in
12 the way proposed by both Witness Glick and Witness
13 Stralberg.
14 Q So that the adoption of an improvement that
15 is litigated has to await either the Postal Service or
16 someone else providing a sufficient case for the
17 adoption of the same improvement to --
18 A That would be my preference.
19 Q May I finish the question? The question is,
20 does it have to wait, not what your preference is.
21 The hypothesis is that you can't do it all now, so it
22 either has to wait, or it can be done partially now.
23 That's just my hypothesis.
24 A Well, I don't view it in those terms, so --
25 Q Well, you can't reject a hypothesis. I'm

1 not asking you to hypothesize that airplanes can leave
2 the ground without flying. I'm asking you to
3 hypothesize something that's easy to hypothesis, that
4 you have evidence to make an improvement in Model A,
5 that you have reason to believe that improvement would
6 have an application to Model B, but you don't have the
7 evidence to make it for Model B.
8 MR. WEIDNER: Mr. Chairman, I think Witness
9 Miller has expressed his disagreement with the very
10 base of the question. He has also expressed why he
11 put footnote 23 in his testimony. I think I would
12 object to this question and ask that we just move on.
13 CHAIRMAN OMAS: Yes. Please move on, Mr.
14 Keegan.
15 BY MR. KEEGAN:
16 Q Referring to the footnote, which I will read
17 again: "In the event that such changes are deemed
18 appropriate, it should be noted that other intervenors
19 who might be affected have not been litigating this
20 issue."
21 Now, would you confirm for me, or would you
22 accept, that the identical text constitutes footnotes
23 30 on page 11, footnote 40 on page 14, footnote 43 on
24 page 16, footnote 46 on page 17, and footnote 51 on
25 page 18?

1 A Yes. That's true.

2 Q Finally, let's turn to bundle breakage, an

3 eternally popular subject, and if you would refer to

4 your testimony at page 17, you have a section

5 entitled, do you not, "Witness Stralberg's Bundle

6 Breakage Comments Should Be Ignored"?

7 A Yes. That's true.

8 Q And at line 21 on that page, you state, "The

9 same flats bundle breakage assumptions have been used

10 in the past three dockets. These data were obtained

11 from two studies presented in Docket No. R2000-1, and

12 in the footnote, you identify those two sources, do

13 you not, as USPS-LRI-88 and USPS-LRI-297?

14 A Yes. That's true.

15 Q Do you happen to recall what Mr. Stralberg

16 had to say about those two data sources?

17 A Not off the top of my head, no.

18 Q If you would take a look at his testimony,

19 at page 20, line 1, does he say there that the LRI-297

20 is "the only reliable study of bundle breakage applied

21 to large numbers of observations in various

22 facilities"?

23 A Yes. He does state that.

24 Q And if you would turn ahead two pages, to

25 page 22 at line 20, does he say of LRI-88, "As I noted

1 in my R2000-1 testimony, the numbers in that study are
2 meaningless and should not be relied on"?
3 A He does make that statement, yes.
4 Q If we go back to your testimony at page 17,
5 right where we left off, you say, "While Witness
6 Stralberg is quite critical of the bundle breakage
7 data and assumptions, he offers little in the way of
8 alternatives."
9 When you say he is quite critical of bundle
10 breakage data, you cite only those two sources, and
11 we've just seen that he describes one of them as a
12 reliable study of bundle breakage. May we assume that
13 you're referring to the other one, LRI-88?
14 A Based on what he said, yes.
15 Q All right. Since you say that the same
16 flats bundle breakage assumptions have been used in
17 the last three dockets, is it safe to assume that when
18 you say he is critical of the bundle breakage
19 assumptions that those are the assumptions you're
20 referring to?
21 A Yes, the data from Library Reference 88.
22 Q Okay. Would you look at Stralberg's
23 testimony at page 19, line 11? He states there, "My
24 direct testimony in Docket R2000-1 included a quite
25 detailed analysis of the dynamics and cost effects of

1 bundle breakage, TW-T1 at 43 to 53. I repeat below
2 only as much of that discussion as I believe necessary
3 to explain my present model."
4 In preparing your rebuttal testimony, Did
5 you review the discussion that he references there?
6 A I'm sorry. What page is this on?
7 Q I'm sorry. It's on page 19, line 11, of Mr.
8 Stralberg's direct testimony in this docket.
9 A No. I did not review that testimony.
10 MR. KEEGAN: Mr. Chairman, may I provide the
11 witness with a copy of that discussion?
12 CHAIRMAN OMAS: Without objection.
13 (Pause.)
14 BY MR. KEEGAN:
15 Q I've given you the whole 10 pages, Mr.
16 Miller, but I only want to look at one of them, page
17 47.
18 You just agreed that Mr. Stralberg's
19 criticism of the assumptions that you were referring
20 to as the assumptions of the last three dockets -- is
21 that correct? -- including R2000-1.
22 A Yes.
23 Q Let's start with the data. Do you agree
24 that his criticism is of LRI-88? Is that right?
25 A Eased on what his testimony said, I'm

1 assuming that's true.

2 Q Well, you're the one who said he was

3 critical. Did you know what --

4 A Based on what we have just discussed, where

5 he said in his testimony that 297 was what he thought

6 was the only accurate data. I was primarily referring

7 to Library Reference 1-88 from R2000.

8 Q If you look at page 47 from his 2001

9 testimony, which he refers to in his testimony in this

10 case at line 7, I'm going to read you a passage and

11 ask if you have any reason to disagree with it. It's

12 about Library Reference 1-88.

13 "In that survey, various facility managers

14 were asked to estimate the percentage of bundles that

15 inadvertently break for, respectively, periodical

16 sacks, periodicals pallets, Standard A sacks, and

17 Standard A pallets. They were not asked to perform

18 any kind of count to support their guesses. The

19 responses ranged from zero to 80-percent breakage for

20 sacks and from zero to 40-percent breakage for

21 pallets. A straight average of these responses gives

22 8 percent for periodicals pallets and 18 percent for

23 periodicals sacks. Most respondents, however,

24 indicated a pallet breakage rate of 5 percent or less,

25 but nonsensical responses from some drove the average

1 to 8 percent,"

2 Take time, if you will, and look at the full

3 paragraph. My question is, do you have any basis for

4 disagreeing with any part of it?

5 A I don't have any basis for agreeing or

6 disagreeing with any of it. I wasn't the person that

7 conducted that study, and, like it or not, it's the

8 only data that we have.

9 Q You did not personally conduct it, and you

10 have no basis on which to make an evaluation of it.

11 A Not the details of it, no.

12 Q Well, can you state for the record, then,

13 why you believe that Mr. Stralberg's comments on the

14 details of it should be ignored?

15 A Well, I believe he said that he thought 10

16 percent was too high, but he doesn't provide any

17 evidence that indicates that it really is. He also

18 proposed some changes to manual operations that I

19 don't agree with.

20 Q What about the paragraph I just read?

21 A Well, I would just disagree with him as to

22 whether -- I can't conclude from this paragraph that

23 the bundle breakage rate is high.

24 Q I'm not asking what you can conclude about

25 the bundle breakage rate; I'm asking what you can

1 conclude about the study.

2 A I didn't conduct the study, so I can't draw

3 any conclusions from it.

4 Q If you can't draw any conclusions about the

5 study, how can you draw conclusions about the bundle

6 breakage rate from the study?

7 A Well, I've said many times that bundle

8 breakage data is really hard to get, and we've used

9 the same data. The Commission has relied on the same

10 data in the last few cases, and, given that there is

11 nothing else to use as an alternative, I continue in

12 this case to rely on that same data.

13 Q And, finally, and this is final -- this is

14 the end of the last line -- I want to look at what Mr.

15 Stralberg says on that page about his criticism of the

16 assumptions. Those appear at lines 4 to 6 and 17 to

17 27.

18 A This is in --

19 Q This is in his R2000-1 testimony on the same

20 page we were looking at, and Witness Yacobucci was the

21 witness in that case who presented the flats cost

22 model.

23 In assuming the same breakage rate, 10

24 percent in each bundle sort, for sacks and pallets,

25 Yacobucci contradicts even the LRI-88 survey that he

1 claims to rely on.

2 Now, I'm skipping down to line 17. "While

3 Yacobucci claims his model uses the breakage data from

4 LRI-88, he, in fact, ignores the one thing that is

5 consistent about these responses, namely that they

6 almost, without exception, indicated higher breakage

7 for sack bundles.

8 "Yacobucci assumes 10 percent for both. In

9 fact, he assumes more for the 90 percent of bundles

10 not broken in the first bundle sort. He assumes that

11 another 10 percent breaks if there is a subsequent

12 bundle sort and another 10 percent of the remainder if

13 there is a third bundle sort, et cetera.

14 "Since palletized bundles tend to have more

15 secondary bundle sorts, Yacobucci effectively ends up

16 assuming that palletized bundles break more than

17 sacked bundles, contrary to all evidence. This not

18 only distorts the cost relationship between sacks and

19 pallets; it also severely distorts the relationship

20 between presort levels, leading to a sharply reduced

21 estimate of savings produced by carrier route

22 presortation."

23 That's Stralberg criticizing the

24 assumptions. Why do you think those comments ought to

25 be ignored?

1 A Well, I would like to point out, I don't use
2 the same assumptions that Yacobucci used in his
3 testimony. I used data from Library Reference 1-297
4 for the first bundle sortation where 1.1 percent of
5 the pallet, mail that's palletized, breaks, and 17.5
6 percent of sacks break, and then, because we had
7 nothing else beyond that, I used 10 percent for
8 anything that has to go through a subsequent bundle-
9 sorting operation.
10 Q You use the same 10 percent, but you call it
11 the "10 percent factor."
12 A At that time, Witness Yacobucci didn't have
13 the data from Library Reference 1-297.
14 Q You used the 10-percent factor as Yacobucci
15 did.
16 A I used 10 percent for all subsequent
17 operations.
18 Q For all subsequent operations?
19 A I think he used it for all operations,
20 including when a container is first opened, which is
21 why he was saying he thought the pallet bundle
22 breakage was too high.
23 Q Sure. None of that responds to my question,
24 which is, you said that, when we were talking about
25 Stralberg's criticisms of the assumptions, that it was

1 the basic assumptions for the past three dockets.
2 Whether you used the exact same assumption for the
3 first bundle breakage possibility, same percentage, is
4 neither here nor there. Stralberg's criticisms
5 obviously are not at that level of technicality.
6 My question is, why don't you find anything
7 worth paying attention to in what I've just read? Do
8 you disagree with any of the factual statements, any
9 of them?
10 A I don't have any basis for agreeing or
11 disagreeing because I wasn't involved in that study.
12 Q You do have a basis for knowing whether that
13 study produced the data you described, for example,
14 the 80-percent breakage for sacks, the much, much
15 lower figure for sacks on pallets than for bundles on
16 pallets and bundles in sacks. Isn't that correct?
17 You're familiar with those data.
18 A I'm not familiar with the details. I
19 haven't looked at that data in a while, but it was the
20 data that was collected, and I don't know why the
21 results were as they are, but there are no other data
22 which to use.
23 MR. KEEGAN: Thank you, Mr. Miller. Thank
24 you, Mr. Chairman. That's all I have.
25 CHAIRMAN OMAS: Mr. McKeever?

1 MR. McKEEVER: Mr. Chairman, we have no
2 questions.
3 CHAIRMAN OMAS: Thank you.
4 Is there any additional person who wishes to
5 cross-examine this witness?
6 (No response.)
7 CHAIRMAN OMAS: Are there any questions from
8 the bench?
9 (No response.)
10 CHAIRMAN OMAS: There being none, Mr.
11 Weidner, would you like some time with your witness?
12 MR. WEIDNER: I would request five to 10
13 minutes, Mr. Chairman.
14 CHAIRMAN OMAS: Which, five or 10?
15 MR. WEIDNER: I would say, let's make it
16 seven.
17 CHAIRMAN OMAS: All right. Seven minutes.
18 (Whereupon, a short recess was taken.)
19 CHAIRMAN OMAS: Mr. Weidner.
20 MR. WEIDNER: No redirect, Mr. Chairman.
21 CHAIRMAN OMAS: Thank you, Mr. Weidner.
22 On that, we will adjourn for lunch, and
23 we'll come back at one-thirty. I'm giving you five
24 additional minutes. I think that's wonderful. Have a
25 good lunch.

1 (Witness excused.)

2 (Whereupon, at 12:22 p.m., a luncheon recess

3 was taken.)

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1 A F T E R N O O N S E S S I O N

2 (1:38 p.m.)

3 CHAIRMAN OMAS: Mr. Reiter.

4 MR. REITER: Good afternoon, Mr. Chairman

5 and Commissioners.

6 CHAIRMAN OMAS: Good afternoon.

7 MR. REITER: Our next witness is James

8 Kiefer.

9 CHAIRMAN OMAS: I think Mr. Kiefer has

10 already been sworn.

11 MR. REITER: That's right.

12 CHAIRMAN OMAS: Okay. You may proceed.

13 Whereupon,

14 JAMES M. KIEFER

15 having been previously sworn, was recalled

16 as a witness and was examined and testified further as

17 follows:

18 DIRECT EXAMINATION

19 BY MR. REITER:

20 Q Mr. Kiefer, you have with you two copies of

21 a document entitled, "Rebuttal Testimony of James M.

22 Kiefer on Behalf of the United States Postal Service,"

23 designated USPS-RT-11. Was this testimony prepared by

24 you or under your direction?

25 A It was.

1 Q And if you were to testify here orally
2 today, would your testimony be the same as is written
3 in that document?
4 A It would.
5 MR. REITER: Mr. Chairman, I will present
6 two copies of that testimony to the reporter and ask
7 that they be entered into the record.
8 CHAIRMAN OMAS: Is there any objection?
9 (No response.)
10 CHAIRMAN OMAS: Hearing none, I will direct
11 counsel to provide the reporter with two copies of the
12 corrected testimony of James M. Kiefer. That
13 testimony is received into evidence and is to be
14 transcribed into the record.
15 (The document referred to was
16 previously marked for
17 identification as Exhibit No.
18 USPS-RT-11 and was received
19 in evidence.)
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Postal Rate Commission 11123
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USPS-RT-11

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

POSTAL RATE AND FEE CHANGES	Docket No. R2006-1

REBUTTAL TESTIMONY
OF
JAMES M. KIEFER
ON BEHALF OF
THE UNITED STATES POSTAL SERVICE

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I. PURPOSE AND SCOPE OF TESTIMONY

My testimony rebuts several arguments and proposals made by a number of witnesses in this docket. These intervenor arguments and proposals concern Standard Mail, Parcel Post, Bound Printed Matter, Media Mail and Library Mail.

II. LIBRARY REFERENCES

There are no library references associated with my testimony.

III. STANDARD MAIL PARCEL AND NFM PRICING

A. Witness Horowitz's proposal to change the definition of Standard Mail should be rejected.

In his testimony, witness Horowitz proposes to redefine Standard Mail by allowing parcels containing up to 16 ounces of merchandise to contain an additional two ounces of advertising inserts beyond the 16-ounce weight limit for Standard Mail.

Witness Horowitz claims that advertising inserts in fulfillment parcels generate new business for mailers and, through the multiplier effect, produce more mail for the Postal Service. I do not dispute that including advertising inserts along with mail order merchandise has some value to mailers. Nor do I dispute that customers, by potentially responding to these advertisements, may generate additional mail pieces. But, based on the record evidence in this case, neither the Postal Service, nor the Commission has enough information to know whether the alleged benefits will be material or trivial. Against this unknown benefit, the Commission must consider possible negative repercussions of significantly redefining the Postal Service's largest mail class.

Witness Horowitz's testimony did not present a thorough analysis of the implications of his proposal. In my view, his proposal raises a number of obvious concerns that must be addressed before it could be considered for recommendation:

- Witness Horowitz proposes to breach the weight limit, but only for advertising inserts. His testimony fails to address how the Postal Service is to determine that the additional weight allowed by breaching the 16

ounce limit is composed of advertising inserts only. For example, consider a mailer that currently mails parcels with 14 ounces of merchandise and two ounces of advertising inserts. If Mr. Horowitz's proposal were to be approved, the mailer could mail 18 ounce parcels, with 16 ounces of merchandise and two ounces of advertising inserts. In this case the mailer would be using the increased weight limit to mail additional merchandise, not advertising, and there would be no additional multiplier benefits.

- Witness Horowitz's testimony does not address the fairness of implementing his proposal for Standard Mail with respect to other classes. While the absolute weight limits for most classes (70 pounds) are unlikely to be reached or surpassed, there are many lower weight rate cells where mailers could make a "fairness" argument for treatment similar to Standard Mail. For example, consider a mailer that uses Media Mail to fulfill mail orders. The mailer commonly mails merchandise parcels that are just below two pounds apiece, for which the mailer pays the two-pound Media Mail rate. The mailer would like to also include advertising inserts for the same reasons cited by Mr. Horowitz, but that would cause the parcels to exceed the two pound limit; the parcel would then be required to pay the three-pound rate. If the Standard Mail weight limit can be breached for advertising inserts, then why not the weight step limits for Media Mail, Library Mail, Parcel Post, or Priority Mail? What would be the impact of making the weight limit on virtually all postage rate cells flexible?

- Witness Horowitz proposes breaching the weight limit only for parcels. Why are flat-shaped pieces excluded? Witness Horowitz has offered no evidence that additional advertisements are beneficial only when mailed in parcel-shaped containers. But then, if the overweight eligibility is extended to flats, the further question arises: has any evidence been presented that the supposed "benefits" of additional advertising accrue only when the additional advertising is in the form of separate sheets or pieces? Couldn't additional net benefits (including multiplier effects) be claimed if an 18-ounce catalog were mailed instead of a 16-ounce catalog?
- What are the extra costs of this additional advertising material? Witness Horowitz implies that extra costs are minimal or none, since he claims that the size of the boxes Cosmetique would use would not increase. Even if that is Cosmetique's intention, in the absence of an explicit limitation on box size, the Postal Service has no assurance that costs will not increase. In addition, other mailers may not have unused space in their boxes, and may increase their package sizes. There is no evidence in this case on what the additional costs would be.

In summary, these and other related issues should be addressed on the record before the Commission recommends a redefinition of the basic boundaries of a major class of mail, such as that proposed by witness Horowitz.

B. The Postal Service's proposed parcel and NFM pricing is not unreasonably high.

A number of parties who currently enter mail that would be assessed postage under the Postal Service's proposed parcel and NFM rates have offered testimony claiming that the proposed rates are too high.[1] I believe that my proposed pricing for parcels and NFMs is reasonable. Yet the Postal Service's principal goal in this docket is to establish separate classifications with meaningful price differentials that lead to the efficiencies that the proposals intend to induce.

Many of these parties' testimonies (for example, POSTCOM-T-6, POSTCOM-T-7 and MBI-T-1) also argue that the proposed pricing will have significant adverse impacts on their businesses. I am aware that I have proposed large increases for some categories of Standard Mail parcels and NFMs. I am also aware that the proposed pricing may have a major impact on some mailers. But I believe that it is important for the Commission to take into consideration that the Postal Service and its customers have long been aware of the Postal Service's concerns that Standard Mail parcels and, especially, NFMs, have not been adequately covering their costs and contributing to institutional costs. As part of the effort to have parcels and NFMs appropriately priced, the impact of rate changes on mailers was taken into account and the proposed rates reflect significant mitigation. The proposed rate design also offers more attractive presort and drop ship options to soften the impact. I recognize that the proposed rates will challenge some mailers, but the proposed rates are already mitigated

[1] See, for example, the testimonies of witnesses Glick (PSA/POSTCOM-T-1), Horowitz (POSTCOM-T-6), Knight (POSTCOM-T-7), and Wilbur (MBI-T-1).

and, without the rate change mitigation already proposed, the impacts could have been much more significant. In the end, while the degree of rate increase is a matter of judgment, what is of primary importance is that the classifications be established with meaningful price differentials.

In his testimony, witness Glick (PSA/POSTCOM-T-1) points out that, on average, the Postal Service is requesting rate increases for Standard Mail parcels and NFMs above the 30 percent general rate increase limit proposed for Parcel Post.[2] Different circumstances apply to these two classes, however. In the case of Standard Mail parcels and NFMs, the Postal Service is proposing a reclassification of pieces that are not adequately covering their costs at present. When items are being reclassified, broader price changes should be expected than when price changes are being proposed for essentially unchanged rate categories (like those in Parcel Post). In addition, the utmost caution and care should be exercised before importing rate design elements (including percentage increase limits) from one class of mail to another. When establishing maximum rate change limits, absolutes do not exist that cover all situations. One size does <u>not</u> fit all mail categories.

While I disagree with many of the counterproposals put forth by some customers who mail Standard Mail parcels (or NFMs), I do appreciate the feedback received through intervenor testimonies and interrogatories to the Postal Service which has been helpful in highlighting potentially anomalous rate

[2] Despite the imposition of the 30 percent general limit, in certain circumstances this limit was exceeded. For example, in Parcel Post Intra-BMC Zone 5, some rate cells show increases of more than 50 percent.

relationships. Specifically, interrogatory UPS/USPS-T36-1 pointed out a potential problem in the Standard Mail Regular parcel pricing proposals where it could appear that the Postal Service's pricing might be encouraging mailers to make otherwise machinable parcels nonmachinable to take advantage of lower rates. The rate relationship highlighted in this interrogatory is an important one and I would certainly want to emphasize that the Postal Service does not want its rates to encourage machinable parcels to become nonmachinable.

C. Witness Glick's criticism of the Postal Service's flat-parcel cost difference passthrough misapplies the principles of efficient component-pricing, and should be rejected.

In his testimony (PSA/POSTCOM-T-1), witness Glick criticizes the Postal Service's pricing proposals for parcels because he claims they "pass through more than 100 percent of the cost difference between Standard Regular flats and parcels." (PSA/POSTCOM-T-1, at 3). The implication of this testimony, and of the PSA Response to NOI No. 2, to which witness Glick directs us in his testimony, is that a passthrough that exceeds100 percent of the flat-parcel cost difference is somehow improper on its face. Again, the Postal Service realizes that the application of judgment in deciding the appropriate size of price increases mailers will be asked to pay may result in flat-parcel cost difference passthroughs that turn out to be less than 100 percent. But as a matter of policy, there is no basis to conclude that 100 percent is the upper bound.

Witness Glick's prescription—that the proper passthrough (absent the need for rate change mitigation) should be 100 percent—is equivalent to the

assertion that unit contributions should be the same for both flats and parcels. It is also equivalent to claiming that the efficient component-pricing (ECP) rule should apply to shape-based cost differences.

The Postal Service disagrees strongly with this view. As the Postal Service stated in its own response to NOI No. 2 (Docket No. R2006-1, Response of the United States Postal Service to Notice of Inquiry No. 2, at 4), the ECP rule is only applicable to pricing worksharing cost differences, not shape-based cost differences. Witness Sidak, one of the original developers of the ECP concept, also agrees: "ECP is not an appropriate concept to use in calculating shape-based rates in the same manner that would be used to determine worksharing discounts." (NAA-T-1, at 11, lines 20-22). This means that passthroughs of shape-based cost differences exceeding 100 percent do not necessarily indicate economically inefficient pricing. Indeed, Valpak's witness Mitchell argues that the letter-flat cost difference should be marked up by the full cost coverage of the subclass.[3] While I am not persuaded of the validity of this "Mitchell rule," his testimony shows that the Postal Service is not the only voice arguing that shape-based cost differences deviating from 100 percent are not, <u>in themselves</u>, evidence of economic inefficiency or price discrimination. Indeed, as I discuss in my rebuttal of certain points of witness Panzar's testimony, requiring equal unit contributions for all shapes of mail (the equivalent of <u>requiring</u> 100 percent passthrough of shape-based cost differences) can lead to nonsensical, and potentially distorting, pricing decisions.

[3] Mitchell acknowledged upon cross examination that his prescription applied not solely to the letter-flat cost difference, but is also applicable to the flat-parcel cost difference as well (Transcript, pp. 9014-15).

Witness Glick cannot appeal to ECP or any other sound theory to support his preference for keeping the flat-parcel cost difference passthrough to 100 percent or less. His critique of the Postal Service's parcel pricing should be rejected and the Postal Service's proposed parcel rates should be evaluated on their merits and not solely on their relation to flats costs.

IV. PARCEL POST PRICING

A. Witness Luciani's claim that the Postal Service inappropriately marks up Parcel Post transportation cost differences is based on a mistaken understanding of the Postal Service's cost data.

In his testimony, witness Luciani (UPS-T-2) criticizes the Postal Service's Parcel Post rate design methodology for applying a markup factor to transportation costs by rate category. The Postal Service's methodology, according to witness Luciani, "marks up transportation worksharing cost differences" (UPS-T-2, at 5) and he claims that this approach "is directly contrary to sound Commission policy." (UPS-T-2, at 6).

Witness Luciani's claims and criticisms may have an immediate superficial appeal, but they are wrong. They are based on a flawed understanding of the Postal Service's Parcel Post transportation cost data.

The key to understanding witness Luciani's error is his identification of the transportation cost differences between Parcel Post rate categories as "worksharing cost avoidances." Although the five principal rate categories in Parcel Post do reflect different levels of worksharing, these categories are not themselves pure worksharing categories for transportation purposes. The Postal Service estimates transportation costs for the five Parcel Post categories based on actual measured transportation data for the five rate categories. These cost estimates, while reasonable and reliable for Parcel Post's rate categories as the categories are currently constituted, do not control for the differences in mail that use these five rate categories. The rate category transportation costs provided by witness Mayes reflect different mixes of mail—that is, differences in size, weight,

distance traveled, etc. For this reason, the differences in transportation costs between the different categories are influenced by a variety of factors and cannot simply be identified as worksharing cost avoidances.

Moreover, estimating transportation costs by zone introduces an additional complicating factor, at least for the Inter-BMC, DBMC and Intra-BMC rate categories. Simply put, zone designations cannot be directly compared across these Parcel Post rate categories. To make this idea more concrete, a zone 3 DBMC piece is not just a zone 3 Inter-BMC piece (or even a zone 3 Intra-BMC piece) that has merely been workshared. Zone designations have different operational meanings, depending on the rate category. For all rate categories, the zone measures the direct distance between the location where the mail piece is deposited and its destination. But the zone, measured in this fashion, has different meanings for cost estimation purposes, depending on the category, as is explained below.

- For Inter-BMC, a zone 3 piece may have to be transported anywhere from a short distance to a fairly significant distance from the place where the piece is entered to the origin BMC. It must then be transported from the origin BMC to the destination BMC and, finally, it must be transported from the destination BMC to the piece's final destination. This final destination can range anywhere from a short distance (for example, a zones 1&2 distance) up to a large distance (for example, a zone 4 distance). The actual transportation distance may be proportional to the postage zone rating of the piece or it may not.

- For DBMC, a zone 3 measures the distance traveled from the BMC to the destination locality. Here the distance traveled is generally proportional to the zone rating.
- For Intra-BMC, a zone 3 is unlikely to be proportional to the distance traveled, since a parcel will have to be transported between the entry point and the BMC, and from the BMC to the parcel's destination. The travel distance has no meaningful correlation with the zone rating, because the origin or destination may be close or far from the BMC.

The key understanding to take away from the foregoing discussion is that a workshared piece, for example, a DBMC zone 3 piece, can avoid widely differing amounts of transportation costs. A DBMC zone 3 piece cannot simply be understood as an Inter-BMC zone 3, or an Intra-BMC zone 3 piece that has some well-defined Postal Service transportation activity avoided by the mailer. No obvious benchmark exists that can be used to calculate with satisfactory precision the avoided transportation costs for a specific category of mail, say DBMC zone 3 parcels. We know that these parcels avoid some Postal Service costs, but it would grossly overstate our knowledge to claim that the avoided transportation cost is the same as the difference in average transportation costs between DBMC zone 3 parcels and Inter-BMC zone 3 or Intra-BMC zone 3 parcels (or even between the costs for DBMC zone 3 parcels and the average Inter-BMC or Intra-BMC parcel). The plain fact is that we do not have a suitable pure transportation cost benchmark for DBMC zone 3 parcels.

Witness Luciani's mistake is to identify the cost differences between the average transportation costs for "workshared" and the average transportation costs for "non-workshared" parcels as solely (or even primarily) due to worksharing, and therefore as "avoided costs." They are not. It is reasonable to conclude that there may be some avoided cost component in these cost differences, but I understand from Postal Service staff who calculate these costs, the avoided cost component cannot be reliably extracted or estimated. Nor can it even be determined that the avoided cost component is either a relatively large or relatively small component of the cost differences.

The Postal Service's methodology is a reasonable way to approach the problem posed by the complex nature of Parcel Post rate categories.[4] Witness Luciani's critique is based on a misunderstanding of the Postal Service's transportation costs.

[4] And, despite witness Luciani's claims (UPS-T-2, at 4-5), the Postal Service's approach is consistent with the approach used by the Commission in the most recent case (Docket No. R2000-1) in which the Commission published rate design workpapers for Parcel Post.

V. USE OF ECP FOR NON-WORKSHARING PRICING

A. Witness Panzar's assertion that Efficient Component-Pricing (ECP) should guide all pricing within a subclass is wrong and should be rejected.

Witness Panzar (PB-T-1) claims that all pricing within a subclass should be set consistent with the Efficient Component-Pricing (ECP) rule and therefore, all pieces within a subclass should have the same unit contributions.[5]

In making this claim, witness Panzar misapplies the ECP rule. As witness Sidak testifies, the ECP rule is appropriate for pricing worksharing cost differences, but ECP is generally not applicable to shape-based cost differences. Witness Sidak explains the reason: these characteristics (i.e. mail shapes) "do not generate costs avoided for the USPS, as does workshared mail." (NAA-T-1, at 11). Witness Panzar's approach does not limit the application of ECP (or, its equivalent, equal unit contributions) to cost differences associated only with worksharing (that is, avoided costs). By extending the ECP rule to all cost differences, he misapplies ECP.

Witness Panzar bases his argument for extending the ECP rule on two premises, both of which are unproven, and likely wrong. The first premise is that mailers choose the characteristics of the mail they send, such as the shape of the mail pieces, and that their choices are highly flexible and largely susceptible to influence by the relative prices set by the Postal Service.

Witness Panzar offers not the slightest bit of evidence to support this premise. In fact, the evidence that is available in this docket strongly suggests

[5] See, for example, PB-T-1, at 45, lines 1-8; also, lines 21-22: "The basic economic argument in support of cost-based rate differentials is the same as that for avoided cost worksharing discounts." See also VP/PB-T1-10 and Transcript, p. 9258.

that the opposite is true: that mailers do not see their mail piece characteristics as highly flexible, and they are not willing and able to switch them, even in response to substantial changes in relative prices.[6]

The second premise on which witness Panzar's argument rests is that the demand characteristics (or, price elasticities) of all subgroups of pieces within the subclass are the same, or at least, inconsequentially different (See, for example, Transcript, p. 9260). Like the first, this second premise is wholly unsupported by witness Panzar, and is probably false. Rather than provide evidence to support this notion, he evidently simply assumes it to be true.

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[6] In this docket the Postal Service is proposing significant rate increases for certain Standard Mail pieces based on their shape (parcels and NFMs). If witness Panzar's assumptions were valid, one would expect mailers to respond primarily by changing their mail piece characteristics to avoid the rate increases. Yet the evidence on the record in this case does not support Panzar's view. For example, witness Knight's testimony expects the Postal Service, rather than its customers to change: "One could suspect that the Postal Service's zeal to modify its customers' products to fit its future operations is self-defeating. A wiser choice for the Postal Service would be to adapt its operations to fit the existing and traditional specifications of its customers' products...." (POSTCOM-T-7, at 2). Elsewhere, Knight testifies that, rather than change its products in response to the price increase, his company will simply ship less: "Unless the Commission rejects or at the very least, very profoundly mitigates the rates proposed by the Postal Service, we anticipate that our annual volume of product shipments would decline drastically." (POSTCOM-T-7, at 9). Witness Horowitz echoes Knight's testimony that the response to the price change is not to change his company's mail piece characteristics (for example, to reduce the weight of its parcels or change their shape). Rather, his title to Section B proclaims, "A Decrease in the Use of the Mailstream is Our Most Logical Choice." (POSTCOM-T-6, at 7). Incidentally, on the same page, Horowitz testifies that postal price signals are not the all-powerful determinant of mail piece characteristics that Panzar seems to suggest: "In fact, it costs us more to drop enter our parcels at some West Coast bulk mail centers than we save in the drop entry discount. For operational and service reasons, however, we drop enter at all bulk mail centers." (POSTCOM-T-6, at 7). Another party does testify on the issue of changing mail piece characteristics in response to the price change proposals, but his testimony clearly undercuts Panzar's presumed mail piece characteristic flexibility: "Theoretically, we could mitigate this increase by reconfiguring our packaging to accommodate the USPS machinery and therefore make it qualify as machinable...However, the nature of our product lines makes this a very challenging if not impossible assignment." (MBI-T-1, at 1. Emphasis added). While the Postal Service suspects that mailers' claims of drastic reductions in mail volumes may be a bit overstated, these testimonies do not appear to wholeheartedly support witness Panzar's assumption that mail shape choices are highly flexible.

1 This assumption reveals a serious misunderstanding of the nature of
2 postal subclasses. With the relatively small number of postal subclasses and the
3 wide range of mail piece types in each, it should not be surprising at all to see
4 significant variations in price elasticity for different subgroups within the broad
5 subclasses, whether or not these elasticities have been separately estimated.
6 Yet, in spite of this fact (acknowledged by witness Panzar for Parcel Post during
7 cross examination (Transcript, pp. 9256-7)), he does not alter his testimony that
8 all pieces of Parcel Post should bear the same absolute markup, regardless of
9 weight, distance transported, machinability, or whether the piece was destination
10 entered or not. (See, for example, VP/PB-T1-10).
11 At most, witness Panzar suggests that modifying his ECP rule prescription
12 might be appropriate "in these kinds of situations" (Transcript, p. 9260) where
13 subgroups within a subclass have demonstrably different demand elasticities.
14 Nevertheless, he reasserts his ECP rule prescription for "the basic,
15 homogeneous elasticity characterization of subclass demand" (Transcript, p.
16 9260) without providing or pointing to any evidence whatsoever that
17 "homogeneous elasticity" can actually characterize postal subclasses.
18 This points out a major flaw in witness Panzar's reasoning. He <u>assumes</u>
19 that subclasses are composed of pieces with homogeneous price elasticity and
20 maintains that his assumption holds generally, even while acknowledging that
21 widely different price elasticities do occur in a subclass that is relatively
22 homogeneous in terms of shape and purpose (Parcel Post).

1 I think this example only shows that witness Panzar doesn't fully
2 appreciate the complex nature of postal subclasses where, to take Standard Mail
3 Regular as an example, mail pieces can range from advertising letters weighing
4 less than one ounce to mail order fulfillment parcels that weigh almost 16
5 ounces.

6 Witness Panzar's overextension of the ECP rule is not just a matter of
7 theoretical concern. It has real-world consequences that may produce
8 undesirable and perverse incentives. For example, it ignores the fact that cost
9 estimates tend to have margins of uncertainty that increase with weight, rather
10 than are constant at every weight. Applying witness Panzar's pricing prescription
11 to Parcel Post would assign the same absolute per-piece markup over marginal
12 cost for a 60 pound parcel as for a one pound parcel, regardless of the degree of
13 uncertainty attached to their respective cost estimates. This rule would tend to
14 discourage the carriage of large parcels and over-encourage the carriage of
15 smaller parcels.[7]

16 Moreover, if the Postal Service has competitors who add a higher risk
17 premium to heavier parcels, or who otherwise mark up their services

[7] Consider the hypothetical example where the Postal Service can carry either 100 large parcels or 10,000 small parcels in its truck. The cost for a particular run is $1,000: $10 for each large parcel, or $0.010 for each small parcel. If the cost of transportation rose for unforeseen reasons from $1,000 to $1,050, the cost increase would amount to $0.50 for each large parcel, or $0.005 for each small parcel. It should be obvious that, in the face of transportation cost uncertainty, Panzar's equal unit contribution rule would give the Postal Service a strong incentive to avoid carrying larger parcels rather than smaller parcels, since $0.50 represents a much larger fraction of any uniform per-piece contribution than $0.005. Moreover, in the face of any significant cost uncertainty or volatility, the larger parcels run the real danger of becoming money-losers, requiring other pieces to pick up the burden of covering the larger parcels' volume variable costs, let alone any contribution to institutional cost coverage. Of course, a contingency could be added to the costs to compensate the Postal Service for the cost uncertainty, but if the contingency were applied at the subclass level (as in Postal Service pricing), Panzar's pricing rule would still distort the price signals, discouraging the carrying of large parcels and excessively encouraging the carrying of small parcels.

1 proportionally to cost (rather than on an absolute basis), heavier parcels would,
2 ceteris paribus, be driven toward the Postal Service. This is not a stable situation.
3 The Postal Service would find itself taking on ever-increasing quantities of
4 potentially money-losing large parcels and proportionately fewer of the smaller,
5 relatively more profitable parcels (which, if witness Panzar's rule were used,
6 would be over-priced compared to the prices charged by the Postal Service's
7 competition).[8]

8 Because witness Panzar's pricing rule applies ECP where no real
9 worksharing is taking place, and because following witness Panzar's rule
10 potentially can lead to perverse incentives for the Postal Service to avoid heavier
11 (or more distant) mail, witness Panzar's pricing rule should not be applied.

12 Another reason that his rule is inappropriate is that he bases his
13 prescription on two premises that he assumes to be true, but that the available
14 evidence strongly indicates are not. Furthermore, dogmatically applying the ECP
15 rule for non-worksharing cost differences robs the Postal Service and the
16 Commission of the ability to use reasonable judgment to reflect information (such
17 as shape-based demand and impact information) that is present, but not
18 discernable in aggregate subclass price elasticities. This additional information
19 may point to appropriate deviations from strict ECP rule application when pricing
20 non-worksharing cost differences.

[8] Although, in the foregoing discussion, products were differentiated by size, similar problems could occur if the differentiation were by distance traveled, or zone.

VI. VALPAK'S STANDARD MAIL PRICING PROPOSALS

A. Witness Mitchell's approach to ratemaking is excessively mechanistic and produces unreasonable rate change proposals.

Witness Mitchell proposes rates for Standard Mail that adhere to the principle that all rates below the subclass level should be based only on estimated cost differences (See USPS/VP-T1-26). Mitchell justifies this approach by appealing to the principles of economic efficiency which, he claims, require prices to be set as he proposes.

While I acknowledge that economic efficiency is an important goal and guide in establishing pricing at all levels, I believe that it is not the sole criterion.[9] Witness Mitchell's approach is too doctrinaire. It is excessively focused on just one pricing factor out of many, and produces prices that fail to acknowledge several other factors that are also important in setting rates.

1. Mitchell's approach does not adequately acknowledge the importance of existing rate relationships.

I do not believe that existing rate relationships are carved in stone and must never change. Indeed, I am sympathetic to the view, strongly advocated by Valpak in this docket, that Standard Mail flats should bear a greater share of the Standard Mail institutional cost burdens. Yet, at the same time, I understand that most Standard Mail flats are making significant positive contributions, and I am sensitive to the impacts that rapid changes in relative prices might have on the businesses of those customers who mail Standard Mail flats. Therefore, I

[9] I agree with the Commission's view, stated in Docket No. R2000-1: "Economic efficiency is neither the exclusive nor even the paramount ratemaking objective under the Act." (Docket No. R2000-1, Opinion and Recommended Decision, para. 4042).

strongly believe that changes in relative letter-flat prices should be evolutionary, not revolutionary. Witness Mitchell's approach would jump instantly to his preferred rate relationships, heedless of the consequences his proposed pricing would have on mailers' businesses. I believe that relative letter-flat prices should adjust gradually, even after considering that the "evolution" has been delayed because of a number of unrelated factors.[10]

2. Mitchell's proposed pricing does not properly acknowledge the impacts it would have on mailers whose mail is otherwise covering its costs.

In his testimony, witness Mitchell concludes that the letter-flat cost difference is not fully recognized in the rates proposed by the Postal Service. In his pricing he attempts to "fix" this "problem," virtually in one step.[11] The upshot of Mitchell's desire to fully recognize the letter-flat cost difference in rates is to place an excessive adjustment burden on Standard Mail Regular flats. Mitchell's Chart 1 shows many minimum-per-piece rated Regular flats rate cells with proposed increases exceeding 40 percent and 50 percent. Mitchell does not argue that increases of this magnitude are required to ensure that Regular flats cover their costs. Rather, his proposals are the direct result of his dogmatic pursuit of "economic correctness," without adequate concern for impacts on mailers.

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[10] These include the unanticipated period of rate stability caused by the recognition of the over-funding of the Postal Service's CSRS pension liability, and the across-the-board rate increase related to the Postal Service's obligation to fund an escrow.

[11] Mitchell's proposed pricing for Standard Mail Regular assigns a passthrough of the letter-flat cost difference of 95 percent, only slightly less than his minimum acceptable passthrough of "at least 100 percent." (VP-T-1, at 118). Mitchell here actually argues for a shape-based cost difference passthrough set at the subclass coverage. While I agree with witness Mitchell (and with witness Sidak (NAA-T-1, at 11) that there is no compelling theory to require, or even limit, setting non-worksharing cost difference passthroughs at 100 percent, I also find Mitchell's alternate passthrough-setting rule to be too rigid and doctrinaire.

The Postal Service's proposals, in contrast, do increase the relative letter-flat rate difference, when compared to current rates. But the Postal Service's rate proposals take into consideration the impact of rate changes on mailers. The Postal Service's proposed rates for minimum-per-piece rated Regular flats increase as much as 23.7 percent for a Mixed ADC origin-entered flat. Increases of this magnitude indicate a clear movement toward assigning flats a greater share of Standard Mail Regular's institutional costs. At the same time, the proposed rates show sensitivity to the fact that our rate increases will have an impact on flats mailers. [12] Witness Mitchell's proposed pricing expects flats mailers to adjust to whatever changes come out of his mechanistic application of "economically correct" pricing. His methodology produces unreasonable rate increases for flats mailers.

3. Mitchell's pricing methodology assumes that only cost-related factors should be used in rate design below the subclass level. It fails to acknowledge the possibility of differences in product market characteristics below the subclass level that may be appropriate to consider.

Witness Mitchell believes that a subclass' price elasticity appropriately reflects all non-cost factors, like value of service, for the subclass (See his response to USPS/VP-T1-17). Yet different product subgroups within a subclass often have different non-cost and market characteristics. If the price elasticity does capture the valuation of non-cost and market characteristics, as witness Mitchell

[12] This is a significant increase and reflects, in part, the push-up effect from de-averaging the Automation basic presort rates. The ADC presorted flats benefit, in part, from the push-down effect of de-averaging. Since many mailers enter mail at several presort levels, the total impact of higher and lower rate increases tend to average out and would probably be less than the maximum increase.

postulates, then different product groups within subclasses would likely also have different own-price elasticities (whether or not these elasticities are separately estimated). But while witness Mitchell's logic thus suggests the likelihood that different subgroups within a subclass have different demand characteristics, his pricing methodology nonetheless insists that these demand-side differences be ignored in rate design. According to witness Mitchell, all products within a subclass should be priced differently based on costs only.[13]

I disagree. While we do not have price elasticities for most subgroups below the subclass level, I see no reason why such market information as is available (whether formally quantified or not) must be ignored in developing appropriate rates. Mitchell's mechanistic rate setting methodology is too doctrinaire and would ignore this information.

There is yet another way in which Mitchell's excessively mechanistic approach to ratemaking reveals itself. Mitchell's testimony clearly reveals that prospects for legislative reform of the postal ratemaking process propelled his rather extreme rate change proposals. At one point he states,

> "It cannot be presumed that a second (or third) step, moving gradually toward preferred rate positions, will be possible in the next omnibus case or in the one after that. [footnote omitted] The most appropriate rates must be reached in one step, even if it is a large one, in order to prevent present inefficiencies and inequities from being etched into relationships that will be difficult, if not impossible, to correct. (VP-T-1, at 9-10).

[13] See. USPS/VP-T1-26. Mitchell's reliance on "costs only" does not preclude marking up cost differences, as he argues we should do to the letter-flat cost differential. It only seems to mean that differences in non-cost factors between products or categories have no meaningful role in setting price differences below the subclass level.

Yet, if legislative restructuring of Postal Service pricing were no longer imminent, an alternate pricing proposal could be had by simply changing two cells in his workpapers:

> In fact, I have given you a spreadsheet where you can go in, and you can change the number in two cells, which anybody in the third grade should be able to do, and the new rates will come out. That's it. Two cells, and you'll have a complete set of rates with increases, and I see no reason why those wouldn't be defensible. (Transcript, p. 9022).

In response to this assertion, one is compelled to ask: where is the careful, balanced consideration of rate change impacts and rate relationships that should be expected if the rate design were to respond to a complete change in so fundamental a driving assumption? The answer is clear: there is none.

Mitchell's approach to ratemaking is so mechanistic that it is immaterial whether or not Congress acts to completely restructure postal ratemaking, and rate levels are significantly changed in response. Mitchell's pricing model can shift to produce a complete set of rates for Standard Mail under either of two fundamentally different environments with no judgment required. I do not believe that rates should be simply produced by turning the crank on some big rate machine. Mitchell's approach to ratemaking is excessively mechanistic and should not be used as the basis for setting Standard Mail rates.

B. Mitchell's pricing proposals and methodology do not reflect a balanced consideration of relevant factors and so should be rejected.

It is clear from reading witness Mitchell's testimony that he views his pricing proposals as primarily completing the work of Standard Mail de-averaging

that was begun in Docket No. MC95-1.[14] This is an excessively narrow lens in which to view rate changes in this docket, and it reflects an inappropriate lack of balance in ratemaking.

Since Docket No. MC95-1, there have been four intervening omnibus rate cases. Although one of the four (Docket No. R2005-1) did not significantly change existing rate relationships, it cannot be denied that circumstances, both within and outside Standard Mail, have changed. It is unrealistic to view Valpak's preferred changes in ECR rates and cost coverage solely within the context of de-averaging Standard Mail as witness Mitchell does. Changes in ECR's rates and cost coverages must be evaluated within the wider context of the circumstances facing the Postal Service and the Commission in Test Year 2008. Witness Mitchell has not done this. He has simply shifted the entire burden of achieving his desired ECR rates to Standard Mail Regular without regard to the wider implication of such a stance.

Even if one were to accept, for the sake of argument, that Standard Mail Regular were the appropriate subclass to bear the burdens of desired ECR rate reductions, Mitchell has provided no evidence showing the likely impacts of his proposed radical rate restructuring of Standard Mail on the Postal Service as a whole, and on other classes of mail, particularly on First-Class Mail. Mitchell's analysis doesn't even attempt to provide the after-rates revenue and contribution impacts of his proposals on the Standard Mail subclasses themselves. This might not be so serious if the suggested changes were minor, and the expected impacts were de minimis. But Mitchell is proposing ECR rate <u>reductions</u> of 8.47

[14] See, for example, VP-T-1, at 8-9.

1 percent (compared to the Postal Service's proposed increase of 8.4 percent),
2 and a Regular rate increase of 17.56 percent (compared to the Postal Service's
3 proposed 10.8 percent increase). Mitchell offers no evidence as to what kind of
4 impacts his rate changes would have.

5 It is clear that witness Mitchell's excessively narrow focus has led him to
6 propose a massive restructuring of Standard Mail rates without providing any
7 evidence of the repercussions of his proposals. Mitchell's analysis is too
8 incomplete to rely on as the basis for so significant a rate restructuring.

VII. PACKAGE SERVICES CLASSIFICATION PROPOSALS

A. Witness Haldi's proposal to change the definition of Bound Printed Matter to allow non-printed material would increase BPM's unit costs and should be rejected.

In his testimony (AMZ-T-1), witness Haldi proposes that Bound Printed Matter (BPM) should be re-defined so that CDs, DVDs and other forms of electronic media (such as memory cards) can be mailed as BPM.[15] This proposal would likely lead to a migration of parcels from Media Mail, and possibly, Parcel Post, to BPM and increase the average unit costs for BPM. Neither witness Haldi's testimony nor any other part of the record provide any evidence showing what the financial impacts of this restructuring of BPM would have on BPM or on Media Mail. Furthermore, witness Haldi's defense of his proposal reveal a serious misunderstanding of the nature of BPM, its cost characteristics, and certain content exceptions that are permitted. Because of these flaws, Haldi's testimony is wholly inadequate and cannot be relied on as the basis for making such a sweeping change in the definition of an important parcel subclass.

1. Haldi's "higher average cost coverage" argument reveals a serious misunderstanding of how Postal Service parcel costs are generated.

Witness Haldi expects his proposal to cause some pieces, currently ineligible for BPM, to migrate from Media Mail to BPM. He asserts that, since

[15] Although witness Haldi initially proposed that just electronically published books and CDs, and DVDs of movies based on books, be admitted into BPM, he later stated in response to written cross examination, "The proposal contained in Appendix II of my testimony would enable all CDs and DVDs to qualify." (USPS/AMZ-T1-3c). [Emphasis added]. Appendix II is Haldi's proposed DMCS language.

1 BPM has a higher average cost coverage than Media Mail, migrating pieces will
2 increase Postal Service contribution.[16]

3 Witness Haldi's assertion is demonstrably false. He first attempts to
4 inoculate his claim from criticism by knocking down a straw-man objection.
5 Immediately after making his assertion he assures us that "reliance on such
6 averages can of course be deceptive, because no mailer makes decisions based
7 on averages." (VP-T-1, at 17). Witness Haldi then segues into a discussion
8 where he argues that Media Mail users would not "cherry pick" and that this
9 problem therefore "does not exist." (VP-T-1, at 18).

10 There is no need to address the merits or flaws of his cherry picking
11 argument, since it is simply a red herring, tossed in to draw attention away from
12 the glaring flaw in his "contribution will be improved" assertion. His argument is
13 false because the only relevant factors in determining the contribution a parcel
14 makes to Postal Service institutional costs are the postage it pays and the costs
15 it imposes on the Postal Service. Period. Cherry picking, mailers' "decisions,"
16 etc., are irrelevant. Only the postage and the costs matter.

17 Since the motivation for witness Haldi's proposal is to lower postage paid,
18 the only way a piece migrating from Media Mail to Bound Printed Matter would
19 increase contribution would be if that mail piece were to cost less as a BPM
20 piece than as a Media Mail piece. The Postal Service processes and delivers
21 similarly presorted and entered bulk Media Mail and BPM in the same way, so

[16] "Based purely on averages, it would appear that each piece which migrates from Media Mail to BPM would increase the contribution to overhead by $0.03, which represents a 14 percent gain over the contribution in Media Mail." (AMZ-T-1, at 17).

the cost would be the same, regardless of the subclass.[17] If migration does not change the costs, and postage goes down, it follows unambiguously that, ceteris paribus, allowing currently non-qualifying pieces to migrate from Media Mail to BPM will reduce Postal Service contribution.

2. Witness Haldi says that his proposal is consistent with past Commission positions to make available low-cost options when possible (AMZ-T-1, at 18).

Here the term "low cost" is intended to mean low postage. But, as shown in the previous discussion, expanding the definition of BPM will not, ceteris paribus, reduce Postal Service costs.

Just because migrating pieces are mailed using a subclass with lower unit costs does not mean that these pieces will be processed and delivered at lower cost. BPM has lower average unit costs than other Package Services subclasses because its composition is different: it has a high proportion of flats, which generally are cheaper to process and deliver than parcels.[18] Bringing more parcels into BPM would increase average unit costs, eroding the low average cost characteristics of BPM.

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[17] Because Media Mail (and Library Mail) do not have destination entry discounts, an argument might be made that eligibility for BPM would encourage additional drop-shipping, and so lower the cost to the Postal Service. This, of course, would only improve contribution if the Postal Service passed through less than 100 percent of its appropriately estimated destination entry avoided costs. While passthroughs may be lower than 100 percent at present, neither the Postal Service nor the Commission has expressed the view that they should remain so indefinitely.

[18] According to FY 2005 RPW by shape, flat-shaped pieces account for 46 percent of BPM. See also, Attachment 14 to the testimony of Postal Service witness Smith(USPS-T-13), which projects that test year mail processing costs for BPM flats will be 23.71 cents per piece, compared to 62.28 cents per piece for parcels/IPPs.

Witness Haldi's proposal would lead to lower postage, but not lower cost for BPM. It would erode the low-cost characteristics for BPM, eventually leading to higher rates for all BPM pieces.

3. Witness Haldi says that BPM has a highly de-averaged, cost-based rate structure that shields mailers of low cost mail from inefficient mail.

Witness Haldi claims that "[d]evelopment of this highly de-averaged, cost-based rate structure has helped protect those BPM mailers who submit highly-prepared and highly-efficient mail from suffering rate increases on account of less-efficient and more costly mail being averaged into the rate structure." (AMZ-T-1, at 13).

One might be tempted to agree with witness Haldi if one were only to give a superficial glance at the BPM rate charts. BPM does have separate rates for presorting, drop-shipping and for flats and parcels. But this ignores the fact that the BPM rate structure is in evolution and has by no means arrived at the blissful state of (near) perfect cost and rate de-averaging that witness Haldi praises. Witness Yeh (USPS-T-38) has testified that she developed the flat-parcel rate differential without having witness Smith's estimated mail processing costs by shape available to her. (See witness Yeh's Response to POIR No. 5, question 2b). It is clear from witness Yeh's testimony and workpapers that her proposed flat-parcel rate differential does not fully reflect all of the combined delivery and mail processing costs differences estimated by witnesses Kelley and Smith.

If cost differences are not yet recognized at their appropriate levels, encouraging migration of higher cost parcels from Media Mail to BPM would be,

at best, premature and, at worst, potentially disastrous for BPM. Simply put, bringing pieces with cost characteristics on the high-cost side of the average into the BPM mix would definitely cause lower-cost BPM mail to suffer increased rates, precisely the outcome that witness Haldi claims would not happen because of BPM's "highly de-averaged" rate structure.

Finally, despite witness Haldi's claims (AMZ-T-1, at 35), the BPM rate design is not "cost-based" in one important aspect: it does not recognize the impacts of cubic volume (or "cube") on costs separately from weight. Because of the difficulties of measuring cube, the Postal Service has traditionally relied on weight as a proxy for cube in rate design. This approach makes some sense when one is dealing with mail pieces all having the same shape (i.e. all parcels, or all flats). But, in a mixed-shape subclass such as BPM, to blindly assume that BPM flats, BPM parcels, and parcels that potentially would migrate from Media Mail all have the same average densities is to run the risk of making disastrous rate design decisions. Nowhere in witness Haldi's testimony, or elsewhere in the record is there any estimate of the cost impacts of bringing in low-density CDs and DVDs into a subclass that consists largely of relatively high-density books and catalogs. This is a serious shortcoming in Haldi's testimony and renders it inadequate to use as the basis for restructuring BPM.

4. Witness Haldi says that excluding books published in electronic format is illogical, particularly because current rules allow certain non-print items to accompany printed books and pay BPM rates. (AMZ-T-1, at 16).

Witness Haldi claims that his proposal would not alter the basic content requirement for BPM. (AMZ-T-1, at 24). He can make this claim because he has redefined the word "content" to refer only to what is communicated by the books, catalogs, CDs, DVDs, etc. (i.e. advertising, editorial matter, and so on) that he argues should be allowed in BPM. But, BPM's attractive cost characteristics rely crucially on a broader notion of content, one that includes inherent physical characteristics: bound printed matter. Bound printed matter is by its very nature dense. High-density parcels and flats have favorable cost characteristics that have led to the low rates that make BPM so attractive. To allow low-density non-printed matter parcels into BPM would erode and, perhaps, eventually destroy BPM's low cost profile. It would certainly shift recovery of the higher average costs onto high-density BPM pieces with favorable cost characteristics to the extent that BPM rates do not fully reflect the impact of density on costs.

Witness Haldi's assertion that his proposal would not alter the content of BPM is untrue. His proposal would shift the content of BPM away from highly dense printed books and catalogs with favorable cost characteristics.

His proposal would likely lower contribution in the short run, and in the longer run would increase the rates of high-density bound printed matter already in the subclass. Witness Haldi's proposal would bring significant undesirable impacts to BPM. Witness Haldi has done no concrete analysis of these impacts and there is nothing on the record to even demonstrate how these impacts might be reasonably estimated.

B. Witness Angelides' proposal to change the Media Mail rate design to include half-pound rate increments is inconsistent and is not based on any record evidence of cost causation by weight. It should be rejected.

Witness Angelides (POSTCOM-T-5) proposes to change the long-standing Media Mail rate design to introduce half-pound rate steps between 1.0 pounds and 5.0 pounds. Below 1.0 pound and above 5.0 pounds, the rate would change in whole pound increments. (POSTCOM-T-5, at 6).

Witness Angelides supports his change to the rate design by arguing that full pound rate increments at low weights "can result in dissimilar packages paying the same rate." (POSTCOM-T-5, at 5, lines 17-19). Of course, the notion that dissimilar mail pieces pay the same rate is fundamental to the notion of averaged rates. Dissimilar mail pieces pay the same rates in all mail classes offered by the Postal Service.

What concerns witness Angelides is apparently not just that 1.1 pound parcels differ from 2.0 pound parcels and 2.1 pound parcels differ from 3.0 pound parcels, etc., but the relative size of the difference. Witness Angelides provides a pair of tables (Tables 2 and 3) (POSTCOM-T-5, at 7) to show some variations between the weights of parcels that pay the same rates. Table 2 shows the variations in weights under the current full-pound weight step rate design. Table 3 shows the variations under his proposed half-pound step rate design.

Witness Angelides does not provide any evidence that the weight differences shown in Tables 2 and 3 <u>in and by themselves</u> have a demonstrable effect either on costs or on other factors that compel them to be separately

recognized in the rate design. Parcels with similar, or even identical, costs can have equally dissimilar cubic volumes (cube) and, from what I understand from Postal Service staff who calculate parcels costs, differences in cube at low weights are of considerable importance in determining differences in costs.

Witness Angelides is also rather inconsistent in the way he applies his principle of avoiding significant relative weight variations within weight steps. For example, in Table 2, the relative weight variations for the 3.1 to 4.0 pound and 4.1 to 5.0 pound rate steps are 23 percent and 18 percent. Apparently witness Angelides finds weight variations this big to be unacceptable, since he proposes to reduce them by setting up half-pound weight steps between 3.0 and 5.0 pounds. But if 23 percent variation is not acceptable in a full pound weight step, why is 27 percent variation acceptable in his half-pound step between 1.0 and 1.5 pounds? At what point exactly does a weight variation within a rate step become unacceptable? Witness Angelides does not explain why 45 percent or 23 percent or 18 percent is unreasonable.

Moreover, witness Angelides does not adequately explain why he exempted the first pound from his half-pound plan. Again, this is inconsistent. Using his methodology, the variation between a 1.0 pound Media Mail piece and a 0.1 pound piece is 90 percent. Of course, one might respond that there may be no 0.1 pound pieces in Media Mail. But there certainly are likely to be pieces that weigh less than eight ounces that would fall in a 0.0 to 0.5 pound rate step. What is more, witness Angelides has not explained why his principle applies <u>only</u> to Media Mail. If the Commission accepts this principle for Media Mail, presumably

it should apply to other subclasses as well. Witness Angelides evidently has not considered the implications of applying his principle throughout the postal rate structure.

CHAIRMAN OMAS: This now brings us to oral cross-examination. Six requests for oral cross-examination have been filed.

MR. VOLNER: Mr. Chairman?

CHAIRMAN OMAS: Yes.

MR. VOLNER: With the consent and the gracious consent of my colleagues, I am going to cross-examine first on behalf of the Association for Postal Commerce.

CHAIRMAN OMAS: Mr. Volner, I was just looking for who you are representing.

MR. VOLNER: The Association for Postal Commerce.

CHAIRMAN OMAS: Thank you.

MR. VOLNER: Thank you.

CHAIRMAN OMAS: Proceed.

CROSS-EXAMINATION

BY MR. VOLNER:

Q Good afternoon, Mr. Kiefer. I have just a very few set of questions dealing with your testimony on two topics, the first of which is standard mail parcels and the now-famous NFMs, and the second of which is on some of your discussion of the rebuttal of Witness Angelides on media services. But let's start, if you could, with page 7 of your testimony.

1 A I have it.

2 Q And you say, at line 5, that you're

3 essentially rebutting Witness Glick on his testimony

4 in PSA POSTCOM-T-1, in which he pointed out that, on

5 average, the Postal Service's request for rate

6 increases for standard mail parcels and NFMs is above

7 the 30-percent general rate increase that you've

8 established for parcel post.

9 Your response, at line 11, is, "When items

10 are being reclassified, broader changes should be

11 expected than when price changes are being proposed

12 for essentially unchanged rate categories like those

13 in parcel post."

14 Do you mean that to be an unqualified

15 statement; that is to say, whenever there is a new

16 category, it should be higher than it would be if you

17 were dealing with rate changes in an established

18 category?

19 A I think that would apply more strongly to

20 cases where we are having a kind of a de-averaging;

21 that is, taking a category that essentially was

22 grouped together, and you're separating it into finer

23 categories, and then you would expect broader changes.

24 Q And would that be true if you're not certain

25 about the cost of the de-averaged subset or category?

1 A Well, this really wasn't comparing a
2 situation where you're certain about the cost versus
3 not certain about the cost. *Any* cost estimate has a
4 certain level of uncertainty, and, within that, if
5 you're dealing with a de-averaging, you would expect a
6 broader increase, whatever the level of certainty is.
7 Q The greater the uncertainty, however, the
8 greater the question of whether you should expect a
9 broader increase. Isn't that true?
10 A As a pricer, I might be led to mitigate a
11 little bit more strongly if there is greater
12 uncertainty.
13 Q Now, what about when there is uncertainty as
14 to the volumes in the new category, as a pricer?
15 A Well, as far as pricing goes, I think that's
16 perhaps not quite the same level of importance. It
17 depends on the size of the uncertainty, but, as a
18 pricer, I use the volumes mainly to project the
19 revenues for the Postal Service.
20 Q Right, but you can't project revenues
21 without having some sense of the accuracy of the
22 volumes that you're using. Correct?
23 A Well, uncertainty in the volumes does
24 introduce some measure of uncertainty into the
25 calculated revenues.

1 Q And when you did the NFM volume projections,
2 you used Witness Loetscher's study, didn't you, for
3 the NFM?
4 A I used -- it was done by Christiansen
5 Association, and that's, I believe, sponsored by
6 Witness Loetscher.
7 Q Okay. Now, what about when you are
8 uncertain as to the elasticity, that is to say, the
9 price sensitivity, of this new category? Is that a
10 factor that you would, as a pricer, consider in
11 mitigating for a new category?
12 A These are all numbers of factors that would
13 be considered. Certainly, uncertainty about what this
14 might have on the subject volume would factor into how
15 we might price it.
16 Q And, finally, if you really aren't certain
17 as to how the sortation discounts and the drop-entry
18 discounts are going to be reacted to by the new
19 category, wouldn't that be a factor that you would
20 take into account in mitigating an otherwise broader
21 increase?
22 A Any degree of uncertainty in that area would
23 probably be a factor that should be taken into
24 consideration.
25 Q Now, I don't think you testified -- well,

1 yes you did. Isn't it the Postal Service's general
2 policy when you're dealing with new worksharing
3 discounts to take the position that they don't to pass
4 through 100 percent of the cost precisely because of
5 uncertainty?
6 A I'm not sure that that's ever been
7 articulated as a hard-and-fast policy, although it is
8 common that when there is uncertainty, to mitigate the
9 passthrough of costs or cost differences.
10 Q Now, in the case of standard parcels, I
11 believe, when you and I visited on this subject in the
12 first round, you indicated that you had mitigated the
13 rates but that you had done it only at the highest
14 level of the rate.
15 A Well, I believe that what I indicated was
16 that the mitigation was done at the highest level of
17 the rates, and then subsequent price differences due
18 to worksharing were perhaps shrunk a little bit
19 because the cost differences could then not be fully
20 passed through; otherwise, we would have ended up with
21 negative prices for certain highly workshared --
22 Q That's exactly what you said, and I
23 appreciate your reconfirming it. Let's go on to a
24 different topic for a moment.
25 One last question. Do you think, going into

1 this case, that increases on the order of 97 percent
2 for people who are now going to be recategorized as
3 NFMs and 47 to 60 percent for people who are going to
4 be in the new parcel category, do you think that those
5 are the kinds of broader increases in order of
6 magnitude that, to use your phrase, should be
7 expected?
8 A I think, as I mentioned earlier, that, as
9 significant as these rate increases are, they did
10 reflect some degree of mitigation. Now, I recognize
11 that, ultimately, the Commission will use its own
12 judgment in determining the appropriate level of
13 mitigation, but I think I'll stick by my testimony, s
14 I've said here, that I thought that the prices
15 proposed were reasonable.
16 Q Let's go on to the next topic, and I'm
17 indebted to my friends at UPS for raising this. I
18 think it may be a little more complicated than even
19 they realized.
20 On page 8 of your testimony, beginning
21 really on line 1 and going through line 7, you refer
22 to a UPS interrogatory in your response in which, as
23 you describe it, there is a potential problem in the
24 parcel pricing proposals which might encourage mailers
25 to make otherwise machineable parcels nonmachinable in

1 order to take advantage of lower rates.

2 Specifically, what you were talking about,

3 isn't it, that under your rate proposals,

4 nonmachinable parcels that have been presorted to

5 three-digit Zip codes in standard parcels would

6 receive a lower rate than a comparable machineable

7 parcel sorted to the BMC?

8 A Yes. That's the background for that.

9 Q Now, Mr. McKeever being a very careful

10 lawyer, said, if you do confirm that, and you did,

11 please indicate whether the Postal Service intends to

12 adopt rules to prevent machineable parcels from being

13 made nonmachinable in order to benefit from the lower

14 rates. And you didn't answer that question. You

15 referred that to the Postal Service.

16 A Okay.

17 Q Are you familiar with the Postal Service's

18 answer?

19 A I'm not sure if I have that answer here.

20 Q Well, let me make it simple for you. I'm

21 just going to read you one sentence.

22 A Sure.

23 Q I can show it to counsel, but I suspect

24 counsel is familiar with it. The response from the

25 Postal Service said, well, you know, it's kind of hard

1 to develop rules that declare nonmachinable parcels
2 unlawful. So what we ought to do is, and I'm quoting
3 now, "Perhaps the most effective way to achieve the
4 goal of encouraging machinability would be the
5 establishment of rate relationships where the rates
6 for three-digit, presorted, nonmachinable parcels were
7 equal to or greater than the proposed rates for BMC
8 presorted, machineable parcels."
9 A Okay.
10 Q So what they seem to be suggesting is that
11 the Commission ought to change those two rate
12 relationships.
13 A That seems to be what the Postal Service was
14 suggesting.
15 Q Is that intended to be a hint to the
16 Commission, in your view?
17 A In my view, it seems like the Postal Service
18 was indicating that if the Commission took that step,
19 it would --
20 Q It wouldn't be totally upset.
21 A It would not be entirely upset.
22 Q Well, let me ask a couple of questions about
23 how you would do that. Do you have a view as to how
24 you might do that, fix the anomaly, that is?
25 A I haven't specifically developed something

1 that would address that.

2 Q And you may not be the right witness to

3 answer this question, and that's sort of a hint, too,

4 but let me ask it anyway. Do parcels that are sorted

5 to the BMC level require more or less handling to get

6 them finally down to final sort than parcels that are

7 sorted to three-digit levels?

8 A I think that I will defer to an operations

9 witness.

10 Q Mr. McCrery will be here tomorrow, and I

11 will not forget.

12 Let's go on, then, to a further aspect of

13 this, which I don't think has yet come out. When you

14 developed your rates for parcels, standard parcels,

15 you indicated in our earlier visit that you took the

16 general view that pieces weighing six ounces or more

17 would be machineable. Do you recall that?

18 A I believe that, under current rules, that is

19 the weight rate, and given that there were no rules,

20 that was what I went with -- no new rules -- that is

21 what I used.

22 Q Are you aware of a special exception

23 procedure in the current rules that allow parcels

24 weighing less than six ounces to be treated as

25 machineable?

1 A I'm not specifically familiar with something
2 like that.
3 Q Well, just for the record, I would like to
4 note that the DMM contains a provision, which is
5 actually 401.1.5.3, which sets forth the procedure by
6 which pieces -- well, I'll read you the first
7 sentence. "Some parcels may be successfully processed
8 on BMC parcel sorters, even though they do not conform
9 to the general machinability criteria which includes
10 the six-ounce piece."
11 So you did not consider that in the course
12 of developing your rate design for standard parcels.
13 A No. I did not specifically make any
14 adjustment to any volumes based on the application of
15 that particular provision. I don't know how big of an
16 impact that has.
17 Q Which means, to put it slightly differently,
18 you don't know how much volume or how many of those
19 special exceptions have been granted. Is that another
20 way of putting it?
21 A I don't know.
22 Q Okay. Thank you. Now, one other piece of
23 your parcel rate design: If I read the rate design
24 correctly, all piece-rated parcels are deemed
25 nonmachinable so that anything weighing less than 3.3

1 and a fraction ounces is nonmachineable.

2 A Yes. Based on current rules, anything

3 weighing 3.3 ounces would be nonmachineable.

4 Q Based on the current rule that's six ounce

5 without regard to the exception.

6 A That's correct. I didn't make any

7 adjustment for possible exception.

8 Q Okay. Good. Now, does that same six-ounce

9 limit apply when we come to NFMs, when you developed

10 your rates?

11 A When I developed the rates --

12 Q Did you assume that it would apply?

13 A I assumed that -- I didn't develop separate

14 sets of rates for that. I assume that NFMs that weigh

15 more than six ounces and appropriately packaged could

16 be processed in the same way as machineable parcels.

17 Q Have you looked at the proposed rules that

18 the Postal Service issued on September 27?

19 A I've looked at them, but I'm certainly not a

20 rules expert, and I certainly have not looked at them

21 to the extent that I would be able to testify on the

22 rules.

23 Q I will take up further again tomorrow

24 morning, but let me ask one last question on this

25 subject. There is no BMC sort rate for NFMs in your

1 proposed rate schedule, is there?

2 A I happen to have the proposed rate schedules

3 here. This is a page from my workpapers. When these

4 workpapers were produced, these items were labeled as

5 hybrid flats and hybrid parcels, and if you look at

6 the first two lines of that -- that's on my

7 workpaper -- I believe it's WP-STDREG-26 -- the first

8 two lines of that are mixed ADC/BMC and ADC/BMC, and

9 that would be my understanding at the time. As I say,

10 I don't want to try to talk about the rules that have

11 been proposed, but that if a piece were able to be

12 machine processed, then the mixed BMC/BMC/five-digit

13 sort plan would be required.

14 Q But the rate schedule, as it was published

15 and submitted, says: "On NFM pieces, piece and pound

16 rate" in bold and beneath that "piece rate." The

17 highest level of sort in the published schedule is

18 mixed ADC. Are you saying, then, that if I,

19 hypothetically, at least until tomorrow, I was

20 required to presort six-ounce or more NFMs to the BMC,

21 I would qualify for the ADC rate or the mixed ADC

22 rate?

23 A No, not the mixed ADC rate.

24 Q Not the mixed ADC rate.

25 A No.

1 Q The ADC rate.

2 A ADC/BMC rate.

3 Q ADC/BMC rate.

4 A I'm sorry. I want to make sure that I

5 didn't misunderstand your question. Would you repeat

6 it?

7 Q It's a little complicated because we don't

8 have Mr. McCrery in the right order here, but let us

9 suppose, hypothetically, the Postal Service, in the

10 rules, says that NFMs weighing more than six ounces

11 must be sorted, mandatory sort, to BMC -- not a

12 mandatory sort to ADC; mandatory sort to BMC. I've

13 got an NFM. I've got a bunch of NFMs. I sort them to

14 the BMC. I now go to your rate schedule, and I say to

15 myself, I'm in the NFM category because I plainly meet

16 the definitions, such as they are. What rate do I

17 pay?

18 A I think it would be the ADC/BMC rate.

19 Q But there is no /BMC rate here in the

20 published schedule. Are you suggesting that the

21 Commission needs to fix this, too?

22 A My understanding, when I put together and

23 proposed the rates, was that a piece that was sorted

24 to the BMC, a machineable piece that was sorted to the

25 BMC, would get the same rate as a nonmachineable piece

1 sorted to --

2 Q -- to the ADC.

3 A -- to the ADC.

4 Q That's very helpful. Thank you. Let's move

5 on, then, to my last topic. We'll revisit a little

6 part of this tomorrow morning, but I did want to make

7 sure that the full extent of the apparent anomaly is

8 fully apparent.

9 My last topic; could you turn to pages 34

10 and 35 of your testimony?

11 A I have it.

12 Q And what you're dealing with here is Witness

13 Angelides's suggested redesign of media services, and

14 would it be fair to say that what Witness Angelides

15 has done is he has proposed a design for media

16 services where between the first pound and the fifth

17 pound, rates would go up in half-pound increments

18 rather than as they now do, in whole-pound increments?

19 A Yes. That's correct.

20 Q And at the bottom of page 34, going over to

21 page 35, you say, starting at line 21: "What is more,

22 Witness Angelides has not explained why his principle

23 applies only to media mail? If the Commission accepts

24 this principle for media mail, presumably it should

25 apply to other subclasses as well. Witness Angelides

1 evidently has not considered the implication of
2 applying his principle throughout the postal rate
3 structure."
4 Now, I know you didn't do the original
5 testimony for bound printed matter in this case, but I
6 know you have done it in a number of prior cases,
7 including certainly 2001. So can I say that you're
8 generally familiar with the bound-printed-matter rate
9 structure?
10 A In general, yes.
11 Q Do you know how the rate increments go in
12 single-piece, what used to be called single-piece, now
13 called nonpresort, bound printed matter?
14 A Yes. The weights go up to 15 pounds, and
15 from one pound to five pounds, they go up in half-
16 pound steps.
17 Q So what Witness Angelides did was not
18 exactly revolutionary, was it?
19 A No. I don't believe I've said it was
20 revolutionary.
21 MR. VOLNER: Now, Mr. Chairman, that
22 concludes my questions. Thank you very much.
23 CHAIRMAN OMAS: Thank you, Mr. Volner.
24 Advo, Incorporated, Mr. McLaughlin.
25 MR. McLAUGHLIN: Thank you, Mr. Chairman.

1 CROSS-EXAMINATION

2 BY MR. McLAUGHLIN:

3 Q Mr. Kiefer, this afternoon, I would like to
4 discuss with you the appropriate pricing within the
5 enhanced carrier route subclass, particularly as it
6 relates to pricing of letters versus flats. Could you
7 turn to page 20 of your testimony?

8 A I have it.

9 Q Here, you're discussing Witness Mitchell's
10 approach, and Witness Mitchell has advocated as a
11 principle, although he didn't exactly apply it in his
12 rates, that for the pricing of letters versus flats
13 and ECR, that the letter-flat cost differential should
14 be marked up by a cost-coverage factor. Are you
15 familiar with that?

16 A Yes. I'm familiar with that principle.

17 Q starting at line 21 of your testimony, you
18 have a statement that I will read concerning Mr.
19 Mitchell. You say, "Indeed, I am sympathetic to the
20 view strongly advocated by Valpak in this docket that
21 standard mail flats should bear a greater share of the
22 standard mail institutional cost burdens." Do you see
23 that statement?

24 A Yes, I do.

25 Q Did you mean this to be a general statement

1 applying to all standard mail flats?

2 A I think that this particular statement is

3 aimed generally at -- I should say primarily or almost

4 entirely at standard mail regular flats. This was an

5 area which Witness Mitchell very strongly increased

6 the rates for flats relative to letters.

7 Q So, in other words, your concern about the

8 need for a greater share of institutional cost

9 contribution for flats related primarily to the

10 regular subclass and not to the ECR subclass.

11 A I don't think that it should be applied,

12 certainly not in anywhere near the same level. If you

13 looked at the proposed rates, the difference in the

14 rate increases for ECR letters and flats were rather

15 similar, whereas we did increase the rates for

16 standard mail regular flats more so than for regular

17 letters.

18 Q Now, in that sentence that we just quoted on

19 page 20, starting at line 21, you talked about

20 institutional cost burdens. If you're looking at an

21 institutional cost burden, for pricing purposes,

22 should you look at a particular rate element, such as

23 the letter-flat rate differential and cost

24 differential, or should you look at the total

25 contribution, including factors such as the pound

1 rate?

2 A I think a broader view would be appropriate.

3 Q Now, in Mitchell's approach, he focused on

4 the letter-flat cost differential. Is that your

5 understanding?

6 A Yes, among other things, yes.

7 Q Did you know whether, and perhaps I've

8 already asked you this in previous cross-examination,

9 Do you know whether the letter-flat cost differential

10 includes the cost effects not only of shape but also

11 cost effects due to weight?

12 A Yes. I believe it does.

13 Q As a pricing witness, would you believe that

14 cost effects related to weight should be more

15 appropriately recovered through the pound rate rather

16 than through the letter-flat rate differential?

17 A Ideally, weight-related cost impact should

18 be recovered through the pound rate.

19 Q And if you take the letter-flat cost

20 differential, which includes weight-related effects in

21 it, and you were then to mark that up, the markup

22 would be marking up both shape-related cost

23 differences and weight-related cost differences. Is

24 that correct?

25 A If the cost differential included weight-

1 related and shape-related cost differences marking it
2 up, we would mark up those cost differences.
3 Q And then if, in addition to those marked-up
4 costs, you added on top of that a pound rate, isn't
5 there a possibility that you would over-recover
6 institutional costs as a result of that kind of an
7 approach?
8 A The possibility exists, but I would want to
9 actually see the numbers.
10 Q Well, in other words, another way of short-
11 circuiting that would be to say that when you want to
12 find out what the relative institutional cost
13 contributions are from letters versus flats, you don't
14 look at a single rate element; you look at the total
15 revenues and the total cost for flats and letters. Is
16 that correct?
17 A I think that you run the risk of, and I
18 think I've spoken to this in my direct testimony and
19 in responses to interrogatories, that I think we run
20 risks of making bad decisions if we focus solely on a
21 specific rate element and try to figure out what is
22 the cost coverage for a particular rate cell.
23 Q So, I take it, you're agreeing with my
24 question.
25 A I think it's preferable to take a broader

1 view. I'll put it that way.
2 Q Turn to page 23, please.
3 A I have it.
4 Q Now, also, I want to get a little bit of
5 clarification. I believe, in some place in your
6 testimony, you've said that with respect to letters
7 versus flats, there is nothing that requires that a
8 mark-up must be 100 percent, that, in some
9 circumstances, it could be higher than 100 percent.
10 Do you recall saying that?
11 A I believe I was addressing the issue of
12 standard mail parcels where I argued that the
13 application of the ECP rule, or efficient component
14 pricing rule, to the shape-based cost difference was
15 not an appropriate use of that rule and that it should
16 not be used to automatically constrain the recognition
17 of those cost differences solely to 100 percent.
18 Q Would you also agree that there is no reason
19 to say that it has to be at least 100 percent, that,
20 in appropriate circumstances, it can be less than 100
21 percent?
22 A If that was not stated explicitly in my
23 testimony, it certainly was the thrust of my idea,
24 that what I believe is a misapplication of the ECP
25 rule requiring an exact 100 percent was not

1 appropriate and that, depending upon the individual
2 circumstances, it could be higher, or it could be
3 lower.
4 Q Now, in terms of individual circumstances,
5 on page 23, you criticize Witness Mitchell. Starting
6 on line 6, you describe Witness Mitchell, first of
7 all, as saying that, according to Witness Mitchell,
8 all products within a subclass should be priced
9 differently based on cost only.
10 You then go on to say, I disagree, and I
11 will roughly paraphrase. You go on to say that while
12 we may not have explicit price elasticities for
13 subgroups, we may very well have market information
14 that should not be ignored in deciding how to set
15 those rates within a subclass. Is that the gist of
16 your statement there?
17 A Yes. This is not meant to exclude the
18 recognition of cost, but the purpose of that statement
19 was that we shouldn't be blind to the fact that there
20 may be some information there, and putting this into
21 the larger context, if we were required to follow the
22 ECP rule in a dogmatic or doctrinaire fashion, we
23 would, in some sense, be handcuffed or unable to
24 recognize certain impacts that pricing of cost
25 differences may have on the products.

1 Q Well, on that score, let's take a look at
2 ECR saturation flats compared to ECR saturation
3 letters. Are you aware that there are very large
4 volumes of saturation flats that are delivered
5 privately, that there are saturation mailers that have
6 discontinued saturation advertising by joining into
7 partnerships with newspapers whereby a portion of
8 their former saturation program is delivered through
9 the newspaper, and the remainder is delivered as high-
10 density mail, TMC partnerships with newspapers?
11 A I believe, again, I've read information on
12 that particular subject, although I can't give you a
13 particular cite.
14 Q Do you know whether those kinds of switches
15 are motivated by the fact that newspaper distribution
16 costs are substantially lower than postal delivery
17 costs in certain circumstances, especially for heavier
18 weight pieces?
19 A I don't know that for a fact. I could
20 speculate, but I don't know that.
21 Q Are you aware of any saturation letter
22 mailers that deliver portions of their mail through
23 private delivery?
24 A I'm not personally, no.
25 Q Do you have any sense as to the probability

1 or likelihood that saturation flats might be more
2 price sensitive because they have more direct
3 competition with newspaper insert advertising and have
4 private delivery alternatives compared to saturation
5 letters?
6 A Well, certainly, since one of the factors
7 that leads into price sensitivity is the number of
8 possible alternatives, then to the extent that there
9 are more alternatives for one particular type of mail
10 than another, I would expect, ceteris paribus, that a
11 particular kind of mail would be more price sensitive.
12 Q And would that possibility or probability at
13 least lead you to caution, in terms of automatically
14 assuming that there ought to be, for example, at least
15 100-percent passthrough of costs?
16 A It would be a factor that would have to be
17 thought about, yes.
18 MR. McLAUGHLIN: Mr. Chairman, I have no
19 further questions.
20 CHAIRMAN OMAS: Thank you, Mr. McLaughlin.
21 Mr. Olson, Amazon.com?
22 CROSS-EXAMINATION
23 **BY MR. OLSON:**
24 Q Mr. Kiefer, Bill Olson from Amazon.com. I
25 want to start off with asking you to look at page 27

1 of your testimony, please --

2 A Yes, I have it.

3 Q -- lines 7 through 9, where you say, "In his

4 testimony, Witness Haldi proposes that bound printed

5 matter should be redefined so that CDs, DVDs, and

6 other forms of electronic media, such as memory cards,

7 can be mailed as BPM. Correct?

8 A That's what the testimony says.

9 Q And in footnote 15, there you discuss that

10 proposal as initially being in terms of electronically

11 published books and CDs and DVDs of movies based on

12 books, and you cite an interrogatory response by Dr.

13 Haldi to T1-3(c) for the Postal Service. Do you see

14 that?

15 A Yes.

16 Q Did you also read Dr. Haldi's response to

17 the Postal Service Interrogatory 18?

18 THE WITNESS: I don't have that here. Do

19 you have a copy?

20 MR. OLSON: Sure.

21 (Pause.)

22 BY MR. OLSON:

23 Q Have you read this response before?

24 A I believe I have. Let me just refresh my

25 memory on it.

1 MR. OLSON: Sure. Take your time.
2 (Pause.)
3 THE WITNESS: Okay.
4 BY MR. OLSON:
5 Q Would you take a look at the first page of
6 the handout, the second paragraph, and could you just
7 read the first sentence into the record?
8 A "As an alternative proposal, however, I set
9 out below DMCS language which would leave implementing
10 details to the Postal Service to specify in the DMM
11 whether all or just some sound and video recordings
12 would be permitted."
13 Q Okay. And then, on the next page, the
14 bottom paragraph, it talks about BPM including a
15 Section B at the end, saying, "Consists of sound
16 recordings or video recordings, as specified by the
17 Postal Service." Correct?
18 A I see that, yes.
19 Q Okay. So when you say that, in your
20 testimony, that Dr. Haldi's proposal should be
21 redefined so that CDs, DVDs, and other forms of
22 electronic media can be mailed at BPM, you never
23 mentioned his response to 18, where he revises or
24 provides this alternative DMCS language if the Postal
25 Service wanted to restrict the coverage to movies,

1 books on CDs, or movies on DVDs that are based on
2 books.
3 A I don't read this response as saying he
4 withdrew his original proposal and substituted this,
5 but --
6 Q I didn't say "withdrew." I think it's
7 categorized as an alternative proposal. Is that not
8 correct?
9 A Okay.
10 Q And I'm just asking, in your testimony, you
11 criticized the proposal and the testimony don't even
12 mention this. I just wondered if there is a reason
13 you didn't even mention it.
14 A I was addressing the original proposal, and
15 that's what I wanted to rebut in my testimony.
16 Q Okay. Well, now that the other alternative
17 language is before you, would you agree that this
18 language gives the Postal Service the flexibility to
19 limit the proposal as to the types of CDs and DVDs
20 that would be acceptable in BPM to be exactly what
21 Witness Haldi originally proposed?
22 A From the way I read the language, it appears
23 that it would give the Postal Service the ability to
24 promulgate rules, but it's not clear, and I would have
25 to defer to those people in the Postal Service who are

1 more expert on issues of acceptance and the rules,
2 whether this was actually a workable solution.
3 Q Okay. Well, that, you didn't comment on in
4 your testimony -- correct? -- nor did any other postal
5 witness criticize this as being not a workable
6 solution.
7 A I'm not aware that anybody else has.
8 Q And if the Postal Service were to issue
9 rules pursuant to this alternative language, and it
10 were to allow more than just books on CDs and movies
11 on DVDs which are based on books, that would be up to
12 the Postal Service -- correct? -- to give it
13 discretion to do that.
14 A Well, my interpretation of this paragraph
15 here would be consistent with that, that the Postal
16 Service could determine whether it wanted to permit
17 pieces beyond just those, the more narrow definition.
18 Q Exactly. Okay. Let's look at your
19 testimony on page 27, also beginning on line 9, and
20 there you say, "This proposal would likely lead to a
21 migration of parcels from media mail and possibly
22 parcel post to BPM." I want to get at what is it that
23 led you to mention parcel post, in that Dr. Haldi's
24 proposal is to allow certain DVDs and CDs to go to BPM
25 when they are included as part of a bulk mailing of

1 300 or more pieces. You do realize that that's one of
2 the requirements. Correct?
3 A Yes.
4 Q Okay. If you could respond to that, I would
5 appreciate it.
6 A This was based upon the original proposal.
7 I'm sorry. It was based on the original proposal,
8 but, as Dr. Haldi described in the interrogatory
9 response mentioned in footnote 15, that it would
10 permit materials that ere contained on electronic
11 storage devices. If we permit it on one type of
12 medium, we might have to permit it on several other
13 types of mediums.
14 Some of these items that did not qualify for
15 media mail might then be permitted to be sent as bound
16 printed matter. The alternative to media mail that
17 does not, at this time, qualify as bound printed
18 matter would be parcel post.
19 One of the concerns that this was trying to
20 capture is that a storage medium that contains, for
21 example, a book could be on something that might
22 itself not be qualified as media mail.
23 Q Do you know of a lot of DVDs and CDs now
24 being sent as parcel post, which could meet the
25 requirements of being part of a bulk mailing of 300 or

1 more pieces that would cause migration from parcel
2 post?
3 A I can't think of any specific examples at
4 this time.
5 Q So, in terms of the migration from parcel
6 post, that's a bit speculative. It's really media
7 mail, isn't it, that is the issue?
8 A I expect that the great majority of this
9 would come from media mail, but I didn't want to
10 exclude the possibility that it might come from
11 another source as well.
12 Q Take a look, please, also on page 27, at
13 lines 14 through 16, you say, and I know you say more
14 than this, but I'm just going to select out certain
15 words of the sentence, "Witness Haldi's defense of his
16 proposal reveals a serious misunderstanding," and I'm
17 going to delete -- ignore the next few words, which
18 are of the nature of BPM, its cost characteristics,
19 and focus you on the language, "certain content
20 exceptions that are permitted."
21 What is the serious misunderstanding that
22 Dr. Haldi has about the content exceptions that are
23 permitted in BPM?
24 A The basic content exception was something
25 that was designed several years ago to, as I

1 understand it, resolve an issue where certain types of
2 non-BPM items were being included as merchandise
3 samples which were permitted under the existing rules,
4 and to try to clean things up, at the same time,
5 certain types of books, primarily children's books,
6 were technically not permitted in bound printed matter
7 because they did not meet the qualification, for
8 example, being on paper.
9 So these problems were addressed by
10 permitting certain non-BPM enclosures to be up to
11 about 20 percent of the weight of the piece, as long
12 as the 80 percent of the piece was bona fide, bound
13 printed matter that was on paper and bound, printed.
14 I wanted to emphasize the importance of the bound
15 printed matter characterization of the subclass is
16 that this kind of material tends to be fairly dense --
17 Q I suggest that that may be a different
18 issue, and I want to focus on the answer you just
19 gave.
20 You make a statement. You say, Haldi has a
21 serious misunderstanding of the content exceptions,
22 and then you gave your recollection of the content
23 exceptions. Now, in his testimony, he details that at
24 page 14. I don't know if you have this, but it's part
25 of footnote 11. He cites the Federal Reaister of June

1 5, '01. I think you'll agree, upon reflection, that
2 it's no more than 25 percent of the weight of the mail
3 piece that can be for the non-BPM piece, not 20. Does
4 that sound correct?
5 A No. That's not correct. It's 25 percent of
6 the bound printed matter in the mail piece. So what
7 that means is that the piece can only be -- if you
8 have four pounds of bound printed matter, you can have
9 one pound.
10 Q Exactly.
11 A So it's one-fifth.
12 Q Maybe I misunderstood it.
13 A One-fifth of the total, yes.
14 Q So it is based, in fact, upon the weight of
15 the BPM.
16 A Absolutely.
17 Q Exactly. Okay. And that's exactly what he
18 says in his testimony. Correct? As a matter of fact,
19 on page 14, he says, lines 13 and 14, "must constitute
20 no more than 25 percent of the weight of the BPM in
21 the mail piece." Could that be more clear? That's
22 exactly what you said your understanding is.
23 A But what --
24 Q Did he get the weight wrong?
25 A No. It wasn't the matter of the weight.

1 The exception was granted as a way to allow certain
2 mailers how mail significant quantities of bound
3 printed matter, paper printed, et cetera, to include
4 premiums that might not actually consist of paper,
5 books, or other things like that.
6 Q You're now discussing the purpose behind the
7 rule, and what you said is that Haldi has a serious
8 misunderstanding of the content exceptions, and I'm
9 suggesting that there are two content definers. One
10 is the one we've just discussed, the 25-percent rule
11 regarding the weight of BPM, and there is another
12 restriction, is there not, having to do with the value
13 of the item that's enclosed, the nonprint item?
14 A Yes. It has to be considered a low-value
15 item.
16 Q Okay. And that is, in fact, exactly what
17 Dr. Haldi says at the top of page 15. Actually, it's
18 called a "low-cost item" in the regs, not a low-value
19 item, and it's $8.60 currently. It's revised each
20 year by the Department of the Treasury. Do you see
21 that?
22 A Yes, I do.
23 Q You said he has a serious misunderstanding
24 of the content exceptions. The content exceptions are
25 expressed in terms of weight and monetary limit, and

1 he explained them, according to you, accurately, so
2 far as you know. Is that a serious misunderstanding?
3 A My testimony, at that point, was dealing
4 with the broader concept of these exceptions and also
5 to include the subject I was talking about earlier,
6 which included the purpose.
7 Q Let me ask you this. If a mailer has a
8 totally different purpose than the Postal Service had
9 when it put the reg in, but it includes a piece, a
10 nonprinted piece, which meets these two requirements,
11 it can go as BPM. Correct?
12 A I believe that's correct.
13 Q So are you able now to point to any serious
14 misunderstanding of Dr. Haldi with respect to content
15 exceptions?
16 A I don't think Dr. Haldi misunderstood the
17 cost limitation or the weight limitation.
18 Q Let's look at page 27 of your testimony
19 again, on line 18, where you talk about a sweeping
20 change. You say, because of these flaws, including
21 his serious misunderstanding of certain content
22 exceptions, because of these flaws, his testimony is
23 wholly in adequate and cannot be relied upon for the
24 basis of making such a sweeping change in the
25 definition.

1 First of all, your "sweeping change" refers
2 primarily to the DMCS language in the testimony, not
3 in the response to Interrogatory 18. Correct?
4 A The big change would be to allow pieces to
5 go
6 as bound printed matter that did not consist of bound
7 printed matter, not something --
8 Q Currently defined as bound printed matter.
9 A Currently defined, yes.
10 Q Because this is a proposal to change the
11 definition.
12 A That is correct. That's a sweeping change.
13 Q Okay. So it's a sweeping change. Is it a
14 sweeping change in terms of the amount of pieces
15 involved or just the fact that it's a change in the
16 content standards of BPM?
17 A I think that I address that in my testimony,
18 where I pointed out the fact that the nature of the
19 bound-printed-matter subclass is that it consists of
20 printed pieces which tend to be dense and are able to
21 be -- from what I understand from the operations
22 people, et cetera, that they tend to be very dense,
23 and that has very good cost characteristics.
24 Q We'll get to the density issue in a moment,
25 but I'm just trying to focus on what you say here.

1 The sweeping change; it may have several components to
2 it. Let's just separate it.
3 Do you believe it's a sweeping change, in
4 that it involves a huge influx of mail potentially
5 from media mail that would dwarf what's --
6 A I haven't estimated the quantity that might
7 come over.
8 Q Okay. Well, let's look at that. Would you
9 accept, subject to check, that the total volume of
10 media mail in FY 2005 was 179 million pieces, roughly?
11 A That sounds in the right ball park.
12 Q And that of those, the presort media mail
13 was 36 million, roughly.
14 A That's probably in the right ball park, too.
15 Q And if migrating pieces must be entered as
16 part of a bulk mailing of 300 or more pieces, it would
17 be reasonable to expect that any migration is going to
18 come from that presorted media mail, not the single
19 piece, I take it.
20 A To agree 100 percent with that statement,
21 you have to assume that --
22 Q Well, it's not 100 percent.
23 A Okay.
24 Q Dominantly.
25 A I would expect them to come largely from

1 that segment.

2 Q Okay. First of all, would you accept,

3 subject to check, that the volume of presorted BPM is

4 555 million pieces?

5 A That sounds, again, about right.

6 Q So if all 36 million pieces of presorted

7 media mail were to migrate, would you accept that that

8 would increase the volume of presorted BPM by about

9 6.5 percent, that 36 is 6.5 percent of 555 million?

10 That sounds about right?

11 A Yeah, that sounds about right.

12 Q Okay. Let's take another aspect of this.

13 Let's go to your testimony, page 29, lines 11 through

14 12. You say, "Expanding the definition of BPM will

15 not, ceteris paribus, reduce Postal Service costs."

16 In that sense, what do you mean by "ceteris paribus"?

17 A What I'm saying is that if, for example, you

18 had a piece that did not qualify as BPM, and it was

19 made to qualify or allowed to qualify as BPM, and

20 ceteris paribus means "all other things being equal" -

21 - it's presorted, and the way it was entered,

22 everything is the same, that would not reduce the

23 Postal Service's cost because it would still be

24 processed by the Postal Service in the same was, as

25 far as I understand it.

1 Q Okay. I'm going to get to that in just one
2 second.
3 You would agree, though, that the rates
4 within BPM permit destination entry discounts, and
5 media mail does not. Correct?
6 A That's correct.
7 Q And that the rates in BPM are shape based
8 for flats and parcels, at least to some degree.
9 A I understand that there are differences,
10 although I think I testified, and I cited back to some
11 testimony by Witness Yeh, who seemed to say imply that
12 not all of the cost differences were reflected. So
13 the rate structure is not fully --
14 Q I understand. But there is no such parallel
15 structure within media mail. Right?
16 A NO.
17 Q Okay. So you've got a situation where the
18 Postal Service has designed rates to encourage
19 mailers, I take it, to, in part, achieve lowest
20 combined costs. Could you look at it that way, for
21 example?
22 A Well, I think that the overall
23 classification structure is there, although I'm not
24 sure that the incentives have been fully implemented.
25 Q Okay. But if mailers respond to the price

1 incentives in BPM, doesn't that help explain why the
2 product has a lower average cost than media mail?
3 A I think there is a caution there, in that,
4 at the present time, I'm not sure just what extent the
5 media mail -- I'm talking now about the presorted
6 media mail -- whether that is already being drop
7 shipped. I go back to -- I believe it's Docket No.
8 R2000-1, in which I was the bound-printed-matter
9 pricing witness, and that was when we first introduced
10 the BPM drop-ship discounts, and we found out, when we
11 were about ready to do that, that even though there
12 were not any drop-ship discounts in BPM, that the
13 majority of BPM is already being drop shipped.
14 So, in that particular circumstance,
15 introduction of the drop-ship discounts did not change
16 the mailers' behavior for a significant amount of the
17 volume. That caution needs to be taken --
18 Q Now we do have drop-ship discounts and BPM -
19 - correct? -- and mailers have adjusted to that,
20 responded to it.
21 A Certainly, some may have responded to that.
22 I'm getting a little farther afield from what I was
23 saying.
24 Q Well, let's go back to exactly what you said
25 in your testimony, page 29, footnote 18. There you

say, "The testimony of Postal Service Witness Smith -- " you cite USPS-T-13 "-- which projects the test year mail-processing cost for BPM flats will be 23.71 cents per piece compared to 62.28 cents per piece for parcels IPPs." Do you see that?

A Yes, I do.

Q Let's talk about the source of those numbers. That's Witness Smith's testimony in this docket. Correct?

A Yes.

MR. OLSON: All right. You probably don't have that. I'll give you a copy.

(Pause.)

BY MR. OLSON:

Q This page that is appended to this handout is the page you're referring to, is it not, as the source of your numbers in footnote 18?

A Yes, it is.

Q Okay. And that's on the line for bound printed matter, the second from the bottom. Correct?

A Correct.

Q Let's explore some of those mail-processing costs for a second. What are the costs shown here for first-class, single-piece and presorted parcels? Single piece is $1.02?

1 A That's the number there. I'm just reading
2 it off the page. I don't know the precise definition
3 of that category, but, yeah, that's what's on the
4 page.
5 Q This is the exact same chart that you drew
6 from in your testimony when you were making a point.
7 A Correct.
8 Q I'm just trying to examine some of the other
9 numbers. We see here the cost of first-class
10 letters -- I'm sorry -- the letters is in the first
11 row, but it's under parcels, IPP. So the first-class,
12 single-piece parcels and IPPs is $1.02, and first-
13 class, presort parcels and IPPs are $3.03. Do you see
14 that?
15 A I see that number.
16 Q Do you feel confident that these reflect the
17 processing costs for presorted, first-class parcels as
18 being three times the cost of single-piece parcels?
19 A I can't address that question. I mean, I'm
20 not familiar with the first-class parcel area.
21 Q Okay. Let's take another. Look down, if
22 you would, in "periodicals for in county and out
23 county," and there do you see that the in-county
24 parcels is 304 cents, and the out-county parcel IPPs
25 is 2,610 cents, or $26.10.

1 A I see those numbers. Again, the comment is
2 the same.
3 Q You have no reason to believe that the out-
4 county parcels are eight times more expensive as the
5 in-county parcels.
6 A I don't have a basis for forming an opinion
7 on that.
8 Q How about let's get closer to home with
9 parcel post. Let's compare the cost of handling a
10 flat and a parcel in this chart, the mail-processing
11 cost. The cost of a flat is 698 cents, and the cost
12 of a parcel is 125 cents. Do you see that?
13 A Yes, I do.
14 Q Don't flats usually cost less to process
15 than parcels?
16 A My understanding of parcel post is that it
17 has relatively few flats in it and that sometimes when
18 the actual amount or proportion of pieces within a
19 class or subclass or whatever is very small, my
20 understanding from people I've talked to is that you
21 may end up getting values that suffer from, let's say,
22 small sample problems --
23 Q A bit anomalous?
24 A -- whereas bound printed matter, as I think
25 I pointed out in the footnote that you cited, 46

1 percent flats and --

2 Q Clearly, that issue wouldn't arise --

3 A Yes.

4 Q -- with a small sample size. Let's see what

5 you say about that. At page 28, beginning on line 20,

6 and you alluded to this at the beginning of your

7 cross, "The Postal Service processes and delivers

8 similarly presorted and entered bulk mail and BPM in

9 the same way so the cost would be the same, regardless

10 of the subclass." Correct?

11 A Yes.

12 Q Let's look at the numbers on this attachment

13 that you referenced to Witness Smith's testimony.

14 What are the estimated test year costs of processing a

15 flat in BPM and media mail? Flats are --

16 A Well, the numbers shown are 23.71 cents for

17 flats and 103.45 cents for media mail.

18 Q Okay. So when you say, in your view, that

19 the cost would be the same, regardless of the

20 subclass, these costs don't tend to support that.

21 Correct?

22 A I don't think that you can draw that

23 inference from that statement. These are aggregates,

24 and what I am talking about is if you take an

25 individual parcel or a pallet of parcels, it doesn't

1 matter what the label is on them; they are going to be
2 processed in similar fashion if they are entered in at
3 the same place and in the same way. These are
4 aggregate numbers.
5 Q I understand they are aggregate numbers. Do
6 you question them, or do you think they may well be
7 accurate, that BMP flats are about 23 cents, and media
8 mail is $1.03 for an average flat?
9 A I don't have a reason to question those
10 particular numbers.
11 Q How about the parcel numbers, BPM parcels
12 being 62 cents and media mail parcels, 111 cents? Is
13 that, again, supportive of your statement that costs
14 would be the same, regardless of the subclass, four
15 times -- I'm sorry -- two times?
16 A First of all, you're comparing an average
17 from one class to an average from another class.
18 Q Exactly.
19 A That's not what I was talking about.
20 Q Now, this is all we have, though, is the
21 average here to work with. Correct? Do you have more
22 detailed information?
23 A Okay. It seems like we have sort of two-way
24 sets of comparisons, either this way or that way. If
25 we are comparing a bound-printed-matter parcel with a

1 media mail parcel, and both of them are entered in the
2 same way, then they should be processed in the same
3 way. If they are the same size, the same shape, and
4 the only difference is that it has a different label
5 on it, different indicia, the Postal Service does not
6 say, stop, we're going to change how we're going to
7 process this because it has a different indicia on it.
8 That's the point I was trying to make.
9 Q I guess I'm trying to look for some support
10 for your conclusion. Your conclusion is the Postal
11 Service processes and delivers similarly presorted and
12 entered bulk media mail and BPM in the same way so the
13 cost would be the same, regardless of the subclass.
14 Do you have evidence for that other than your
15 statement you just made, which is they process and
16 deliver it the same; therefore, the costs should be
17 the same. It's a tautology. Do you have any evidence
18 for it beyond that?
19 A No, but I've run this notion by people in
20 the cost and people familiar with the operations, and
21 they --
22 Q None of them have testified on this point.
23 A No, but I don't consider it tautology or
24 tautological that if the piece goes through the same
25 processes, it would generate the same costs.

1 Q Well, let's ask you to look at this density
2 issue that you raise on page 31. I'm going to see if
3 I can better understand what you mean by this, and you
4 mentioned this also at the beginning of your cross.
5 At page 31, line 6, you say -- this is a bit
6 long, but if you don't mind, I'll just read it so we
7 are on the same page: "Finally, despite Witness
8 Haldi's claims ... the BPM rate design is not cost
9 based in one important respect. It does not recognize
10 the impacts of cubic volume or cube on costs
11 separately from weight. Because of the difficulties
12 in measuring cube, the Postal Service has traditional
13 relied upon weight as a proxy for cube in rate design.
14 This approach makes some sense when one is dealing
15 with mail pieces all having the same shape, all
16 parcels or all flats, but in a mixed-shape subclass,
17 such as BPM, to blindly assume that BPM flats, BPM
18 parcels, and parcels that potentially could migrate
19 from media mail all have the same average densities is
20 to run the risk of making a disastrous rate design
21 decision." Correct?
22 A That's what it says.
23 Q Okay. Now, just so we're clear, when we
24 talk in standard mail about density, for example, we
25 very often talk about density tiers. You're not

1 talking about density in that sense. Correct?
2 A Not addressed density. I'm talking about
3 actual pounds per cubic foot density.
4 Q Pounds per cubic foot; density in that
5 sense.
6 A Yes.
7 Q And in other classes, for example, in
8 priority mail, the Postal Service has filed, in its
9 proposal, a request for a surcharge on the packages
10 that are very light in weight compared to their size
11 that occupy a lot of space in comparison to their
12 weight, and those are normally considered low-density
13 packages. Correct?
14 A Yes. There is a proposal to charge for low-
15 density parcels.
16 Q And in priority mail, the proposal is
17 supported by the fact that these pieces, a certain
18 percentage of them, travel by air, and that cube is at
19 a premium in the air and that people should have to
20 pay for it if they put in extra cube. Correct?
21 A My understanding is that the costs are paid
22 by cube. So there is a direct relationship to, I
23 think, what we pay for transport and the cubic density
24 of the piece.
25 Q And, therefore, a weight charge would not

1 recapture that cost-causing factor. Correct?

2 A It may not adequately.

3 Q So there is a surcharge. But BPM doesn't

4 travel by air. Correct?

5 A No, but transportation costs are generally

6 related to the cube, and also a lot of, as I

7 understand it, a lot of the -- I'll call it material-

8 handling costs depend upon the cube, how many pieces

9 you can get into a container.

10 Q Okay, And that's what I want to talk about.

11 On page 32, you develop this notion about high-density

12 parcels and flats in BPM, the way you evaluate it

13 currently. Correct?

14 A I do discuss that a little bit more.

15 Q And on line 9, for example, when you talk

16 about high-density parcels and flats, you speak of

17 them as having favorable cost characteristics, and the

18 way you describe those would be the printed matter,

19 books and such. Correct?

20 A Printed matter, nonpaper, generally is

21 fairly dense, as is common knowledge, and it gives you

22 significant amount of weight for a fairly compact

23 size.

24 Q And then you're assuming that CDs and DVDs,

25 on the other hand, are low density and have high Cost

1 characteristics. Correct?

2 A The discussion there, when I use the terms

3 "high" and "low," these are in relative terms. If

4 we're talking about bound printed matter or media

5 mail, that's something that may travel on the ground.

6 I wasn't trying to imply that the cost was high, let's

7 say, the way it would be with express mail or

8 something like that, but relative to bound printed

9 matter, something that's less dense for a given

10 weight, which is how we presumably charge for it, it

11 would take up more space and thereby proportionately

12 generate more costs than a more dense piece.

13 Q Three times on page 32 you describe highly

14 dense, printed catalogs, books, having what you call

15 "favorable cost characteristics." Correct?

16 A I haven't counted them, but --

17 Q It's on line 8, line 12, line 16,

18 symmetrical.

19 A Okay. I see all three references.

20 Q Okay. What evidence do you have in your

21 testimony that CDs and DVDs are low density compared

22 to books?

23 A I haven't actually presented -- I haven't

24 put them on the scale and weighed, but I think this is

25 based upon my personal knowledge, having owned both

1 books and CDs, and I'm rather familiar with the fact
2 that a CD is fairly light, and a book is fairly dense.
3 Q Okay. Let's see if that's the way to think
4 about this. Let me ask you this. If you were to take
5 a book, and you were to multiply the length and the
6 width and the height, you would get the actual cubic
7 volume of the book, would you not?
8 A Length times width times height, yes.
9 Q Okay. And if I take a book, and I ship it
10 in a box -- I know this probably isn't a term that the
11 Postal Service has in its glossary yet, but would you
12 mind if we call the dimensions of the box the "postage
13 cube" of the package?
14 A Okay. That works.
15 Q So we're not talking about the cube of the
16 book inside the box; we're talking about the cube of
17 the box that the book is in.
18 A That's correct.
19 Q Okay. You would not be surprised, I take
20 it, that if, as a general principle, the postage cube
21 would exceed the actual cube of the book. Correct?
22 A Probably, by the laws of physics, it would
23 have to.
24 Q Okay. When you were preparing your
25 testimony, did you happen to review Dr. Haldi's

1 response to Interrogatory 8 from the Postal Service?
2 A I would like to see it. I don't think I
3 have that here.
4 (Pause.)
5 BY MR. OLSON:
6 Q Have you seen that response before?
7 A Yes, I have.
8 Q Okay. Well, let's talk about it for a
9 moment. In that interrogatory, the Postal Service
10 posits three different mailings, each with 300 pieces,
11 and one is a three-pound, shrink-wrapped catalog, one
12 is a box containing a book of the same total weight in
13 cube, and the third is closely related CDs or DVDs,
14 and the question posed to Dr. Haldi was to explain his
15 understanding of the differences in postal cost-
16 causing characteristics. Do you see that?
17 A Yes.
18 Q Okay. Now, with respect to books in his
19 answer, he takes the total number of books of 300
20 times three pounds a piece and says the weight would
21 be about 900 pounds.
22 A Yes.
23 Q Okay. And if you divide 900 pounds of books
24 by -- I'm sorry -- I should say that about two-thirds
25 of the way down there in the first paragraph he

1 calculates that they would have a total cube of 75
2 square feet. Do you see that? That's for the box
3 size that was prescribed in the question.
4 A Okay.
5 Q Do you see the standard set in the question?
6 A Okay. The sentence that says the 300
7 catalogs and books, each weighing three pounds, et
8 cetera, et cetera, would have a total weight of 900
9 pounds and a total cube of 75 cubic feet.
10 Q I think I said "square feet." Of course, I
11 meant cubic feet.
12 So if you take 900 pounds of books, and you
13 divide it by 75 cubic feet, would you agree that you
14 get a density of pounds per cubic feet of about 12?
15 A I think that's correct.
16 Q Okay. Let's just keep that number in mind,
17 and let's then talk about the other mailing here,
18 which is the CDs and the DVDs. There would be 300 of
19 those packages. The response by Dr. Haldi explains
20 how they would be packaged, discusses them as having
21 an average weight of 1.5 pounds for a total weight of
22 450 pounds. Do you see that?
23 A Yes, I do.
24 Q So 300 times one and a half, 450 pounds, and
25 the total cube there is specified as being up to five

1 cubic feet. Do you see that?

2 A Yes.

3 Q Now, for DVDs and CDs, if you divide the 450

4 pounds by five cubic feet, would you agree you get a

5 density of 90 pounds per cubic foot?

6 A What was your denominator?

7 Q If you take 450 pounds of the CDs wrapped up

8 in these -- packaging, and Dr. Haldi calculated that

9 would fit in up to, or no more than, five cubic feet,

10 you get a density of about 90 pounds per cubic foot.

11 Correct?

12 A That's what the calculation comes out to

13 when you divide the two numbers.

14 Q And just to be conservative, let's assume

15 that it takes twice as much space to have the CDs.

16 Let's assume, instead of five cubic feet, it's 10

17 cubic feet to fit those CDs. Then the density would

18 be about 45 pounds per cubic foot. Correct?

19 A If you divided 450 pounds by 10, you would

20 get 45 pounds.

21 Q And that 45, even there, to be conservative,

22 is well in excess of 12 pounds per cubic foot for the

23 books, as specified.

24 A I'm looking here at Item No. 1 in the

25 question, and I'm a bit puzzled because it talks about

1 a three-pound, shrink-wrapped catalog measuring nine
2 inches by 12 inches by four inches.
3 Q This is your question.
4 A I understand, but you're bringing it to me -
5 - it was not my question, and I've never seen a
6 catalog that would be 9-by-12, which is this big, and
7 four inches thick that weighed three pounds.
8 Q None of my questions dealt with catalogs,
9 did they?
10 A No, they didn't.
11 Q They dealt with boxes that books were in.
12 Correct?
13 A Correct.
14 Q Have you ever seen a book in a box that was
15 9-by-12-by-4? Is that utterly --
16 A I believe I've received them.
17 Q Okay.
18 A I believe I've received them in Amazon boxes
19 --
20 Q In 9-by-12-by-4?
21 A Yes, and books that were perhaps three-
22 eighths of an inch thick. Anytime I see that, I
23 think, this is totally wrecking the favorable cost
24 characteristics of bound printed matter.
25 Q Well, what I'm trying to get at is your

1 assertion, your conclusion, which you admit was
2 without support other than it being intuitively
3 apparent to you, that the density of books would be
4 far higher than CDs. We see here, in the calculations
5 that Dr. Haldi did, there were no follow-up questions
6 to this -- correct? -- to your knowledge.
7 A I'm not aware of any follow-up questions on
8 that. The issue is, if you're going to talk about --
9 what I said in my testimony was that books, because
10 they are bound printed matter, and catalogs have
11 favorable cost characteristics because they are dense,
12 but I'm not saying that a mailer could not sort of
13 undo the favorable cost characteristics by taking a
14 fairly dense piece and putting it into some kind of a
15 balloon package, and if Amazon will do that with a
16 book, why wouldn't they do it for a CD?
17 Q Well, Dr. Haldi's testimony -- I guess I
18 shouldn't be answering questions from the witness, but
19 you may find the answer exactly in Dr. Haldi's
20 response here as to the way these are packaged. What
21 I'm trying to get you --
22 A Let me say that I'm skeptical about this.
23 It may be possible that these could be put in fairly
24 small packages that will, in some sense, maximize the
25 density of the CD while still maintaining sufficient

1 cushioning to protect the product. Amazon or other
2 mailers could do that with books, too, but my
3 experience is that they often have not chosen to do
4 that.
5 Q Okay. In point of fact, you don't have to
6 speculate because a question was asked of a witness, a
7 response was provided with respect to the way in which
8 these are packaged, and this is now on the record, and
9 I'm trying to get you to work from record evidence as
10 opposed to personal belief.
11 Based on the hypothesis the Postal Service
12 provided and the numbers with respect to cubic feet
13 that were calculated, would you not agree that they
14 indicate that the density of CDs and DVDs shipped in
15 these -- packages, which is the way they are shipped,
16 is greater than for books in a box with air in it?
17 A I will agree with that, that if we are
18 comparing a very sort of like tightly packaged CD with
19 an air box with a small paperback book in it, that it
20 may well be the case that --
21 Q It might have three books in it. It might
22 just not be quite as extreme as you're now
23 characterizing. Correct?
24 A As I said before, it certainly is possible
25 to undo what I would call the favorable density

1 characteristics of bound printed matter packaging.

2 Q Is there a requirement imposed upon mailers

3 who send BPM that they have to tightly wrap their

4 books and cannot put them in boxes that are bigger

5 than the books? Is there such a requirement?

6 A Not to my knowledge.

7 Q Let me ask you to look at the end of the

8 response of Dr. Haldi to this particular

9 interrogatory. He discusses a package containing a CD

10 or DVD being considerably smaller.

11 A Could you direct me a little more?

12 Q It's the last paragraph of the second page.

13 A Yes.

14 Q He says -- let me see if I can find exactly

15 where this is. He says, in the fourth line down, "I

16 would note, though, that small packages containing

17 CDs, DVDs will fit into mailboxes more readily than

18 larger boxes containing books. If any such

19 relationship exists between cube and cost, it would

20 seem entirely reasonable to expect that increases in

21 cube will cause some increase in cost.

22 Let me ask you, do you have an opinion -- I

23 don't know if this is an operations question, but I'll

24 ask you, isn't it more likely that larger packages

25 would be more likely to cause dismounts on motorized

1 routes than smaller packages?

2 A Answering solely from a conceptual and

3 knowledgeable layman's perspective, I would say that,

4 yes, if a package is very large and could not fit in a

5 mailbox, it would necessitate a dismount, and a

6 smaller piece might --

7 Q If that's the case, based on your

8 perspective, isn't it true that the cost of delivering

9 smaller packages should generally be less than the

10 cost of delivering larger packages?

11 A Well, with respect to the single factor that

12 you just mentioned, if you can avoid a dismount, it

13 might avoid the cost, but I don't want to get into --

14 MR. OLSON: That's all I'm trying to

15 achieve. Thank you so much. I appreciate it, Mr.

16 Kiefer. Thank you, Mr. Chairman.

17 CHAIRMAN OMAS: Thank you, Mr. Olson.

18 Mr. Scanlon?

19 MR. SCANLON: Mr. Chairman, Michael Scanlon

20 on behalf of Pitney Bowes.

21 CHAIRMAN OMAS: Would you put your mike on,

22 please?

23 CROSS-EXAMINATION

24 BY MR. SCANLON:

25 Q Good afternoon, Mr. Kiefer.

1 A Good afternoon.

2 Q I think it's fair to say that your rebuttal
3 testimony covers quite a bit of ground. By my count,
4 your testimony addresses seven witnesses: Mr.
5 Horowitz, Mr. Glick, Mr. Lucciani, Dr. Panzar, Dr.
6 Mitchell, Dr. Haldi, and Dr. Angelides. Is that
7 correct?

8 A All of those people are, yes, addressed in
9 my testimony.

10 Q But I want to focus our discussion on the
11 five or so pages of your testimony where you purport
12 to rebut Dr. Panzar's testimony.

13 A Okay.

14 Q And, specifically, I would like to refer you
15 to page 15 of your testimony. If I read your
16 testimony correctly, you're challenging Dr. Panzar's
17 contention, and here I'm quoting from the language
18 that you quote at the bottom of the footnote, page 15,
19 Dr. Panzar's contention that "the basic economic
20 argument in support of cost-based rate differentials
21 is the same as that for avoided-cost, worksharing
22 discounts." Is that correct?

23 A Yes. That captures the essence of it.

24 Q And just to be clear, does this criticism
25 apply to ECP, as traditionally applied to worksharing

1 cost avoidances or just to the extension of ECP
2 discussed in Section 7 of Dr. Panzar's testimony?
3 A The criticism does not apply to the
4 application of ECP to worksharing cost differences.
5 Q Okay. And drawing down on that just a point
6 further, and following up in your colloquy with
7 counsel for Advo earlier today, are you taking issue
8 with Dr. Panzar's statement that the basic economic
9 argument in support of cost-based rate differentials
10 is the same for avoided costs, worksharing discounts,
11 or are you really taking issue with what you've
12 categorized as a strict or rigid application of 100-
13 percent passthrough for these cost differentials?
14 A Are we talking about worksharing cost
15 differences?
16 Q No. We're talking about nonworksharing-
17 related cost differences.
18 A Could you repeat the question, please?
19 Q Yes. Dr. Panzar sets out -- in Section 7,
20 what he is really talking about here is an extension
21 of ECP, a theoretical application of that for
22 nonworkshare-related cost factors. And the question I
23 have is, is your criticism directed to that general
24 theoretical approach, or is it more specifically
25 directed at your reservation with what you've termed a

1 strict or dogmatic or rigid application where you
2 would always be addressing 100 percent of the cost
3 avoid?
4 A In a general sense, I'm concerned with the
5 application of ECP rule in circumstances where there
6 is not activity of the Postal Service that is actually
7 avoided by the mailer.
8 Q And we'll get to that when you address the
9 premises in Dr. Panzar's testimony.
10 Could you now please refer to page 9 of your
11 testimony?
12 A Page 9, did you say?
13 Q Please. And specifically, I direct your
14 attention to lines 19 through 22, where you assert,
15 and here I'm quoting, "that requiring equal unit
16 contributions for all shapes of mail (the equivalent
17 of requiring 100-percent passthroughs of shape-based
18 cost differences) can lead to nonsensical and
19 potentially distorting pricing decisions." Do you see
20 that?
21 A Yes, I do.
22 Q And have you read Witness O'Hara's testimony
23 in this case?
24 A I don't recollect, I think I read parts of
25 it, but I'm not sure I can recollect --

1 MR. SCANLON: Without objection, Mr.
2 Chairman, may I approach the witness?
3 CHAIRMAN OMAS: Yes.
4 (Pause.)
5 BY MR. SCANLON:
6 Q What I just provided you, Mr. Kiefer, are
7 pages 4 and 5 of the "Direct Testimony of Donald
8 O'Hara on behalf of the Postal Service," USPS-T-31.
9 A Okay.
10 Q Witness O'Hara is the Postal Service's rate-
11 policy witness in this case. Isn't that correct?
12 A That's correct.
13 Q Okay. And now, if you would refer to page 4
14 of Witness O'Hara's testimony, specifically lines 12
15 through 16, where Witness O'Hara states, and here I'm
16 reading from his testimony, "In this case, we continue
17 the process of developing appropriate price signals by
18 focusing on the effect of shape on postal costs. In
19 reexamining the relationship between costs and prices,
20 it became clear that the current rate structure did
21 not adequately reflect the greater cost of handling a
22 flat or parcel as compared to a letter." Do you see
23 that?
24 A Yes, I do.
25 Q Okay. So is it your position that a rate

1 proposal which passes through 100 percent of the
2 shape-based cost differences would lead to
3 "nonsensical results"?
4 A When I wrote that section, I was, in fact --
5 in the earlier part when you introduced your line of
6 questioning, you said that you wanted to focus initial
7 attention on my rebuttal of Dr. Panzar's extension of
8 ECP beyond the worksharing area, and in that section
9 of my testimony, I give at least one example of a
10 concern that I had.
11 When I wrote this section of the testimony
12 on page 9, I had that particular illustration in mind,
13 that, in fact, Dr. Panzar had answered an
14 interrogatory by saying that essentially, with respect
15 to parcel post, it was his view that -- I believe he
16 said that the unit contribution for a one-pound,
17 parcel post piece should be exactly the same as the
18 unit contribution for -- I believe it was, like, a 50-
19 pound parcel post piece.
20 I pointed out, in my rebuttal of Dr. Panzar
21 on that particular issue, that I have seen concerned
22 that this could lead to what I would say, nonsensical
23 pricing decisions. So that's what I'm referring to
24 there.
25 Q But my question is more specific here.

Given the general testimony of Witness O'Hara, is it your position or your testimony today that if you were to adopt the general proposition advocated by Witness O'Hara in this case, and if, in fact, the Postal Service were to develop rates that pass through 100 percent of a shape-based cost difference within a subclass, would that be a nonsensical result?

A Of the shape-based? Only shape-based.

Q Well, we could take any cost causative characteristic, but, in this case, the Postal Service is focused on shape, and Witness O'Hara's testimony that I read specifically addresses shape.

A I hadn't actually considered that from applying in every class because I'm not that familiar with every class from the perspective of shape only, but, as I think I pointed out, that if we adhere to that 100-percent passthrough, the application of the ECP rule to every possible cost-causative characteristic, we could end up with nonsensical results.

The one that I illustrated in my rebuttal testimony, I think, was an example of one. Witness O'Hara, from what I read here, is looking at a much more limited case of differences in shape-based. I'm not sure I would say that the results would be quite

1 as dire.

2 Q Your testimony is not that any time you had

3 a rate that reflected 100 percent that that would be a

4 nonsensical result.

5 A Oh, no. In fact --

6 Q That was all my question was.

7 A Okay. Well, I wanted to say, I was not

8 condemning the fact of a passthrough of 100 percent.

9 I wanted to illustrate that requiring 100 percent at

10 all costs could lead, if you applied that to every

11 single cost-causative characteristic, that could lead

12 to some problematical results.

13 Q Okay. Referring your attention now to page

14 15 of your rebuttal testimony --

15 A Okay.

16 Q -- and here I refer your attention down to

17 lines 19 and 20, please. Here, you assert that Dr.

18 Panzar's argument for extending the ECP rule is based

19 on "two premises, both of which are unproven and

20 likely wrong." Do you see that?

21 A Yes, I do.

22 Q I would like to address each of the two

23 premises that you identify in turn. The first premise

24 in your characterization of Dr. Panzar's testimony is

25 that, and here I'm quoting again from page 15 of your

1 testimony, lines 20 to 23, you identify the first
2 premise that "mailers can choose the characteristics
3 of the mail they send, such as the shape of the mail
4 pieces and that their choices are highly flexible and
5 largely susceptible to influence by the relative
6 prices set by the Postal Service." Do you see that?
7 A I see that, yes.
8 Q Okay. And then if you direct your attention
9 to page 16, lines 1 through 3, where you state, "The
10 opposite is true. Mailers do not see their mail piece
11 characteristics as highly flexible, and they are not
12 willing and able to switch them, even in response to
13 substantial changes in relative prices.'' Do you see
14 that?
15 A I see that.
16 Q Okay. And are you aware that the Postal
17 Service issued a news release on May 3rd of 2006
18 entitled, "Postal Service Proposes New Approach To
19 Shape a More Efficient Future. Reshaping Mail Allows
20 Businesses to Reduce Costs"?
21 A I may have read it, but quite a few days
22 have passed between May 3rd and the present.
23 MR. SCANLON: Without objection, I would
24 like to show it to the witness.
25 CHAIRMAN OMAS: Yes.

1 (Pause.)

2 BY MR. SCANLON:

3 Q I would specifically like to refer your

4 attention to the third paragraph --

5 A Okay.

6 Q -- where it states, and here I'll read it:

7 "The new pricing plan, in effect, creates an

8 adjustable rate system by giving mailers the

9 opportunity to obtain lower rates as they find ways to

10 configure their mail into shapes that reduce

11 processing costs for the Postal Service. For example,

12 if the contents of a first-class flat can be folded

13 and placed in a letter-sized envelope, the mailer can

14 reduce the postage by as much as 20 cents per piece.

15 If a first-class parcel can be configured as a flat,

16 the mailer will save 36 cents." Do you see that?

17 A Yes, I do.

18 Q And then, again, in the fifth paragraph,

19 Postmaster General Potter states that the Postal

20 Service, and here I'm quoting, "will work closely with

21 our business mailers in the coming months to show them

22 how they can take advantage of the new pricing to keep

23 their mailing costs as low as possible." Do you see

24 that?

25 A Yes, I do.

1 Q And, in fact, the Postal Service has been
2 working, as promised, with mailers to manage the
3 transition to shape-based rates and to identify mail-
4 preparation opportunities. Here, I refer your
5 attention to a copy of an MTAC presentation delivered
6 by Steven Kearney, Vice President, USPS Pricing
7 Classification, dated May 17, and the title is
8 "Shaping a More Efficient Future, Price Change
9 Proposal." Have you seen this?
10 A I think I might have, but, again, it's been
11 a while.
12 Q And we don't need to go through the entire
13 presentation, but if you direct your attention to
14 pages 8 and 12, I think you'll find that there are
15 examples presented in the presentation that detail
16 opportunities that mailers could take to prepare their
17 mail differently to manage their postal costs.
18 And, finally, we can look again to the
19 testimony from Witness O'Hara that I've provided you,
20 and here, if you look at the bottom of page 4, line
21 20, it starts, "Because the costs of handling a flat,
22 for example, are greater than the costs of handling a
23 letter, customers sending light-weight, first-class
24 mail flats could face larger-than-average price
25 increases, and I expect this may cause some customers

1 to reevaluate their choices. In some instances, a
2 customer would pay lower prices by simply folding the
3 mail piece and reconfiguring it as a letter. In other
4 cases, a customer may determine that the aesthetics of
5 a flat-shaped piece better communicates their message
6 to the recipient. In both cases, the customer can
7 make a choice as to the value of 'shape' versus
8 postage expense, and thereby the implicit costs of the
9 Postal Service handling a mail piece that is not
10 letter shaped." Do you see that?
11 A Yes, I do.
12 Q So, in your testimony, when you take issue
13 with Dr. Panzar's suggestion that mailers often have a
14 choice as to how they prepare their mail and state,
15 and again I'm quoting your testimony, "The opposite is
16 true, that mailers do not see their mail piece
17 characteristics as highly flexible, and they are not
18 willing and able to switch them, even in response to
19 substantial changes in prices."
20 The question is, is that the position of the
21 Postal Service in this case, and if it is the position
22 of the Postal Service, how is that consistent with the
23 remarks of the postmaster general and the direct
24 testimony of Witness O'Hara in this case?
25 A In putting that in my testimony. What I was

1 trying to do is not to illustrate that it would be
2 impossible for mailers to reconfigure their mail
3 pieces, but to indicate that there was significant
4 testimony indicating that some mailers might find it
5 difficult and so that the choice of shape is not
6 always something that can be influenced by let's say
7 Postal pricing signals or something that the mailer
8 can just choose to do.
9 If a mailer was let's say somebody who would
10 sell golf balls, well, I don't think there's any way
11 that a golf ball could be put into a package that
12 could be configured as a flat, for example.
13 So I was just trying to point out that there
14 appeared to be an assumption in Dr. Panzar's testimony
15 that mail piece shape was sort of just a matter of
16 choice. I wanted to give some counterexample.
17 Q Just so I understand your testimony, is it
18 the Postal Service's position that mailers do have a
19 choice in how they can prepare their mail, or they do
20 not?
21 A Well, I think it is my understanding of the
22 Postal Service's position that to the extent that
23 mailers do have a choice and they can easily
24 reconfigure, we hope that some of the pricing signals
25 will cause them to choose mail forms that would lower

1 our cost to the benefit of both the Postal Service and
2 the mailers.
3 Q Okay. In your testimony you also say that
4 Dr. Panzar doesn't offer any evidence of mailer choice
5 and that in fact you assert there is none available in
6 the record in this case.
7 Witness O'Hara's testimony is part of the
8 record evidence in this case, isn't it?
9 A Witness O'Hara's testimony is part of the
10 record evidence in this case.
11 Q Okay. One last point on mailer choice at
12 Footnote 6 on the bottom of page 16.
13 A Yes.
14 Q If you would refer to that, please? You
15 cite PostCom Witness Knight's arguments against shape-
16 based rates, and you quote his testimony to the effect
17 that the Commission must "reject or at the very least
18 very profoundly mitigate the rates proposed by the
19 Postal Service to preserve volumes."
20 Do you see that?
21 A Yes, I see that section.
22 Q Okay. Is it the Postal Service's position
23 in this case that the Commission should reject or
24 profoundly mitigate the shape-based rates proposed by
25 the Postal Service?

1 A Well, I understand that the Commission has
2 to weigh many factors in determining the actual rate
3 it's going to recommend. The impact on mailers is
4 certainly a very important one.
5 The rates that were recommended for standard
6 mail parcels were already mitigated, but, as I think I
7 point out in my testimony, I think it is the Postal
8 Service's position that the key element that it feels
9 it should have from its pricing and classification
10 proposals is that we do begin the effort to establish
11 shape-based rates with meaningful price differentials.
12 The exact amount of the mitigation obviously
13 is a matter of judgment, and that is the judgment that
14 the Postal Rate Commission will have to make.
15 Q Okay. Is it your testimony today that
16 you're endorsing Witness Knight's position that the
17 Commission should reject or "very profoundly mitigate"
18 the rates proposed?
19 A That was not the purpose of my including
20 that in there. I'm not --
21 Q No. I think I understand why you included
22 it in there to show that some mailers feel this way,
23 but I don't think you're contending that it's the
24 Postal Service's argument.
25 And the fact I think that you're saying now

1 that the Postal Service, including the record
2 evidence, states just the opposite; that you don't
3 think that the Commission should reject or very
4 profoundly mitigate shaped-based rates as proposed by
5 the Postal Service.
6 A Well, the Commission may choose to -- as I
7 said already in my testimony, the parcel and NFM rates
8 that are proposed and which the Postal Service has not
9 indicated it is not sort of withdrawing, but it
10 understands that the Commission may choose to do
11 further mitigation than we have already proposed; that
12 there is some mitigation in these already, and the
13 Commission may choose as part of its deliberations to
14 do additional rate mitigation on these pieces.
15 Q Okay. I don't want to belabor the point,
16 but just so we're clear. You're not endorsing Witness
17 Knight's proposal that the Commission reject --
18 A No.
19 Q Okay.
20 A That the Commission totally reject this?
21 No.
22 Q Okay. Let's move on, and let's turn now to
23 the second premise that you assert underlies Dr.
24 Panzar's argument for an extension of ECP to
25 nonworksharing related cost differences.

1 Here I would ask you to please refer to page
2 17 of your rebuttal testimony.
3 A Okay.
4 Q Specifically I would ask you to refer to
5 line 18 where you discuss what you characterize as a
6 "major flaw" in Dr. Panzar's reasoning.
7 You assert further on lines 19 through 22
8 that Dr. Panzar "assumes that subclasses are composed
9 of pieces with homogeneous price elasticity and
10 maintains that his assumption holds generally even
11 while acknowledging that widely different price
12 elasticities do occur in a subclass that is relatively
13 homogeneous in terms of shape and purpose (parcel
14 post)."
15 Do you see that?
16 A Yes, I do.
17 Q Okay. Did you have a chance to observe Dr.
18 Panzar's oral testimony before the Commission?
19 A I've read it. I heard part of it through a
20 feed.
21 Q Okay. But you have reviewed the transcript?
22 A I've reviewed the transcript where he was
23 asked some questions about the parcel post, yes.
24 Q Okay. Again, you state that Dr. Panzar
25 bases his argument for extending ECP on two premises,

1 one of which you characterize as an assumption that
2 subclasses are composed of pieces with the same or
3 similar elasticities. Is that correct?
4 A That was my interpretation of some of his
5 testimony. I believe it was the oral testimony.
6 Q And that's what I want to turn to next.
7 Specifically I want to focus your attention on the
8 cross-examination by counsel for the Parcel Shippers
9 Association, Mr. May. The transcript cite is page
10 9255.
11 Dr. Panzar was asked specifically by Mr.
12 May:
13 "Q So is it the case that in your
14 discussion of interclass rate differences in your
15 testimony depends at least to some extent on the
16 assumption that the elasticities within a subclass are
17 relatively similar?"
18 Dr. Panzar answered that question in part:
19 "A I wouldn't say the analysis depends on
20 that."
21 Again, that exchange appears on page 9255,
22 lines 15 through 18 and then again at line 21. Are
23 you aware of that testimony?
24 A I've read over the section. I mean, I
25 believe that he later states, and I'm not sure of the

1 exact wording, but he talks about the basic case of
2 homogeneous elasticity.
3 I mean, my interpretation of what he said
4 was that while he was not saying that there weren't
5 cases like, for example, in the case of parcel post
6 where you could have different components with
7 different elasticities, his basic assumption was that
8 the subclasses had homogeneous price responses.
9 Q Okay. In fact, in that discussion with
10 counsel for Parcel Shippers Dr. Panzar was not
11 immediately aware of the elasticities within that
12 subclass. Witness Thress' analysis was provided to
13 him for purposes of his testimony.
14 Later, at page 9262 of the transcript, and
15 this is part of a colloquy with the Postal Service
16 counsel, Mr. Koetting, Dr. Panzar states his position
17 more broadly, which is to say, and here I'm quoting,
18 "So absent any direct information that demand
19 elasticities are significantly different, my testimony
20 recommends following the ECPR logic within a
21 subclass."
22 Again, that's at lines 7 through 10 on the
23 transcript, page 9262.
24 A Okay.
25 Q Setting aside his testimony, for purposes of

1 our discussion let's take your characterization of Dr.
2 Panzar's position that he assumes that the
3 elasticities are all the same within a subclass, okay?
4 A We're taking that as -- okay.
5 Q Right.
6 A That's our kickoff point. Okay.
7 Q Is it your testimony then that the Postal
8 Service's position is, again absent any direct
9 information about the elasticities within the
10 subclass, that one should start with the premise by
11 assuming that the elasticities are not the same within
12 a subclass?
13 A Well, subclasses generally have been
14 designed to contain mail that is generally similar,
15 and one might expect it to have generally similar
16 price elasticities, but I don't think that we assume
17 that they're all the same.
18 Q My question was do you assume as a starting
19 premise that they're all different?
20 A Okay. I was approaching it from another
21 direction to say that I assume that there is a range
22 within the subclass, and it may be either broader or
23 more narrow depending upon different categories.
24 Q And that's what I want to follow up on
25 because if you read through the discussion in the

1 transcript, particularly some of the pages right
2 around where you've cited as well, Dr. Panzar, as I
3 read his testimony, is saying the same thing.
4 His general understanding is that within a
5 subclass the elasticities should be relatively
6 similar. That's the starting premise, the same
7 understanding that you just expressed.
8 I'd like to talk about some of the direct
9 information where he says absent this direct
10 information this is my assumption and drill down a
11 little bit in terms of what direct information we
12 have. Here I'd refer you to page 23 of your
13 testimony.
14 I think it's important to look at what the
15 direct information that we actually have is because as
16 part of your discussion, and this is at the top of
17 page 18 of your testimony where you're talking about
18 the parcel post example. You state that this is an
19 example that shows that Witness Panzar doesn't fully
20 appreciate the complex nature of Postal subclasses.
21 That's part of the sentence there on lines 1 and 2 of
22 page 18.
23 I think it's worth exploring what
24 information is he failing to appreciate? If we turn
25 to page 23 of your testimony and specifically if we

1 look to lines 8 and 9 of your rebuttal testimony you
2 concede that the Postal Service "does not have price
3 elasticities for most subgroups below the subclass
4 level."
5 Do you see that?
6 A Yes.
7 Q And so can you tell me where the Postal
8 Service does have price elasticity information below
9 the subclass level other than parcel select and retail
10 parcel post?
11 A I'm not familiar with all the demand
12 equations for all of the subclasses. There may be
13 some in first class, but, as I say, I'm not familiar
14 with every demand equation.
15 Q But is it your understanding, for example,
16 that the Postal Service has price elasticity
17 information for different rate categories within first
18 class -- for AADC or three-digit or five-digit first
19 class workshare letters?
20 A Not to my knowledge.
21 Q Okay. Can you tell me where, if anywhere,
22 the Postal Service has price elasticity information
23 below the subclass level by shape? For example, does
24 the Postal Service have information for first class
25 letters relative to flats or parcels or standard

1 presort?

2 A I think that my statement here on lines 8

3 and 9 indicates that in general we don't have price

4 elasticities for subgroups below the subclass level.

5 Q Okay.

6 A I mean, I'm not disagreeing with you that we

7 don't have them.

8 Q And I think the point here is that the

9 rebuttal testimony criticizes Dr. Panzar for offering

10 a theoretical expansion of ECP by assuming as a

11 starting premise absent other direct information that

12 the elasticities within a subclass are similar, the

13 same understanding you just testified to.

14 If the Postal Service doesn't have the

15 information, that seems an odd basis to criticize his

16 testimony.

17 A Okay. I was with you up to the point when

18 you said absent other information. A price elasticity

19 for a subgroup is one kind of information, but you say

20 absent other information. Absent information of a

21 very specific and narrow type is a different issue.

22 Q No. I understand that. Referring

23 specifically to Dr. Panzar's testimony, his testimony

24 says, "Absent direct information that the demand

25 elasticities..."

1 That is definitely different. I mean,
2 that's the information we're talking about here.
3 A I think the criticism that I was making was
4 that the fact that we have not actually estimated -- I
5 mean, one reason why we don't have demand elasticities
6 for various subgroups is very obvious. One is that we
7 have not estimated them.
8 The fact that we have not estimated them
9 doesn't mean that they're not different. Without
10 getting into going further afield into that area, my
11 point was just because we have not made estimates does
12 not automatically mean that they are the same, and it
13 also doesn't mean that we may not have any other
14 information that might suggest that some categories
15 are more responsive than others. That was the thrust
16 of this part of the testimony.
17 MR. SCANLON: Okay. Nothing further, Mr.
18 Chairman.
19 CHAIRMAN OMAS: Thank you, Mr. Scanlon.
20 I think before we begin with Mr. McKeever
21 let's take about a 10-minute break for an afternoon
22 break. We'll come back at 3:50.
23 (Whereupon, a short recess was taken.)
24 COMMISSIONER ACTON: Mr. McKeever, do you
25 plan to continue with cross-examination?

1 MR. MCKEEVER: No. We do not have any cross
2 for Mr. Kiefer.
3 COMMISSIONER ACTON: Thank you.
4 Mr. Olson, please continue.
5 MR. OLSON: Thank you.
6 CROSS-EXAMINATION
7 BY MR. OLSON:
8 Q Mr. Kiefer, Bill Olson this time for Valpak.
9 I want you to help me, and we will be the soul of
10 brevity today.
11 Page 20, line 6, the beginning of the
12 section on Valpak. You say Witness Mitchell proposes
13 rates for standard mail that adhere to the principle
14 that all rates below the subclass level should be
15 based only on estimated cost differences, correct?
16 A That's what it says, yes.
17 Q All rates only on cost differences. Would
18 that imply to you that all passthroughs that he would
19 be recommending are 100 percent?
20 A I believe that Witness Mitchell did indicate
21 that there could be cases where certain factors like
22 rate change mitigation might lead to differences, and
23 in fact he did propose some passthrouyhs which he said
24 were not 100 percent, but his rate differences were
25 only based on the cost.

1 Q Well, if he's proposing passthroughs of
2 other than 100 percent, isn't he basing his proposed
3 rates on something other than purely cost differences?
4 A I'm drawing from Witness Mitchell's response
5 to the USPS Interrogatory No. 26, which he was asked,
6 "Is it your view that once the cost coverage has been
7 established for a subclass rate differences within the
8 subclass should only be based on cost difference,
9 assuming those differences are available and
10 accurately estimated?"
11 He answers, "Yes." He does qualify. It
12 says there are differences in how costs should be
13 recognized, but essentially he's saying that you
14 should really do it only on basis of cost.
15 Q Okay. So you're commenting on his answer to
16 that interrogatory, not on his proposed rates, which
17 is what you say?
18 You say Witness Mitchell's proposed rates
19 adhered to all rates being based only on cost
20 differences. That's not true, correct? If any of the
21 passthroughs are not 100 percent, then he's
22 recognizing other principles, whether it be rate
23 effects --
24 A Well, let's put it this way. His response
25 to the question was yes.

1 Q Well, wasn't that quite a different
2 question?
3 All I'm trying to focus on is here you
4 appear to be criticizing not his theory of costing,
5 but his proposed rates, and all I'm asking you to do
6 is acknowledge that his proposed rates don't do what
7 you say they do if he has other than 100 percent
8 passthroughs, and he does, does he not?
9 A I do agree that he does have other than 100
10 percent passthroughs for certain rates.
11 Q And therefore the rates are not necessarily
12 100 percent based on costs like you say?
13 A Well, in his response he says there are
14 differences in how costs should be recognized.
15 Q Okay. For regular, for example, did you
16 notice a passthrough of 65 percent between mixed ADC
17 machineable letters and nonmachineable letters in line
18 with the Postal Service's proposal? Would you accept
19 that if you didn't notice?
20 A I mean, I'll accept that.
21 Q And in regular there were 17 other
22 passthroughs different from 100 percent, some a lot
23 different?
24 A There were some that were different from 100
25 percent. He accepted our parcel pricing, which

1 obviously had less than 100 percent passthroughs on
2 some.
3 Q Passthroughs different from 100 percent in
4 standard ECR sometimes too?
5 A Right.
6 Q Okay. So let's take a look at the next
7 sentence there where you say, "Mitchell justifies this
8 approach by appealing to principles of economic
9 efficiency."
10 Just concisely could you tell me what
11 principles of economic efficiency you had in mind?
12 A I think that his arguments were that to the
13 extent that we have cost differences -- let's say an
14 example of worksharing cost differences -- that they
15 should be passed through at 100 percent.
16 Now, absent something like a rate change
17 mitigation reason for deviating, for shape-based
18 differences he advocates actually marking up those
19 shape-based differences so this is a cost difference,
20 but he advocates marking those up by the subclass
21 average, and I disagree with that.
22 Q Right, but that's another --
23 A That's an example of a cost -- what would
24 you say? A situation where the difference in rates is
25 based on cost, but it differs from I think what you

1 were saying before where everything has to be passed
2 through at 100 percent. He's advocating for something
3 other than 100 percent.
4 Q Exactly. A passthrough of letter/flats at
5 up to the subclass level, even though he didn't
6 recommend that in his rates. He recommended 95
7 percent, correct?
8 A For regular.
9 Q Letter/flats, yes.
10 A My recollection is that was for regular.
11 Q Yes. Would you take a look at your Footnote
12 11 on page 21?
13 A Page 21?
14 Q Yes. At the very end of that response you
15 have a phrase that I don't understand and I wanted to
16 ask you to help me with.
17 It says I also find, and I know I'm just
18 reading a part of the sentence here, part of your
19 footnote. I also find Mitchell's alternate
20 passthrough setting rule to be too rigid and
21 doctrinaire.
22 What is the alternate passthrough setting
23 rule?
24 A What I was referring to there was the point
25 that we were just discussing; that if you had shaped-

1 based cost differences that you should mark them up by
2 the subclass average markup.
3 Q Okay. And in his actual rates recommended
4 he didn't mark it up by the subclass average, did he?
5 A That is correct, but I was critiquing the
6 rule.
7 Q So what he recommends is not too rigid or
8 too doctrinaire, correct?
9 A I was critiquing. As I say there, his rule
10 was rigid and doctrinaire.
11 Q So that's not a commentary on his
12 recommended rates in this docket?
13 A Not on the passthrough of the letter. I was
14 not implying that the application in this particular
15 case where he actually deviated from his rule --
16 Q And was not rigid and was not doctrinaire?
17 A Well, in this particular case he mitigated
18 it, mitigated the impacts. They were already pretty
19 significant.
20 Q I'll take that. Okay. Let's quickly look
21 at the sentence you have on page 20, lines 11 and 12.
22 You say, "While I acknowledge that economic efficiency
23 is an important goal and guidance in establishing
24 pricing at all levels, I believe it is not the sole
25 criterion."

1 When you say at all levels, is it your
2 contention that Mitchell applied notions of economic
3 efficiency below the subclass level?
4 A I believe that notions of economic
5 efficiency or his notions of economic efficiency
6 influenced and guided his selection of pricing below
7 the subclass level.
8 Q Can you be specific as to where economic
9 efficiency motivated him as you see it? Notions of
10 economic efficiency.
11 A Well, if he says that, for example -- let's
12 go to the example that we were just talking about
13 where Mr. Mitchell argues that the shape-based
14 differences should be reflected by a mark-up which is
15 the same as the subclass average.
16 My recollection may be actually spilling
17 over into some of his rebuttal testimony, but I
18 believe he makes an economic efficiency argument why
19 this is actually a better -- it is better to actually
20 mark up those at that rate than to just have a 100
21 percent passthrough of the --
22 Q Marking up certain cost differences? That's
23 what you're referring to?
24 A Yes. I mean, if he says that the 100
25 percent passthrough should apply to other cost

1 differences he's also made an economic efficiency
2 argument.
3 Q Is it your view that he did, other than the
4 letter/flat differential that he applied?
5 A Do you want me to --
6 Q It may take too long for you to find it in
7 there, but if you know where to look go right ahead.
8 (Pause.)
9 A If we look at page 142 of Mr. Mitchell's
10 testimony where he's talking about the nonmachineable
11 letters and regular and he's describing the proposal
12 to increase the pricing significantly for the
13 nonmachineable letters, he says his view is, and he
14 says:
15 "In my words, the message is 'if you want to
16 send letters that cost us more to process, you must
17 bear the additional cost. No one else is going to pay
18 them for you.' At the same time the mailer is given
19 choices. If he is not receiving adequate value from
20 sending nonmachineable pieces, he can change them for
21 a net improvement in efficiency. I approve of this
22 change in structure. It is in line with making the
23 Postal Service a more effective organization."
24 His goal here was actually he supported this
25 particular rate structure because he said, for

1 example, it would make the Postal Service a more
2 effective organization and would result in a net
3 improvement in efficiency.
4 Q So that's what you're referring to?
5 A I mean, this is an example.
6 Q Okay. That's the one you were able to find?
7 A When I'm sitting down here.
8 P Yes.
9 A I was not asked to come in with a list of
10 those.
11 Q No. It's not a test. I was just trying to
12 understand your point and why you draw the conclusions
13 you do.
14 Let me ask you to look at two words you use
15 on page 21. You say on lines 1 and 2, "Witness
16 Mitchell's approach would jump instantly to his
17 preferred rate relationships heedless of the
18 consequences."
19 I believe that the context there has to do
20 with letters and flats. For example, the one you just
21 read, that was an illustration where he supported the
22 Postal Service proposal, correct?
23 A He supported the Postal Service's, yes,
24 proposal to significantly increase the rates and
25 essentially deaverage the rates for machineable versus

1 nonmachineable letters.

2 Q So he wasn't too rigid or doctrinaire in

3 that area?

4 A No.

5 Q Okay. But when you say he would jump

6 instantly to his preferred rate relationships heedless

7 of the consequences, and we just established that his

8 preferred letter/flat rate relationship was based on

9 marking up the cost differences, and he recommends 95

10 percent passthrough. Is that jumping instantly to his

11 preferred rate relationships?

12 A It jumps a good bit of the way because the

13 result of his rate proposals is, for example, to

14 increase the rates for standard mail regular flats by

15 40 and 50 percent. If we're looking at the minimum

16 per piece rated pieces, there's a very substantial

17 jump.

18 Q Substantial I understand. It's jumping

19 instantaneously to his preferred rate relationships.

20 At least in the letter/flat area would you

21 concede that he was not jumping instantaneously to his

22 preferred rate relationships?

23 A He did not actually propose increases that

24 would reach all the way to about 180 or 190 percent

25 times the letter/flat differential. He confined it to

1 100 percent. That was a pretty substantial jump.
2 Q To 100 percent?
3 A Ninety-five. In regular it was 95 percent.
4 Q Okay.
5 A So about halfway about.
6 Q Well, would you concede that's not jumping
7 instantly to his preferred rate relationships heedless
8 of the consequences?
9 A Perhaps not taking as full heed of the
10 consequences as perhaps he should.
11 Q Let's go with my final question, which has
12 to do with your testimony on page 25, particularly
13 where you begin on the end of line 19.
14 You say, "Mitchell's analysis doesn't even
15 attempt to provide the after rates revenue and
16 contribution impacts of his proposals on the standard
17 mail subclasses themselves," correct?
18 A That's what it says, yes.
19 Q So are you saying Mitchell provided
20 absolutely no information whatsoever about the after
21 rates situation, or he didn't provide after rates
22 volumes and the associated costs and revenues?
23 A It says what it says. He didn't provide
24 after rates revenue and contribution impacts in these
25 proposals.

1 Q Impacts?
2 A Yes.
3 Q Okay. You would agree, for example, he
4 proposed a full set of rates for standard mail?
5 A Yes, he did.
6 Q Okay. And he showed the percentage changes
7 of those rates cell-by-cell?
8 A He provided the percentage changes for the
9 minimum per piece rated pieces, and he provided the
10 percentage changes for the rate elements, for example,
11 for the piece rate and the pound rate separately.
12 He didn't give any rate changes, rate change
13 impacts, for let's say sample pieces.
14 Q Of particular weights?
15 A Yes.
16 Q Yes, I understand.
17 A Okay.
18 Q Would you agree that he provided revenues
19 and contribution and cost coverage at before rates
20 volumes?
21 A That's my understanding, yes.
22 Q Okay. Are you aware that Witness Mitchell
23 argued that the cost coverage changes very little when
24 going to after rates conditions?
25 A I'm aware that he made that argument, but

1 I'm not convinced.

2 Q Do you disagree with that?

3 A With large changes, you could have

4 significant differences.

5 Q Have you attempted to test that hypothesis

6 of yours?

7 A I did not try it on Mr. Mitchell's numbers.

8 Q Have you tried it on other more significant

9 rate changes than what the Postal Service has

10 proposed?

11 A What I did was I did some calculations let's

12 say algebraically.

13 Q And you concluded that it can have a

14 significant after rates effect?

15 A That it potentially could, yes.

16 Q What did your algebraic calculation show in

17 terms of order of magnitude here?

18 A I don't remember the exact order of

19 magnitude of it, but I felt that it wasn't something

20 that could be just sort of swept under the rug.

21 Q Well, if you expressly address an issue and

22 you say that in your opinion the after rates effects

23 are minor, is that sweeping it under the rug? Isn't

24 that addressing it directly?

25 A I suppose one could look at it that way and

1 say it's been addressed. It's been addressed and
2 perhaps dismissed. To dismiss something is perhaps to
3 address it, I suppose, if we're going to pick words.
4 Q Okay. Here's what I'm getting at. When
5 Intervenors propose rates that are different than the
6 rates that are proposed by the Postal Service, is it
7 your position that the Intervenors have a duty to do
8 separate, detailed volume forecasts for those rates?
9 They have to then do a cost roll forward,
10 they have to calculate revenues and contributions
11 after rates, and they have to put that evidence in
12 before the Commission in order to have their proposals
13 considered by the Commission?
14 A I think that if the Intervenor is making a
15 proposal that is likely to have a very minor impact
16 and it can be bounded, then that may be an analysis
17 that perhaps would reveal impacts that may not be in
18 some sense worth the extra effort of going through and
19 doing the additional analysis, but I think I pointed
20 out in my testimony that Mr. Mitchell is proposing
21 alternate rates that, for example, change the -- well,
22 the Postal Service has proposed about an eight and a
23 half percent increase for standard mail ECR and
24 Mr. Mitchell is proposing a rate change of negative
25 eight and a half percent, so we're looking at about a

17 percent swing.

I would have hoped that he would have given us a little bit more guidance on what the impacts might be of doing something that has that large of a swing.

Q So your position would be that unless the changes that a mailer proposes to the Postal Service proposal are small that they should have the duty imposed on them to do all of these volume forecasts and cost roll forwards and such, to have their views considered by the commission?

A I think that if there may be significant changes in the rate relationships and significant changes, very, very large changes or swings in rates at the subclass level, then it would certainly help the case of the person who is proposing this to provide the information that would help the commission and also help other people to evaluate the differences in the changes.

Q Well, respect to the commission, if the commission were to find the testimony persuasive, do you think they would have any difficulty doing the volume projections or the cost roll forwards and achieving full break even for the Postal Service?

A The commission has a staff and I think they

1 are able to separate evaluate these items.

2 MR. OLSON: Excellent. Thank you.

3 I appreciate it, Mr. Chairman.

4 CHAIRMAN OMAS: Thank you, Mr. Olson.

5 Is there anyone else who wishes to

6 cross-examine Witness Kiefer?

7 (No response.)

8 CHAIRMAN OMAS: Mr. Reiter, would you like

9 some time with your witness?

10 MR. REITER: We have no questions,

11 Mr. Chairman.

12 CHAIRMAN OMAS: Thank you, Mr. Reiter.

13 Mr. Kiefer, that concludes your testimony

14 here today. We appreciate your contribution to the

15 record and you are now excused. Thank you.

16 (The witness was excused.)

17 CHAIRMAN OMAS: Mr. May?

18 MR. MAY: I call Steve Zwieg.

19 Whereupon,

20 STEVE ZWIEG

21 having been first duly sworn, was called aa

22 witness herein and was examined and testified as

23 follows:

24 DIRECT EXAMINATION

25 BY MR. MAY:

1 Q Mr. Zwieg, I've given you two copies of a
2 document titled "Rebuttal Testimony of PSA Witness
3 Zwieg" and it's PSA-RT-2.
4 Have you had a chance to examine these two
5 documents?
6 A Yes, I have.
7 Q And if you were to testify fully today,
8 would that be your rebuttal testimony you're offering
9 in this proceeding?
10 A Yes.
11 MR. MAY: Mr. Chairman, I ask that the
12 rebuttal testimony of Mr. Zwieg be admitted into
13 evidence and I'm giving two copies to the reporter.
14 CHAIRMAN OMAS: Is there any objection?
15 (No response.)
16 CHAIRMAN OMAS: Hearing none, I will direct
17 counsel to provide the reporter with two copies of the
18 corrected testimony of Steve Zwieg. That testimony is
19 received into evidence and is to be transcribed into
20 the record.
21 (The document referred to was
22 marked for identification as
23 Exhibit No. PSA-RT-2 and was
24 received in evidence.)
25 //

Postal *Rate Commission*
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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0111

PSA-RT-2

POSTAL RATE AND FEES CHANGES, 2006 **Docket No. R2006-1**

REBUTTAL TESTIMONY OF PSA WITNESS ZWIEG TO UNITED PARCEL SERVICE WITNESS LUCIANI (UPS-T-2)

Respectfully submitted,

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Dated November 20, 2006

4842831

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Autobiographical Sketch

My name is Steve Zwieg. I am the Managing Director of Account Services for FedEx SmartPost. I have worked in the mail distribution business and directly with the USPS for the past 25 years. I was the Manager of Mail Distribution for Quad/Graphics from 1981 to 1997, the Vice President of Customer Service for Parcel Direct from 1997 to 2004 prior to my current position. In each of these roles I also served as the lead liaison between my company and the USPS.

I am the current President of the Parcel Shippers Association (PSA) and a board member of the Association of Postal Commerce (PostCom). I have participated on multiple *Mailer* Technical Advisory Committee (MTAC) work groups and was the Co-Chair of the Product Redesign Committee for parcels.

FedEx SmartPost specializes in the destination entry of Parcel Select parcels with an emphasis on destination delivery unit (DDU) delivery. We tender parcels to the USPS at over 9,000 destination delivery units comprising a majority of the DDU parcels delivered by the USPS. We partner with the USPS to provide residential delivery for hundreds of e-retailers and catalogers.

I. Purpose and Scope of Testimony

In his testimony, UPS witness Luciani speculates that the number of Parcel Select pieces that are entered at each Postal Service delivery unit may be small, which could result in the cost for DDU-entered parcels being higher than estimated by the Postal Service. UPS-T-2 (Luciani) at 7-8. Witness Luciani also suggests that the proportions of DDU parcels that are nonmachinable and oversized may be different than estimated by the Postal Service. UPS-T-2 at 19 (Luciani). Using actual FedEx SmartPost data, I show that the number of parcels entered per DDU is large and that the Postal Service's estimate of the percentage of DDU parcels that are nonmachinable and oversized is reasonable.

Wimess Luciani also recommends using a unit cost for Parcel Select no-fee electronic delivery confirmation of 14.67 cents per piece. UPS-T-2 at 16 (Luciani). This unit cost estimate includes 2.85 cents of costs for instances when a "window clerk accepts mail item with eDC and scans barcode" for "customers that print and adhere an electronic label but submit their item(s) at the window." USPS-LR-L-59, DC-TY2008(AR).xls. My testimony explains that the 2.85-cent window service cost is not applicable to Parcel Select because Parcel Select is not accepted by window clerks at postal windows.

II. Characteristics of DDU Parcels

In his direct testimony, witness Luciani states, "[t]he possibility that a small number of Parcel Post pieces may be entered at a DDU is not as unrealistic as Postal Service witness Miller suggests.. ..Mailers may drop more than one subclass of mail at the DDU, so that Parcel Post parcels may be only a small fraction of the total dropshipment." UPS-T-2 at 7-8, footnote 14 (Luciani).

While the Domestic Mail Manual (DMM) allows parcel shippers to drop a small number of Parcel Select pieces at a DDU as long as there were at least fifty pieces in the entire mailing, FedEx SmartPost data show that this is not what actually happens. This is, of course, because dropping only a small number of parcels at a DDU simply wouldn't make economic sense for the shipper.

In the company's most recent fiscal year (which ran from June 1,2005 to May 31, 2006), FedEx SmartPost entered an average of 67 parcels per DDU delivery. In the first quarter of FY 2007, FedEx SmartPost entered an average of more than seventy Parcel Select pieces per DDU delivery.[1]

Further, in support of lower passthroughs, witness Ludani states, "despite the fact that DDU parcels represent more than 50% of total Parcel Post volume, the Postal Service does not know the percentage of DDU parcels that would be classified as nonmachinable if entered upstream of the DDU. Instead, it uses a DBMC-entry/DSCF-entry data proxy for the DDU parcels in the mail processing cost model." UPS-T-2 at 19 (Luciani).

While witness Luciani is correct that the Postal Service uses the percentage of DBMC-entry/DSCF-entry parcels that ate nonmachinable as a proxy for the percentage of DDU parcels that would be nonmachinable if entered at an upstream facility, Table 1 below shows that the DBMC-entry/DSCF-entry proxy appears to be reasonable.

[1] FedEx SmartPost's DDU-entry procedures are similar to the *entry* procedures described by PSA witness Wittnebel (PSA-RT-2) in Docket No. R2000-1. Tr. 41/18044-5 (Wittnebel). I understand that other mailers of DDU parcels follow similar procedures. Also, I would note that FedEx SmartPost enters all of its DDU parcels on pallets

Table 1. Percentage of DDU-Entered Parcels
(USPS Estimate vs. FedEx SmartPost Actuals)

Category	USPS	FedEx SmartPost
Nonmachinable	6.1%	5.7%
Oversized	0.07%	0.05%

III. Parcel Select Is Not Entered At Postal Windows

Witness Luciani recommends using a 14.67-cent unit cost for Parcel Select no-fee electronic delivery conhation, which includes 2.85 cents of costs for instances when a "window derk accepts mail item with eDC and scans barcode" for "customers that print and adhere an electronic label but submit their item(s) at the window." UPS-T-2 at 16 (Luciani); USPS-LR-L-59, DC-TY2008(AR).xls.

While the inclusion of window service costs in the costs for electronic delivery confirmation that is purchased by retail customers may be appropriate, it is clearly inappropriate for Parcel Select no-fee electronic delivery confirmation because Parcel Select is not entered at postal windows.

Parcel Select is a destination entry product requiring shippers to enter bulk shipments of parcels at DBMCs, DSCFs, and DDUs for delivery by the USPS. This product is not entered at the postal window of the local Post Office. FedEx SmartPost collects parcels from several hundred customers and sorts, containerizes and delivers to destination entry points through out the Postal Network. Parcels are prepared in accordance with DMM 455.4.6.1, 455.4.4, and 456.2.0.

1 CHAIRMAN OMAS: This brings us to oral
2 cross-examination. One party has requested oral
3 cross.
4 Mr. McKeever, you may begin.
5 MR. MCKEEVER: Thank you, Mr. Chairman.
6 For the record, John McKeever for United
7 Parcel Service.
8 CROSS-EXAMINATION
9 BY MR. MCKEEVER:
10 Q Mr. Zwieg, on page 1 of your testimony at
11 lines 14 to 15, you state that "FedEx Smart Post
12 specializes in the destination entry of parcels/select
13 parcels with an emphasis on destination delivery/unit
14 delivery."
15 Does FedEx Smart Post drop into the Postal
16 Service any type of mail other than parcels?
17 A Smart Post does not. It's parcels.
18 Q Okay. The company that you're representing
19 does not.
20 A That's correct.
21 Q Just parcels, no standard mail, letter
22 shaped mail or anything of that sort?
23 A A standard parcel, but it's parcel.
24 Q Okay. So FedEx Smart Post does drop into
25 the Postal Service parcels that are entered other than

as parcel past?

A Parcel select and standard parcels.

Q Standard mail parcels?

A Correct.

Q No BPM, bound printed matter?

A No longer.

Q Used to but not any more?

A That is correct.

Q Media mail?

A No.

Q Is that because of a decision not to do that or because there just are no customers that are using FedEx Smart Post at this time?

A A decision not to do that.

Q Okay. So you're dropping really parcels that fall under either the parcel post classification or the standard mail classification?

A Parcel select or standard mail. Correct.

Q Okay. What percentage of the parcels that FedEx Smart Post drops into the Postal Service are standard mail parcels?

A It's approximately 9 percent.

Q Does FedEx Smart Post enter into the Postal Service pieces rated as inter BMC parcel post?

A We do not.

1 Q How about intra BMC parcel post?
2 A We do not.
3 Q Okay. Do you drop into the Postal Service
4 parcels rated as DBMC entry parcel post?
5 A That we do.
6 Q Okay. And DSCF entry?
7 A A very, very small portion, but we do.
8 Q About what portion of the total parcels,
9 standard and parcel post, is DSCF entry?
10 A It's less than 1 percent.
11 Q Okay. How about DBMC entry? About what
12 percentage of the total parcels, whether parcel post
13 or standard mail, is DBMC entry parcel post?
14 A A rough percentage of DBMC entry would be 20
15 percent.
16 Q Twenty percent? And that's 20 percent of
17 the total parcels you enter, both standard mail and
18 parcel post?
19 A Twenty percent of volume. Yes.
20 Q Your total?
21 A Total volume.
22 Q Okay. What is the volume of DDU entry rated
23 parcel post pieces that FedEx Smart Post entered into
24 the Postal Service in 2005?
25 A I don't have that number available.

1 Q Do you have any idea?

2 A The actual volume I know on percentage, but

3 I do not have a volume number that I would feel

4 comfortable stating at this point.

5 Q All right. Well, what is the percentage,

6 then, that is entered as DDU entry pp?

7 parcel post?

8 A In 2005, did you say?

9 Q Well, generally, now.

10 A Generally?

11 Q Yes.

12 A Seventy-eight to eighty percent.

13 Q Is DDU entry?

14 A DDU entry.

15 Q Well, I'm a little confused. Let's take the

16 80 percent because I think you told me 20 percent

17 DBMC, 80 percent DDU and 9 percent standard mail.

18 A Standard mail would be part of that DBMC

19 entry or part of the DDU entry.

20 Q Okay. I'm sorry. We were talking past each

21 other then. So of the total parcels you enter, 9

22 percent are entered as standard mail and 91 percent as

23 parcel post, roughly?

24 A That is correct.

25 Q Okay. Now. of the parcel post parcels, what

1 percent of that 91 percent is DBMC?

2 A That would still remain 20 percent.

3 Q And what percent is DDU?

4 A Eighty percent.

5 Q Okay. Now, can you tell me the total

6 volume, whether standard mail or parcel post, of

7 parcels that FedEx Smart Post entered into the Postal

8 Service in 2005? Just total volume. I'm not asking

9 for a split between standard or parcel post.

10 A Total volume would have been in 2005 right

11 around 100 million

12 Q Is that calendar year ZOOS? That was the

13 intent of my question, but I just want to make sure

14 we're on the same page.

15 A Well, at that point, yes. Calendar year

16 2005 is what I'm speaking to.

17 Q Okay. And this year to date, about how many

18 total parcels has FedEx Smart Post dropped into the

19 Postal Service, 2006 year-to-date?

20 A Calendar year-to-date would be somewhere in

21 the 130 million range.

22 Q So a fair amount more volume this year than

23 last year.

24 A Correct.

25 Q Okay. Does FedEx Smart Post sometimes enter

1 both parcel se ac DDU entry ra ed parcels and
2 standard mail parcels at the same time at the same
3 DDU?
4 A Correct.
5 Q Okay. So on page 3 of your testimony at
6 lines 6 to 7, you say that in FedEx Smart Post's most
7 recent fiscal year it entered an average of 67 parcels
8 per DDU delivery. Is that correct?
9 A That is correct.
10 Q So that average is 67 parcels, some of which
11 may be DDU entry parcel post and some of which are
12 standard mail parcels?
13 A There would be some standard mail that would
14 be mixed in. Yes.
15 Q Okay. Now, that's an average number, that
16 67 parcels on average. Is that correct?
17 A That's an average number. Yes.
18 Q So there are occasions where you would enter
19 less than 67 pieces at a DDU.
20 A There is.
21 Q Do you have any idea what percentage of your
22 shipments would enter less than 67 to 70 parcels per
23 DDU?
24 A What percentage? I do not.
25 Q Do you have a number?

1 A As opposed to a percent? I don't.
2 Q Okay. Now, if you enter 100 parcels at one
3 DDU and 24 parcels at another DDU, that's a total of
4 134 parcels and it would average to 67 parcels per
5 delivery. Is that correct?
6 A Yes.
7 Q Do you know whether a difference like that,
8 110 parcels at one DDU and 24 at another DDU, affects
9 the productivity of the Postal Service employee who
10 has to move the parcels from the entry or acceptance
11 point to the area where the parcels are sorted?
12 A There's no difference in preparation, so
13 I would have to say it would not affect productivity.
14 Q They're all palletized, your parcels, right?
15 A They're all palletized.
16 Q Okay. And do you always have occasions
17 where you have to enter two pallets as opposed to just
18 one pallet?
19 A Yes, there are.
20 Q Okay. do you know what the mean is for the
21 number of parcels that you enter at a DDU? In other
22 words, the number of parcels per entry where half the
23 shipments are above that number and half the shipments
24 are parcels below that number?
25 A I'm not prepared with that answer.

1 Q Is that information that FedEx Smart Post
2 would have?
3 A It is something that would be available at
4 some point, yes.
5 Q Okay. Not too difficult to calculate that,
6 is it?
7 A I would think that it's doable.
8 MR. MCKEEVER: Mr. Chairman, I would like to
9 request that that information be provided.
10 CHAIRMAN OMAS: Can you provide us with that
11 information?
12 MR. MCKEEVER: At a later date.
13 CHAIRMAN OMAS: At a later date.
14 THE WITNESS: I can't today, but, yes.
15 CHAIRMAN OMAS: Well, within, say, five
16 working days?
17 THE WITNESS: Yes.
18 CHAIRMAN OMAS: Is that all right with you,
19 Mr. McKeever?
20 MR. MCKEEVER: Yes, Mr. Chairman. Thank
21 you, Mr. Chairman, and thank you, Mr. Zwieg.
22 BY MR. MCKEEVER:
23 Q Now, at the top of page 2 of your testimony,
24 you state that Mr. Luciani, and I'm quoting here,
25 "speculates that the number of parcel select pieces

1 that are entered at each Postal Service delivery unit
2 may be small." Do you see that?
3 A Which page is that? I'm sorry.
4 Q Page 2.
5 A Page 2?
6 Q At the top of the page. Beginning right on
7 page 3, you state Mr. Luciani and, again, here's where
8 the quote begins, "speculates that the number of
9 parcel select pieces that are entered at each Postal
10 Service delivery unit may be small."
11 A Mm-hmm.
12 Q I assume you're referring to footnote 14 in
13 his testimony? Do you have his testimony with you,
14 Mr. Luciani's?
15 A I do.
16 Q If you can pull that out, then? In that
17 sentence you cite pages 7 and 8, I assume you're
18 referring to Mr. Luciani's footnote 14?
19 A Footnote 14?
20 Q Yes. That's what you had in mind when you
21 made that statement?
22 A Okay. I just want to make sure I'm on the
23 right page with you here.
24 Q Oh, sure. Take your time.
25 A So back to my testimony, page 3, you're

1 saying?

2 Q Your testimony, page 2.

3 A Page 2.

4 Q You state that Mr. Lucian- speculates that

5 the number of parcel select pieces that are entered at

6 each Postal Service delivery unit may be small.

7 A Mm-hmm.

8 Q And you cite pages 7 and 8. And I'm asking

9 you if it's footnote 14, really, that led you to say

10 that. Is that correct?

11 A Yes, it would appear so.

12 Q Okay. And in that footnote, Mr. Luciani

13 states, among other things, "the possibility that a

14 small number of parcel post pieces may be entered at a

15 DDU is not as unrealistic as Postal Service Witness

16 Miller suggests." Is that correct?

17 A At A. Yes.

18 Q He says the possibility that a small number

19 may be entered at DDU, as opposed to pieces that are

20 entered at each delivery unit may be small. Is that

21 correct? I'm sorry, did you say yes? Do you agree?

22 I didn't hear you.

23 A Yes, that would be true.

24 MR. MCKEEVER: I have no further questions,

25 Mr. Chairman.

1 CHAIRMAN OMAS: Thank you, Mr. McKeever.
2 Is there any follow-up cross-examination?
3 (No response.)
4 CHAIRMAN OMAS: Are there any questions from
5 the bench?
6 (No response,)
7 CHAIRMAN OMAS: Mr. May?
8 MR. MAY: Yes. Just one question.
9 REDIRECT EXAMINATION
10 BY MR. MAY:
11 Q Mr. McKeever posited a situation where there
12 might be 110 parcels at one DDU and only 24 at another
13 and if you average those two together you'd get 67
14 parcels. Right?
15 A Correct.
16 Q How frequently, in your opinion, would that
17 kind of divergence occur, i.e., 110 parcels at one DDU
18 and only 24 at another? How frequently would that
19 occur, in your opinion?
20 A Not very. I don't think it would be on a
21 very frequent basis, but it certainly does and could
22 occur, but I think the numbers -- when I bring the
23 mean avesage the study asks for, I think it will show
24 that it's higher.
25 MR. MAY: Thank you.

1 Tha s all, Mr. Chairman.

2 MR. MCKEEVER: Mr. Chairman, just a couple

3 more, if I may, then?

4 CHAIRMAN OMAS: Mr. McKeever.

5 RECROSS-EXAMINATION

6 BY MR. MCKEEVER:

7 Q What is the range of the number of parcels

8 that FedEx Smart Post enters at a DDU? In other

9 words, give me an idea of the highest number you enter

10 at a DDU and an idea of the lowest number.

11 A Okay. The lowest number would be 15.

12 That's the lowest that we have.

13 MR. MCKEEVER: All right. That's fine.

14 Thank you, Mr. Chairman.

15 CHAIRMAN OMAS: Thank you.

16 Mr. Zwieg, that completes your testimony

17 here today. We appreciate your contribution to the

18 record and you are now excused. Thank you for your

19 appearance.

20 (The witness was excused.)

21 CHAIRMAN OMAS: Mr. May?

22 MR. MAY: I call Mr. Glick to the stand.

23 CHAIRMAN OMAS: Witness Glick has been sworn

24 in, so as soon as the gentleman is seated, you may

25 begin.

1 Whereupon,

2 SANDER GLICK

3 having been previously duly sworn, was

4 recalled as a witness herein and was examined and

5 testified further as follows:

6 DIRECT EXAMINATION

7 BY MR. MAY:

8 Q Mr. Glick, I've given you two copies of a

9 document captioned "Rebuttal Testimony of PSA Witness

10 Glick," PSA-RT-1. I'm going to ask that you examine

11 these documents.

12 Are these the documents that were prepared

13 under your direction?

14 A Yes, they are.

15 A And if you were to testify fully today,

16 would this be your testimony?

17 A Yes, it would.

18 MR. MAY: Mr. Chairman, I request that these

19 be admitted into evidence and I'm giving two copies of

20 the rebuttal testimony to the reporter.

21 CHAIRMAN OMAS: Is there any objection?

22 (No response.)

23 CHAIRMAN OMAS: Hearing none, I will direct

24 counsel to provide the reporter with two copies of the

25 corrected testimony of Sander A. Glick. That

1 testimony is received into evidence and is to be
2 transcribed into the record.
3 (The document referred to was
4 marked for identification as
5 Exhibit No. PSA-RT-1 and was
6 received in evidence.)
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Postal Rate Commission
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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 202684111

PSA-RT-1

POSTAL RATE AND FEES CHANGES, 2006

Docket No. R2006-1

REBUTTAL TESTIMONY OF PSA WITNESS GLICK TO UNITED PARCEL SERVICE WITNESS LUCIAN1 (UPS-T-2)

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Dated November 20,2006

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Autobiographical Sketch

My name is Sander A. Glick. I am a Vice-president and co-founder of SLS Consulting, Inc., a Washington, D.C. consulting firm specializing in postal economics. I have testified before the Postal Rate Commission in two previous cases. I also submitted three pieces of direct testimony in this docket.

In Docket No. R97-1, I testified on behalf of the Magazine Publishers of America. In Docket No. R2000-1, I submitted direct testimony on behalf of the Association of Postal Commerce, the Recording Industry Association of America, and the Magazine Publishers of America. I also submitted rebuttal testimony in that case on behalf of the Parcel Shippers Association.

I have also participated on multiple Mailers' Technical Advisory Committee (MTAC) work groups, including the Package Integrity Work Group and the Presort Optimization Work Group.

I attended the Maxwell School of Citizenship and Public Affairs at Syracuse University, where I received a Masters of Public Administration in 1994, and Carleton College, where I received a Bachelors Degree, magna *cum* laude, in Physics in 1993.

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I. Purpose and Scope of My Testimony

United Parcel Service (UPS) witness Luciani (UPS-T-2) criticizes many aspects of the Postal Service's rate design and cost avoidance modeling approach for Parcel Post. He also argues that the Final Adjustment to Parcel Post costs should be larger than that estimated by the Postal Service. In my testimony, I **show** that many of his arguments are incorrect. Speafically, I make five points:

- Given the different demand characteristics of non-destination entry Parcel Post and Parcel Select, marking up transportation cost differences in setting Parcel Post rates is reasonable. Looking forward, the Postal Service should consider breaking Parcel Post into **two** subclasses.

- Wimess Luciani's "interim improvement" to the Postal Service's Parcel Post mail processing cost avoidance model is no improvement at **all.** Rather, it appears to significantly overstate **mail** processing costs of DDU-entered parcels. Thus, his proposed change should be rejected.

- The Postal Service's final adjustment does not understate Parcel Post costs as suggested by witness Luciani. It actually overstates Parcel Post costs because it assumes that there will be more Parcel Select no-fee delivery confirmation pieces **than** total Parcel Select pieces.

- The best estimate of the Test Year unit cost of Parcel Select no-fee electronic delivery confirmation is **11.82** cents per piece, not the 14.67 cents per piece recommended by wimess Luciani. As discussed by PSA witness Zwieg (PSA-RT-2),

Parcel Select no-fee electronic delivery confirmation pieces will not incur window service acceptance costs because Parcel Select is not entered at postal windows.

- Witness Luciani's recommendation that Parcel Return Service (PRS) pieces be treated as non-destination entry Parcel Post volumes for calculating the Parcel Select window service cost avoidance would inappropriately understate the Parcel Select window service cost avoidance.

II. Given the different demand characteristics of non-destination entry Parcel Post and Parcel Select, marking up transportation cost differences in setting Parcel Post rates is reasonable. Looking forward, the Postal Service should consider breaking Parcel Post into two subclasses.

Wimess Luciani argues that the Postal Service approach of marking up transportation cost differences when setting Parcel Post rates inappropriately passes through more than 100 percent of transportation cost differences. Specifically, he states:

> Under its longstanding mail classification policies, the Commission applies a single cost coverage to a subclass as a whole. Furthermore, the Commission has generally adhered to the principle that within a subclass, worksharing rate differences should, to the extent possible, reflect only the costs that the Postal Service would avoid (or incur) if a mail piece were to move from a non-workshared rate category to a workshared rate category, or from one workshared rate category to another. This practice sends price signals that encourage worksharing by mailers when a mailer's cost of worksharing is less than or equal to the resulting reduction in the Postal Service's costs. UPS-T-2 at 3 (Luciani).

I generally agree with witness Luciani that discounts within a subclass should (when appropriate)' be set according to the efficient component pricing rule (ECPR), i.e., discounts should be set equal to unit costs avoided. However, Parcel Post presents a unique case. According to the Postal Service, the own-price elasticity of non-destination entry Parcel

Post, -.374, is approximately one-fourth the sue of the own-price elasticity, *-1.399,* of destination entry Parcel Post (commonly referred to as "Parcel Select"). USPS-T-7 at 178, 185 (Thress). Further, the cross-price elasticity between these two products, if any, is minimal.[2]

While non-destination entry Parcel Post and Parcel Select are currently in the same subclass, the vastly different demand and cost characteristics' of these two products suggest that they are in the same subclass in name only. This was illustrated during the *oral* cross examination of Dr. Panzar (PB-T-1), who is a strong proponent of the use of ECPR within a subclass to promote efficiency.

When presented with the elasticity information discussed above, Dr. Panzar's reaction was quite telling – "Looking at this example, my reaction would be, why are these two services in the same subclass?" Tr. 26/9259 *(Panzar).*" During cross examination, Dr. Panzar goes on to explain that:

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[1] It would not be appropriate, for example, if setting a particular discount equal to unit avoided cost would result in rate shock.

[2] In his testimony, USPS wimess Thress (USPS-T-7) identifies the price of UPS Ground delivery and the price of non-destination mag Parcel Post mail as the factors that principally affect non-destination mag Parcel Post volume and the price of competitor products and the price of Parcel *Select* as the factors that principally affect Parcel *select* volume. USPS-T-7 at 173,181 (Thress). Further, witness Thress does not even include cross-price terms between non-destination entry Parcel Post and Parcel Select in his econometric demand equations. USPS-T-7 at 176-178, 184-185 mess).

[3] *The* vastly different costs between *non-destination* entry Parcel Post and Parcel Select are illustrated in Table 2 below.

[4] Similarly, the Commission's Docket No. MC95-1 analysis of what is now Standard Mail also suggests that non-destination entry Parcel Post and Parcel Select should be in different subclasses.

> The *distinguishing* property of a market is the ability to maintain a single common price among participants that is at least somewhat independent of the prices charged for similar products or services in other markets. The absence of high cross-price elasticities of demand with other subclass is the most relevant evidence of the existence of a distinct market for a proposed subdass. Two subclasses with high cross-price elasticities occupy the same market and cannot sustain different prices without virtually eliminating the demand for some categories of the higher-priced subclass.
>
> However, establishment of subclasses wherever market studies reveal a possibility for price discrimination is not useful unless it can also be demonstrated that corresponding opportunities exist

> But taking that [non-destination entry Parcel Post and Parcel Select are in the same subclass] as a given, the difference in elasticities that you pointed out suggest that, in weighing the advantages of productive efficiency, as reflected through ECPR-based discount policy versus the Ramsey-type elasticity-based price differences, that the argument in this particular example shifts more to the use of price-elasticity-based differences in setting the market...Based on these elasticities with no cross-elasticities, the inverse elasticity rule would apply fairly directly, and we would say that the markup on the workshared product would be less. Tr. 26/9259, 9261 (Panzar).[5]

Looking towards the future, the Postal Service should consider separating non-destination entry Parcel Post and Parcel Select into two subclasses and pricing them based upon a full consideration of all of the non-cost factors of the Postal Reorganization Act. In the meantime, however, marking up transportation cost differences is reasonable based upon the very different elasticities of non-destination entry Parcel Post and Parcel Select.

Further, as Table 1 below (which is essentially based upon the same data sources that wimess Luciani used to create Table 4 in UPST-26) shows, despite marking up

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m *make* postal pricing more efficient or more equitable to mailers. Approximate uniformity of own-price elasticities is desirable among worksharing categories grouped as a subclass even though such uniformity is not required by the economic *concept of a market.* Such uniformity is broadly desirable because equity and efficiency considerations are foundations of Commission rate recommendations. If the own-price elasticities of two proposed subclasses are substantially dissimilar, then there is a potential benefit from setting separate rates provided that distinct markets are being served.

Equity and economic efficiency considerations can have the same force and effect among the mailers within a subclass only when these mailers' own-price elasticities are similar. The most appropriate demonstration that opportunities exist to *make* postal pricing more efficient and more equitable for mailers is the presentation of reliable estimates showing that a proposal separates mailers with distinctly different own-price elasticities of demand into more homogeneous subclasses. MC95-1 Op., Para 5446-5448.

[5] While the Commission does not use Ramsey pricing to establish markups, price elasticities are measures of the value of service, a non-cost factor that is considered when establishing markups. As the Commission noted in Docket No. R2000-1, "While the Commission recognizes the potential perils of undue reliance on the use of own-price elasticity to guide pricing recommendations, it remains the pre-eminent empirical measure available across all classes of postal services to gauge the economic value of *each.*" R2000-1 Op., Para 5302.

[6] The one difference in the data sources is that I include dim-weight pieces in my calculations. These are pieces that are assumed m migrate from Priority Mail to inter-BMC Parcel Post to avoid the implementation of dim-weight pricing in Priority Mail. Also, for the purpose of discussing the implicit markups of non-destination entry Parcel Post and Parcel Select and the average passthrough between these categories, I have accepted the accuracy of the data underlying witness Luciani's Table 4. I, however, would note that no wimess (including USPS witness Kiefer who provided the data) has vouched for that data's accuracy. Tr. 8/2148 (Kiefer).

transportation cost differences, the implicit markup on Parcel Select is still substantially higher than the implicit markup on non-destination entry Parcel Post.[7]

Table 1. Implicit TYAR **Markup** (USPS-Proposed Rates) **on** Non-Destination **Entry** Parcel Post **and** Parcel Select

Product	Markup
Non-Destinahon Entry	12%
Parcel Select	27%

Finally, as discussed above, the argument for efficient component pricing is weaker between non-destination entry Parcel Post and Parcel Select **than** in most subclasses. Nonetheless, the average passthrough between non-destination entry Parcel Post and Parcel Select resulting from the Postal Service's proposal deviates less **from** ECP-based 100 percent passthroughs than do the 90 percent passthroughs of **mail** processing cost avoidances advocated by witness Luciani. UPS-T-2 at 18-19 (Luciani).

Given the thousands of rate cells within Parcel Post and the Postal Service's approach of applying constraints on rate increases to mitigate impact, the passthroughs of cost avoidances vary from rate cell to rate cell. However, as Table 2 (which again is based upon essentially the same data as witness Luciani used to create Table 4 in his testimony) below shows, the average passthrough (106 percent) between non-destination entry Parcel Post and Parcel Select barely exceeds 100 percent.[8]

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[7] As mentioned by Dr. Panzar (Tr. 26/9259-9261), under Ramsey-type pricing, the markup on Parcel Select would be less than that on non-destination entry Parcel Post. Thus, the Postal Service's proposal in this case stops well short of Ramsey-type pricing.

[8] One of witness Luciani's justifications for his proposal to pass through only 90 percent of the mail processing cost avoidance is that, given uncertainties in the Postal Service's cost model, a less-than-full passthrough will "help ensure that the worksharing cost avoidances built into the Parcel Post rates do not exceed the costs actually avoided." UPS-T-2 at 18 (Luciani). In the face of uncertain cost estimates and the much higher own-price elasticity of Parcel Select, a bigger concern should be guarding against volume losses resulting from discounts that are too small. Passing through slightly more than 100 percent of avoided costs protects against this more important concern.

Table 2. Differences in Assigned Costs and Revenues Between Non-Destination Entry Parcel Post and Parcel Select

Unit Revenue Difference	$5.23
Unit Assigned Cost Difference	$4.92
Passthrough	106%

Source: Exhibit PSA-RT-lb

III. Witness Luciani's "interim improvement" to the Postal Service's Parcel Post mail processing cost avoidance model is no improvement at all. Rather, it appears to significantly overstate mail processing costs of DDU-entered parcels. Thus, his proposed change should be rejected.

Witness Luciani proposes what he describes as an "interim improvement" to the Postal Setvice's mail processing cost avoidance model for Parcel Post. Specifically, he proposes one change – increasing the unit cost of a manual parcel sort at the destination delivery unit (DDU) from 10.7 cents per piece to 24.0 cents per piece.[9] UPS-T-2 at 13-14 (Luciani). This is not an improvement because it appears to significantly overstate the cost of DDU parcels, a significant problem given that DDU parcels will comprise a majority of parcels in the Test Year. UPS-T-2 at 19 (Luciani).

To test the appropriateness of his adjustment to the Parcel Post mail processing cost avoidance model, I increased the cost per piece of a manual parcel sort to 24.0 cents per piece as recommended by witness Luciani.[10] Making just this one change to the model produces a unit CRA-adjusted mail processing cost for DDU-entered panels of 53.1 cents per piece, approximately 11 cents higher than the Postal Service's 41.9-cent cost estimate per DDU-entered piece.[11]

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[9] 24.0 cents per piece is the unit incoming cost in the om-MODS manual parcel sorting cost pool. UPS-T-2 at 14 (Luciani).

[10] To do this, I used the method described by witness Luciani in footnote 34 on page 15 of his testimony. Specifically, I changed the value in cell C27 in USPS-LR-L-46, Parcel Post Rev 8-2-06.xls, page 4 to 228.

[11] The CRA-adjusted cost figure is the relevant cost figure because CRA-adjusted unit costs are used to estimate mail processing Cost avoidances. Also, note that the 53.1-cent figure can be seen in USPS-LR-L-46, Parcel Post Rev 8-2-

Then, as a reality check, I compared the 53.1-cent cost estimate for DDU parcels to costs from the In-Office Cost System (IOCS). In general, DDU-entered parcels avoid costs at mail processing plants[12] (because these parcels are deposited at the destination delivery unit and thus bypass processing at plants) and also avoid outgoing costs[13] at the delivery unit (because DDU-entered parcels are not "outgoing" from DDUs to other facilities).[14]

Thus, the costs that DDU-entered parcels would generally incur are non-outgoing costs at post offices, stations, and branches.[15] According to IOCS, the Test Year unit non-outgoing costs for Parcel Post parcels at post offices, stations, and branches is 37.5 cents per piece, almost thirty percent less than the cost for DDU-entered parcels according to witness Luaani's "improved" model.[16] While this unit cost figure from IOCS is not a perfect representation of the cost of DDU-entered parcels,[17] the large deviation raises significant concern with the accuracy of witness Luciani's model.

06.xls, page 1, cell 138 *once* the adjustment described in footnote 8 is made. The 41.9-cent cost figure *can* be seen in the same cell in the Postal Setvice's version of the model.

[12] While he is "not familiar enough with the activities embodied within each MODS cost pool [which contain the costs for postal plants] to provide a definitive list" of MODS pools that DDU-entered parcels avoid, even witness Luciani agrees that "[i]t is likely that the activities in certain MODS cost pools treated as fixed by Postal Service wimess Miller would not be generally incurred by DDU-entry parcels." Tr. 27/9423, 9444 (Luciani). Despite his lack of familiarity, witness Luciani does list several examples of activities in MODS cost pools that he is unable to "conclude that DDU-entry parcels *can* avoid" – verification, computerized forwarding, and empty equipment (Tr. 27/9409 (Luciani)). However, the Test Year unit costs in MODS pools dedicated to these activities – LD49, LD79, and 1EEQMT – are *small, totaling only 1.4 cents per piece.* USPS-T-11 at 49 (Van-Ty-Smith); USPS-LR-L-46, Parcel Post Rev 8-2-06.xls, page 3. Witness Luciani also indicates that he is "not able to conclude that DDU-entry *can* avoid the costs for miscellaneous and support operations at MODS facilities." Tr. 27/9409 (Luciani). While the unit cost in the *general* MODS miscellaneous and support cost pool (1SUPPF1) is 1.6 cents, the Postal Service distributes these costs to subclasses in proportion m costs in the pools they support. USPS-T-11 at 18-19 (Van-Ty-Smith). Because DDU parcels generally avoid direct msts in the supported cost pools, the Postal *Service's* distribution approach *indicates* they will also generally avoid costs in this general support cost pool.

[13] Witness Luciani agrees that "as a general matter" DDU parcels avoid outgoing *costs* at Noo-MODS facilities. Tr. 27/9410 (Luciani).

[14] Of course, these *general* rules are not absolute For example, in Docket No. *R2000-1*, UPS *witness Luciani* found that DBMC parcels do incur some costs (outgoing, non-BMC costs) that would not have been expected. Tr. 271945940 (Luciani). However, it is important to note that while DBMC parcels were found to incur some outgoing, non-BMC costs in Docket No. R2000-1, they nonetheless avoided the vast majority of these costs. In that case, the Commission found that while DBMC parcels do incur some outgoing, non-BMC costs, DBMC parcels would nonetheless avoid 56.2 cents per piece in outgoing costs in the Docket No. R2000-1 Test Year. Docket No. R2000-1, PRC-LR-17, LR17pp.xls, worksheet "DropSavings."

[15] Under USPS costing methods, the mail processing costs for post offices, stations, and branches are now classified as non-MODS costs. USPS-T-11 at 27 (Van-Ty-Smith).

[16] This can be calculated by multiplying the Unit non-MODS cost (41.97 cents per piece) from USPS-LR-L-46, Parcel Post Rev 8-2-06.xls, page 3 by the percentage of non-MODS Parcel Post costs that are non-outgoing (89.5 percent) from USPS-LR-L-144. The latter percentage can be calculated by dividing the Test Year non-outgoing non-MODS costs by the total Test Year non-MODS costs in USPS-LR-L-144, LR144PPBF.xls.

[17] For example, according to the Postal Setvice's parcel cost model, machinable DDU-entered parcels avoid about ten cents per piece in unloading and sack dumping costs at the delivery Unit that other parcels incur. USPS-LR-L-46, Parcel Post Rev 8-2-06.xls, pages 9, 12, 15, and 18. The savings are even larger for nonmachinable and oversized parcels. All else

A reason why witness Luciani's "improved" model results in a much higher cost estimate (53.1 cents versus the 37.5 cents I estimated using IOCS data) is that his cost model (like the Postal Service's) implicitly distributes 15.59 cents (the same amount that is distributed to all other rate categories) of mail processing costs at postal plants to DDU parcels. This results from witness Luciani's (as well as the Postal Service's) treatment of these costs as "fixed" with respect to rate category. Tr. 27/9466 (Luaani). Distributing such a large amount of costs for processing at postal plants to DDU parcels is clearly inappropriate because, as discussed above, DDU parcels bypass postal plants.

If the Commission accepts witness Luciani's interim "improvement" to the Postal Service's cost model, I recommend that it also distribute the vast majority of "fixed" costs at postal plants only to non-DDU-entered parcels.[18]

IV. The Postal Service's final adjustment does not (as suggested by witness Luciani) understate Parcel Post costs. It actually *overstates* Parcel Post costs because it assumes that there will be more Parcel Select no-fee delivery confirmation pieces than total Parcel Select pieces.

In his testimony, witness Luciani argues that the PRS Final Adjustment should be larger than estimated by the Postal Service. UPS-T-2 at 16 (Luciani). He is silent, however, on a larger problem in the Parcel Post Final Adjustment. Specifically, the Final Adjustment charges Parcel Post for 267.8 million TYAR Parcel Select no-fee electronic delivery confirmation pieces when there will only be 244.1 million total Parcel Select pieces, not all of which will use no-fee electronic delivery confirmation. Tr. 27/9474-9475 (Lucid).

The Final Adjustment should be modified to only charge Parcel Post for 209.7 million Parcel Select no-fee delivery confirmation pieces, the best estimate on the record of Parcel Select no-fee delivery confirmation volume. The 209.7 million piece figure is derived by multiplying the total number of TYAR Parcel Select pieces by the FY 2005 percentage

being equal, avoiding these costs would cause the unit cost of DDU-entered parcels to be less than 37.5 cents per piece. On the other hand, DDU-entered parcels may incur some costs in MODS cost pools as well as higher non-MODS acceptance costs. Non-MODS acceptance costs represent 14 percent of costs in the non-MODS MISC cost pool. Tr. 10/2456 (Van-Ty-Smith)

[18] In practice, this could be accomplished by establishing a new cost pool classification in USPS-LR-L-46, Parcel Post Rev 8-2-06.xls, page 3 entitled "Non-DDU Fixed," re-classifying cost pools into this new classification, and then distributing the Non-DDU Fixed costs only to Non-DDU parcels.

(85.9 percent) of Parcel Select pieces that use no-fee electronic delivery confirmation. Tr. 8/2152 (Kiefer); Tr. 27/9412-9413 (Luciani). Further, even witness Luciani agrees that 209.7 million is a reasonable estimate of TYAR Parcel Select no-fee delivery confirmation volume. Tr. 27/9474 (Luciani).

Apparently, the significant overstatement in the Parcel Select no-fee delivery confirmation volume used in the Final Adjustment process is the result of the Postal Service's process for estimating Delivery Confirmation volume, which forecasts total TYAR Delivery Confirmation volume and then assumes that the TYAR distribution across products would be similar to the Base Year distribution. Tr. 15/4530-31 (Berkeley), 4741 (Page).[19]

In the future, the Postal Service could avoid anomalous estimates of Parcel Select no-fee delivery confirmation by estimating these volumes as a function of Parcel Select volume. In this case, the significant overstatement of Parcel Select no-fee delivery confirmation volume can be easily corrected by substituting a much more reasonable TYAR estimate of Parcel Select no-fee delivery confirmation volume – 209.7 million pieces – for the clearly incorrect 267.8 million piece forecast.

V. The best estimate of the Test Year unit cost of Parcel Select no-fee electronic delivery confirmation is 11.82 cents per piece, not the 14.67 cents per piece recommended by witness Luciani. As discussed by PSA wimess Zwieg (PSA-RT-2), Parcel Select no-fee electronic delivery confirmation pieces will not incur window service acceptance *costs* because Parcel Select is not entered at postal windows.

In his testimony, wimess Luciani recommends that "[b]ased on better data being available, the no-fee electronic delivery conhation cost in the Parcel Post rate design model for Parcel Select parcels (applied on USPS-LR-L-82, WP-PP-20, lines [t], [u] and [v]) should be 14.67 cents per piece." UPS-T-2 at 16 (Luciani)

[19] According to witness Thress (USPS-T-7 at 298-299), the equation used to estimate delivery and signature confirmation volume does not include the price or volume of Parcel Select This may explain why Parcel Select no-fee electronic delivery confirmation volume is implicitly estimated to increase from FY 2005 to TYAR while Parcel Select volume is estimated m decrease over the same time period. *USPS-LR-L-82, WP-PP-6* and 28; *USPS-LR-L-59, Attachment* 14A.

As discussed by PSA witness Zwieg, this would be inappropriate because this 14.67-cent per piece unit cost estimate for Parcel Select no-fee electronic delivery confirmation cost includes 2.85 cents of window service costs for window clerks to accept pieces with eDC and scan barcodes on the pieces for "customers that print and adhere an electronic label but submit their item(s) at the window." This cost is not applicable to Parcel Select because Parcel Select is not entered at postal windows.

A more reasonable cost estimate for Parcel Select no-fee electronic delivery confirmation to be used in the Parcel Post rate design model is 11.82 cents, which is the 14.67-cent cost recommended by witness Luciani minus the 2.85-cent window service cost that is included in wimess Luciani's cost figure.

Similarly, the Final Adjustment (discussed in Section IV above) that transfers Parcel Select no-fee electronic delivery conhation costs to Parcel Post should exclude any transfer of window service costs to Parcel Post.[20]

VI. Witness Luciani's recommendation that PRS pieces be treated as non-destination entry Parcel Post volumes for calculating the Parcel Select window service cost avoidance would inappropriately understate the Parcel Select window service cost avoidance.

To calculate the window service cost difference between non-destination entry Parcel Post and Parcel Select parcels, USPS witness Miller (USPS-T-21) must estimate the unit cost of non-destination entry Parcel Post and Parcel Select parcels. See USPS-LR-L-46, page 34.

[20] USPS witness Page (USPS-T-23) explains in response to a UPS interrogatory that he uses the 14.67-cent cost figure (which includes window service costs) in the final adjustment. Tr. 15/4741 *(Page).*

In developing these unit cost estimates, witness Miller treats PRS parcel volume as Parcel Select volume. He does this because "it is [his] understanding that PRS mail would likely be treated as 'dropship' mail in the IOCS activity codes [which is the source of the window service cost data]. It is also [his] understanding that it is not possible to distinguish between any PRS-related tallies and non-PRS Parcel Select tallies at this time." Tr. 31333 (Miller). USPS has since clarified that the treatment of PRS parcels as dropship mail is more than just likely; rather, "PRS mailpieces will be systematically assigned to dropship." Institutional Response to PSA/USPS-2.

Given that PRS costs are being treated as Parcel Select costs and the inability to separately identify these costs, witness Miller's inclusion of PRS volumes with other Parcel Select volumes in calculating the unit cost difference seems like the only appropriate approach.[21]

On the other hand, witness Luciani's recommendation that "[t]he Window Service worksharing cost avoidances should be calculated using PRS pieces counted as non-dropship pieces" (UPS-T-2 at 16 (Luciani)) is inappropriate in this docket because it would result in an inconsistent treatment of PRS costs and volume – PRS costs would be treated as Parcel Select costs while PRS volumes would be treated as non-destination entry Parcel Post volumes.

[21] Of course, it would be better in the future (as suggested by witness Luciani) to separately identify and analyze PRS costs and volumes. Unfortunately, this is not an option in this case

ATTACHMENT 1: INCREMENTAL IMPACT OF WITNESS GLICK'S COST MODEL CHANGES

ACTUAL MAIL PROCESSING UNIT COST ESTIMATES (CENTS)

Rate Category	(1) USPS-LR-L-43	(2) Cost By Shape Modification	(3) 1FLATPRP Cost Pool Modification	(4) ALLIED Cost Pool Modification	(5) Cost Pool Classification Modification	(6) 1SUPP_F1 Cost Pool Modification	(7) Man Inc Sec Coverage Factor Modification
Basic Nonauto	29.605	30.677	31.134	32.057	32.967	33.604	32.355
3-Digit Nonauto	22.157	22.981	23.438	23.928	24.413	24.763	24.259
5-Digit Nonauto	14.161	14.719	15.175	15.204	15.230	15.273	15.725
Carrier Route Nonauto	9.835	10.248	8.753	9.530	9.309	9.134	8.947
Basic Auto	25.212	26.137	26.595	27263	27.922	28.389	27.580
3-Digit Auto	21.078	21.886	22.323	22.751	23.174	23.402	23.145
5-Digit Auto	14.314	14.876	15.334	15.370	15.405	15.454	15.012
Benchmark:							
5-Digit Nonauto	4.326	4.471	5.423	5.674	5.921	8.139	6.778
5-Digit Auto	4.479		5.581	5.840	6.096	6.320	7.065

PRESORT ADJUSTED MAIL PROCESSING UNIT COST ESTIMATES (CENTS)

Rate Category	(1) USPS-LR-L-43	(2) Cost By Shape Modification	(3) 1FLATPRP Cost Pool Modification	(4) ALLIED Cost Pool Modification	(5) Cost Pool Classification Modification	(6) 1SUPP_F1 Modification	(7) Man Inc Sec Coverage Factor Modification
Basic Nonauto	29.605	30.677	31.134	32.057	32.967	33.604	32.355
3-Digit Nonauto	22.157	22.981	23.438	23.929	24.413	24.763	24.269
5-Digit Nonauto	14.161	14.719	15.178	15.204	15.230	15273	15.725
Carrier Route Nonauto	9.835	10.248	9.753	9.m	9.309	9.134	8.947
Basic Auto	28.321	29.350	29.807	30.655	31.493	32.079	30.987
3-Digit Auto	20.936	21.719	22.177	22.597	23.011	23.314	22.959
5-Digit Auto	13.860	14.407	14.865	14.874	14.884	14.915	15.460
Be...hmark:							
5-Digit Nonauto	4.326	4.471	5.423	5.674	5.921	6.139	6.778
5-Digit Auto	4.025	4.159	5.112	5.344	5.575	5.781	6.513

(1) USPS-LR-L-43
(2) Values based on witness Glick's cost by shape modification
(3) Values based on witness Glick's 1FLATPRP cost pool modification
(4) Values based on witness Glick's ALLIED cost pool modification
(5) Values based on witness Glick's cost pool classification changes
(6) Values based on witness Glick's 1SUPP_F1 cost pool modification
(7) MPA/ANM-LR-2

1 CHAIRMAN OMAS: This brings us to oral
2 cross-examination. One party has requested oral
3 cross-examination.
4 Mr. McKeever, you may begin.
5 MR. MCKEEVER: Thank you again,
6 Mr. Chairman.
7 Again, for the record, John McKeever for
8 United Parcel Service.
9 CROSS-EXAMINATION
10 BY MR. MCKEEVER:
11 Q Mr. Glick, on page 2 of your testimony at
12 lines 3 to 4, you state that the cross price
13 elasticity between parcel select and non-destination
14 entry parcel post, if any, is minimal.
15 A Can you give me the page again?
16 Q Sure. And maybe I have the wrong page, let
17 me check.
18 A Well, one of us does.
19 Q And I do have the wrong page. If you'll
20 give me a moment?
21 A Okay.
22 Q Oh, yes. It's page 4, not page 2.
23 I apologize.
24 A Okay.
25 Q On page 4 of your testimony at lines 3 to

1 4 -- I had the lines right, anyway -- on page 4, you
2 state that the cross price elasticity between parcel
3 select and non-destination entry parcel post, if any,
4 is minimal.
5 A Right.
6 Q And you have a footnote to that sentence
7 where you state in the footnote that, "Witness Thress
8 does not even include cross price terms between
9 non-destination entry parcel post and parcel select in
10 his econometric demand equations." Do you see that?
11 A I do see that.
12 Q Do you know whether Dr. Thress tested to see
13 whether there is a cross elasticity between parcel
14 select and non-destination entry parcel post?
15 A No, I don't know. He had a price index for
16 non-destination entry parcel post and also for parcel
17 select, so I assume that he could have done it, that
18 he either judgmentally determined it wasn't necessary
19 or he empirically determined it, but I don't know.
20 Q Or he didn't think about it. Is that a
21 possibility?
22 A I can't read his mind.
23 Q Okay. So we don't know why he didn't test
24 for that.
25 A We don't know why.

1 Q Okay. Now, there's a tendency to think of
2 inter BMC parcels as a non-rate shared work category.
3 I don't know if you'll agree with me on that, but I'll
4 make that as a statement as a prelude to my question.
5 A Okay.
6 Q There is an inter BMC discount for BMC
7 pre-sorting, though, isn't there?
8 A Yes. I think that there's a very small
9 amount of mail which takes advantage of it, but
10 I don't have the number in front of me.
11 Q Okay. But a mailer can and some mailers do
12 do some BMC pre-sorting and enter the parcels as inter
13 BMC parcels. Is that right?
14 A I know there's a rate category. I don't
15 have in front of me what volume does it. I understand
16 it's pretty small.
17 CHAIRMAN OMAS: Mr. Glick, excuse me. Would
18 you speak a little bit louder, please?
19 THE WITNESS: Sure. Sorry about that.
20 BY MR. MCKEEVER:
21 Q There's also an origin BMC discount within
22 inter BMC mail. Is that correct?
23 A Yes, that's true.
24 Q And that's where the mailer enters his
25 parcels, brings the parcels to the origin bulk mail

1 center?

2 A Yes, I assume so.

3 Q And the mailer gets a discount for that?

4 A Yes.

5 Q But they're inter BMC parcels?

6 A Yes.

7 Q Both of those are a form of mailer work

8 sharing. Is that correct?

9 A Yes, and I think that there's a small amount

10 of those.

11 MR. MAY: Mr. Chairman, with your

12 permission, I'd like to present the witness with

13 Mr. Kiefer's workpaper WP-PP-1.

14 CHAIRMAN OMAS: Without objection.

15 BY MR. MCKEEVER:

16 Q Now, Mr. Glick, as I mentioned, as the

17 document indicates, this is a workpaper, WP-PP-1

18 associated with Mr. Kiefer's testimony, USPS-T-37.

19 If you would take a look at the bottom of

20 that workpaper, the volume share of inter BMC volumes

21 that consist of BMC pre-sort volume and OBMC pre-sort

22 volume is stated there: BMC pre-sort volume share of

23 inter BMC and OBMC pre-sort volume share of inter BMC.

24 Do you see that?

25 A Yes, I do.

1 Q And that's a little over 17 percent of inter
2 BMC volume?
3 A Yes.
4 Q I would assume, and I'm asking if you would
5 assume, that Dr. Thress included those work shared
6 discount volumes as inter BMC volumes when he
7 estimated his econometric demand equations. Would you
8 agree with that?
9 A Yes, I would expect that's the case.
10 Q Okay. Do you have Dr. Thress' testimony
11 with you?
12 A I have portions of it.
13 Q Do you have the parcel post portion?
14 A Yes.
15 Q Okay. If you can turn to that?
16 A Okay.
17 Q On page 167, at lines 21 to 23, Dr. Thress
18 points out that the growth rates for non-destination
19 entry and destination entry parcel post have the same
20 sign in only ten of the last 40 quarters. Do you see
21 that?
22 A I do see that.
23 Q In other words, 75 percent of the time, 30
24 quarters out of 40, over the past ten years, when
25 destination entry volume was growing, non-destination

1 entry volume was declining and when destination entry
2 volume was declining, non-destination entry volume was
3 increasing. Is that correct?
4 A Can you just read me your question again?
5 Q Sure. Sure. He points out that the growth
6 rates for non-destination entry and destination entry
7 parcel post in 30 out of 40 quarters really move in
8 different directions. That's what he's saying, isn't
9 he? So that when one is growing, the other is
10 declining in volume and vice versa and you could see
11 that, I think, on the table on page 169.
12 A That looks to be right.
13 Q Okay. In fact, on page 170 of his
14 testimony, at lines 18 and 19, Dr. Thress testifies,
15 "In many ways, the story of non-destination entry
16 parcel post is a mirror image of the destination entry
17 story." Do you see that?
18 A I may remember reading it, but can you give
19 me the line number again?
20 Q Sure. Page 170.
21 A Okay.
22 Q At lines 18 and 19. He says, "In many ways,
23 the story of non-destination entry parcel post is a
24 mirror image of the destination entry story."
25 A Yes. Which is consistent with the other

1 point.

2 Q The 30 out of 40 quarters, et cetera, where

3 the volume goes in different directions? Is that what

4 you mean?

5 A Yes.

6 Q Okay. Does that suggest to you that volume

7 might be shifting from one category to another?

8 A Not necessarily, no.

9 Q That doesn't suggest that to you?

10 A No.

11 MR. MAY: I have no further questions,

12 Mr. Chairman.

13 CHAIRMAN OMAS: Thank you, Mr. McKeever.

14 Is there anyone else who wishes to

15 cross-examine Witness Glick?

16 (No response.)

17 CHAIRMAN OMAS: Are there any questions from

18 the bench?

19 (No response.)

20 CHAIRMAN OMAS: Mr. May, would you like some

21 time with your witness?

22 MR. MAY: That's not necessary. Thank you.

23 CHAIRMAN OMAS: Mr. Glick, that completes

24 your testimony here today. We appreciate your

25 contribution to the record and you are now excused.

1 THE WITNESS: Thank you.

2 (The witness was excused.)

3 CHAIRMAN OMAS: Mr. Rubin?

4 MR. RUBIN: The Postal Service calls Drew

5 Mitchum as its next witness.

6 CHAIRMAN OMAS: Mr. Mitchum has already been

7 sworn in in this proceeding, so you may begin,

8 Mr. Rubin.

9 Whereupon,

10 DREW MITCHUM

11 having been previously duly sworn, was

12 recalled as a witness herein and was examined and

13 testified further as follows:

14 DIRECT EXAMINATION

15 BY MR. RUBIN:

16 Q Mr. Mitchum, do you have two copies of a

17 document designated USPS-RT-13 entitled, "Rebuttal

18 Testimony of Drew Mitchum on behalf of the U.S. Postal

19 Service?

20 A Yes.

21 CHAIRMAN OMAS: Excuse me, Mr. Mitchum.

22 Would you speak up a little bit?

23 THE WITNESS: Yes, I do.

24 BY MR. RUBIN:

25 Q I note that these copies include a revised

1 page 16, as revised November 27th, and also that the
2 cover page on these copies has been corrected today to
3 state "Rebuttal Testimony" instead of "Direct
4 Testimony."
5 Was this testimony prepared by you or under
6 your supervision?
7 A Yes, it was.
8 Q And if you were to testify orally here
9 today, would this be your testimony?
10 A Yes.
11 MR. RUBIN: Two copies of the rebuttal
12 testimony of Drew Mitchum on behalf of the U.S. Postal
13 Service are being provided to the reporter and I ask
14 that this testimony be entered into evidence in this
15 docket.
16 CHAIRMAN OMAS: Is there any objection?
17 (No response.)
18 CHAIRMAN OMAS: Hearing none, I will direct
19 counsel to provide the reporter with two copies of the
20 corrected testimony of Drew Mitchum. That testimony
21 is received into evidence and is to be transcribed
22 into the record.
23 //
24 //
25 //

1 (The document referred to was
2 marked for identification as
3 Exhibit No. USPS-RT-13 and
4 was received in evidence.)
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USPS-RT-13

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

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

REBUTTAL TESTIMONY
OF
DREW MITCHUM
ON BEHALF OF THE
UNITED STATES POSTAL SERVICE

Revised November 30,2006

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AUTOBIOGRAPHICAL SKETCH

My name is Drew A. Mitchum. I am currently an economist in the office of Pricing at the United States Postal Service. Prior to joining the Postal Service in July, 2004, I was employed by the National Association of Home Builders (NAHB), starting in 2002. At NAHB, I was the Manager, Economics and Statistical Research. My responsibilities there included providing research support to senior staff, researching and writing articles, and maintaining the national, regional, and state forecasts. From 2001 to 2002, I worked at the NASDAQ Stock Market as a Market Data Specialist. My responsibilities were generally related to product management, but also included ensuring the integrity of the data that were disseminated, and writing technical documents. From 2000 to 2001, I worked in the Economic Research department of the National Association of Securities Dealers and the NASDAQ Stock Market. From 1997 to 1999 I was an associate in the Research department at Watson Wyatt Worldwide (WWW). My work at WWW related to research on defined contribution pension plans. I began my professional career as a Labor Economist at the Bureau of Labor Statistics in the Office of Employment Projection, from 1994 to 1997.

I received a Master of Arts degree in Economics from Georgia State University in 1993, and a Bachelor of Science degree in Managerial Economics from Lynchburg College in Virginia in 1991.

This is the second time I am testifying before the Postal Rate Commission, as I also offered testimony designated as USPS-T-40 in this proceeding.

I. Purpose

The purpose of this testimony is to respond to the testimonies of OCA witness Callow (OCA-T-5), GrayHair Software witness Bellamy (GHS-T-1), and Major Mailers Association witness Bentley (MMA-T-1), concerning proposals for pricing Confirm service. My testimony explains why the Postal Service deemed it necessary to propose a new fee structure, why the OCA proposal is inadequate, and how the Postal Service proposal addresses each of the challenges that identified the need for a new pricing structure. I also respond to some specific criticisms and comments by the participants.

II. The Issues and How the Proposals Address Them

Two participants in this case believe that it was unnecessary for the Postal Service to propose a new fee structure.[1] Moreover, OCA witness Callow expressly proposes retention of the existing fee structure.[2] The Postal Service disagrees, having concluded that 1) experience with the existing approach to pricing Confirm service demonstrates its shortcomings; 2) even under the OCA's proposed modifications, revenue is unlikely to exceed costs; and 3) pricing for Confirm service needs to accommodate possible future developments while covering costs and making a contribution to institutional costs.

The decision to propose a new fee structure for Confirm service was not made lightly. Analysis of how best to price Confirm service began with its failure to cover costs. Then, afler evaluating the existing fee structure to identify why

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[1] See the testimony of witness Callow (OCA-T-5 at 4), and the testimony of witness Bellamy (GHS-T-1 at 2).
[2] OCA-T-5 at 14-21.

the product was not covering its costs, I identified other shortcomings in the existing fee structure that could be addressed; this resulted in a list of 7 issues that guided the development of a new fee structure. The seven issues are:

(1) the current fees do not generate revenue sufficient to cover costs;
(2) fee increases sufficient to generate a moderate cost coverage must compensate for the reduced usage that results;
(3) higher fees would increase the potential size of arbitrage opportunities;
(4) within each tier in the existing fee structure, higher scan volume users benefit more than lower volume users:'
(5) choosing the optimal tier can be difficult for new subscribers;
(6) availability of unlimited scans actually benefits few subscribers; and
(7) the structure does not facilitate the introduction of other information-based services.

A. Covering Costs

The failure of Confirm to cover its costs was one of the primary concerns regarding the existing fee schedule. In preparing Docket No. R2005-1, the Postal Service determined that issues involving maturation of the product, costs and revenues were of sufficient import to leave Confirm service out of the case.[3] In preparation for filing Docket No. R2006-1 (and to some extent in preparation for filing Docket No. R2005-1) substantial analysis was undertaken to determine how best to obtain the necessary revenue. My analysis began with evaluating the existing pricing structure. A fee increase could encourage mailers to begin seeding to keep their overall fees low, and fee increases would need to be distributed such that no entity would benefit excessively or be harmed excessively. Most importantly, the fee increases, given their magnitude, needed to be structured to account for the potential that they would reduce demand. The

[3] See Notice Of The United States Postal Service Regarding Exclusion of Confirm Service from General Rate Proceeding, filed April 8, 2005.

task was to find the least disruptive, yet reasonably effective, way to get the needed revenue while making at least a moderate contribution to the institutional costs of the Postal Service! Unfortunately, accomplishing this goal while retaining the existing structure is hindered by many considerations, including:

(1) Fee increases decrease demand, and may cause subscribers to stop using Confirm, or to diminish use;
(2) Higher fees for Platinum subscribers would encourage migration to the Gold tier:
(3) Pure arbitrage could greatly reduce the number of direct end user subscribers; and
(4) Users of disparate sizes face the same fees.

For these reasons, we concluded that covering costs using the existing fee structure was improbable.

1. OCA Proposal - Covering Costs

The ability of the OCA proposal to cover costs depends on several assumptions about subscriber reaction to the proposed fee increases: **(1)** no decrease in demand, (2) no migration to a less expensive tier, (3) no subscribers will stop using Confirm, and (4) no impact from arbitrage. The OCA proposal also depends on those subscribers who previously chose the more expensive Platinum tier, even while the Gold tier could have satisfied their demand, to continue doing so despite fee differential increases of **160** percent?

---

[4] GrayHair Software witness Bellamy agrees. GHS-T-1 at 3.
[5] This 160 percent increase in the differential is derived by dividing the differential under the OCA proposal by the differential that exists today and then subtracting 1: **$14,300 / $5,500 -1 = 160%.**

2. Postal Service Proposal - Covering Costs

No participant asserts that the Postal Service proposal would generate insufficient revenue to cover costs. That is because the proposal affirmatively addresses the weaknesses of the existing fee structure (see, *e.g.*, section II(A), above), rather than assuming them away. Additionally, unlike witness Bentley's proposal, the Postal Service proposal recognizes and accommodates the need to cover costs.

B. Impact on Customer Behavior

With the large revenue increase necessary to cover costs, any fee increase is likely to affect customer use of Confirm service. Confirm service is a necessity only for those subscribers who derive their revenue from the reselling of Confirm scans. Many end user subscribers may well view Confirm service as a discretionary good, which could be cut from the budget during tough times or in the face of large fee increases that are applied recklessly.

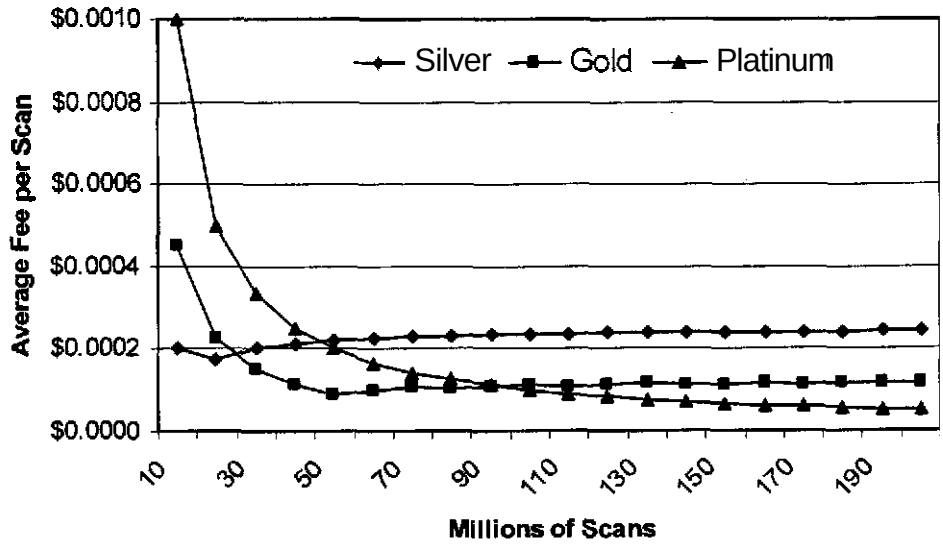
Aside from stopping use of Confirm altogether, three responses are readily available: (1) begin seeding, (2) move to a less expensive tier, and (3) take business to a reseller.

Each tier allows for any number of scans, but for any specific number of scans only one tier provides the lowest cost per scan (see Figure 1, below). Note that the average fee per scan for both Silver and Gold subscribers starts increasing shortly after acquisition of additional scans (while the average fee per scan for Platinum subscribers declines continuously). Also note that the Gold

a

subscription is the least expensive option until a subscriber uses more than 92 million scans.

Figure 1: Average Fee per Scan for Scan Volumes from 10 to 200 Million **by Tier**



The current fee schedule has resulted in some Confirm subscribers buying more scans than, in retrospect, they actually used. Some Platinum subscribers, for example, could have realized a lower net cost per scan with Gold subscriptions. While customer overpayment has reduced the amount of the shortfall in Confirm revenues, it would be imprudent to assume its continuation, especially when faced with substantial fee increases.

The chief reason why a subscriber might overpay upon signing up for Confirm service is the inability to project how many scans will be used over the course of a year. For $10,000, a subscriber would be sure to have enough scans. In the face of a substantial fee increase, and after gaining experience with Confirm

service, customers are likely to make more cautious and more accurate projections, thus reducing the number of overpayers.

One concern related to the existing fee structure is that the fees paid by the 45 Platinum subscribers (25 percent of all subscriptions) account for 44 percent of total revenue in the base year (excluding revenue from Additional IDs). These 45 subscribers include many whose use is less than 50 million scans, a level that really warrants only a Gold subscription.

As the gap between Gold and Platinum subscription prices increases, so, too, does the threshold (millions of scans) at which a Gold subscription costs less than a Platinum subscription. Table 1, below, illustrates this by holding the Gold subscription price at $4,500 while increasing the Platinum subscription price from $10,000 to $50,000.

Table 1. How Increases in the Platinum Fee Make the Gold Tier More Attractive

Platinum Tier Fee ($)	Gold Tier Fee ($)	Difference in Fees ($)	Additional Block Fee	Blocks that could be Purchased	Millions of Scans Below Which Gold Tier is Cheaper
10,000	4,500	5,500	750	7	92
15,000	4,500	10,500	750	14	134
20,000	4,500	15,500	750	20	170
25,000	4,500	20,500	750	27	212
30,000	4,500	25,500	750	34	254
35,000	4,500	30,500	750	40	290
40,000	4,500	35,500	750	47	332
45,000	4,500	40,500	750	54	374
50,000	4,500	45,500	750	60	410

This exercise illustrates why the existing 45 Platinum subscribers would be increasingly unlikely to remain as Platinum subscribers if there were a large increase in fees. For each Platinum subscriber that chooses to move to a lower tier, the price for the remaining Platinum subscribers would also need to increase even more. Another consequence of increasing the gap between Gold and Platinum subscription prices is an increase in the arbitrage opportunity, a topic discussed separately in section II(C).

Finally, the existence of resellers must be considered. Today most resellers add value to the raw Confirm scans a direct subscriber would receive. Resellers accordingly expand the market for Confirm service by assisting firms without the technological expertise or mail volume that might permit them to be direct subscribers. The Postal Service fully supports the existence of the Confirm aftermarket, much as it supports other businesses dependent upon mail, including, for example, firms that provide automation compatibility, presortation, co-mailing, or co-palletization to mailers. Nonetheless, each direct subscriber of Confirm that moves to a reseller under the existing fee structure reduces Confirm revenue while imposing a greater cost burden on the remaining Confirm subscribers.

1. The OCA Proposal - ***Impact*** on ***Customer Behavior***

Witness Callow provides no support for his assumption that his proposed fees would not reduce usage of Confirm. Yet he recognizes that the Postal Service proposal assumes a decrease in usage as a result of the fee increase, and

apparently agrees that usage will decrease with price increases.[6] Since both proposals involve significant increases, it is implausible to think that only one of them reduces usage. As such, it is difficult to accept witness Callow's dual claims that the OCA proposal will achieve a cost coverage greater than under the Postal Service proposal without incurring a decrease in demand.

Witness Callow does not consider the potential for subscribers to react to fee increases by seeding their mailings with Confirm barcodes or moving to a less expensive tier. For example, under the existing fee schedule a Platinum subscriber getting 51 million scans a year could choose to seed some mailings to reduce usage below the 50 million scan threshold and (1) move from the Platinum to the Gold tier without needing to buy additional scans, or (2) to save $750 by not buying an additional block of scans. If the price differential between the two tiers were to be widened from $5,500 to $14,300, as the OCA proposes, customers are even more likely to seed or move to a lower tier.

Witness Callow assumes that those Platinum subscribers who could save as much as $5,500 by moving to the Gold tier under the existing fees will decide to pay as much as $14,300 more than is necessary under his proposed fees.' Witness Callow offers two justifications for this assumption. First, he assumes a lack of price sensitivity because the Postal Service has not explained why some subscribers overpay by $5,500 today. Second, after confirming that 29 Platinum subscribers could save at least $12,800 by switching to a Gold subscription he

[6] OCA-Td at 7.
[7] Response to USPS/OCA-T5-2, Tr. 21/7791-93.

1 says that "such a decision on the part of the 29 subscribers is not assured."[8]
2 Trusting that subscribers will choose to spend substantially more than necessary,
3 he concludes "that there would be little or no effect on the number of Platinum
4 subscribers."[9]

5 Assuming that current overpayers will continue to overpay when faced with
6 the OCA's proposed prices, and the much bigger gap between Gold and
7 Platinum, is unreasonable. At least seven of the existing subscribers must
a continue to overpay (by much more than today) for the OCA proposal to result in
9 a cost coverage of greater than 100 percent.[10] This is an odd revelation given
10 that one of the reasons that OCA considers its proposal superior is that it is
11 intended to produce a slightly higher cost coverage than the Postal Service
12 proposal.[11]

13 To quantify the sensitivity of the overpay assumption made by witness
14 Callow, I assume that Confirm subscribers choose to pay as little as possible,
15 and choose the Gold tier when it is less expensive. When the 29 Platinum
16 subscribers that could save money move to the Gold tier, the fee for Platinum
17 subscribers would have to be raised to a value in excess of $42,500[12] if the fees

---

[8] Response to USPS/OCA-T5-2, Tr. 21/7791-63.
[9] Response to USPS/OCA-T5-2, Tr. 2117791-93.
[10] Response to USPS/OCA-T5-3, Tr. 2117794.
[11] See the testimony of witness Callow (OCA-T-5 at 19, 25).
[12] Actually, witness Callow has calculated this figure as an even higher $45,400 (USPS/OCA-T5 at 3, Tr. 21/7794 and 20, Tr. 21/7821-22). He failed to consider that some of the subscribers making the move to the lower tier would need to buy additional blocks of scans at $750 each, which lowers the required fee for the Platinum subscription to about $42,500.

for the Silver and Gold tiers were to remain at the level proposed by the OCA.[13] Witness Callow did not appear to recognize that if the Platinum fee increased to this level, still more subscribers would save money by moving to the Gold tier, thus requiring the fee for a Platinum subscription to be even higher. This spiral effect must be considered when trying to assure any level of contribution from Confirm service.

Additionally, if any Gold and Platinum subscribers stopped subscribing due to the price increases, the fees for Platinum subscribers would have to increase even more. Finally, given that Gold subscribers can upgrade their subscriptions to Platinum by paying the difference in fees between the two tiers at any time, customers should feel comfortable switching to the Gold tier, even if early projections of scan usage appear to justify a Platinum subscription.

The OCA proposal also appears to ignore that resellers are an alternative source for Confirm service. As the fees increase under the existing structure the potential for pure arbitrage reselling increases, and some users will likely take advantage of the opportunity to reduce their Confirm expenditures by having their scans routed through a reseller. The problems surrounding arbitrage are discussed in section II(C), below.

2. Postal Service Proposal - Impact on Customer Behavior

The Postal Service proposal fully recognizes that a significant increase in fees will result in a decrease in demand. Thus, I conservatively assume that

[13] I chose to hold the fee levels for the Silver and Gold tiers at those proposed by the OCA, as does witness Callow in his response to USPS/OCA-T5-20, by creating a table whose cost coverage calculations are based exclusively upon changes in subscription fees.

increasing fees will reduce demand by ten percent: I elaborate upon my reasoning behind this assumption in my response to POIR 4, question 3.

I did not find it necessary to explain why some current subscribers overpay, because the Postal Service proposal does not depend on subscribers choosing to overpay to generate the projected revenue. I considered customer overpayment – and the likelihood that it may not continue – as a reason for concern that contributed to my decision to develop a new fee structure.

The Postal Service proposal does not prevent mailers from seeding; on the contrary the Postal Service assumes that some mailers will begin seeding to reduce their costs. My assumption that the overall number of scans used will decrease by 10 percent accommodates the expected seeding.

Movement to resellers is accepted as a likely reality in the future under the Postal Service proposal. The impact of this movement is limited by the introduction of per scan fees. This will be discussed in detail in the arbitrage section.

C. Reseller Arbitrage Opportunity

Arbitrage is the process by which someone purchases a commodity and then resells the commodity so as to profit from a pricing discrepancy. In the case of Confirm service, a reseller takes advantage of the availability of unlimited scans for a fixed price by acting as a middle man for several subscribers, offering each of them a savings over what they would pay the Postal Service to subscribe directly to the service. The reseller profits by collecting more money from his customers than he pays for the unlimited scans.

The current pricing structure promotes arbitrage because the Platinum subscription provides unlimited scans.[14] The Postal Service was aware of this potential before implementing Confirm service (see the testimony of witness Rothschild, USPS-T-4, PRC Docket No. MC2002-1) and continues to support this market sector. For two reasons, arbitrage is not currently a major problem for Confirm service:

(1) the fee for Confirm is relatively low, requiring a fairly large number of customers to make reselling profitable; and
(2) adding value to the raw scans can be more lucrative than simply reselling raw data.

Confirm service provides raw scan data, which require aggregation, manipulation, or analysis to be useful. The Postal Service recognizes that many resellers are providing these value added services to their customers, and that resellers increase usage of Confirm. However, resellers have greatly benefited from their ability to attract potential Postal Service customers and redirect their payments away from the Postal Service. While the fact that resellers earn a profit is not a problem, the failure of Confirm service to cover costs is not permitted.

Maintaining the existing fee structure while trying to increase revenue by nearly 50 percent so the product has a moderate cost coverage would increase the opportunity for pure arbitrage reselling. Higher prices for Confirm service mean that a pure arbitrage reseller can charge more for raw scans routed through them. Thus, fewer customers are needed to make reselling, without adding value, feasible. Rather than paying 95 percent more than customers do

[14] See my response to Presiding Officer's Information Request No. 12, Question 5.

today, as they would under the OCA proposal, a direct subscriber might well choose to save money by having their scans routed through a reseller. Under the existing fee structure, each customer that moves to a reseller results in the Postal Service losing the Confirm service revenue for that customer, which in turn requires a larger overall fee increase to offset the lost revenue.[15] Once pure arbitrage resellers enter the picture a troubling cycle begins:

(1) Increased fees make arbitrage resellers feasible;
(2) Direct end users choose resellers to save money;
(3) Fees need to be raised to offset revenue lost from customers switching to resellers;
(4) Higher fees make resellers even more attractive, causing more users to choose resellers;
(5) Steps (3) and (4) repeat until almost all customers are resellers. with the fees prohibitively high for any new direct subscribers.

1. The OCA Proposal - Reseller Arbitrage *Opportunity*

The OCA did not consider arbitrage, which was one of the concerns that led to the Postal Service proposal. Witness Callow not only admits that it was not considered during the development of his proposal, but he also admits that he had not reviewed POIR No. 12, question 5, which was filed 2 weeks before his testimony. [16]

Pure arbitrage reselling[17] is a more pressing concern under the OCA proposal than under the Postal Service proposal. As noted above the higher the fees Subscribers face the more attractive resellers become. As the OCA proposal

[15] If the number of subscribers decreases then the fee increase must be higher; for example, if you have a revenue target of $100 and 10 customers, the fee per customer is $10. However if 2 of those customers stop buying the product, the fee needs to be $12.50 for the remaining 8 customers to get $100 in revenue.
[16] Tr. 21/7839.
[17] That is, the data are provided in raw format, with no analysis or value added by the reseller.

utilizes the existing fee structure, each subscriber lost to a reseller results in the Postal Service losing all of the revenue for that customer. Thus the loss of a Platinum subscriber under the OCA proposal would reduce the revenue for the Postal Service by $19,500, or 1.3 percent of total projected revenue. Of course, the loss of revenue would require larger fee increases for the remaining subscribers to generate the requisite revenue, further encouraging use of resellers.

2. Postal Service Proposal - Reseller Arbitrage *Opportunity*

Under the OCA proposal the Postal Service loses all the revenue from a Confirm subscriber who switches to a reseller. However, under the Postal Service proposal, the reseller must purchase additional scans for each new customer, so the Postal Service does not lose all of that customer's revenue. In witness Callow's response to USPS/OCA-T5-24, he confirms that under the OCA proposal the loss of a subscriber using 200 million scans to a reseller would reduce revenue by $19,500; under the Postal Service proposal the lost revenue would be at most $7,030.[18]

D. Fairness and Equity

The wide range in the number of scans used by customers within a tier complicates the pricing of Confirm service. With the unlimited option, grossly different costs per scan can exist between customers in the same tier. But even

[18] Under the Postal Service proposal the subscriber would have been paying $16.380 for their scans, and the reseller would have to expend $9,800 for 560 additional blocks of scans, this assumes that the reseller is buying blocks at the $17.50 rate.

for the other tiers, a Confirm subscriber who uses a small number of Scans pays much more per scan than does a user of a large number of scans. This pricing approach definitely favors high-volume subscribers, a consequence that is unduly exacerbated by the fee increases proposed by the OCA. See Table 2.

Table 2. Average Price per Million Scans for Platinum Subscribers Under Existing Fees, and the OCA and Postal Service Proposals.

	Average Price per Million Scans[19]		
Scans Used	**Existing Fees**	**OCA Proposal**	**USPS Proposal**
51,000,000	$196.08	$382.35	$186.91
164,000,000	60.98	118.90	91.95
1,000,000,000	10.00	19.50	56.03
10,000,000,000	1.00	1.95	49.70

Table 2 shows how the Postal Service proposal retains more revenue from very high volume Confirm customers than does the OCA proposal. Note that no customers have yet used as many as 1 billion scans in a year, so the top two rows are more representative of the situation today.

1. The OCA Proposal - Fairness and Equity

The fee increase proposed by the OCA significantly reduces fairness and equity. It appears the OCA has ignored the disparate treatment afforded small and large users under the existing structure, as its proposal exacerbates current differences.

[19] Witness Callow confirms that, in his response to interrogatory USPS/OCA-T5-15 (Tr. 21/7809-11), the numbers presented in columns 3 and 4 are accurate representations of the average price per million scans subscribers would face under his proposal and the Postal Service proposal. The second column is then derived by dividing $10,000 by the number of millions of scans presented in the first column, example (e.g., $10,000 I 5 1 = $196.08).

Under the OCA proposal, the fee per scan disparity between the largest and smallest users can be very large. In response to interrogatory USPS/OCA-T5-15, witness Callow confirms that a Platinum subscriber using 51 million scans pays 19.8 times more per scan than a subscriber using 1 billion scans, and 198 times more than a subscriber using 10 billion scans. His justification for continuing this disparity is that it is an incentive for subscribers to place Planet Codes on all of their mail?[20] But no incentive would help a small subscriber who is already placing Planet Codes on all of her mailpieces. The result for these smaller mailers is that they pay substantially higher fees per scan.

2. Postal Service Proposal - Fairness and Equity

One benefit of the Postal Service proposal is that all customers face a single fee schedule, with all customers who use the same number of scans incurring the same fee for those scans. Table 2 shows that a subscriber using 51 million scans only pays 4 times as much per million scans as the subscriber using 10 billion scans, whereas under the OCA proposal a 51 million scan customer pays 198 times as much as the ten billion scan customer. Thus the Postal Service unit-based fee proposal clearly offers improvement with regard to both fairness and equity. In particular, the average fee for the Platinum subscriber using 51 million scans will actually decrease relative to the existing fees. This lower fee for smaller users better encourages use than does the OCA proposal, which almost doubles the cost to these users.

[20] See the response to USPS/OCA-T5-15(d), Tr. 21/7809-11.

E. Simplicity

The existing fee structure can apparently encourage a new subscriber to over-project its expected use of Confirm service. Potential subscribers uncertain about how many scans they will use apparently choose to purchase a Platinum subscription even when, in retrospect, a Gold subscription would have sufficed.

1. The OCA Proposal - Simplicity

The OCA retains the existing structure and the complexity or 3 different sets of subscription prices: it appears likely that retention of that structure will continue depressing the number of subscribers. The large fee increase proposed for Platinum subscribers will likely reduce the number of subscribers that choose to start with the Platinum subscription.

2. Postal Service Proposal - Simplicity

The Postal Service proposal places all subscribers on a level playing field, as all subscribers pay the same amount for the same number of units. This is simpler than the existing structure, under which customers can obtain any number of scans under any of the three tiers, but the cost per scan differs greatly from one tier to the next. The simplicity of the Postal Service proposal also eliminates the possibility of overpaying.

F. Value of Unlimited Scans

The availability of unlimited scans provides value to only to a few subscribers. As noted by witness Bentley. "a gold subscriber could purchase 98 million First-Class scans for $10,500." Therefore, all but the 23 current subscribers using

more than 92 million scans would save money under the current fees by selecting a Gold subscription ($4,500) and buying up to 7 additional blocks of 6 million scans ($5,250 = $750 X 7). Thus under the current fee structure only those mailers using more than 92 million scans benefit financially from the availability of unlimited scans.

Additionally, the number of potential direct end user subscribers that can benefit from unlimited scans is limited. Witness Bentley's testimony provides a First-class Mail example of this when he notes that the 100 most active First-Class Mail permits account for 42 percent of all presorted First-class Mail in 2005.[21] In 2005, there were 42,452 presort First-class Mail permits. Thus the remaining 42,352 of those permits account for the other 58 percent of presort First-class Mail, and average only 658,926 pieces per permit, far less than the number of pieces which would justify a Platinum subscription.[22] Customers using Planet Codes on fewer than 69 million pieces would pay less using the Gold tier, so the availability of unlimited scans at the Platinum tier for those customers is not beneficial.[23] Thus, very few First-class Mail mailers would be able to benefit from the availability of unlimited scans if they were to become subscribers.

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[21] See Appendix 1, footnote 2, of witness Bentley's testimony, and the response to MMA/USPS-5, Tr. 14/3924.

[22] The number of Permits were reported in USPS-LR-L-124. The average number of pieces was derived from the information provided in response to MMA/USPS-5. 658,926 = 20,208,386,457 10.42 X 0.58 142,352.

[23] The point where the Platinum tier is more cost effective than a Gold tier subscription is 164 million scans; see response to USPS/OCA-T5-2(d), Tr. 21/7791-93. Assuming 2.3638 scans per mail piece (see the response to USPS/OCA-T5-5, Tr. 21/7796-97), 164 million scans are sufficient to track 69,379,812 mailpieces.

1. The OCA Proposal - Value of Unlimited Scans

As noted above, unlimited scans ultimately benefit only those for whom a Gold subscription, with the purchase of additional scans, costs more than a Platinum subscription. Under the OCA proposal, a subscriber must use more than 164 million scans for a Platinum subscription to make economic sense. Only 15 subscribers (8.3 percent of subscribers) currently use that many scans.

Under the OCA proposal, and assuming no change in Confirm volume by existing customers, only 15 subscribers will find the OCA's Platinum tier their least expensive option. Thus less than 10 percent of subscribers would benefit from the availability of unlimited scans.

2. Postal Service Proposal - Value of Unlimited Scans

The Postal Service proposal eliminates the availability of unlimited scans. thus protecting the revenue stream from arbitrage. As discussed above, the movement to a per scan fee allows the Postal Service to limit the revenue lost when resellers successfully recruit existing direct subscribers. Rather than losing the full revenue stream, as would be the case under the OCA proposal, the Postal Service still retains some revenue.

G. Compatibility with Future Enhancements

The Postal Service is pursuing other activities that might provide information-based services, such as container scans to improve mail processing, and recognizes that these potential services could have value to mailers. A method for distributing the information generated by those scans will be necessary. One

method for disseminating that information is the Confirm infrastructure. But the current Confirm fee structure does not offer the flexibility to differentiate among the various types of information and the relative cost of gathering and distributing that data.

1. The OCA Proposal - Compatibility with Future Enhancements

The OCA proposal's design fails to consider any accommodation in Confirm service to pricing other uses of scans, including the possible use of the Confirm infrastructure to facilitate the dissemination of information originating from sources other than passive scans. In response to USPS/OCA-T5-16 witness Callow states:

> My proposal does not address the potential introduction of manual scans of containers into Confirm service. I gave no consideration to this possibility.

This omission by the OCA in developing its own proposal for pricing Confirm service exemplifies how failure to consider the context in which products and services exist can lead to short sighted proposals. The Postal Service proposal instead recognizes the dynamic environment in which pricing decisions must be made.

2. Postal Service Proposal - Compatibility with Future Enhancements

One reason that the Postal Service decided to base fees on units rather than scans was to accommodate the possibility of using Confirm to disseminate information about, for example, container scans. Units would allow that Postal

Service to charge a different fee for container scans than for mailpiece scans to the extent the generation and provision of such data is more costly.

III. Participant Testimony and Responses to Written Cross-Examination

The testimony of the three intervenors raised various issues that merit comment. The previous sections touch on these issues, and this section summarizes the specific limitations of the intervenors' testimony. Each intervenor's comments are addressed separately.

A. GrayHair Software Witness Bellamy

GrayHair Software is a large reseller of Confirm service, and its witness, Cameron Bellamy, focuses on how the OCA and Postal Service proposals would affect his firm's ability to profitably use the Confirm service. His testimony includes many assertions which are poorly explained or substantiated. Using discovery, the Postal Service attempted to improve its understanding of how our proposal would impact GrayHair Software's ability to continue a profitable use of Confirm service. Unfortunately, his evasive responses to those interrogatories shed little light on the subject, and merely criticized the Postal Service proposal.

One argument made in witness Bellamy's testimony is that Confirm service should use an Internet pricing model with an unlimited option. In response to the Postal Service's request for the basis of his perceived requirement, he compares Confirm service to Google. He notes that Google wisely chooses not to charge for each search a customer submits. He fails to recognize that Google's business model is based on generating revenue via advertising. Trying to charge

for each search submitted when other search engines exist that offer searches for free would have reduced user visits to the site, thereby decreasing the amount Google could charge for advertising. However, since Confirm service does not generate its revenue from advertising, Google cannot reasonably be compared to Confirm service.[24]

Much of witness Bellamy's concerns about the Postal Service proposal simply echo the fact that GrayHair Software would no longer receive the benefit of unlimited scans. His claims are that the existing fee schedule is superior, while he fails to consider or address its failure to cover costs each year that the service has been offered. The Postal Service proposal will result in large customers paying more for Confirm service than under the existing structure, but it should place Confirm service on a sound financial footing, thus allowing the Postal Service to continue making it available, and thereby benefiting GrayHair Software.

B. Witness Bentley

MMA witness Bentley notes that the unit contribution First-class Mail makes to institutional costs is more than twice that of Standard Mail. This, he asserts, justifies charging less for First-class Mail than for other classes.[25] As such, witness Bentley implicitly supports the Postal Service proposal to charge fewer

[24] While Confirm service could become more like Google by charging resellers based on how many customers they obtain, the record is berefl of explanations as to why this should be. The Postal Service is not planning on imposing a special fee on resellers, even though, arguably, such a fee could be likened to an advertising charge, since the existence of Confirm service is the basis for each reseller's ability to attract customers.

[25] See the response to USPS/MMA-T1-22, Tr. 2117900-01.

units per First-class Mail Confirm scan than for each Standard Mail scan. The Postal Service agrees that First-class Mail's higher value of service is consistent with the inclusion of various ancillary services at no additional charge?'

Witness Bentley's recommendation that Confirm be rolled into the price of First-class Mail or that First-class Mail users only pay $2,000 for unlimited usage, is not a complete proposal for Confirm service. It fails to address many necessary issues, such as:

- Whether such a subscription would provide any information about Standard Mail pieces to the extent a mailer sends both First-class Mail and Standard. Would a separate subscription be necessary for Standard Mail?
- Should a portion of Confirm costs be allocated to First-class Mail, and if so, how much?

Under the Postal Service proposal, a customer could obtain 1 billion First-Class Mail scans for only **$24,530.**[27] That is enough scans to monitor 1 percent of all presort First-class Mail (423 million pieces), at a cost of only 0.006 cents per mailpiece. The ability to track the progress of a mailpiece for only 0.006 cents appears to be quite a bargain.[28] Moreover, Confirm fees would be less than 0.02 percent[29] of the postage for 423 million First-class Mail 5-digit automation presort letters ($132 *million*).[30]

Nevertheless, witness Bentley offers an intriguing notion of providing scans for First-class Mail at zero units each. While this would still have some of the problems associated with an unlimited scan option, limiting the "zero unit" pricing

[26] See the response to OCA/USPS-T40-31(d), Tr. 14/3959-60.
[27] See the table presented in the response to USPS/GHS-T5-16, Tr. 21-7496.
[28] $24,530/423,047,635 = $0.0000580
[29] $0.0000580/$0.312=.01858%
[30] This represents the per-piece proposed postage of $0.312, which is the lowest rate available to presort First-class Mail users.

to First-class Mail would limit those concerns, and be consistent with the notion that First-class Mail is a premium product

C. OCA **and Witness Callow**

The Office of the Consumer Advocate has been a leading critic of the Postal Service proposal for the commercial product called Confirm. OCA criticism often lacks supporting explanation, or is based on incorrect calculations.

Witness Callow claims that the loss of the unlimited scan option would greatly hamper Confirm subscribers. However a maximum of 15 Platinum subscribers would benefit from unlimited scans under his proposal, and the benefit they gain is at the expense of the smaller users that cannot benefit from unlimited scans.[31] Under the Postal Service proposal a subscriber would need to use in excess of 712 million units (254 million scans) to have a total fees exceeding $19,500.[32] Only 12 Platinum subscribers use more than 254 million scans, so 3 of the remaining 15 Platinum subscribers would pay less under the Postal Service proposal than under the OCA proposal. Additionally, all of the Platinum subscribers who buy down to the Gold tier and use more than 110 million scans would pay less under the Postal Service proposal.[33]

Additionally, the cross-examination conducted by counsel for the OCA was concentrated on resellers and their ability to receive as many as 10 billion scans

[31] Only 15 subscribers use more than 164 million scans, which is the number of scans a Gold subscriber can acquire for less than the OCA's proposed price for the Platinum tier of $19,500.
[32] See the response to USPS/OCA-T5-10, Tr. 21/7803.
[33] A Gold subscriber using 110 million scans under the OCA proposal would pay $12,700 ($5,200 fee plus $7,500 for 10 additional blocks of scans). Under the Postal Service proposal the same subscriber would pay $12,420 ($5,000 for the annual fee and $7,420 for 307 additional blocks of units.

per year for a very low fee.[34] Of course, any successful limitation of the price increase for these large resellers can only mean larger increases to other Confirm subscribers. Some of those other subscribers would have to pay the same amount as the resellers that OCA, by virtue of its proposal, seems most concerned about. And despite paying the same amount as the largest resellers, these other subscribers would be obtaining only a small fraction of the scan information that the larger subscribers receive.

IV. Conclusion

The Postal Service proposal is based on thorough analysis of the shortcomings of the existing fee schedule. I was tasked with developing a plan to allow Confirm to cover its costs, while also improving the product. I concluded that the best way to do so was to create a pricing structure that would not only cover costs, but also improve fairness and equity, prepare the product for future enhancements regarding the dissemination of other information, and protect the revenue stream from some of the effects of arbitrage. The Postal Service accordingly stands by its proposals for Confirm service in this docket.

[34] Tr. 14/4159.

1 CHAIRMAN OMAS: This brings us to oral
2 cross-examination. There are three requests for oral
3 cross.
4 Mr. Todd, Mail Order Association of America.
5 Mr. Levy, would you introduce yourself,
6 please, and begin?
7 MR. LEVY: Thank you, Mr. Chairman.
8 CROSS-EXAMINATION
9 BY MR. LEVY:
10 Q Mr. Mitchum, I'm David Levy. I'll be
11 cross-examining for the National Association of
12 Pre-Sort Mailers and the National Postal Policy
13 Council.
14 Would you go to page 5 of your rebuttal
15 testimony?
16 A I'm there.
17 Q On pages 5 through 7, you discuss the issue
18 of covering costs?
19 A Yes.
20 Q Whether Confirm covers its costs depends in
21 part on the revenue the Postal Service gets from
22 permits, correct?
23 A I'm not sure I understand the question.
24 Q Well, the Postal Service gets revenue from
25 selling permits for the use of Confirm?

1 A You mean subscriptions?
2 Q Yes.
3 A Yes.
4 Q And those subscriptions have revenue
5 associated with them?
6 A Yes, they do.
7 Q The number of subscriptions sold will be one
8 factor affecting whether Confirm covers its costs?
9 A Are you referring to the existing fee
10 schedule or my fee schedule?
11 Q Either.
12 A Yes.
13 Q Now, whether Confirm covers its costs is
14 also affected in part by how many scans your customers
15 pay for?
16 A In both cases, yes.
17 Q And whether Confirm covers its costs is also
18 affected by the availability of Confirm to generate
19 additional revenue from first class or standard mail?
20 A Yes.
21 Q And whether Confirm covers its costs is
22 affected by the contribution that the Postal Service
23 gets from that extra mail volume, correct?
24 A I think in terms of contributions after the
25 costs have been covered, contributions are made

1 towards institutional costs. There wouldn't be a
2 contribution until after the costs were actually
3 covered, so I don't think I understand your question
4 Q Whether Confirm produces a net contribution
5 or shortfall for the Postal Service will depend in
6 part on the amount of extra mail volume that the
7 existence of Confirm stimulates.
8 A I'm not sure that's the case.
9 Q Well, let me give you a hypothetical. If
10 you just looked at the revenue from Confirm proper and
11 the costs of Confirm proper, there was a shortfall of
12 $200,000 a year.
13 A That sounds right, yes.
14 Q But that the availability of Confirm caused
15 mailers to enter enough additional mail that the
16 Postal Service gets an additional $100 million a year
17 in contribution from extra postage, do you follow the
18 assumptions?
19 A I'm not aware of that information, that
20 Confirm has caused an increase in volume in mail.
21 Q I wasn't asking you her to accept whether
22 that was true, I was just asking you if you understood
23 the terms of the hypothetical.
24 A Can you repeat it, please?
25 Q Yes. Confirm proper loses $200,000 a year,

1 but hypothetically generates enough extra mail volume
2 because of its added value to consumers that the
3 Postal Service gains $100 million in extra
4 contribution per year from first class and standard
5 postage revenue. Do you follow the terms of the
6 hypothetical assumption?
7 A Yes, I understand what you're trying to get
8 across. Yes.
9 Q Now, in deciding whether the existence of
10 Confirm makes a positive contribution to the Postal
11 Service or not, is it relevant to consider any
12 additional contribution generated by the underlying
13 mail services as a result of Confirm?
14 A My understanding is no. The product must
15 cover its own costs.
16 Q That's your view as an economist or view as
17 what the Postal Service does as a matter of
18 accounting?
19 A It's my understanding based on the criteria,
20 the pricing criteria. I believe number 3 is that it
21 has to cover its costs.
22 Q Are you testifying as an expert on those
23 criteria?
24 A Just a second, please.
25 (Pause.)

1 A The third criteria, I have it here, is the
2 requirement that each class of mail or type of mail
3 service bear the direct and indirect postal costs
4 attributable to that class or type plus a portion of
5 all of the costs of the Postal Service reasonably
6 assignable to such a class or type. My understanding
7 is that it has to cover its costs, but, no, I'm not an
8 expert on this portion of the code.
9 Q The Postal Service offers free return of
10 undeliverable as addressed first class mail, doesn't
11 it?
12 A Yes, it does.
13 Q There's not a separate price for that
14 service, is there?
15 A It's included in the price of first class
16 mail. It's not included in standard mail, for
17 instance.
18 Q So when it's provided for first class mail,
19 that would be an instance of something that doesn't
20 cover its cost from the sense of that service proper?
21 A I don't believe that's the case?
22 Q Well, because it's covered by the overall
23 price of a first class stamp, isn't it?
24 A Yes, it is.
25 Q Now, if the commission took the position

1 that it was free in considering the profitability of
2 Confirm to consider the revenue generated by mail that
3 bears Confirm on it as postage revenue, would you as
4 economist think it relevant to consider that
5 additional revenue?
6 A As a pricing economist for the Postal
7 Service, my understanding is that I have to meet the
8 criteria and I don't think that -- I wasn't aware that
9 I had leeway any other way. I don't believe that
10 I do.
11 Q Well, I'm not asking you testify what the
12 act says. I'm asking you to testify as an economist.
13 If the commission were to find that it had leeway,
14 would you advise it to consider or to ignore the
15 additional revenue, if any, from the underlying
16 services that Confirm may generate?
17 A Honestly, I don't feel that I'm qualified to
18 make a decision on that, to make a comment on that.
19 I don't mean qualified as an economist; I don't
20 believe that I'm qualified with the knowledge that the
21 commission would have. I'm not familiar enough with
22 the commission's process on making decisions to know
23 whether or not that's possible.
24 Q Let's maybe take this away from the postal
25 world so that we don't get tangled up in what the

1 statute permits or not.

2 You know there's a sandwich shop downstairs

3 called Lawson's?

4 A Yes.

5 Q Have you ever eaten there?

6 A NO.

7 Q I'm going to ask you to accept subject to

8 check that if you eat at Lawson's you can get straws

9 and napkins free. Will you accept that subject to

10 check?

11 A Sure.

12 Q Now, that's typical of sandwich shops, isn't

13 it?

14 A In my experience, yes.

15 Q Now, presumably those straws and napkins

16 cost the restaurant something.

17 A Yes, I would expect they do.

18 Q And if you looked solely at the revenue that

19 the restaurant generates from the straws and napkins,

20 those are losers.

21 A I guess one could look at it that way or one

22 could also look at it as by providing those free of

23 charge they attract customers that they wouldn't

24 normally get if a customer had to pay for napkins or

25 bring their own.

1 Q And the customers would generate revenue
2 from buying food and drink.
3 A If they had to bring their own napkins? I'm
4 sorry.
5 Q The additional customers attracted by the
6 availability of free straws and napkins hopefully
7 would pay enough for food and drink to make the cost
8 worthwhile.
9 A Sure.
10 Q I mean, that's a rational way for a
11 restaurant to think, isn't it?
12 A It seems so, yes.
13 Q Would it be rational for the commission to
14 think about it, leaving aside the question of the
15 statute, when we're talking not about napkins, straws
16 and sandwiches, but we're talking about Confirm and
17 postage?
18 A Once again, I don't feel comfortable
19 deciding how the commission should view the
20 possibility of ignoring the pricing criteria.
21 Q Would you go to page 26 of your rebuttal
22 testimony?
23 A Sure.
24 Q I'll direct your attention to line 22 and
25 there's a sentence that has the word intriguing in it.

1 A Actually, can you tell me which section that
2 was? I think I have a version that was numbered
3 differently.
4 Q Yes, I can certainly do that. It is section
5 III-B, Witness Bentley.
6 A I'm sorry, that was the problem. I was
7 looking at the wrong testimony. Yes, I'm sorry.
8 Q Now, on page 26, line 22, do you see the
9 word intriguing?
10 A Yes, I do.
11 Q Now, there you're referring to Witness
12 Bentley's notion of providing scans for first class
13 mail as zero units each?
14 A Yes.
15 Q Your testimony, you don't accept that
16 proposal, but you don't reject it out of hand, do you?
17 A No.
18 Q The proposal would entail charging nothing
19 for scans for first class mail, right?
20 A You're referring to Witness Bentley's
21 proposal?
22 Q Yes.
23 A Yes.
24 Q So you don't view that charging nothing for
25 scans for first class mail violates the pricing

1 requirements of the act?

2 A As long as the product covers its costs,

3 I don't think it would be violating the act. No.

4 Q You've read the direct testimony of

5 Mr. Bellamy in this case?

6 A Yes, I have.

7 Q And his supplemental testimony?

8 A Yes, I have.

9 Q And his testimony discusses value

10 enhancements that third-party vendors like Gray Hair

11 Software have made to Confirm?

12 A Yes, it does.

13 Q And you agree that third-party vendors do

14 offer value added services to Confirm?

15 A Not necessarily all, but, yes, some do. At

16 least some do.

17 Q And those enhancements increase the

18 attractiveness of Confirm to customers?

19 A Apparently it increases the attraction to

20 customers for those resellers. Yes.

21 Q But those enhancements increase the

22 attractiveness of the Confirm service itself, don't

23 they?

24 A In terms of --

25 Q Making Confirm data easier to use.

1 A Yes.
2 Q And a number of the value added services
3 added by vendors are recent, aren't they?
4 A I'm sorry?
5 Q Recent, r-e-c-e-n-t.
6 A The product itself is recent, but that's a
7 relative term in this case. Do you mean recent as in
8 the last 30 days or you mean recent as in since the
9 product was priced or recent since the product was
10 made available?
11 Q Recent within the past year.
12 A I have no idea.
13 Q Did you investigate to see whether the
14 functionalities added by third-party vendors in the
15 past year have changed?
16 A No, I did not.
17 Q In calculating the profitability of Confirm,
18 did you make any adjustment for the possibility that
19 additional enhancements to Confirm within the test
20 year would generate additional revenue for the Postal
21 Service during the test year?
22 A I'm sorry, can you ask the question again?
23 Q Yes. In determining the profitability of
24 Confirm, did you make any adjustment for the
25 possibility that enhancements to Confirm during the

1 test year would increase the number of subscriptions
2 or scans sold?
3 A I did take into consideration the
4 introduction of the four-state bar code is likely to
5 make the need for additional IDs unnecessary for most
6 users. And I'm not aware of any other enhancements to
7 Confirm service other than that.
8 Q You didn't investigate the existence of
9 other enhancements?
10 A I'm not aware of any enhancements other than
11 the fact that the four-state bar code will be
12 available for use at the Confirm service.
13 Q I'm sorry. My question wasn't whether you
14 were aware of them, but whether you made an effort to
15 find out.
16 A Yes, I've talked greatly with the people in
17 product development about the Confirm service and the
18 only enhancement I'm aware of the Postal Service is
19 making is the introduction of the four-state bar code.
20 Q Did you make any inquiry about the near-term
21 roll-out of enhancements by third-party vendors?
22 A A third-party vendor's enhancements under
23 the existing fee schedule won't increase revenue
24 because we don't receive any additional income as a
25 result of a reseller under the existing fee schedule

1 increasing its usage. So in that case, an enhancement
2 under the existing fee schedule by a third-party
3 reseller I don't believe would actually impact
4 revenue.
5 Q Enhancements by third-party vendors could
6 impact revenue if they induced customers to have the
7 vendor buy an additional customer ID. Isn't that
8 possible?
9 A That is possible, yes.
10 Q Did you talk to any third-party vendors
11 about that possibility?
12 A No, I did not.
13 Q Do you know whether the Postal Service is
14 going to be adding any other functionalities to
15 Confirm during the test year?
16 A As of this moment, I am not aware of
17 anything that is being added other than the four-state
18 bar code and that's not dependent on the rate case,
19 it's just dependent on functionality. That's my
20 understanding.
21 Q Will the addition of the four-state bar code
22 make the use of Confirm more attractive?
23 A I don't think there's reason necessarily to
24 believe that's the case.
25 Q Did you ask anyone within the Postal Service

1 whether that was likely to happen, whether the
2 addition of the four-state bar code was likely to make
3 Confirm more attractive?
4 A No, I have not.
5 Q Did you ask any of the Postal Service's
6 customers that question?
7 A No, I have not.
8 Q Did you ask any of the third-party vendors
9 that question?
10 A No, I did not.
11 Q Is it possible that an increased use of one
12 code ACS will increase the demand for Confirm?
13 A It's possible, yes. Probable, I can't speak
14 to.
15 Q Again, you didn't investigate?
16 A I considered it. I just don't see --
17 I didn't see anything that convinces me that it would
18 be the base.
19 Q But you didn't ask anyone who works in that
20 field?
21 A Works in what field?
22 Q The field of one code ACS?
23 A I'm actually the witness for ACS as well and
24 it did not come up during the discussions regarding
25 one code ACS and the pricing of it.

Q On another matter, you're aware that the Postal Service is in the middle of something called an evolutionary network design?

A I am aware of that, yes.

Q And one of its consequences is a possible change in service standards in specific locations?

A My knowledge actually ends with the fact that I'm aware that we're in the process of it.

Q Have you asked anyone involved in the END process whether the changes in service standards might induce additional demand for Confirm service?

A No, I have not.

Q Is it plausible that that disruption or reshuffling of service standards might make mailers more concerned about the transit time of their mail?

A I really don't have knowledge to even offer an opinion on that.

Q In estimating the revenue from Confirm during the test year, did you make any adjustment for the growth in the number of mailers during the test year or did you assume that the number of mailers at the end of the test year was the same as the number at the beginning?

A I believe in response to a POIR that I said that the number of mailers in the test year would be

1 180, but it wouldn't necessarily be the same 180
2 mailers.
3 Q So you assumed that the total number of
4 customers for Confirm would be the same at the end as
5 the beginning of the year?
6 A Yes.
7 Q Is it your assumption that the U.S. economy
8 will be stagnant throughout the test year in terms of
9 its total size?
10 A Can you relate that to my rebuttal
11 testimony, please? I'm not sure I understand the
12 relationship.
13 Q Is it your understanding that the total size
14 of the economy will not grow during the test year?
15 A In the past, I've done national forecasts,
16 but I'm not in that process any more. Having done it
17 in the past, I know that I'm not qualified to make a
18 decision about that.
19 Q You don't have an opinion whether the
20 economy is likely to grow during the test year?
21 A My personal opinion doesn't -- I don't feel
22 confident in my personal opinion about the economy
23 related to my position as a postal employee and it's
24 not based -- if you're asking whether or not
25 I considered this in the development of my pricing

1 proposal, no, I did not.

2 Q Do you believe that the number of delivery

3 points in the United States, postal delivery points in

4 the United States, will remain constant during the

5 test year?

6 A No, I do not.

7 Q Did you make an adjustment to your Confirm

8 study for the anticipated increase?

9 A No, I did not.

10 Q Did you consider the possibility that

11 concerns over privacy or confidentiality might induce

12 customers to request the purchase of additional

13 Confirm IDs from third-party vendors like Gray Hair

14 Software?

15 A I did consider that and my understanding in

16 conversations with the people in product development

17 is that the number of additional IDs has been

18 decreasing as people have figured out ways to get

19 around buying them and still being able to identify

20 individual mail information.

21 Q In determining whether Confirm will cover

22 its costs under any of the proposed rate designs, did

23 you talk with any Confirm customers at all?

24 A I did not talk to customers directly, but

25 I did interact with product development who did

1 provide input from customers to me.
2 Q Do you know how many customers they talked
3 to about the proposed rate designs?
4 A There was a number of them. I do not have
5 an idea of the exact number.
6 Q Do you know how many customers the Postal
7 Service product design people talked to about the OCA
8 proposal?
9 A No, I do not.
10 Q Do you know whether they talked to any
11 customers about the OCA proposal?
12 A Yes, I do know they have talked to some.
13 Q Was the some more than one?
14 A I believe it was more than one.
15 Q was it more than five?
16 A I know there was more than one. I do not
17 know how much more than one.
18 Q Now, you indicated before that in estimating
19 whether Confirm is going to cover its costs during the
20 test year you didn't include in the revenue and cost
21 analysis any revenue from increased sale of first
22 class of standard postage. Is that correct?
23 A That is correct.
24 Q But in fact the existence of Confirm is
25 likely to increase the demand for postage, isn't it?

1 A I don't have any reason to believe that.
2 I'm sorry. I just really have no knowledge of that.
3 Q Well, let me clarify. Is it your position
4 that it will not have any effect or is it your
5 position that you don't know?
6 A I have no reason to know that it would have
7 an effect.
8 Q And you have no reason to know that it would
9 not have an effect?
10 A I am also unaware of any reason why it would
11 have an effect. Correct. Or would not have an
12 effect.
13 MR. LEVY: I'm going to elect to have marked
14 as Exhibit NPPC-X-1 a document which I'll hand out and
15 then identify.
16 (The document referred to was
17 marked for identification as
18 Exhibit No. NPPC-X-1.)
19 MR. LEVY: I will describe NPCC-X-1 as a
20 12-page document with the letterhead of ICPA
21 Washington, D.C., the date May 2006, and it appears to
22 be a paper presented by Nick Barranca at the 6th
23 International Conference on Postal Automation. The
24 title of the paper is "Confirm Service: The Use of
25 Bar Code Technology to Maximize Effectiveness and

1 Minimize Cost."

2 BY MR. LEVY:

3 Q For the record, sir, could you identify who

4 Mr. Barranca is?

5 A Mr. Barranca is the Vice President of

6 Product Development for the United States Postal

7 Service.

8 Q And what is his relation to Confirm?

9 A He is the vice president under which the

10 product falls.

11 Q Would you turn to page 7 of the document?

12 A Okay.

13 Q I'm going to read to you the last six or so

14 lines on page 7. "Confirm was a service that would

15 benefit not only postal customers but also present the

16 U.S.P.S. with a novel view of its operations that may

17 lead to important performance measurement benefits.

18 While customer benefits begin to accrue at almost any

19 level of usage, U.S.P.S.'s greatest benefits were

20 expected to flow from widespread usage of the product.

21 This attribute, it was determined, justified a pricing

22 stance that promoted product usage.''

23 Now, have you seen that statement before?

24 A I don't believe I have.

25 Q Have you seen similar statements from a

1 Postal Service witness in Docket MC2002-1?

2 A I read most of what was in there, so I might

3 have read it at the time, but I don't recall it.

4 Q Would you turn to page 11? I'm going to

5 read to you the last paragraph on the page. "Confirm

6 constitutes a key step in providing a value-added

7 service, not just in delivery of mail, but also in

8 delivery of information. This information is used by

9 the U.S.P.S. as a performance measurement tool and

10 facilitates a proactive approach to assess and correct

11 mail processing inefficiencies. Confirm represents a

12 definite win-win for the U.S.P.S. and its customers."

13 Have you ever seen that statement before?

14 A No, I have not.

15 Q And, again, your analysis of the costs and

16 benefits of Confirm for the Postal Service in the test

17 year did not include any allowance for the imputed

18 value of Confirm to the Postal Service as a

19 performance measurement tool? Is that correct?

20 A The performance measurement part that's used

21 by the Postal Service --

22 Q Excuse me. You can give the explanation,

23 but I'd like you to answer first my question.

24 A Ask the question again, please.

25 Q Which is whether in your calculation of the

1 costs and benefits of Confirm, you included any
2 allowance for its benefit to the Postal Service as a
3 performance measurement tool.
4 A I would say the answer to that would be yes.
5 The costs that are associated with performance
6 measurement that the Postal Service uses are not
7 included in Confirm.
8 Q And the benefits?
9 A The benefits that are received from that
10 are -- the Postal Service uses Confirm -- it seeds
11 mail by itself, the scans that are generated are by
12 Planet codes placed on the mail pieces and reentered
13 back into the mail stream by the Postal Service. As
14 such, the benefits that are received from that are not
15 generated by consumers, by customer scans, so the
16 benefits for mail performance purposes are not
17 dependent on customer use.
18 Q Now, when the Postal Service reads the
19 seeded scans, what equipment does it read it with?
20 A It's the passive scanner.
21 Q And where does the information go?
22 A It goes into a server. It's routed into a
23 server that's specifically used by operations for the
24 performance measurement that is separate from the
25 Confirm servers.

Q Was any of the hardware or software used in this process originally developed for Confirm?

A All costs for depreciation for that hardware is fully depreciated by the time the test year occurs, so they're not included in the costs for the test year,

Q That wasn't my question, though.

A I'm sorry.

Q My question wasn't about depreciation. My question was does the seeding process and the use of the data involve any hardware or software that were developed for Confirm?

A Yes, it does.

Q And you say it was fully depreciated. That means that as an accounting method the costs were assumed to be completely consumed by the test year. Is that right?

A That is correct.

Q Which is equivalent to saying that by the test year the investment in hardware and software had exhausted its usefulness?

A I'm not an accountant. I'm an economist.

Q Now, I want to change to a different subject, the suppression of demand for Confirm by the OCA rate design. You discuss that issue beginning on

1 page 7 of your rebuttal testimony.
2 A Okay.
3 Q Now, the OCA proposal, unlike the Postal
4 Service proposal, would maintain the existence of a
5 tier of service with unlimited scans, right?
6 A That is my understanding.
7 Q And you've read the OCA testimony setting
8 forth the proposal, haven't you?
9 A Yes, I have.
10 Q And instead, the OCA proposal would try to
11 make up the revenue shortfall by raising the
12 subscription charges, correct?
13 A Try. Yes.
14 Q And you predict that the OCA proposal may
15 cause some mailers to discontinue use of Confirm as
16 one reaction?
17 A In the fact of fee increases, yes. That's
18 possible.
19 Q Or engage in seeding?
20 A Yes.
21 Q And seeding is your term for having only a
22 sample of pieces in a mailing tracked as opposed to
23 every piece?
24 A Correct.
25 Q And you also predict that the OCA proposal

1 may induce some mailers to migrate to a less expensive
2 tier of service?
3 A Yes.
4 Q And you also predict the OCA proposal may
5 cause some mailers to migrate to resellers instead of
6 buying a confirm subscription themselves. Is that
7 correct?
8 A I believe that it could lead to the birth of
9 pure arbitrage resellers. Yes. And that customers
10 could go to those pure arbitrage resellers and save
11 money. Yes.
12 Q Now, has the Postal Service conducted a
13 market survey of how its customers would respond to
14 the OCA proposal?
15 A No, it has not.
16 Q Has it shown the OCA proposal to any of its
17 customers?
18 A I believe that product development has, yes.
19 Q Has product development or anyone else at
20 the Postal Service asked those customers how they
21 would respond?
22 A If they have, I'm not aware of it.
23 Q Did you ask?
24 A It never actually came up. No, I did not
25 ask.

1 Q Well, in preparing testimony on how
2 customers might respond to the Postal Service
3 proposal, would you consider it relevant what
4 information product development might have gotten by
5 asking the customers?
6 A With regard to my proposal, I did ask. We
7 had discussed it, yes
8 Q But not with regard to the OCA proposal?
9 A No, we had not.
10 Q Would you go to page 8 of your rebuttal
11 testimony? I want to direct your attention to line 6
12 on page 8.
13 A Okay.
14 Q Now, beginning on line 6, you state that
15 raising permit fees might cause some customers to stop
16 overpaying for permits.
17 A Yes, I did.
18 Q Now, by overpaying, you mean subscribing to
19 a higher tier of service than is really cost
20 minimizing?
21 A Yes. There are currently -- 29 of the 45
22 subscribers in the base year could have chosen a gold
23 subscription, some of them with a requirement to buy a
24 couple of additional blocks of scan, others not
25 needing to and could have saved $5500. Yes.

1 Q And each of those customers nonetheless
2 bought a platinum subscription.
3 A Yes, they did.
4 Q Which has a higher annual fee.
5 A Yes.
6 Q And by your calculation produces a higher
7 total cost for those customers
8 A They would incur higher fees. Yes.
9 Q Higher total fees when you combine both
10 subscription and scan fees?
11 A Yes.
12 Q And that's under the current rate schedule,
13 right?
14 A That is under the existing rate schedule.
15 Yes.
16 Q Now, if you go to line 12 of page 8?
17 A Yes.
18 Q There you talk about reasons why a
19 subscriber might overpay, might be engaging in this
20 practice.
21 A Yes.
22 Q Now, I want to focus on the word might. Has
23 the Postal Service ever asked its customers why they
24 are overpaying, in a sense?
25 A Not that I'm aware of.

1 Q So you don't really know what motivates
2 customers to overpay?
3 A No, I do not.
4 Q You don't know whether it's because they're
5 foolish or whether they are getting some insurance
6 benefit or whether they're saving some transaction
7 costs or whatever the reason, you don't know.
8 A That is correct.
9 Q And if you don't know what the motives are
10 for overpaying, then you're not in a position to know
11 whether the OCA rate ncrease would override them, do
12 you?
13 A No, I don't but I would think that the
14 difference between paying an extra $5500 versus paying
15 an extra $14,300 might influence them to reevaluate
16 their decisions.
17 Q But it wouldn't influence them if the
18 economic value or the reasons that cause them to
19 overpay are greater than $14,500?
20 A That would seem appropriate. Yes.
21 Q And you have no idea what the economic value
22 or the reasons for the customers to overpay is.
23 A No, I don't.
24 Q Now, I want to talk about another subject,
25 which is the suppression of demand for Confirm by the

1 Postal Service's proposal. Now, you do agree that the
2 Postal Service's proposal will somewhat decrease
3 demand for Confirm, correct?
4 A I think that it's a reasonable assumption to
5 assume that when you increase the fees that demand
6 would decrease. Yes.
7 Q And would you go to page 13 of your
8 testimony? You estimate there that your rate proposal
9 will reduce demand by 10 percent.
10 A I estimate that it will decrease the number
11 of scans by 10 percent. Yes.
12 Q And going to line 21 of page 13, you
13 describe your 10 percent assumption as conservative?
14 A I believe so. Yes.
15 Q But the 10 percent assumption is just a
16 guess, isn't it?
17 A I felt that it was better to assume some
18 decrease in demand than to ignore the possibility that
19 people might react to a fee increase by reducing their
20 usage. Yes.
21 Q But alternatively, you could have assumed
22 that demand would go down by 20 percent.
23 A And in my proposal, if the demand were to go
24 down by 20 percent, the number of scans were to
25 decrease by 20 percent, it would still cover Costs.

1 Q Thirty percent?
2 A That would still cover costs.
3 Q At what point would it not cover costs?
4 A I'm not exactly aware, but I think it's
5 right around 50 percent.
6 Q Now, the 10 percent assumption is not based
7 on any market research, correct?
8 A No, it is not. But, again, one of the
9 reasons was my target for cost coverage of 126.3
10 percent was to make sure that if I had erred that
11 I would still be able to cover costs.
12 Q Have you asked any of your customers how
13 they would respond to the elimination of the unlimited
14 scan tier of service?
15 A I have heard from some customers that there
16 was concern -- well, Witness Bellamy's testimony, but
17 no, I have not.
18 Q Whose testimony?
19 A Witness Bellamy. But I have heard from --
20 in conversations with another subscriber that I had
21 directly that they didn't think it would impact their
22 decisions.
23 Q When was that discussion?
24 A I'm guessing late October -- early or late
25 October.

1 Q Was the substance of that discussion
2 revealed in response to a discovery request in this
3 case?
4 A No, it was not. I was contacted by a
5 subscriber.
6 Q In fact, the Postal Service has previously
7 taken the position that eliminating the unlimited scan
8 tier could suppress demand significantly, hasn't it?
9 A I'm sorry. Can you repeat the question?
10 Q The Postal Service has previously taken the
11 position that eliminating the unlimited scan tier
12 could badly suppress demand.
13 A I'm not aware of that.
14 MR. LEVY: I would like to have marked as
15 NPPC-X-2 a document which I will identify as the
16 pre-filed direct testimony of James Kiefer in the
17 Confirm case, MC2002-1, filed April 24, 2002.
18 (The document referred to was
19 marked for identification as
20 Exhibit No. NPPC-X-2.)
21 BY MR. LEVY:
22 Q Have you seen that document before?
23 A Yes, I have.
24 (The document referred to,
25 previously identified as

1 Exhibit No. NPPC-X-2, was
2 received in evidence.)
3 BY MR. LEVY:
4 Q Mr. Mitchum, would you go to page 4 of
5 NPPC-X-2? I'm going to begin reading on page 5. "A
6 transaction based price would accordingly exceed the
7 true marginal cost by a large factor."
8 Now, transaction based price there is
9 referring to charging a fee per scan. Correct?
10 A That is my understanding. Yes.
11 Q And then it continues, "This would be
12 economically inefficient pricing and would likely
13 produce several undesirable outcomes. It would lead
14 some potential customers to restrict usage by bar
15 coding only some mailings or by just 'seeding' bar
16 coded pieces within a larger mailing. Limiting the
17 number of bar coded pieces both diminishes the value
18 of the information received by the customer and more
19 critically impairs use of the Confirm product for
20 measuring operational performance." And then it goes
21 on with a couple other issues.
22 Have you seen that before?
23 A Yes, I have.
24 Q Is that still the Postal Service's position?
25 A Given that the product under this pricing

1 proposal that we're referring to, Witness Kieffer's
2 proposal never covered costs. I would question the
3 validity of the comment.
4 Q You believe that events have superseded it
5 and it is not currently an accurate position?
6 A I think that it's been shown over the past
7 few years that the presence of unlimited scans has not
8 resulted in a pricing structure that is capable of
9 covering costs.
10 Q So the Postal Service no longer supports the
11 position espoused on lines 5 through 12 of page 4 of
12 Exhibit NPPC-X-2?
13 A I think that's fair to say since we are
14 proposing a fee structure that actually is
15 transactionally based. That would be an accurate
16 statement on your part. Yes.
17 Q Or stated otherwise, the Postal Service has
18 abandoned or rejected this position? Is that correct?
19 A I think the Postal Service has recognized
20 that the existing fee structure is incapable of
21 covering costs.
22 Q Mr. Mitchum, would you turn back to NPCC
23 Cross Examine Exhibit 1, the Barranca paper? And go
24 to page 8.
25 A Yes.

Q I direct your attention to the last paragraph that begins with the words, "With most postal products." Do you see that?

A Yes, I do.

Q Would you read beginning with the third sentence in that paragraph?

A "Once Confirm hardware and software were in place, the cost of additional scans were extremely small."

Q Keep going, please.

A I'm sorry. "A transaction based price then would exceed the true marginal costs by a large factor. This would be an economically inefficient pricing and would likely produce several undesirable outcomes."

Q And then there continue the same three bullet points that appeared in Mr. Kiefer's 2002 testimony. Is that correct?

A It is correct.

Q The Barranca document is dated May 2006?

A Yes, it is.

Q The same month in which the Postal Service filed its rate case?

A Yes, it is.

Q I want to now ask you about a different

subject, economic efficiency, that we've already touched on a bit. You don't discuss economic efficiency in your rebuttal testimony, do you?

A No, I do not.

Q And you don't discuss the subject of incentives for efficient behavior, do you, in your rebuttal testimony?

A No, I do not.

Q And while you discuss efficiency once in your direct testimony, it's not in the context of Confirm, is it?

A Not that I'm aware of.

Q And you'll agree with Mr. Kieffer and Mr. Barranca that the marginal costs of an additional scan is virtually zero, isn't it?

A It is very small. Virtually zero? It's approaching zero, but it's not zero.

Q You would agree with the following statement, "Confirm's costs are mostly fixed. In contrast, the per usage costs are extraordinarily small, so small that they approach zero"?

A That sounds reasonable. Yes.

Q And charging more than that amount per scan gives mailers incentives to buy too few scans?

A I don't think that's necessarily the case.

1 Q Well, a larger charge per scan than the
2 actual marginal cost gives a signal to a mailer to
3 that each extra scan costs society more than it really
4 does. Isn't that correct?
5 A Can you repeat the question, please?
6 Q Yes. The marginal price charged by the
7 Postal Service for a scan gives a signal to the mailer
8 about what the cost of the scan is. Correct?
9 A Yes.
10 Q And if there is a mailer for whom the scan's
11 value is greater than the Postal Service's marginal
12 cost, but less than the marginal price that the Postal
13 Service is charging for the scan, then the mailer is
14 likely to forego that scan. Isn't that correct?
15 A Yes.
16 Q And if the value to the customer of that
17 scan is greater than the marginal cost to the Postal
18 Service, the result is a loss to society. Isn't that
19 correct?
20 A Not necessarily. If the product doesn't
21 cover its cost and can no longer be offered then no
22 one benefits. To me, that would be a greater loss.
23 Q Well, let's assume that it's determined that
24 the product does cover its total costs and we're
25 focusing on a marginal analysis. You would agree that

1 charging a price that dissuades a customer from
2 purchasing an additional unit when the value to that
3 customer of that daily log unit is greater than the
4 additional cost to the Postal Service of that unit is
5 a loss to society?
6 A Not necessarily. If you can price it above
7 the marginal cost for each additional unit all the way
8 from the very first one -- I don't necessarily agree
9 with you. No.
10 Q Buying a unit for three cents and it costs
11 you half a cent to provide and somebody says you have
12 to charge at least five cents and I decide not to buy
13 it as a result, then we've foregone a transaction that
14 would have produced a gain of two and a half cents.
15 Isn't that right?
16 A Potentially.
17 Q Have you heard of the efficient component
18 pricing rule?
19 A I've heard of it, but I'm not very familiar
20 with it. No.
21 Q Let's talk about increased arbitraging
22 opportunities. Would you go to page 14 of your
23 rebuttal testimony?
24 A Okay.
25 Q Now, beginning there you discuss arbitraging

1 by resellers. Correct?

2 A Yes, I do.

3 Q And I think you indicated before that you

4 think that the OCA proposal by increasing the

5 subscription prices would make arbitraging more

6 likely?

7 A Yes, I do.

8 Q Now. you agree that many resellers provide

9 value-added services to their customers?

10 A Yes, I do.

11 Q And you've testified that arbitraging is not

12 currently a major problem for Confirm service?

13 A That is true.

14 Q Now, one reason is that adding value to the

15 raw scans can be more lucrative to third-party

16 providers than simply selling the raw data?

17 A That was one of two reasons. Yes.

18 Q And in response to POIR 12, question 5, you

19 stated your belief that, "Customers are not choosing

20 to use an intermediary to receive a discounted price,

21 but instead are using the intermediary for the

22 value-added services provide." Do you recall saying

23 that?

24 A That was referring to the existing fee

25 structure, not the OCA proposal, but, yes. And also

1 the Postal Service proposal.

2 Q Isn't it a fact that small and medium size

3 customers couldn't use the raw scans because they

4 don't have the know how or equipment to digest them

5 themselves?

6 A Not necessarily.

7 Q Isn't it true that small and mid size

8 customers generally depend on third-party vendors to

9 interpret that raw scan data for them?

10 A I don't have a reason to necessarily believe

11 that.

12 Q You don't have an opinion on whether that

13 statement is true?

14 A I haven't been told by resellers how many

15 small and medium size customers they have, so I can't

16 make a determination.

17 Q Would you take a look at Cross-Examination

18 Exhibit NPPC-X-1 on page 7? Since you read it the

19 last time, I'll read this time. I'm going to go in

20 the first full paragraph, the second sentence, which

21 is the third line of the paragraph. "Because Confirm

22 provides raw scan data to the customer, it is the

23 customer's responsibility to transform it into

24 meaningful information that the company can employ in

25 making business decisions. This requires additional

1 programming resources which are often difficult to
2 justify for small to mid size companies. These
3 challenges led some companies to decide to use an
4 outside vendor having expertise in developing reports
5 and in-depth understanding of postal processing
6 systems in order to analyze Confirm data." Did I read
7 that correctly?
8 A Yes.
9 Q Have you seen that statement before
10 anywhere?
11 A No, I had not.
12 Q Now, the platinum fee proposed by the OCA is
13 $19,500. Correct?
14 A Yes, it is.
15 Q And that's the highest subscription fee that
16 the OCA is proposing. Correct?
17 A Yes, it is, but as I've shown in my rebuttal
18 testimony, I don't believe it will actually cover
19 costs.
20 Q It's still a small percentage of the revenue
21 generated by Confirm, isn't it?
22 A What is?
23 Q $19,500.
24 A I believe it's 1.3 percent of the total
25 revenue.

1 Q And has any mailer told you that a
2 subscription fee of $19,500 will make them terminate
3 an existing subscription?
4 A No, I have not discussed it with any
5 subscribers. No,
6 Q Your view is because customers will drop
7 off, that the platinum subscription price would have
8 to rise to break even, a higher number?
9 A I believe that an assumption of no decrease
10 in demand regardless of whether it's a drop in -- it's
11 in my rebuttal testimony -- whether there's a shift in
12 downward to a lower tier or stopping its usage would
13 be the reason why it would not cover costs and the fee
14 would have to be increased.
15 Q Have you discussed with any mailer whether a
16 fee higher than $19,5000 would cause them to terminate
17 an existing subcontract?
18 A No, I have not, but I have had discussions
19 with product development where customers have had
20 concerns about the existing fee schedule being too
21 high.
22 Q Were those customers users of platinum?
23 A Those were potential customers and customers
24 that were platinum customers. Yes.
25 Q Existing platinum customers?

1 A That was my understanding. Yes.
2 Q Did those customers drop the platinum
3 subscription?
4 A I don't know.
5 Q And presumably those customers would not be
6 the same customers who are overpaying.
7 A I don't know.
8 Q Well, if you thought that the subscription
9 price was too high and you could get the same number
10 of scans for a lower combined cost by going from
11 platinum to gold, wouldn't you switch to gold?
12 A Once again, I don't know the answer to that.
13 I mean, would I do it? Yes. Would they? I don't
14 know,
15 Q Let's talk about fairness and equity. You
16 discuss that starting on page 17 of your rebuttal
17 testimony.
18 A Okay.
19 Q Beginning on that section, you contend that
20 the OCA proposal would be unfair to small users.
21 A I believe that the existing fee schedule is
22 already less fair than it could be and I believe that
23 the OCA proposal makes it worse. Yes.
24 Q Now, you understand that there's a term in
25 the statute about unjust and unreasonable discretion?

1 Something like that?

2 A Can you point me to something?

3 Q No, I'm just asking your understanding.

4 A Off the top of my head, that's not ringing a

5 bell, but I'm not saying that's not the case.

6 Q When you were talking about fairness and

7 equity, therefore, you weren't referring to any

8 particular section of the statute?

9 A I was referring to pricing criteria 1, the

10 establishment and maintenance of a fair and equitable

11 schedule.

12 Q That would be 3622(b)(1)? This is not a pop

13 quiz of statutory sections, I just want to make sure

14 we're on the same page.

15 A That sounds right. My lawyers are nodding,

16 so I'll accept it.

17 Q We'll accept subject to check. Do you have

18 an opinion on whether the existing Confirm schedule

19 violates 3622(b)(1)?

20 A As I believe I responded in an

21 interrogatory response, I don't necessarily think it's

22 unfair, but I don't think it's superlative in fairness

23 or in equity and I believe that my proposal is a

24 superior product with regards to fairness and equity.

25 Q I think I heard the answer, but let me make

1 sure. You're not testifying that the existing range
2 of prices per scan in the existing rate structure is
3 so unfair as to violate what we call 3622(b)(1)?
4 A I'm assuming that the commission would not
5 have approved it if that was the case.
6 Q And you're not testifying that as a matter
7 of law the OCA proposal would be so extreme as to
8 violate 3622(b)(1)?
9 A What I'm test fying is that my proposal is
10 vastly superior to the OCA proposal with regards to
11 fairness and equity.
12 Q That wasn't my question. I'm simply asking
13 whether you're tendering to the commission the opinion
14 that the OCA proposal would be so unfair as to violate
15 3622(b)(1). I think you can answer that yes, no, or
16 I don't have an opinion.
17 A Do I think it violates it? No. But do
18 I think it makes it worse that what the existing fee
19 schedule is? Yes. And I'm not sure that making
20 things worse is necessarily living up to the criteria.
21 Q So if the commission is presented with two
22 different rate schedules, one of which has a steeper
23 set of volume discounts than the other, is it your
24 advice that the commission should always choose the
25 one that has the less steep taper?

1 A I'm here to discuss Confirm and with regards
2 to Confirm, I don't have the expertise to discuss
3 other classes or other pricing situations.
4 Q Is it your position that all other things
5 being equal for Confirm the commission should adopt a
6 less steep taper, rather than a steeper volume taper?
7 That's the only consideration the should look at?
8 A With respect to fairness and equity?
9 Q Yes.
10 A I don't think that it's that black and
11 white, but I think it should be a consideration.
12 Q Now, would you go to page 18? You have a
13 table on that page.
14 A Yes, I do.
15 Q And this Table 2 is meant is to illustrate
16 the unfairness of the OCA proposal for small users, in
17 your view?
18 A Yes, it is.
19 Q And you're focusing on the comparison
20 between 51 million scans and 164 million scans.
21 Correct?
22 A I think that was most relevant in
23 considering the level of usage. Yes.
24 Q Because the 1 billion and 1 trillion levels
25 are unlikely to be achieved?

1 A I can't speak of 1 billion being likely to
2 be achieved because a witness in this proceeding said
3 that they expect to achieve that, but 10 billion being
4 achieved soon, I don't think that's necessarily --
5 Q In any event, the most important comparison,
6 in your view, is the first two lines, 51 million and
7 164 million?
8 A Relatively, yes.
9 Q Okay. Now, by your calculation, the OCA
10 proposal, the average price per million scans would be
11 roughly a little more than three times 51 million
12 versus 164 million. Is that correct? Three
13 eighty-two divided by 119?
14 A Three and a half or so, yes.
15 Q And the Postal Service proposal, the ratio
16 is roughly two to one?
17 A Correct.
18 Q And that's the basis for your view that the
19 Postal Service proposal is fairer?
20 A Actually, I think it also had to do with the
21 fact that the Postal Service proposal is less than
22 half of -- the fee for the user of 51 million scans is
23 less than half of that under the OCA proposal, which
24 would be a small user. And then it's also less than
25 164 million, the average price million scans is lower

1 than under the OCA proposal, which in both cases would
2 benefit smaller users.
3 Q So your point is not only the ratio between
4 the two volume levels, but also the absolute level of
5 the charge?
6 A Yes.
7 Q Now, the existing fee structure of the ratio
8 between the cost per scan at 51 million versus 164
9 million is also more than three to one, isn't it?
10 A Yes, it is.
11 Q And we agree the commission approved that,
12 presumably, as being lawful?
13 A Yes, they did, but I'd also like to note
14 that under my proposal a user using 51 million scans
15 would pay less than under the existing fee schedule.
16 Q Now, let's focus on the 382.35 figure that
17 you attribute to the OCA. That calculation assumes
18 that the customer would buy a platinum level
19 subscription, right?
20 A Yes, it does.
21 Q What would be the cost per million scans
22 under the OCA proposal if the customer got 51 million
23 scans through a gold level subscription?
24 A $5,950.
25 Q So the 382.35 is the cheapest?

1 A I'm sorry, per million?

2 Q Yes.

3 A It would be $5,950 divided by 51 million.

4 Q Which works out to roughly?

5 A I don't have a calculator. I'm not sure.

6 Q Let's do that. What are the two numbers?

7 A It's $5,950, which is 5200 plus $750 for one

8 additional block of scans, divided by 51 million.

9 Q Well, if you were figuring out the cost per

10 million scans it would be 5950 divided by 51, right?

11 A Yes, it would. Sorry. Correct.

12 Q And that works out to about a little more

13 than $100?

14 A That sounds reasonable, yes.

15 Q That's not quite as gruesome a ratio as

16 three to one, is it?

17 A But I was referring to platinum subscribers.

18 And I'd like to point out that if that were the case,

19 that these people buy down, you assume that they buy

20 down, the OCA proposal won't cover costs.

21 Q But I want to focus here on fairness.

22 Do you think the commission should consider it unfair

23 if a mailer voluntarily chooses to pay at a higher

24 price than is offered by the OCA proposal?

25 A I think that it would be unwise to -- hold

1 on. I don't think it would be appropriate to think
2 just in terms of fairness and equity if a product
3 still has to cover its costs. All the criteria need
4 to be balanced and focusing on one and ignoring all
5 others wouldn't be prudent.
6 Q Well, you have a separate section in your
7 testimony on fairness and equity, don't you?
8 A Yes, I do.
9 Q Are you suggesting that fairness and equity
10 is not an additional argument against the OCA
11 proposal?
12 A I think that the arguments need to be
13 taken -- they're individual arguments but they need to
14 be taken into consideration as a whole.
15 Q Well, if the guy who has 51 million scans
16 can get them for a little bit more than $100 per
17 million sans, doesn't that make the fairness and
18 equity argument go away? It may in your view
19 exacerbate the revenue deficiency argument, but
20 doesn't that dispose of the fairness and equity
21 argument?
22 A The product has to cover costs, so if I have
23 to decide whether or not a proposal that doesn't cover
24 costs -- the premise is that if they move, they won't
25 cover costs. I have to consider that if they don't

1 cover costs that it's more fair? Yes, I guess it
2 would be more fair for them to pay -- I mean, if they
3 pay less -- assuming that we don't have to cover
4 costs, okay.
5 Q So your fairness and equity argument
6 concerning OCA really collapses into another cost
7 coverage argument, doesn't it?
8 A No, it doesn't.
9 Q Well, if the price for 51 million scans is a
10 little more than $100 per million, they may not cover
11 its costs by your assumptions, but there's no fairness
12 and equity issue, is there?
13 A If the OCA proposal is not likely to cover
14 costs, I don't think fairness and equity matters in
15 their proposal, with regard to their proposal.
16 Q Go to simplicity of rate design. You
17 discuss that on page 20 of your testimony.
18 A Yes.
19 Q Now there you contend that the Postal
20 Service proposal has the benefit of being simpler than
21 the OCA proposal?
22 A I believe so.
23 Q The OCA proposal is no more complex than the
24 existing rate design, is it?
25 A No, it's not.

1 Q It's basically the same?
2 A Yes, it is.
3 Q Has anyone complained to you that the OCA
4 proposal is too complex? Any customer?
5 A No, they haven't.
6 Q Now, under the current rate structure,
7 platinum customers don't need to keep track of how
8 many scans they use, do they?
9 A No, they do not.
10 Q Under your proposal, the Postal Service
11 would need to keep track of how many scans each
12 platinum customer uses, correct?
13 A There would be no platinum subscribers.
14 Q Under your proposal, the Postal Service
15 would need to keep track of how many scans every
16 customer used, including former platinum customers.
17 A Which we do today.
18 Q And under your proposal, the customer would
19 presumably want to keep track of how many scans it was
20 using to make sure it was billed correctly.
21 A I would assume so, yes.
22 Q Under the existing rate design, platinum
23 customers don't need to worry about whether the Postal
24 Service is billing them correctly for the number of
25 scans, do they?

1 A No, they don't.
2 Q Under the OCA proposal, platinum customers
3 wouldn't need to keep track of the number of scans to
4 make sure that they were being billed correctly?
5 A Correct. It would be those 16 remaining
6 people that would benefit from unlimited scans would
7 not need to, yes.
8 Q So you don't think that that aspect of
9 simplicity is a significant one, do you?
10 A I think that it's significantly complicated
11 that 29 of 45 subscribers overpay for the service.
12 Q Mr. Barranca, I believe we read one of the
13 passages, thought that the avoidance of billing and
14 tracking was a significant enough advantage of having
15 an unlimited scan tier to mention in his paper, didn't
16 he?
17 A Yes.
18 Q And Mr. Kiefer did as well in his testimony
19 from MC2002, didn't he?
20 A Yes, he did. Once again, that fee structure
21 has not covered its costs since the price has been
22 implemented.
23 Q Now, go to page 20, line 19. There's a
24 caption "Value of Unlimited Scans."
25 A Yes.

1 Q There you make a point I think you've made
2 orally a couple of times today, that unlimited scans
3 provide value to only a few subscribers.
4 A Correct.
5 Q Now, isn't it more accurate to say that
6 unlimited scans provide value directly only to a few
7 subscribers?
8 A Can you explain what you mean by directly?
9 Q Yes. Any mailer could share the benefit of
10 a platinum subscription by using it through a
11 value-added reseller, right?
12 A I'm sorry, one more time?
13 Q Smaller mailers could share the benefit of a
14 platinum subscription by using it through a
15 value-added reseller.
16 A Yes, they can.
17 Q And, in fact, that fact is a premise of your
18 argument about arbitraging, isn't it?
19 A Yes, it is.
20 Q Now, would you go to page 22, line 18?
21 A Okay.
22 Q There, you talk about compatibility with
23 future enhancements.
24 A Yes, I do.
25 Q Now, you contend that your proposal is more

1 compatible with future enhancements to confirm than
2 the OCA proposal is?
3 A I believe actually Witness Callow confirmed
4 that he never took into consideration future
5 enhancements, so, yes, I would agree with that
6 statement.
7 Q Are any future enhancements likely to occur
8 in the test year?
9 A I'm not aware of any that are likely to
10 occur in the test year. No.
11 Q So if the Postal Service had some future
12 advancements on its drawing board, it could come back
13 in the next rate case and ask that the Confirm rate
14 structure be modified to accommodate those
15 enhancements, couldn't it?
16 A The reason that we're trying to move to
17 units is because that while they're programming for
18 this structure they will be able to incorporate it and
19 incur the fee one time as they're redesigning and
20 doing their system engineering and the costs will be
21 will be reduced. They won't incur those costs in the
22 future when we decide to implement those enhancements
23 and those costs would not become a burden on the
24 customers.
25 Q The costs of going to the commission?

1 A The costs of making the system enhancements.
2 Q You give one example of a future system
3 enhancement which is scanning of containers.
4 A Yes.
5 Q And that's the only example of future
6 enhancements you mention in this section, correct?
7 A That is correct.
8 Q Now, does the Postal Service currently offer
9 Confirm scans of containers?
10 A No, they don't.
11 Q Have they announced a roll-out date for
12 Confirm scans of containers?
13 A Not that I'm aware of.
14 Q Does the Postal Service have a roll-out date
15 for Confirm scans of containers?
16 A I think you might be missing the point. The
17 reason that it can't be done right now is because the
18 infrastructure doesn't allow for differentiation in
19 the fee for scans on different types of materials,
20 which would be part of the reason why Confirm can't be
21 used today and an enhancement would be necessary and
22 units would be necessary.
23 Q I'm sorry. Does the Postal Service have a
24 roll-out date for Confirm scans of containers?
25 CHAIRMAN OMAS: Excuse me, Mr. Levy. Can

1 I interrupt for a minute? How much longer do you have
2 with this witness?
3 MR. LEVY: I'm about to go to the last of 13
4 pages of script. If you're hinting at a break, that
5 would be fine with me or we could --
6 CHAIRMAN OMAS: The problem is we need to
7 have the people who are parked down in the garage go
8 and get their keys and they exit with a credit card or
9 something. I didn't want to run to seven --
10 MR. LEVY: Oh, I should be done before
11 seven. I should be done before 6:45.
12 CHAIRMAN OMAS: Well, then, we'd better take
13 a break right now. Thank you very much.
14 We'll take a ten-minute break and come back
15 at 6:25.
16 (A brief recess was taken.)
17 CHAIRMAN OMAS: Mr. Levy?
18 MR. LEVY: This is my last line of
19 questioning standing between us and dinner or at least
20 between us and the next cross-examiner.
21 CHAIRMAN OMAS: The next cross-examiner.
22 BY MR. LEVY:
23 Q We were talking about Confirm scans for
24 containers and you were indicating that something
25 prevented it from happening. If the Postal Service

1 wanted to offer scans for containers today, under the
2 OCA proposal, the Postal Service would need to go back
3 to the commission for permission to charge a different
4 number of units for container scans?
5 A Under the OCA proposal, they wouldn't be
6 able to do that because there are no units.
7 Q Under the OCA proposal, the Postal Service
8 would have to go to the commission for a dollar and
9 cents price per scan for scans of containers, right?
10 A Yes.
11 Q Under your proposal, would the Postal
12 Service have to go back to the commission to set a new
13 number of units for scans of containers?
14 A Yes, we would.
15 Q So in either event, under either your
16 proposal or the OCA proposal, you would have to go
17 back to the commission for permission to set a price
18 for scans of containers?
19 A But we wouldn't have to incur costs to do
20 system engineering work to make it capable, which
21 would benefit the Confirm subscribers by reducing the
22 costs that would have to be covered.
23 Q I didn't hear in your answer the words yes
24 or no. Is the answer yes, but?
25 A Yes, we would have to go back to the

1 commission, but we wouldn't have to incur larger costs
2 which would have to be covered by rasing the fees for
3 Confirm subscribers.
4 Q What is the difference in cost between
5 setting a different price for container scans in terms
6 of cents versus in terms of units?
7 A As part of the process that we're going
8 through now, it's been budgeted for the system
9 engineering work to implement an accounting system
10 that uses units. If we were to use the OCA proposal
11 and then something were done, the system would have to
12 be opened up and more systems engineering work would
13 have to be done other than just saying service type X
14 is this number of units, a larger amount of effort
15 would have to be made and that would incur additional
16 costs.
17 Q The costs would be to change the software so
18 that the charge would be stated in terms of cents
19 rather than in terms of units?
20 A I don't believe it's that simple, but if
21 that --
22 Q Basically, what's entailed?
23 A I've worked with systems engineering people
24 before in developing software programs and I think it
25 would be wrong to say it's that simple.

1 Q Well, how many hours of rewriting software
2 would be required to have the charges stated in terms
3 of cents versus in terms of units?
4 A I've worked with systems engineering people
5 in other firms, not in the Postal Service, and I'm not
6 sure what the costs would be.
7 Q Would it be more than an hour of time?
8 A In my experience, there were tens or
9 hundreds of hours in quality control alone, so, yes, I
10 think it would be more than an hour.
11 Q What's your best estimate if you know, how
12 much time -- you can't give me even an order of
13 magnitude to change the software from units to cents?
14 A I'm assuming that the customers would want
15 the software to go through a quality assurance process
16 to make sure it doesn't screw up their scans, so it
17 would take more than an hour. I'm very confident it
18 would take more than an hour, but that's not my area
19 of expertise at the Postal Service. I'm a pricing
20 economist.
21 Q So even within an order of magnitude, you
22 cant' give an estimate of the number of hours of
23 rewriting the software that would be required?
24 A I think it would be inappropriate for me to
25 do so.

1 MR. LEVY: Thank you. That's all I have.
2 Thank you, Mr. Mitchum.
3 Thank you, Mr. Chairman.
4 CHAIRMAN OMAS: Thank you.
5 Before we continue with OCA, Mr. Levy
6 brought up an interesting point. When the Postal
7 Service sends mail, it charges itself the appropriate
8 postage. Do you know if the revenues for Confirm
9 include revenue from the Postal Service include
10 revenue from the Postal Service use of Confirm on
11 seeded mail?
12 THE WITNESS: I think those are considered
13 institutional costs. I think it's considered a part
14 of the operational process. I don't think it's
15 something that we're paying for, but I don't know.
16 That's my understanding, but I don't know.
17 CHAIRMAN OMAS: Could you get that
18 information to us within five working days, Mr. Rubin?
19 THE WITNESS: Maybe.
20 MR. RUBIN: Did you say in five working
21 days?
22 CHAIRMAN OMAS: Yes.
23 MR. RUBIN: Yes, we can do that.
24 CHAIRMAN OMAS: Thank you.
25 Mr. Richardson?

1 MR. TODD: Mr. Chairman, David Todd for Mail
2 Order Association. I believe that I had filed a
3 notice.
4 CHAIRMAN OMAS: Yes, you did, but you were
5 not here when I started.
6 MR. TODD: I understand and I apologize for
7 having not gotten here on time, but I do have brief
8 questions.
9 CHAIRMAN OMAS: Okay. Well, Mr. Richardson,
10 it's up to you. Is that all right with you?
11 MR. RICHARDSON: Certainly it is. That
12 would be fine.
13 MR. TODD: Thank you, Mr. Chairman.
14 I apologize for having been late.
15 CHAIRMAN OMAS: I hope you understand my
16 position. If one misses, then you go to the back of
17 the line, is the way we usually do that.
18 MR. TODD: I certainly do and I'm quite
19 willing to go to the back of the line and follow the
20 OCA.
21 CHAIRMAN OMAS: Mr. Richardson has agreed,
22 please continue.
23 MR. RICHARDSON: All right. Thank you.
24 CHAIRMAN OMAS:
25 CROSS-EXAMINATION

1 BY MR. TODD:

2 Q I believe that you stated in answer to

3 questions from Mr. Levy that you had been contacted by

4 a subscriber in October concerning the rate structure

5 for Confirm. Is that correct?

6 A I believe it was October. Yes.

7 Q Before the filing of your testimony making

8 proposed structural changes in the fee structure for

9 Confirm, did you do market research?

10 A No, the Postal Service did not conduct

11 market research.

12 Q Did you even talk to customers about it?

13 A Before the proposal was made, I do believe

14 that staff in the product development group did

15 discuss aspects of what we were proposing with

16 subscribers.

17 Q Do you believe that or do you know that?

18 A I know that.

19 Q You don't know how many subscribers?

20 A I do not know how many.

21 MR. TODD: Thank you. That completes my

22 questions.

23 CHAIRMAN OMAS: Thank you, Mr. Todd. Have a

24 nice evening.

25 Mr. Richardson?

1 MR. RICHARDSON: Thank you, Mr. Chairman.

2 CROSS-EXAMINATION

3 BY MR. RICHARDSON:

4 Q Mr. Mitchum, I'm Kenneth Richardson. I'll

5 be cross-examining for the OCA. Good evening.

6 A Good evening.

7 Q I want to ask you a few things about Confirm

8 service generally and it is a relatively new service.

9 Is that correct?

10 A Yes, it is.

11 Q Would you say it's the smallest service in

12 terms of revenue that the Postal Service provides?

13 A No, it is not.

14 Q What other services are smaller than that,

15 just as a general proposition? Is it maybe the third

16 or second smallest?

17 A I don't know exactly where it falls, but

18 I know that I personally have made pricing proposals

19 for services that have less revenue.

20 Q And the revenue here in the base year was

21 about 1.2 million? Is that correct?

22 A That sounds -- revenue -- no, the revenue

23 wasn't 1.2 million. The costs are 1.2 million for the

24 test year. I don't remember exactly what the revenue

25 was.

Q And are you aware that the number of customers and financial projections for Confirm today are not as high as they were originally projected in the original docket, MC2002-1?

A Yes, I am and that's one of the reasons we consider the existing pricing structure to be insufficient.

Q And one of those reasons is the market has not developed as anticipated. Is that correct?

A The market under the existing pricing structure did not develop. Yes.

Q Although in your view is there still a potential market out there that could increase the use of Confirm?

A That is a possibility, yes.

Q And would you agree that there are possible uses for Confirm such as the one code ACS could increase the use of Confirm?

A Possibly, yes. Reason to believe so, I don't have any.

Q And there could be new users due to growth in mailings or new users seeking service performance data that are not now using Confirm. Is that correct?

A That is possible.

Q And there could be new users that might

increase revenues by ordering additional IDs.

A That's possible, but I don't think it's very likely.

Q Were resellers originally anticipated to be part of the Confirm service?

A Yes, they were. It is my understanding they were.

Q How many resellers are there?

A I personally don't know, but there was a reference in Witness Bellamy's testimony that said that over half of the existing subscribers were resellers.

Q Of the existing platinum subscribers?

A I think it was of existing subscribers, not just platinum subscribers. I think the reference was all subscribers.

Q And how many would you say that would be, then?

A If it is actually over half, that would have to be at least 90. Excuse me. Half, at least 91.

Q Now, although Confirm is relatively new, would you say by now that the Confirm service is currently working satisfactorily?

A There were technical problems in the past, but my understanding is that most of those have been

1 addressed.

2 Q Does it still have problems sometimes with

3 defective scans?

4 A There are situations that are still being

5 corrected, but I don't think it's at the level it was.

6 I think there are still situations where the

7 information is not correct, as I believe we responded

8 to interrogatories in that manner, but I think that

9 the problems are being addressed and improved.

10 Q Do you know what percentage of scans are

11 defective?

12 A No, I do not.

13 Q To the extent those problems are addressed

14 and met, do you think more customers would use Confirm

15 than use it today?

16 A I don't think it would increase demand much.

17 no.

18 Q Now, you indicated earlier that you have not

19 had any complaints about the type of fee schedule,

20 that it's a subscription service. Is that correct?

21 There's been no complaints?

22 A I have not solicited complaints, but I have

23 heard that at least one subscriber would prefer the

24 Postal Service proposal.

25 Q Would prefer -- I'm sorry?

1 A Would prefer a fee per scan proposal.
2 Q Would it be fair to say that the Confirm
3 service is working smoothly as far as the Postal
4 Service is concerned except for recovering the costs
5 at this point?
6 A That would be a product management call.
7 I'm not aware of dissatisfaction, but that's not my
8 area of expertise.
9 Q At this point, you propose to change the fe
10 structure to a transaction type fee structure from a
11 subscription fee structure. Is that correct?
12 A Yes, it is.
13 Q And that is to meet a shortfall in revenue
14 of about how much?
15 A I believe it's about 15 percent in the test
16 year.
17 Q And that's about how much, 300,000, give or
18 take?
19 A I think it's roughly around there, yes. But
20 that is not the only reason, as my rebuttal testimony
21 points out. The idea is also to enhance the product
22 to address some shortcomings of the existing fee
23 structure, including the increased ability of
24 arbitrage, lack of fairness or the ability to improve
25 fairness and equity.

1 Q Are you saying that the rate schedule today
2 isn't fair and equitable?
3 A As I put in my response to an interrogatory,
4 I'm not saying it's not fair and equitable. I'm
5 saying it's not superlative in either fairness or
6 equity and it can be improved and my proposal does do
7 that.
8 Q But were it not for the revenue shortfall,
9 you would not be proposing a new rate structure, would
10 you?
11 A I can't say that's the case. It's likely
12 that we would still want to improve the product and to
13 get more fair and equitable, among other things.
14 Q I want to talk to you about some of the
15 costs that may not be accounted for. Mr. Levy talked
16 about Witness Kiefer's testimony and put it in the
17 record. Do you agree with Witness Kiefer's testimony
18 in Docket No. MC2002-1, that it's easier to administer
19 a subscription system because of the limited amount of
20 billing that's necessary?
21 A I wouldn't be the right person to ask that.
22 I'm not in the product management group and I'm not in
23 the accounting department either, so I don't have that
24 area of expertise there. Sorry.
25 Q Under the current system, you discussed

1 earlier that the Postal Service tracks the scans, but
2 under the billing procedure now, under the
3 subscription method, the billing is not done
4 frequently. Is that correct?
5 A I'm sorry, I'm not sure.
6 Q Under the subscription based system, how
7 does the Postal Service handle the billing?
8 A I have no idea.
9 Q And under a transaction based system, the
10 Postal Service will be required to track and bill the
11 scans. Is that correct?
12 A No, that's not true.
13 Q Why is that not true?
14 A The customers would be required to buy units
15 ahead of time and we wouldn't be billing them after
16 usage. They would be using units they had already
17 purchased.
18 Q And that's for the transaction based system?
19 A Yes, sir.
20 Q And if there's any concern about scans that
21 are defective, how is that handled in terms of
22 billing?
23 A As I noted in response to an interrogatory,
24 we would not be offering refunds on individual scans
25 because the cost of evaluating whether or not the scan

1 were valid or not would actually add more costs than
2 it would save and it would be a disadvantage to the
3 subscribers.
4 Q You say on page 6 of your testimony, line 1,
5 that your task was to find the least disruptive yet
6 reasonably effective way to get the needed revenue and
7 when you say least disruptive, least disruptive to
8 whom?
9 A Can you point me to what line that was?
10 Q I'm sorry, line 1 on page 6 of your
11 testimony.
12 A Can you please repeat the question?
13 Q When you say least disruptive, I asked you
14 least disruptive to whom?
15 A Least disruptive to all parties involved,
16 I believe.
17 Q Here you've recommended to change the entire
18 fee structure to a totally different system of
19 transactions. Wouldn't you call that a disruptive
20 change?
21 A Given that I wanted to cover costs and
22 I didn't believe the existing fee structure was
23 capable of covering costs and I didn't believe that I
24 was allowed to make a proposal that didn't cover
25 costs, no.

1 Q Let me go to page 26 of your testimony where
2 you refer to -- you say under the Postal Service
3 proposal, 1 billion first class mail scans could be
4 obtained for $24,530 and that would be a mail piece
5 cost of only .006 cents. Do you see that?
6 A Yes, sir.
7 Q And you say that appears to be quite a
8 bargain.
9 A Yes, sir.
10 Q Now, isn't it true that under the OCA
11 proposal the same number of scans would be even less
12 than $24,530 but would be $19,500?
13 A If all of the assumptions made by Witness
14 Callow were to come true, if there were no decrease in
15 demands, if no one decided to buy down to a lower
16 price and save over $14,000, that would be the case.
17 But if Witness Callow's proposal were to reflect the
18 $45,000 number roughly if everybody that can move to a
19 lower cost does, then no.
20 Q Well, you've referred to the situation like
21 this several times, what would happen if there was a
22 buying down or if customers left the system. Your
23 example as to what would happen is what would happen
24 in the next rate case, all other things being equal,
25 isn't it? What you're setting up is a situation where

1 the rates would be higher only after review by the
2 commission in another rate case. They would not be
3 affected here.
4 A As I noted in my rebuttal testimony,
5 I though that it was reasonable to make an assumption
6 that there would be a decrease in demand and that
7 people would choose to spend as little money as
8 possible. If the commission were to accept the
9 assumptions that customers don't want to save money
10 and that increasing prices doesn't affect demand, then
11 the OCA proposal to cover costs -- that's the only way
12 the OCA proposal will cover costs, is making those
13 assumptions, and if it doesn't cover costs, I don't
14 think that it's reasonable to look at $19,500. Even
15 Witness Callow recognized that at $19,500 if all the
16 customers that could move down did, he would need to
17 retain seven of them to cover costs at all
18 Q But those are all assumptions that you're
19 making and it's up to the commission to decide whether
20 those assumptions are reasonable when it establishes
21 the rate and if it decides that the assumptions are
22 not correct and that the OCA assumptions are correct
23 and establishes the rate as OCA proposed, then if
24 these things occur, there will not be any change in
25 the rates to other customers until the next rate case.

1 Is that correct?

2 A If the OCA proposal is accepted and it turns

3 out that it does not cover costs, the next option to

4 fix it would be at the next filing. Yes.

5 Q And there could be a lot of different

6 situations that could occur between now and then,

7 other customers could come on line, as you indicated,

8 there's a possibility of new customers. There could

9 be growth in existing customers. Resellers may, for

10 instance, redouble their efforts to market their

11 product and to buy new IDs. Is that correct? All of

12 those?

13 A If resellers manage to acquire new customers

14 and they choose not to use additional IDs, there's no

15 additional revenue. If resellers manage to recruit

16 existing customers, there's a decrease in revenue.

17 And if arbitrage takes place, which is the increase

18 Witness Callow is proposing, which will encourage more

19 arbitrage, as my testimony states, then there would be

20 less subscribers and less revenue.

21 Q That's not certain. That's just one

22 possible outcome. Is that correct?

23 A It's just rational expectations.

24 Q If a silver subscriber decided to move to a

25 reseller, a silver subscriber pays $2000. Is that

1 correct?

2 A As I noted in a response to POIR, I think

3 it's POIR -- one second. Using a full 12-month period

4 of data that we had available, there were 19

5 subscriptions held by eight silver subscribers. Three

6 of the subscribers renewed for each of four years.

7 So, no. They don't pay $2000 necessarily. They may

8 pay as much as $8000.

9 Q But some could pay $2000.

10 A That is true.

11 Q And you agree that the subscribers don't

12 stay constant, there's a turnover in subscribers,

13 isn't there?

14 A Yes. I actually acknowledged that in

15 response to a different POIR.

16 Q So from period to period, whatever

17 subscribers did in a previous period, you may have a

18 different set of activities by, say, a new silver

19 subscriber may not necessarily purchase additional

20 scans and so they may just pay $2000.

21 A I agree with you and that's the same reason

22 why I think that it's likely that a subscriber that

23 now is overpaying may choose not to overpay, for the

24 exact same reason they may decide that they could save

25 money by moving down to a gold tier rather than paying

1 $19,500 for a platinum tier.

2 Q Well, I just wanted to finish the point that

3 if a silver subscriber is paying $2000 and he moved to

4 a reseller and the reseller purchased an additional ID

5 for $2000, there would be no net loss in revenue. Is

6 that correct?

7 A That is correct, but if a silver subscriber

8 were to move to a reseller and the reseller had any

9 markup at all, he'd have to charge in excess of $2000

10 or he would be losing money. In the best case, he'd

11 be breaking even, but assuming there's some additional

12 cost to him by having another customer, paying $2000,

13 he would have to -- what would be the incentive to a

14 reseller when the reseller has to pay $2000? He's

15 going to have to pay the resellers trade agreement

16 least $2000. I don't see the economic incentive.

17 Q Well, the incentive would be that he has an

18 improved database available to him. There's a value

19 added that the reseller offers the silver subscriber

20 that the silver subscriber may not have or may not

21 even have the capability to generate.

22 A That's true, but the reseller also doesn't

23 need to buy an additional ID. The presence of the

24 four-state bar code, as I noted in my testimony, my

25 original testimony, the four-state bar code will allow

1 the reseller to have 1 billion different combinations
2 of ID information and that means that that silver
3 subscriber could easily go to a reseller that does not
4 use additional IDs, he can sort the data himself.
5 Q Is it your testimony that there will not be
6 additional IDs purchased by resellers?
7 A It is my testimony that there's not
8 necessarily a need for them to buy any additional IDs.
9 That doesn't mean that they won't, just that they
10 don't need to.
11 Q And you agree that based on some of the
12 history in the past where subscribers have paid more
13 than they needed to for the scans that they actually
14 received, such as I think your own testimony indicated
15 some platinum subscribers actually could have saved
16 money had they purchased a gold subscription?
17 A That is correct. True.
18 Q Now, I want to ask you about your forecast
19 for a 10 percent reduction in demand. You responded
20 to a POIR, I believe POIR number 4, question 3, which
21 you calculated how you determined the 10 percent. Is
22 that correct?
23 A Actually, I don't think that's true.
24 I don't think I actually calculated 10 percent.
25 Q Or you explained your method of reducing

1 scans by 10 percent.

2 A I explained my assumption that there would

3 be a 10 percent decrease in demand, yes. Or decrease

4 in the use of scans. Sorry.

5 Q Now, did you ever actually have a number in

6 terms of the scans that would be reduced? The reason

7 I ask that is your response is couched in terms of

8 units and in reviewing your response to the POIR, you

9 talked in terms of units and apparently you took the

10 scans and transferred them to units and then indicated

11 that there's a certain number of units.

12 A I actually apologize. I seem to have

13 misplaced my response.

14 Q Let me ask it another way. I have it before

15 me and I could show it to you, but it may be easier,

16 quicker, I don't know. In Library Reference L124, you

17 forecasted 28,152 blocks of 1 million units in the

18 test year. Are you familiar with that?

19 A Yes.

20 Q And I believe that appeared in the response

21 to the POIR, which your counsel is handing you,

22 I believe.

23 A I'm sorry, my response to this, was actually

24 to reduce the number of scans, not units. Response

25 .2, I actually reduce the number of scans for each

subscriber by 10 percent to reflect the contraction in demand. It's not in terms of units, that I'm aware of.

Q Do you have before you the special services Confirm test year 2008, USPS-T-40, WP-4, which I believe is part of your response to the POIR?

A I'm sorry, it would be -- you're talking about --

Q Your workpaper, WP-4.

A Okay. Yes. I have it in front of me.

Q And that refers to -- under volume, you show blocks of units total. I guess that would be the under volumes after rates, volume of 28,152, and that's blocks of 1 million units in the test year. Is that correct?

A That is correct.

Q Now, we're just trying for the record to determine whether or not you had a number of scans that were reduced in your estimates.

A Yes, I did.

Q And what is that number?

A I believe it was around 11 billion. It might have been a little below 11 billion. It was about a billion scan decrease, roughly.

Q And we've done some math. Would you accept

1 subject to check that the 90 percent number would be
2 11.171 billion?
3 A That's possible. Yes.
4 Q And the reduction scans would be 1.117
5 billion.
6 A That's very possible. Yes.
7 Q And does that appear anywhere in the record?
8 A Not that I'm aware of.
9 Q Now, you say in your testimony on page 7,
10 lines 2 to 3, that no participant asserts the Postal
11 Service's proposal would generate insufficient revenue
12 to cover costs. Now, that's not a certainty, that
13 your proposal would cover costs, is it?
14 A Of course it's not a certainty, but the
15 assumption upon which my proposal is based, I am very
16 confident that it will cover its costs. As I noted in
17 responding to Mr. Levy, even if my scans were to fall
18 off by as much as -- I believe it's right around 50
19 percent, I would still cover costs. So, yes, I'm very
20 confident it will cover costs.
21 Q That's if scans fall off by 50 percent, but
22 that does not assume customer falloff by 50 percent.
23 Is that correct?
24 A That is correct.
25 Q And that's because under your proposal the

1 customers pay $5000 up front?

2 A Yes.

3 Q And have you calculated what percentage of

4 customers you would need to fall off before you did

5 not recover costs?

6 A No, I haven't.

7 Q But it would be substantially lower than

8 50 percent?

9 A It would be substantially less than 50

10 percent.

11 Q Do you have a ballpark, 10 percent?

12 A No, I don't.

13 Q But that could be calculated fairly easily?

14 A It could be calculated fairly easily.

15 Q I asked you earlier if you knew how many

16 resellers there are today and you say you don't really

17 know that?

18 A My understanding is that it's more than half

19 and that would be at least 91.

20 Q And if the commission accepted your proposal

21 and it had the effect of discouraging resellers and so

22 that some of them left, many of them or a portion of

23 them left the business and actually no longer

24 subscribed, then under your proposal you would not

25 recover the costs. Is that correct?

1 A I don't see a reason why that would be the
2 case and I believe Witness Bellamy did not say that
3 there would be any decrease in subscribers. We asked
4 him that question in an interrogatory and I would
5 defer to his expertise as being a reseller himself.
6 So the answer to the question would be no.
7 Q It's your view that platinum subscribers
8 would stay in the system under your proposal but under
9 the OCA proposal several subscribers would leave?
10 A There is no platinum subscriber in my
11 proposal.
12 Q But the current platinum subscribers would
13 not renew under your proposal? Is that correct? Is
14 that your view?
15 A I'm sorry, can you please repeat that?
16 Q Is it your view that under the OCA proposal
17 the platinum subscribers would not renew their
18 subscriptions but that under your proposal platinum
19 subscribers would stay on the system?
20 A I believe that under the OCA proposal that
21 of the 45 platinum subscribers 29 of them would have a
22 strong incentive to move down to a gold tier, not
23 necessarily quit using it. Some of them may choose to
24 quit using it, some of them may choose to go to
25 resellers. I just disagree with the assumption that

1 they will stay and continue to pay $14,000 more than
2 they need to to receive the same number of scans.
3 Q When you say 29 out of 45, that would
4 probably include some resellers. Is that correct?
5 A That's possible. Yes.
6 Q Because resellers may make up more than half
7 of the customer base.
8 A That's possible. Yes.
9 Q Now, if the commission had before it two
10 different Confirm rate proposals and it was not
11 certain that either one would recover all of the
12 attributable costs, do you agree the commission might
13 look to other characteristics and advantages and
14 disadvantages between the two rate proposals?
15 A I would greatly hope they would take into
16 consideration things such as fairness and equity and
17 the fact that my proposal improves fairness and
18 equity, particularly for smaller users. But I think
19 there is only one proposal before the commission
20 that's unlikely to cover costs and it's not mine.
21 Q You say that your proposal is fairer to
22 small users. Now, under the OCA proposal a small user
23 could purchase silver subscription for $2000. Is that
24 correct? Whereas under your proposal, the cost of the
25 fee is $5000 just to have access to Confirm. Is that

correct?

A Not exactly.

Q How is that cheaper?

A As I mentioned before, there were 19 subscribers in the full year data, when I responded to the one POIR. Of those, three of the subscribers had renewed for all four quarters and $2000 is only for a quarter, not for a year, and additional ones renewed for three quarters and it's possible they actually renewed for four, but the data truncation may not -- I don't know if they had before that period renewed. There were continual renewers. But in that case, there's a number of those eight subscribers that make up the 19 subscriptions, at least three of which bought $5000 of usage who would save money under the proposal. Or potentially save money under the proposal.

Q But for the very smallest user, the OCA proposal is cheaper. Is that correct?

A Not necessarily.

Q If a silver subscriber subscribed for one quarter and paid $2000 versus your $5000, it would be cheaper under OCA. Is that correct?

A One second. In response to POIR 12, question 6, five subscribers would save money under

1 the OCA proposal out of the eight and that's two of
2 those used two subscriptions, so they'd save $1000.
3 The other three used it only for one quarter and it's
4 possible they could have renewed in the following
5 quarter.
6 Q The silver subscription is considered an
7 entry level subscription for Confirm, isn't it, at
8 this point? Potentially new customers who may want to
9 try out Confirm service?
10 A It's possible that given the fact that at
11 least three subscribers renewed four times, I would
12 have to say that it's not necessarily an entry level
13 product.
14 Q Did you check to see how many subscribers
15 subscribed to silver and stayed there one quarter and
16 then moved up to gold?
17 A Actually, I did kind of look at that and
18 I didn't actually see anybody -- I didn't go into
19 great detail because I was focusing on answering the
20 POIR, but I was curious about that and I looked and
21 I didn't see anything. I didn't see any.
22 Q I'd like to go to another subject. On page
23 26, line 12, where you discuss some of Witness
24 Bentley's recommendations about rolling in the price
25 of first class, rolling in the costs of first class,

1 and on line 12, you point out one of the issues:
2 should a portion of Confirm costs be allocated to
3 first class mail and, if so, how much?
4 There, you're talking about a portion being
5 allocated to all of first class mail in a way that
6 would reduce the attributable costs of confirm. Is
7 that correct?
8 A Yes.
9 Q And the logic behind that is that all first
10 class mailers benefit from the Confirm service and not
11 just those who use Confirm services.
12 A I don't think I implied that at all. I was
13 pointing out an issue that he failed to address.
14 Q If that issue were addressed, the logic to
15 reach that conclusion would be because the benefits of
16 confirm applied to all first class mailers or, perhaps
17 another way of stating it, to the Postal Service
18 generally in terms of measuring its own service
19 performance?
20 A The Postal Service measures its service
21 performance by seeding its mail, its own mail pieces.
22 It does not use customer scans, so it does not benefit
23 from customer scans in that way. It has a seeding
24 process. There's several interrogatories addressing
25 that.

1 Q But the Postal Service does benefit from
2 Confirm. Isn't that correct?
3 A It benefits greatly from Confirm from those
4 mail pieces that we seed. There was response to an
5 OCA interrogatory and I'm sorry I was focusing
6 primarily on my rebuttal testimony in preparing for
7 today, but I believe it's in the 30s and it might have
8 been an institutional response, I don't think it was
9 my response, which is part of the reason why I'm not
10 particularly familiar with it, but I believe they said
11 that mail pieces are pulled out of the mail stream,
12 Planet codes are applied to them and they're reentered
13 into the mail stream and they're tracked. They are
14 not customer applied Planet codes.
15 Q Is it your testimony that the only customers
16 of the Postal Service that benefit from Confirm are
17 those that use Confirm?
18 A If the Postal Service is capable of seeding
19 mail and believes that that's the best way to measure
20 performance, as I said the last time I was on the
21 stand, if there's improvements made to performance or
22 to the mail processing process, then I think all
23 mailers benefit, regardless of just first class, not
24 just first class mailers. But, once again, those
25 aren't Confirm service scans. Those are separate

1 items.

2 Q When you designed your rates for Confirm,

3 did you consider allocating a portion of the costs to

4 first class and/or to standard mail as a way of

5 reducing the attributable costs that are applicable to

6 the Confirm service?

7 A There was discussion about it, but I don't

8 think I would ever say it was actually -- it was never

9 considered as part of a proposal. There was

10 discussion that that's something that could be

11 considered. Actually, let me restate that. In

12 preparing for R2005-1, it was considered because the

13 costs were substantially higher as part. As part of

14 2006-1, I don't believe it was ever considered.

15 Q And the logic behind that or at least one

16 logical reason behind that would be because the Postal

17 Service generally benefits from confirm other than the

18 actual users of Confirm and it would be fair to

19 attribute some of the costs of Confirm service to the

20 Postal Service.

21 A As I said, I don't think it was ever

22 discussed at that level of detail. It was talked

23 about. I never developed a proposal that had that and

24 I'm not aware of the reasoning behind -- I never went

25 so far as to think about the reasoning of that. Other

1 people might have, but not me.

2 Q As a theoretical position, wouldn't it be

3 possible to make the cost recovery whole or to have

4 Confirm revenue recover costs if that were done by

5 merely allocating 15 percent of the costs to the

6 Postal Service overall and the remainder to the

7 Confirm customers, then the revenue would recover the

8 costs? Is that correct?

9 A I don't think that's -- my understanding was

10 that the product had to cover its costs. I didn't

11 think it's fair that mailers that don't use the

12 service and they're not benefiting from the service,

13 only subscribers are benefitting from the service, the

14 people are benefitting from the existence of the

15 Confirm program are benefitting from those scans that

16 are received from pieces of mail that are seeded by

17 the Postal Service. I don't think that it makes sense

18 to benefit those customers that are actually

19 benefiting from the Confirm service by taking costs

20 out of it and applying it to people that are not using

21 that service and are not getting any benefit from

22 those people using that service.

23 Q But if people were benefitting overall, if

24 the Postal Service were benefitting generally and

25 other customers were benefitting then there would be

1 some logic to doing that, wouldn't there?

2 A You're asking me to hypothetically say

3 something that's not happening is happening? Yes. In

4 that case, sure.

5 Q Now you had several objections to the OCA

6 proposal, one of which on page 7, lines 16 to 18, you

7 list at least three items, and Mr. Levy spoke about

8 these, where you suggest customers might reduce their

9 usage of Confirm in response to an OCA proposal by

10 seeding and use a less expensive tier or move their

11 business to a reseller. Is that correct?

12 A Yes.

13 Q But there is one alternative which you don't

14 discus there, which you don't mention. Isn't it at

15 least possible and in many cases probable that

16 customers may do nothing in response to a fee

17 increase, if they're happy with the Confirm service?

18 A Previously, Mr. Levy had been trying to make

19 me act as an economist. As an economist, rational

20 expectations would say that a customer is likely to

21 choose the least expensive thing. We do have

22 customers now that aren't doing that, for whatever

23 reason which we're not aware of, but when their option

24 is to pay $14,000 more than they need to, I think it's

25 unlikely that they're going to choose to do that and

1 I don't think that's -- the reason I didn't list it as
2 an option is because I don't think it's a probable
3 option. Yes, it's possible. Is it probable? I don't
4 think so.
5 Q Why did you say they would pay $14,000 more
6 than they need to?
7 A Because the proposal, as I recall Witness
8 Callow's proposal, he wants to raise the rate from
9 $10,000 -- the current fee for gold is $4,500. The
10 proposed fee is $6,200. The current fee for platinum
11 is $10,000 He wants to raise it to $13,500. The
12 difference between gold under his proposal and
13 platinum under his proposal is $14,300 and that would
14 be a potential savings for -- I think in my rebuttal
15 testimony I said that there would only be 15
16 subscribers left that would not save money by moving
17 to a gold tier, at which point his proposal would not
18 cover costs.
19 Q But, again, if the proposal doesn't recover
20 costs, that's not a question that will arise until the
21 next rate case. There may be other changes that may
22 occur, other new customers, as I mentioned to you
23 before, that may offset those losses.
24 A In reading Witness Callow's testimony,
25 I saw no reason -- he never offered that as a

1 possibility. I'm just basing mine on rational
2 assumptions.
3 Q I just wanted to put into context that
4 I don't think it's been put into context here. You've
5 talked about under the OCA proposal the platinum rate
6 would go to $19,500 and that that may cause customers
7 to leave the system. Is that correct?
8 A I think that it's unreasonable to assume
9 that it wouldn't and that consideration should be
10 given to the fact that they're likely to.
11 Q What's your response to the fact that the
12 mailers involved are spending tens of millions or
13 hundreds of millions of dollars on a mailing and, in
14 fact, you indicate in your testimony a cost of $135
15 million for postage alone if somebody had 400 million
16 plus scans, when a mailer is spending tens of millions
17 of dollars, would they be concerned about a
18 differential of a few thousand dollars in the
19 additional costs to track their mail?
20 A Just a second. I'm sorry. Can you re-ask
21 the question again?
22 Q My question is putting the situation into
23 the overall context of the expense the mailers are
24 incurring in situations with Confirm, they're mailing
25 millions of letters and they're incurring costs for

1 postage and printing costs in the tens of millions or
2 hundreds of millions of dollars, why do you think that
3 an expense of $9,500 additional over what they're
4 paying now would be particularly significant to them?
5 A In Witness Callow's testimony, he takes
6 strong note of the fact that I'm forecasting a
7 decrease in demand due to my price increases, which in
8 many cases are lower than his. If I were to assume
9 that he's right, that even smaller decreases under my
10 proposal would decrease demand, then it would be
11 logical to assume that demand would decrease under his
12 proposal.
13 Q Are you just applying the general rule that
14 when the price increases there's a decrease in demand,
15 elasticity?
16 A I think that it's more logical or more
17 reasonable to assume that if you raise prices that
18 demand is going to decrease than to assume that if you
19 raise prices there's going to be no impact at all,
20 particularly assuming that customers won't choose to
21 move to a tier to receive the exact same product for
22 $14,300 less.
23 Q But you don't know what the elasticity is of
24 the Confirm demand?
25 A No, I don't. I'm not aware from

1 Mr. Callow's testimony that he is either.

2 Q And if you were measuring the elasticity,

3 would it be fair to look at the impact on demand for

4 Confirm as between the cost of, say, $10,000,000 and

5 $10,019,500 and measure the impact on the demand

6 curve?

7 A I'm aware that there's potential customers

8 that have balked at the price and decided not to use

9 Confirm at today's prices, so I would assume that if

10 you almost double the price for platinum that that

11 would probably discourage customers and it may

12 discourage existing customers, if it discourages

13 potential customers, or at least encourage them to pay

14 $14,300 less.

15 Q What potential customers have you talked to

16 or how many?

17 A These are conversations that I've had with

18 product development and managers of the product in

19 product development. They've had discussions with

20 potential customers that have said the price is too

21 high and they would subscribe if the price were lower.

22 Q Is that recent? Recent discussions?

23 A They're discussions over the course of the

24 past -- primarily in terms of when I was developing my

25 proposal and writing my testimony.

1 Q I want to look at your table on page 18
2 which Mr. Levy talked about, Table 2, which he talked
3 about in terms of the fairness and equity, which is
4 the section where it appears. Do you have that in
5 front of you?
6 A Yes.
7 Q I just wanted to nail down some of the
8 mathematical relationships which Mr. Levy alluded to,
9 but I don't think he had done the math at that point
10 and I would just like to ask if you would accept
11 subject to check that obviously under the existing fee
12 situation which has been approved by the commission,
13 if you look at the cost per million scans for 51
14 million scans, it's $196.08 and you divide that by the
15 10 billion scans, the ratio is obvious 196 to 1.
16 Then if you do the same type of arithmetic
17 under the OCA proposal, for 51 million scans divide
18 $382.35 by the price per million scans for 10 billion
19 scans of $1.95, you also get a ratio of 196 to 1.
20 Would you agree subject to check that those
21 are the same ratios?
22 A Actually, I'll agree without subject to
23 check. That's true.
24 Q Okay. And the existing fees are
25 presumptively fair and equitable. Would you agree to

1 that?

2 A As I stated before, while the fees may not

3 be unfair or inequitable, they're not superlatively

4 fair or equitable and my proposal improves the

5 fairness and equity.

6 Q And just to be complete for the picture,

7 again, if you divide the price for 51 million scans by

8 the price for 164 million scans, that's $196.08, by

9 $60.98, under the existing fees, you have a ratio

10 of -- I believe it's 3.2 to 1 and if you do the same

11 for the OCA proposal, $382.35 divided by $118.90, you

12 also get a 3.2 to 1 ratio, Is that correct? Will you

13 accept that?

14 A That's correct. And the U.S.P.S. proposal

15 which has lower fees for both of those, it's only a

16 little over 2. Which seems more fair and equitable.

17 Q And Mr. Levy talked to you about that.

18 A Yes, he did and given that the OCA proposal,

19 the way he was talking about it, it would encourage

20 people to move down -- the only way that would work is

21 if they moved down from the platinum tier to the gold

22 tier and that would result in the OCA proposal not

23 covering costs.

24 Q Now, another point on the fairness and

25 equity issue I would like to bring out, you talk about

1 fairness and equity on page 19 of your rebuttal
2 testimony, under the OCA proposal, a platinum
3 subscriber purchasing 51 million scans would pay the
4 same amount and have the same costs per scan as any
5 other platinum subscriber whereas --
6 A That's not true. I'm sorry. I cut you off
7 before you finished your question. I apologize.
8 Please continue.
9 Q Under the OCA proposal, a platinum
10 subscriber purchasing 51 million scans would pay the
11 same amount and have the same cost per scan as any
12 other platinum subscriber purchasing 51 million scans.
13 A All right. That's true.
14 Q Okay. But under your proposal, a subscriber
15 purchasing 51 million scans for standard mail would be
16 effectively charged five times as much for each scan
17 than they would be for a first class scan. Is that
18 correct?
19 A No, it's not correct.
20 Q And why is that?
21 A As I responded, Witness Bellamy actually
22 made that same accusation and in a follow-up
23 interrogatory we showed him that he's incorrect.
24 Q But under your proposal, subscribers are not
25 paying the same amount as they are under the OCA

1 proposal. Is that correct?
2 A I think what you're trying to ask is under
3 my proposal two subscribers could potentially for the
4 same number of scans pay different amounts. And in
5 that case, that's true.
6 Q Now, just one last series of questions that
7 I want to bring out again. I've mentioned to you
8 several times that several times in your testimony you
9 discuss the situation that would occur under the OCA
10 proposal and subscribers would leave the system and
11 there would be a shortfall and essentially you suggest
12 that the costs would go up to existing customers.
13 I just want to point out again that any impact would
14 be delayed until a further rate increase or a further
15 rate case when all things are taken into account, new
16 customers when the situation is looked at in the
17 future.
18 A Actually, let me clarify something and
19 I apologize for not clarifying this earlier. I am not
20 saying that they're going to fall out of the system.
21 Actually, I'm being rather conservative in assuming
22 they will and still showing that the OCA proposal does
23 not cover costs. As I've mentioned in my rebuttal
24 testimony, if we were to assume that there's actually
25 a decrease in the number of subscribers as well, then

1 the costs would actually have to be raised above the
2 $45,000 that Witness Callow says that if all 29
3 subscribers were to move to gold and choose to pay
4 less, choose to pay as little as possible, they would
5 have to pay $45,000 -- I apologize. He said $45,500.
6 I believe it's $42,500. But if any of the subscribers
7 were to leave or arbitrage were to kick in and the
8 subscribers were to move to resellers, pure arbitrage
9 resellers, then the revenue shortage would be much
10 lower and while, yes, the commissioners do have the
11 right to recommend a proposal that's unlikely to cover
12 costs, they have a proposal before them that is very
13 likely to cover costs. That's the one the Postal
14 Service is offering.
15 Q And you have a table on page 9 of your
16 testimony where you suggest what might happen if the
17 platinum tier fee approached 50,000, a range of 10 to
18 50,000, but, again, that's based on a fee that would
19 be prescribed at a future rate case. That is not
20 happening in this case. I just want to make that
21 clear.
22 A I think what I'm trying to say in that table
23 is that if the OCA proposal were likely to cover costs
24 they would have to offer a platinum proposal, a
25 platinum fee -- I'm sorry. In that particular table,

1 that's not what I'm saying, but if the OCA were to
2 recognize that subscribers could choose to pay less
3 money, they would have to raise the platinum fee and
4 this just basically shows that the gold tier actually
5 becomes a fee per scan tier after 50 million scans,
6 which is what we're proposing in the first place, a
7 fee per scan proposal.
8 MR. RICHARDSON: Thank you.
9 Those are all the questions I have. It's
10 late, Mr. Commissioner.
11 COMMISSIONER ACTON: Thank you, counsellor.
12 Any further cross-examination?
13 MR. TODD: Yes, just a brief follow-up.
14 COMMISSIONER ACTON: Would you please
15 identify yourself?
16 MR. TODD: David Todd on behalf of the Mail
17 Order Association of America.
18 FURTHER CROSS-EXAMINATION
19 BY MR. TODD:
20 Q You expressed a concern about people buying
21 platinum service when if they had any sense they would
22 have bought gold service and this apparently a large
23 part of your argument about fairness, but you also
24 have said that you're going to have to buy your units
25 ahead of time. Doesn't the subscriber face the same

1 dilemma in buying units ahead of time?

2 A Actually, I'd like to address a couple of

3 comments you made. One, I didn't question the

4 sensibility of our customers. I think they could

5 choose a lower option. Two, the possibility of buying

6 units, the system hasn't been developed but some of

7 the things that we've talked about is allowing them to

8 buy additional units on line and being notified when

9 the units were running low. The system has not been

10 developed yet, but they don't have to buy all their

11 units up front. They can start running low and then

12 choose to buy more units and that way they can be

13 unlikely to overpay.

14 Q Are you aware that this commission has

15 established rates for whole classes of mail that have

16 been very close to the attributable cost level of that

17 class and that afterwards it turned out that the class

18 of mail did not collect sufficient revenues to meet

19 the attributable costs?

20 A Yes, I am aware of that.

21 Q And would you not agree that given the

22 revenues involved in this service, the Confirm

23 service, that even if your fears are correct that the

24 risk to the Postal Service of a failure to recover

25 attributable costs is very, very low, is it not?

1 A The risk is quite low, but in protection of
2 my integrity, I was asked to develop a proposal that
3 would cover costs, not one that might cover costs or
4 one that was unlikely to cover costs, so I developed a
5 proposal that has an extreme high likelihood of
6 covering costs.
7 Q Did you say that the risks were relatively
8 low or they're extremely low? This is in the context
9 of the Postal Service with a $70 billion annual
10 budget.
11 A That's true. We're talking about 180
12 customers' ability to save a few thousand dollars.
13 Both yourself and Mr. Levy and the consumer advocate
14 suggest that this is a very high value service and
15 offers these customers a great deal of benefit.
16 I don't think that my proposal, the likelihood to
17 cover costs, should be ignored for a proposal that is
18 unlikely to cover costs.
19 MR. TODD: Thank you.
20 CHAIRMAN OMAS: Thank you, Mr. Todd.
21 Is there anyone else who wishes to
22 cross-examine?
23 Mr. Levy?
24 MR. LEVY: Thank you, Mr. Chairman. David
25 Levy again for NPCC and APM.

FURTHER CROSS-EXAMINATION

BY MR. LEVY:

Q This is a follow-up question to something OCA counsel asked you. I believe I heard you say that under your proposal the Postal Service would not need to track usage of scans for billing because scans are pre-purchased. Did you say something like that?

A The question as I understood it was will the Postal Service need to track scans so they can bill the customers. The Postal Service currently monitors the number of scans that are being used. Under my proposal, they would continue to have to monitor the number of scans that would be used, but there would be no need to bill because if the customer didn't have sufficient units, they would not receive scans.

Q So the Postal Service would still need to track how many of the pre-purchased scans were consumed.

A That is what we do today.

Q And the customer would presumably want to track how many of the pre-purchased scans were consumed to make sure that the Postal Service's count was correct.

A Just a second. If they wanted to ensure that they were being correctly billed for as little as

1 six one-thousandths of a penny for a scan, yes. But
2 I think that there is reason to think that the Postal
3 Service is not going to try to over-bill them to gain
4 six one-thousandths of a penny per scan.
5 Q People sometimes make inadvertent errors?
6 A That's true.
7 Q Software sometimes has mistakes in it?
8 A As we were talking before, when you wanted
9 to make the software change in an hour, and I was
10 suggesting we might want to use quality assurance,
11 that was the reason why.
12 Q Under the OCA proposal, customers would not
13 have to track the number of pre-purchased scans that
14 were being consumed in the platinum tier because in
15 the platinum tier you wouldn't be pre-purchasing any
16 specific number of scans.
17 A The 15 subscribers that remained in the
18 platinum tier, if the other ones bought down to gold,
19 the ones that bought down to gold, some of them will
20 be using additional scans and would need to monitor to
21 buy additional scans.
22 Q The answer to my question is yes?
23 A The answer to your question is -- I'm sorry,
24 can you repeat the question?
25 Q I'll repeat it and then I'd like you to

1 answer it. Customers in the platinum tier under the
2 OCA proposal would not need to monitor the number of
3 scans that they consumed.
4 A That is true.
5 MR. LEVY: Thank you.
6 That's all I have other than I neglected to
7 move into evidence and transcribe into the record NPPC
8 Cross-Examination Exhibits 1 and 2 and I would like to
9 do so now.
10 CHAIRMAN OMAS: Without objection, so
11 ordered.
12 (The documents referred to,
13 previously identified as
14 Exhibit Nos. NPPC-X-1 and
15 NPPC-X-2 were received in
16 evidence.)
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ICPA Washington DC
May 2006

UNITED STATES

NPPC-X-1

CONFIRM® SERVICE—THE USE OF BARCODE TECHNOLOGY TO MAXIMIZE EFFECTIVENESS AND MINIMIZE COST

Subtitle

Adding value through the use of Intelligent Mail®

Nick Barranca
Vice President, Product Development
United States Postal Service

Abstract

Originally developed to track mailpieces through the postal system, Confirm" has become a robust marketing and financial performance tool with wide application. Industries that benefit include financial, insurance, credit card. direct mail. mail order, retail, utility, and non-profit. Near-real time data gives these organizations, our customers, the current information necessary to be proactive in managing business, rather than just reactive IO information that may be weeks old.

Integrating Confirm data into current business practices puts valuable information in the hands of corporate decision-makers. This can increase the effectiveness of marketing efforts to time message delivery; coordinate message delivery with other marketing efforts; improve customer relationships; optimize call center performance; and enhance the effectiveness of future campaign strategies. Confirm data can also be used to improve financial performance through better management of payment receipts or cash flows that directly impact investment and borrowing decisions; improve operational efficiencies such as reducing collection costs and telemarketing effectiveness: adjust staffing levels based on anticipated mail volumes or retail traffic; and reduce fraud.

Confirm service provides decision makers with the ability to manage from "live mail" data, which increases the value of mail to foster business growth and improve operational efficiencies.

Introduction

In 1995, the Postal Service had concerns about the future growth of Standard Mail and its contribution to the overall stability of the USPS rate structure. The organization understood that for growth to occur there must be improved methods to predict mail delivery more accurately. It was felt that through the use of Confirm, mailers would he better equipped to predict delivery of Standard mailings and over time improve the coordination of Standard mailings in conjunction with other media advertising such as radio, TV and newspaper.

Confirm service uses barcoding technology – PLANET Code' barcodes – to help mailers track their First-class Mail", Standard Mail and Periodicals, letters, and flats. The Confirm program is explained in detail in USPS Publication 197.

CONFIRM Service User Guide which is available on the Confirm service web site: https://mailtracking.usps.com/mtr/resources/confirm/resources.pge.

PLANET Codes, used to help uniquely identify individual mailpieces, consist of a series of **tall** and short bars. PLANET Code symbology is the inverse **of** POSTNET Code symbology which is used to sort the mail. Each POSTNET Code digit uses a combination of two tall bars and three short bars and each PLANET Code digit uses three tall bars and two short bars.

Authorized subscribers place a **12-** or 14-digit PLANET Code on the front of their mailpieces, in addition to the POSTNET Code, to identify mailpieces uniquely. Within the PLANET Code, mailers embed their own information that helps them track the mailpieces through the mailstream. PLANET Coded mailpieces processed on automated equipment generate Confirm data which is captured and sent electronically in near real-time to the mailer.

Even though Confirm's original concept was that of an internal operations management tool when it was first introduced, Confirm® service was positioned as a value-added service that provided customers with electronic intelligence. This new service was designed to give customers electronic data for both outgoing and incoming reply mail. **By** meeting the needs of key customers, we also helped support the retention of the Correspondence and Transactions (First-Class Mail') business and the Direct Mail base (Standard Mail).

Aside from customer benefits, USPS also anticipated greater **mail** processing efficiencies. Information generated through the use of PLANET Codes would be used to facilitate a proactive approach to dealing with mail processing inefficiencies and problems. Confirm service was built **to** support service performance measurement that would, in the future, enable even more accurate tracking of mail through the postal system.

The benefits of the Confirm program touched several areas of CustomerPerfect! Initiatives, and later the Transformation Plan, including decreasing core business erosion, bringing in new revenue, increasing saving with processing efficiencies, and providing valuable customer information to augment marketing and financial business initiatives.

As for the future of Confirm, International Post Corporation conducted the first tests of mail tracking of ordinary letter mail using mailpiece barcodes. This was done using barcoded ID tagging on the back **of** the letters rather than the PLANET Code, but it is the principles of identifying and tracking that are important. Through adoption of common barcode symbologies on a worldwide basis, the time is coming when an international program with benefits similar to Confirm can become feasible, With Confirm, the **USPS** has already gained valuable experience that will help it **to** continue **to** play a leading role in improving the value of mail as a worldwide means of communication.

Background

The USPS has long functioned as a "black box" to mailers, who had become accustomed to the experience of entering mail and receiving a response without knowing what happened in between. For most of USPS history there was no other possible alternative. The technology did not exist to track mail pieces, aside from exceptional cases that involved high-value items, utilized labor-intensive processes, and wcrc available only for fees many times greater than ordinary postage rates. But more recently, it became both technically and economically feasible to change this situation.

There was much to be gained by changing USPS to a "glass box," its operations visible at a number of points. both to those responsible for those operations, and to the customers who submit the mailpieces. For mailpieces processed on automated equipment, the development of barcodes for sorting mail also brought the possibility of those same, or similar, barcodes, being used to identify the mail. This was done with a passive approach, in which the equipment read the tracking codes as a byproduct of sorting the mail. This was the basis on which the USPS has become more like a glass box into which customers and postal managers can look into the mailstream. This increased visibility is well suited for an institution that seeks to maintain public trust and confidence in its ability to perform well under all circumstances. The advantages of increased visibility show up not only in times of difficulty, but also in normal times, particularly for a majority of mailers who value consistency and reliability in mail service.

The Confirm program contains Destination Confirm and Origin Confirm, two distinct service types. Destination Confirm involves placing PLANET Codes on outbound mail pieces and requires that the mailer "start the clock" by providing a means for automated identification of the time of mail entry into the system. It has several major uses. Mailers of Standard Mail or Periodicals who use drop shipping are often trying to meet some goals in terms of the pattern of delivery of the mailpieces. Usually, this means getting mailpieces delivered, if possible, on a desired day, or within a window of three to five days, but it may also mean staggering the delivery to smooth out call center staffing or the flow of orders. The Postal Service provides delivery guidelines to help the mailer determine how to do this in a general way. Using Destination Confirm, more precise data are available, and by making some assumptions on the remaining time to deliver after the final scan is rcccivcd on a mailpiece, delivery dates can be estimated fairly accurately, and the drop shipping plan can be fine tuned for future mailings.

Besides uniquely identifying mailpieces. the mailer digits can also identify separate mailings, or separate segments of mailings, subdivided either by production variables such as date of entry. entry point or container number, or by marketing variables such as list code or offer code.

The USPS is able to provide multiple PLANET Code observations back on a single mailpiece, depending on the number of automated son operations required to deliver it. Certain mailers are interested primarily in the first observation, because it is the earliest opportunity to know that a mailpiece has been processed. With appropriate use of the mailer digits of the PLANET Code, it may be possible to infer that the container in which the mailpiece was entered has been processed, or even that the truck on which it arrived has been unloaded. Other mailers are interested primarily in the last observation, because it is the nearest to delivery. Depending on how close to the delivery office this observation occurs, and the operation code included with the data, the mailer may predict with reasonable accuracy when delivery is likely to occur.

Some mailers are interested in intermediate observations, because they show how the mailpiece works its way through the postal system. For example, a mailer in a position to choose between Bulk Mail Center (BMC), Sectional Center Facility (SCF), and perhaps Destination Delivery Unit (DDU) drop shipping based on costs and service performance could use the intermediate observations to find out whether faster delivery might be possible by increased use of drop shipping.

For mailings that must be coordinated with telemarketing efforts, knowing the probable day of delivery can make a major difference. The telemarketer cannot, after all, follow up on a mailing that has not yet been delivered. But calling the recipient too many days after delivery risks the mailpiece having been forgotten or discarded. Synchronization of the call with the delivery provides a direct economic benefit to these programs.

Origin Confirm involves placing PLANET Codes on inbound reply mailpieces to support cash flow management and allow faster processing of purchases and information requests. It uses PLANET Coded business or courtesy reply piece to inform a recipient that a mailpiece will be coming before it arrives. The mailpiece could be a subscription renewal, an authorization for a mortgage payment, or a request for information. There is no need for a Confirm subscription identifier within the PLANET Code because the piece can be differentiated by the POSTNET code. As a result, there are at least nine digits available to the mailer to uniquely identify the transaction.

To illustrate, many companies use a series of dunning notices, sent out at intervals until a payment is made, to remind customers of their obligation to pay. Knowing that the payment is on the way could eliminate the need for sending additional notices, which forms better customer relations and saves money. In the long run, greater efficiency in using the mail is more important than the postage generated by these pieces (a temporary benefit) because the mail has greater value to the customer (providing long-term value).

Development stage

Confirm was conceived in 1995 as a means to give mailers and postal managers tracking information on First-Class Mail and Standard Mail pieces. **USPS** decided that the Confirm service should be built around **PLANET** Code technology, which had already been developed **as** a feasible approach for generating mail tracking information. This technology was chosen because: (1) it already existed and did not have to be developed from scratch; and **(2) PLANET** Code is a two-state barcode similar to **POSTNET** Code, making it relatively easy to be implemented by **USPS** and accepted by the mailing industry.

USPS worked with the Mailers Technical Advisory Committee (MTAC), a work group made up of postal managers and mailing industry professionals, to develop processes and guidelines to track ordinary mailpieces through the postal system. The outcome was the introduction of Confirm service pilot program in 1998.

It is important to understand that the primary function of the Confirm program is to enhance the value of mail as a means of communication. **A** firm using television advertising knows exactly when the message will be delivered. If it uses newspaper advertising, the delivery **of** the message is also subject to control within a matter of hours. But mail delivery, especially Standard Mail, has a greater degree of variability. Mailers have long understood this and have known that the rates they pay are partly based on the value of the service they receive for a particular mail class. Nonetheless, this variability detracts from the value of the service. Mailers have sought to compensate for this variability through means under their control such as drop shipping and meeting critical **entry** times. Being able to follow the course of the mail through the system provides a new opportunity to measure this variability, ***to*** gain knowledge of it, to adjust to it, and over time to reduce it, without blurring the identity **of** mail classes or diminishing the distinctive features or service expectations of any mail class.

Automated postal equipment was configured to read **PLANET** and POSTNET codes easily and reliably. Mailers fall into three groups when it comes to interest in tracking mailpieces. The first group wants to make extensive and regular use **of** the **PLANET** Code in **order** to track virtually all mail pieces. Others only want to use the **PLANET** Code as a sampling technique to obtain data sooner than conventional seeding methods. This second group **uses** the **PLANET** Code regularly but seiectively. The third group **wants** *to* know where the mail is during times of difficulty or to resolve problems that are the exception to the norm.

In 1998, the **USPS** established a pilot program for **Confirm** allowing customers to use the service free of charge as it was being developed. The **USPS** established a prototype system in Wilkes-Barre, **PA** to collect Confirm data corning in from major postal facilities and transmit it to Confirm customers via an automated **FTP** process. Later in 1998, the **USPS** established a prototype web site for customers wishing to view and download relatively small **amounts** of data at their convenience.

By June 2000, Confirm demand exceeded the capacity of the prototype system. To meet this added and future demand, USPS moved the system to Raleigh, NC and implemented the first major system upgrade. At the same time, anticipating Confirm's growth, it expanded customer support at the Memphis National Customer **Support** Center. Confirm had over 800 mailers in its pilot program.

On October 1,2001, the production version of the Confirm system was launched. The Advance Shipping Notice (ASN) was required, though a transition period gave mailers time to comply with the new requirement. This is how the Postal Service determined the "start the clock" for potential **use** in service performance measurement. The Postal Service redesigned the system and moved its operation **to** Eagan. MN in order to take advantage **of** that facility's superior technology capabilities. The new system enabled improvements to Confirm, including:

- Increased data capacity and processing power
- Near real-time access to Confirm data from the web site
- Expanded PLANET Code functionality
- Verification of time mailings were accepted by the Postal Service
- Dedicated customer support

In addition, the new system enabled the Postal Service **to** utilize **Confirm** data to measure and improve overall mail processing performance nationwide.

In 2003. the system was modified to provide shared service performance reports. To **ensure** report accuracy, the Postal Service began requiring Confirm customers to submit Pre-Shipment Notifications via Electronic Mailing Data (EMD) – a replacement for the old ASN format. This gave USPS data concerning the date and locations for future mailing and the PLANET Codes being used within each mailing. The **Postal** Service also required Confirm customers **to** demonstrate their ability to correctly print PLANET Codes and Shipment ID (i.e. start-the-clock) barcodes as part of the application process.

In October 2004, the Confirm shared report functions were redesigned to improve performance. The two service performance reports, Delivery vs. Service **Goal** Report and **In** Home Window Delivery Report, are currently available to all subscribers. They provide service performance measurement by mailing based on USPS service standards and mailer compliance with program business rules. This is a foundation for potential service performance measurement tools in the future.

Present situation

The program currently has 200 paid subscribers generating in excess ***of*** 800 million scans **per** month. The number of subscribers does **not** reflect the cottage industry which has grown as a direct result of the program. Approximately half of all subscribers are resellers of Confirm service. They vary from **full** service providers who maintain data bases. develop PLANET Codes for mailings,

perform data analysis, and have developed customized reports for as many mailers as are willing to pay for them. In some cases, these service providers or resellers have several hundred customers while others provide Confirm service to a few key customers as a value-add in addition to other mailing service.

Pricing was originally established based on the value-add that the data provides the customers when used in combination with their marketing and financial intelligence. Because Confirm provides raw scan data to the customer, it is the customer's responsibility to transform it into meaningful information that the company can employ in making business decisions. This requires additional programming resources which are often difficult to justify for small to mid-size companies. These challenges led some companies to decide to use an outside vendor having expertise in developing reports and in-depth understanding of postal processing systems in order to analyze Confirm data.

In 2005, Confirm began certifying subscribers in an effort to ensure more accurate EMD data was provided in the pre-shipment information. This process has led to only 2 customers out of 6 being certified and 4 declined to participate at the time it was originally offered for pilot customers.

Pricing

For a time there was an industry debate, with some mailers taking the position that the PLANET Code should be a free service, while others felt there should be a charge for it. Those favoring a free service argued that the USPS was the major beneficiary of the PLANET Code, and should want as many mailers as possible to use it. What price could attract more users than no charge at all?

For example, if some mailers inform the Service of upcoming large mailing events, this allows for some degree of planning. But if all large mailers all give advance notice of upcoming mailing events, then workload can be predicted, staffing adjusted, equipment utilization optimized, and productivity increased. Therefore. it only makes sense to encourage high participation rates through an attractive pricing policy.

Confirm is a product that presented several challenges to the traditional USPS and Commission approach when pricing services. Like many other electronic products, Confirm's costs were/are mostly fixed. In contrast, the per-usage costs were extraordinarily small, so small that they approached zero. In addition to these technical issues, Confirm presented some novel and interesting policy concerns that needed to be addressed when pricing the product. Confirm was a service that would benefit not only postal customers, but also present the USPS with a novel view of it5 operations that may lead to important performance measurement benefits. While customer benefits begin to accrue at almost any level of usage, USPS greatest benefits were expected to flow from widespread usage of the product. This attribute, it was determined, justified a pricing stance that promoted product usage.

Confirm service enhances and adds value to first-class mail, standard mail, and automated periodicals. It allows a degree of mail tracking and improved delivery predictability that otherwise would not exist within these mail classifications. Confirm provides large business mailers with a cost-effective way to pain valuable information **to** enable them to use mail more efficiently in their operations. The use of Confirm by business mailers is transparent to the general public and the public experiences no increase in the rates they pay. Only those business mailers who choose to subscribe to Confirm pay for the service, and our market research indicates that those who sign up believe they receive benefits that fully compensate them for the proposed level of fees.

With these alternate delivery channels, mailers can often identify the delivery date of their materials with a reasonable degree of certainty. Confirm simply adds this capability to mail and in no way gives the **USPS** an unfair advantage in the marketplace for delivering such materials. Confirm, by enhancing hard-copy letter mail, allows it to compete more effectively against electronic alternatives, and helps resist potential erosion of letter mail volumes to electronic channels

As Confirm was being developed, **USPS** considered two distinct approaches to pricing the product. These approaches were referred to as transaction based pricing and subscription based pricing.

Transaction Based Pricing

This was the familiar approach underlying most **USPS** pricing. Customers paid a set charge for every unit of product or service they purchased. The unit charge covered all costs of the product, both fixed and marginal. and contributed toward **USPS** institutional costs.

With most postal products, the marginal costs of additional mailpieces constitute a large portion **of** a product's attributable cost. Confirm was considered different in this respect. Once Confirm hardware **and** software were in place, the **cost of** additional scans was extremely small. **A** transaction-based price then would exceed the true marginal cost by a large factor. This would be economically inefficient pricing, and would likely produce several undesirable outcomes:

- **It** would lead some potential customers to restrict usage by barcoding only some mailings or by just "seeding" barcoded pieces in larger mailings. Limiting the number of barcoded pieces both would diminish the value of the information received by the customer but, more critically, impair use of the Confirm product for measuring operational performance.
- It would **also** increase administrative costs since 'each transaction would have to be tracked and billed.
- It would increase the difficulty ***of*** projecting Confirm revenues, since revenues would fluctuate depending **on** customers' potentially volatile needs.

Subscription **Based** Pricing

The simple alternative to pricing Confirm by the number of scans was a subscription price. Under this approach, customers paid a *fixed* fee to use Confirm for a specified period of time. During the Subscription period they could use the service without paying *for* each transaction. Pricing by subscription had several attractive features:

- It encouraged Confirm subscribers to place barcodes on all mail rather than limiting usage to occasional mailings. or seeding barcodes within mailings.
- It was easy to administer, since the USPS billed for a limited number of subscriptions. rather than tracking and billing all transactions.
- It made Confirm revenue forecasting easier, since the number of subscriptions would likely be more stable than the number of barcoded pieces mailed.

After giving consideration to these two approaches, the USPS decided that subscription based pricing would better meet the goals established for the Confirm product and it was the model tested in the Confirm market research.

The pricing proposed was expected to covers all Confirm's costs and makes a reasonable contribution toward the **USPS** institutional costs. Confirm's cost coverage for FY **2003** was expected to be close to 200%. This was the first year that the USPS would be charging for the service. During the test phase Confirm had over 800 subscribers. While several important factors were taken into consideration including the fact that it was a new product and neither its usage nor costs could be projected with the highest degree of certainty, the anticipated revenues were well below what was anticipated. Subscriber levels fell to **48** and grew to only 114 by the end of the first year. The new fees and added requirements for pre-shipment notification contributed to the dramatic fall in subscriptions. On the positive side, these resulted in even more customers using Confirm. Many customers found that using resellers or vendors gave them data analysis and reports more easily than developing them with their IT departments. It is estimated that Confirm users exceed 1000 as of October **2005.**

Subscriptions have continued to increase over the past two years and new pricing changes are currently under consideration for 2007.

Creating value

The decision to position Confirm as a value-add to customers was very cutting-edge at the time it was proposed. This was the first service that was not priced based on the cost to provide the scan data which is negligible, but priced based on customer feedback on the value they felt they could gain from the scan data. Based on the variety of applications that have made use of Confirm data to improve their business, Confirm has proven to be very valuable. The following are but a **few applications used by** Confirm **users.**

8

A consulting firm has a patent pending on its own product and service that utilizes Confirm data to monitor third party remittance processors. Its clients can now monitor the processor's timeliness against the terms of service level agreement. One client experienced a 70% improvement and another demonstrated a 91% improvement in overall remittance processing network timeliness. The consulting firm also has customers who have reduced collection efforts and costs by 30%; a 10% reduction in dunning notices; and they have also experienced significant improvements in cash flows.

A retailer uses Confirm to monitor delivery of First-class and Standard mailings. This has allowed them to improve the timing of their mail drops to better achieve in-home delivery dates and maximize the effectiveness of their advertising and promotions to increase response rates. The data allows them to evaluate potential delays and to be proactive in providing their stores with guidance on how to handle customer inquiries concerning sale dates, keeping customers happy and eliminating embarrassing in store situations. They have also used the data to monitor their vendors' performance. Another retailer uses Confirm to evaluate the habits of their customers. "We know through this data when they receive the mail and how long it takes them to come into the store...Is a coupon better? Is just an offering better?... [and] when we know the customer has the mail, and we have an email address, we can use this to reference the mailing that they just received."

A large bank uses Confirm to code over 20 million pieces of mail each month. It has used the data to become more intelligent about the way it produces and presents the mail. Using the data to develop delivery trends and analyzing customer reply habits has enabled the bank to vastly alter its collection call centers and save over $1 million per month!

A national training provider used Confirm to evaluate the effectiveness of its mailings. In doing so it was able to restructure its processes and mailing schedule for training sessions. This allowed it to use the advertising budget more effectively with additional mailings targeted at developing relationships with customers. These, in turn, generated increased attendance at training sessions and yielded additional referrals.

A very large credit card issuer uses destination and origin Confirm. Destination Confirm gives additional security to outgoing pieces because the company can identify potential problems quickly and contact the Inspection Service if fraud is suspected. Origin Confirm indicates if the check or envelope is REALLY in the mail. The issuer uses it to manage cash flow within the company and has made call center changes resulting in increased efficiency and customer satisfaction.

Aside from the various customer applications that have emerged for Confirm, the USPS also utilizes PLANET Codes to improve service performance. Plants use Confirm daily to diagnose problems with automation mail flows and equipment

and can take corrective actions to resolve the issues. Several plants have indicated that use of PLANET Codes has helped them increase their service performance scores and in some cases this has also resulted in lowering transportation costs.

Conclusion

Current Confirm customers have made it clear they want Confirm to enhance their marketing efforts and customer relationships, and save money by improving operational cfficiency. By continuing to offer mailers Confirm generated information, the USPS looks to improve customer satisfaction with the mail.

Confirm constitutes a key step in providing a value-added service not just in delivery of mail, but also in delivery of information. This information is used by the USPS as a performance measurement tool and facilitates a proactive approach to assess and correct mail processing inefficiencies. Confirm represents a definite "win-win" for the USPS and its customers.

ICPA Washington DC
May 2006

NPPC-X-2

Postal Rate Commission
Submitted 4/24/02

USPS-T-5

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

CONFIRM

Docket No. MC2002-1

DIRECT TESTIMONY
OF
JAMES M. KIEFER
ON BEHALF OF
UNITED STATES POSTAL SERVICE

LIST OF ATTACHMENTS

Attachment A Projected Demand For Confirm@

Attachment B Projected Revenue From Confirm"

Attachment C Proposed Confirm" Classification and Pricing Details

Attachment D Financial Summary for Confirm@

I. PURPOSE OF TESTIMONY

My testimony presents the Postal Service's pricing and classification proposals for Confirm@.My testimony describes the design of the new fee and classification changes, and discusses the financial impacts of my proposals. My testimony also shows how the proposed classification and fee changes are consistent with the classification and pricing criteria set forth in the Postal Reorganization Act.

In developing my testimony I have relied on the testimony and work of several other witnesses. These witnesses are identified in my testimony. Detailed citations are given in the attachments. There are no workpapers or library references directly associated with this testimony.

III. RATIONALE FOR CLASSIFICATION AND PRICING PROPOSALS

A. Pricing Issues

Confirm@is a product that presents several challenges to the traditional approach used by the Postal Service and the Commission when pricing services. Like many other electronic products, Confirm's costs are mostly fixed. In contrast, the per-usage costs are extraordinarily small, so small that they approach zero. In addition to these technical issues, Confirm@presents some novel and interesting policy concerns that need to be addressed when pricing the product. Confirm@is a service that benefits not only postal customers who use it, but also the Postal Service by providing a novel view of its operations that may lead to important performance measurement benefits. While the customer's benefits begin to accrue at almost any level of usage, the Postal Service's greatest benefits flow from widespread usage of the product. This attribute justifies a pricing stance that promotes product usage.

B. Potential Pricing Approaches

As Confirm® was being developed, the Postal Service considered two distinct approaches to pricing the product. These approaches, described below, can be referred to as transaction based pricing and subscription based pricing.

Transaction Based Pricing

This is the familiar approach underlying most of the Postal Service's pricing. Customers pay a set charge for every unit of product or service they purchase. The unit charge covers all costs of providing the product, both fixed and marginal, as well as makes a contribution toward the Postal Service's institutional costs.

- It is easier to administer than transaction based pricing, since the Postal Service would have to bill for a limited number of subscriptions, rather than tracking and billing all transactions.
- It would make Confirm' revenue forecasting easier, since the number of subscriptions would likely be more stable than the number of barcoded pieces mailed.

Along with these advantages, pricing by subscription also presents several challenges that, while not insurmountable, require that they be addressed with care to preserve the full benefits of the subscription approach. These issues will be explored more fully in the Rate Design section.

After giving consideration to these two approaches, the Postal Service decided that subscription based pricing would better meet the goals established for the Confirm® product (see the testimony of witness Bakshi—USPS-T-I—for a detailed discussion of the goals of Confirm®), and subscription pricing was the model tested in the Confirm® market research.

C. Rate Design

While using subscription based pricing may better reflect the cost causation for Confirm'. it does raise several other issues. These are the level of the subscription price, and what services would be offered for the basic subscription price. Related to the second issue is whether to offer different kinds of subscriptions and service enhancements with different fees for each.

The Gold subscription offers a basic set of service features that is expected to meet the needs of most of the target customer group. For customers who require a premium level of service, the Postal Service is proposing the Platinum subscription. This subscription offers the highest level of service, with extra ID Codes and unlimited scans. These customers can be charged a premium subscription fee, reflecting the higher level of service offered by the Platinum subscription.

3. Service Expansion Features

The Postal Service is aware that some potential customers may find that they outgrow their initial service levels and, therefore, would like to expand to one or more service features without graduating to the next tier. For example, a customer who was interested in sending out a large, one-time mailing might find that the Silver subscription would be the most cost effective choice, except that the number of scans offered in the basic Silver subscription, 15 million, was too few to adequately service the mailing. Rather than requiring this mailer to upgrade to a Gold subscription, the Postal Service is proposing to allow the customer to purchase service expansions. Customers in each tier would be able to purchase additional scans or additional ID Codes.[2]

Not only would this unbundling of service features permit customers to tailor Confirm® to meet their own requirements in a cos!-effective manner, it also would help to keep subscription fees down. Rather than build higher levels of service into the standard subscription tiers, and collect higher subscription fees from all customers, the Postal Service believes that only those customers who need the expanded service should pay. Incorporating service feature unbundling

[2] **Subscribers to the Platinum service already receive unlimited scans, so their service expansion options are limited to purchasing additional ID Codes.**

At the request of Postal Service management, witness Rothschild quantified how many subscriptions and service enhancements would be purchased by only those customers whose probability of purchase was 80% or higher. The Postal Service believes that the projections of subscriptions and service enhancement purchases derived using this 80% probability cutoff represents a reasonable, conservative and appropriate forecast of demand for the new Confirm® service. Both witness Nieto (USPS-T-3) and I have adopted this forecast for the purposes of developing the cost and revenue projections we are filing in this case.

Attachment A to my testimony presents a summary of the demand forecast. For each price point the attachment shows the number of subscriptions and service enhancements, adjusted for probability of purchase, for those potential customers whose probability of purchase was at least 80%. Comparing the customer response at the two price points makes it immediately apparent that the demand for Confirm® is highly price elastic.

Attachment B shows the projected revenue produced from pricing Confirm@at both the high and low price points, using the forecasted volumes from Attachment A. Pricing Confirm@at the high price points yields projected annual revenue of $5.3 million. Offering Confirm® at the low price points produces projected annual revenue of $9.2 million. The fact that lower prices generate much higher revenue is further evidence of the high price elasticity of demand.

I propose that the Commission recommend Confirm@as a new product classification, with each tier and expanded service option priced using the low price points tested in the market research. Attachment C summarizes my classification and pricing proposals.

R2001-1 omnibus rate case (180% over volume variable costs)! I believe my proposal is reasonable, particularly so when several important factors are taken into consideration.[5]

- Confirm@is a new product and neither its usage nor costs can be projected with the highest degree of certainty. For this reason it is reasonable to build an extra "safety margin" into the rates to ensure that the product covers its costs and does not impose any net burden on the Postal Service.
- If adoption of Confirm@turns out to be slower than anticipated, program management might find it advisable to enhance the promotion campaign for Confirm®. Having a cushion built into Confirm®'s net revenues would permit management to increase advertising expenditures if needed to meet program goals without concerns that additional promotions might cause Confirm@to fail to cover its costs.

My proposal to price Confirm@at the low price points tested in the market research produces a win-win situation. The lower prices for subscriptions extend the opportunity for a wider range of mailers to enjoy the benefits from using Confirm@. Lower prices for additional scans will encourage mailers to use Confirm" on more mail pieces, again benefiting mailers, while better helping the Postal Service to achieve its monitoring goals. In addition to these tangible benefits for both mailers and the Postal Service, the lower prices generate higher

[4] On April 8.2002, the Postal Service Governors adopted the Recommended Decision of the PRC on rates and fees proposed in Docket No. R2001-1. Due to a settlement reached in that proceeding, the approved rates and fees differed slightly—but not materially–from those initially proposed by the Postal Service, however, the overall cost coverage remained the same.

My testimony here, however, should not be interpreted to suggest that these factors necessarily *require* a cost coverage above or near the system-wide average. Instead. these factors show why such a cost coverage is not unreasonable under circumstances in which the market research

a Confirm' customer were nonetheless to apply PLANET Codes to mail pieces in excluded subclasses, there would be no way for the Postal Service to prevent the customer from receiving scan data if sortation occurred on automated equipment.

The Availability subsection of proposed DMCS 991 does identify the prerequisites for use of Confirm', which amount to payment of a subscription fee, assignment of one or more ID codes, and technically compliant mail pieces.

The Postal Service has identified no operational or other basis for precluding the use of any particular special service together with Confirm@. It seems more prudent to permit customers to choose those options they prefer, incidental to their participation in Confirm®. Accordingly, DMCS subsection 991.41 states that Confirm' neither precludes nor requires any other special services.

of mail flows to business mailers. and enables them to manage direct mail campaigns more effectively. and to respond more cost-effectively to customer responses. Confirm'' also can provide valuable information to the Postal Service by allowing it to monitor mail flows in real time and observe where and how mail processing bottlenecks occur. These features make Confirm@both valuable and desirable to both the Postal Service and its customers (Criteria 2 and 5).

Confirm'' is offered to customers who mail First-class Mail and Periodicals. These mail classifications generally are given priority in processing to ensure that they are delivered speedily and reliably. By enabling mailers to predict the delivery dates for their mail better, Confirm'' enhances the reliability of these types of mail and makes them more effective for marketing purposes. Confirm'' also increases a business' ability to manage incoming reply mail more cost-effectively. These features add important value to users of First-class Mail and Periodicals (Criterion 3).

Confirm'' is also offered to customers who mail Standard Mail, which receives a lower level of service than First-class Mail. Many mailers use Standard Mail for direct marketing or, in the case of nonprofit mailers, to solicit contributions for charitable causes. Because of its lower service level, it can be more difficult to predict the time between mailing and delivery for Standard Mail than for First-class Mail. Confirm® allows Standard Mail users to predict when their materials will arrive in their customers' homes and time their activities to enhance the effectiveness of their follow-up efforts. This capability offers important value to users of Standard Mail (Criterion 4).

The proposal to establish Confirm' as a classification reflects a balanced consideration of all relevant criteria. Confirm' meets the needs of customers by providing a valuable service enhancement to users of several mail classes. It also enables the Postal Service to better monitor mail flows and processing

V. PRICING CRITERIA

Section 3622(b) of USC Title 39 requires the Commission to make its recommended decision on changes in rates and fees in accordance with the following factors:

(1) the establishment and maintenance of a fair and equitable schedule;

(2) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;

(3) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;

(4) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;

(5) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;

(6) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;

(7) simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;

(8) the educational, cultural, scientific, and informational value to the recipient of mail matter: and

(9) such other factors as the Commission deems appropriate.

reasonable degree of certainty. Confirm'' simply adds conceptually similar capability to Postal Service mail and in no way gives the Postal Service an unfair advantage in the marketplace for the delivery of such materials (Criteria 4 and 5).

Several alternatives also exist for letter mail that might use Confirm@ service. Business mailers and their customers can communicate orders, bills, payments, statements of account, solicitations, and similar letter mail using fax and Internet communications like e-mail. Confirm@by enhancing the use of hard-copy letter mail, allows hard-copy mail to compete more effectively against electronic alternatives, and helps to resist potential erosion of letter mail volumes to these electronic channels (Criterion 5).

Furthermore, Confirm® does not alter or affect the degree of preparation required for eligibility for worksharing discounts, or the size of the discounts themselves. Customers who wish to participate in the Confirm'' program will be required to prepare mail in certain ways, such as applying PLANET codes as specified by the Postal Service. These preparation requirements are discussed in general in witness Bakshi's testimony, and are presupposed in the cost estimates developed by witness Nieto and in my pricing proposals (Criterion 6).

Introduction of a new product always adds some degree of complexity to the mail classification schedule. In the case of Confirm@the added complexity is warranted for several reasons. First, the customers for Confirm' are large, sophisticated business mailers who are accustomed to dealing with complex postal rate schedules and regulations. Adding a new classification and associated fees should not constitute a significant burden for them. Second, the overall pricing structure for Confirm@is relatively simple in comparison to its benefits. On the whole, the Confirm@pricing structure achieves a reasonable balance between simplicity and the goal of having identifiable relationships between fees and the level of services offered (Criterion 7).

Attachment A

Projected Demand For *Confirm* Low Price Point

	Silver		Gold		Platinum	
	Price	Quantity	Price	Quantity	Price	Quantity
Basic Subscription	$2,000	111	$4,500	654	$10,000	361
Additional Scans	$500	37	$1,500	186	---	---
Additional ID Codes	$500	144	$2,000	364	$2,000	653

Projected Demand For *Confirm* High Price Point

	Silver		Gold		Platinum	
	Price	Quantity	Price	Quantity	Price	Quantity
Basic Subscription	$4,000	132	$7,500	289	$20,000	80
Additional Scans	$500	53	$1,500	150	---	---
Additional ID Codes	$500	25	$2,000	197	$2,000	150

Source USPS-LR-1/MC2002-1, Table 9a (Low Price Point data) and Table 9b (High Price Point data).

1 CHAIRMAN OMAS: Is there anyone else?

2 Mr. Rubin, would you like some time with

3 your witness?

4 MR. RUBIN: Yes, I would. Because of the

5 amount of cross, I think we'd like 10 minutes.

6 CHAIRMAN OMAS: Okay. We understand.

7 Thank you.

8 (A brief recess was taken.)

9 CHAIRMAN OMAS: Mr. Rubin?

10 REDIRECT EXAMINATION

11 BY MR. RUBIN:

12 Q Mr. Mitchum, during the cross-examination by

13 OCA counsel, there were several instances in which the

14 discussion of Confirm proposals not covering costs

15 being an issue for a future case. Do you believe that

16 cost coverage for Confirm is primarily an issue for a

17 future rate case?

18 A I believe that the cost coverage for the

19 proposals are relevant to this case.

20 Q And would that be an issue that the Postal

21 Rate Commission should consider in recommending

22 something for Confirm in this case?

23 A Yes. I disagree with the OCA's counsel that

24 this is something that should not be considered until

25 the next rate case. I think it should be addressed in

1 this rate case.

2 MR. RUBIN: That's all I have.

3 CHAIRMAN OMAS: Is there anyone else who

4 wishes to recross?

5 Mr. Levy?

6 MR. LEVY: That does prompt a question.

7 RECROSS-EXAMINATION

8 BY MR. LEVY:

9 Q Should the commission also consider the

10 possibility that under a scan based fee schedule that

11 you're proposing that the number of scans will be

12 higher than you've calculated and that the service

13 will be much more profitable than you've calculated?

14 A If the commission believes that's a

15 possibility, then I would encourage them to do so.

16 Q How many scans do you think you'll have in

17 the test year under your proposal?

18 A I think OCA calculated it or estimated it

19 for me and I think it was around 11 billion.

20 Q How many scans does the Postal Service think

21 it's going to get in the test year?

22 A Subject to check, I'll agree with the

23 consumer advocate that it's about billion.

24 MR. LEVY: That's all I have.

25 CHAIRMAN OMAS: Thank you, Mr. Levy.

1 Is there anyone else?

2 (No response.)

3 CHAIRMAN OMAS: There being none,

4 Mr. Mitchum, that completes your testimony here today.

5 We appreciate your contribution to the record and you

6 are now excused.

7 THE WITNESS: Thank you very much.

8 (The witness was excused.)

9 CHAIRMAN OMAS: There was a written

10 objection to the testimony of our final witness

11 scheduled today, Mr. Cameron Bellamy. I ruled on that

12 objection yesterday in Ruling No. 115. There has been

13 no request for oral cross-examination of this witness.

14 Mr. Levy, would you please assist us to

15 receive a corrected version of Mr. Bellamy's testimony

16 into evidence, please? Whichever way you choose,

17 Mr. Bellamy can come up and verify it since he is

18 here.

19 Mr. Mitchum, you're excused, sir.

20 Mr. Bellamy, would you stand, please?

21 Whereupon,

22 CAMERON BELLAMY

23 having been first duly sworn, was called as

24 a witness herein and was examined and testified as

25 follows:

1 DIRECT EXAMINATION

2 BY MR. LEVY:

3 Q Mr. Bellamy, you have before you two copies

4 of a document marked GHS-ST-1. Do you recognize

5 those?

6 A Yes, I do.

7 Q Those are in fact your written supplemental

8 testimony in this proceeding?

9 A Yes.

10 Q That document was prepared by you or under

11 your supervision?

12 A Yes, it was.

13 Q If you were asked to testify orally about

14 the subject of your testimony, would be your oral

15 testimony be the same?

16 A Yes, it would.

17 Q Do you have any changes you wish to make to

18 the two pre-filed copies?

19 A No, I do not.

20 Q And you adopt it as your testimony?

21 A Yes.

22 MR. LEVY: Mr. Chairman, I'm going to

23 approach the witness, take the two copies, give them

24 to the reporter and ask that the testimony be admitted

25 into evidence.

1 CHAIRMAN OMAS: Is there any objection?
2 (No response.)
3 CHAIRMAN OMAS: Hearing none, Mr. Levy,
4 please provide the reporter with two copies of the
5 corrected testimony of Cameron Bellamy. That
6 testimony is received into evidence. However, as is
7 our practice, it will not be transcribed.
8 (The document referred to was
9 marked for identification as
10 Exhibit No. GHS-ST-1 and was
11 received in evidence.)
12 CHAIRMAN OMAS: Thank you, Mr. Bellamy. We
13 appreciate your appearance here and your verification
14 of testimony. You are now excused.
15 (The witness was excused.)
16 CHAIRMAN OMAS: This concludes today's
17 hearing. We will reconvene tomorrow morning at 9:30,
18 when we will receive testimony from witnesses
19 McCleary, Bradley and Crowder.
20 Have a good evening.
21 (Whereupon, at 7:55 p.m., the hearing was
22 adjourned, to be reconvened the following day, Friday,
23 December 1, 2006, at 9:30 a.m.)
24 //
25 //

11447

REPORTER'S CERTIFICATE

DOCKET NO.: R2006-1

CASE TITLE: Postal Rate and Fee Changes, 2006

HEARING DATE: 11/30/06

LOCATION: Washington, D.C.

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the Postal Rate Commission

Date: 11/30/06

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