

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

POSTAL RATE AND FEE CHANGES, 2006

DOCKET NO. R2006-1

**INITIAL BRIEF OF THE
ASSOCIATION FOR POSTAL COMMERCE
AND THE
MAILING AND FULFILLMENT SERVICE ASSOCIATION**

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The Association for Postal Commerce and the Mailing and Fulfillment Service Association (herein, collectively PostCom) submit this brief in support of the positions it has advocated in Docket No. R2006-1.

EXECUTIVE SUMMARY

Certain of the issues that we address in this brief are all too familiar: the Postal Service persists in its refusal to establish drop entry and presort discounts for Standard Regular and ECR mail that fully reflect the avoided costs of these worksharing efforts; it opposes alignment of the Heavy Letter category with the manner in which letter-shaped mailpieces actually are processed; and it continues to ignore and make rate adjustments to account for inexplicable cost fluctuations of the Bound Printed Matter and Media Services subclasses.

Other questions that the Commission must address, as detailed in our brief, are entirely novel: the Postal Service has cobbled together two new categories of Standard Mail – Not Flat-Machinables (“NFM’s”) and Standard Regular Parcels; relying on conjecture and surmise, it has proposed rate increases for these categories that can only be characterized as punitive.

Separately, PostCom has asked the Commission to undertake a long overdue reexamination of the rate design for Media Services.

Our positions may be summarized as follows:

- The Commission has insisted that, absent countervailing considerations, worksharing discounts – and particularly drop entry discounts – should fully reflect efficient component pricing. Nonetheless, the Postal Service has declined to adhere to that precept in its proposed passthroughs for Standard Regular and ECR drop entry discounts, offering less than 90% of avoided costs for each of those discounts. The record in this case establishes unmistakably that setting the discounts for drop entry and for presortation at the full measure of avoided cost will not have any significant push-up effect and will further the Postal Service’s own goals by promoting increased palletization. The drop entry and presort discount proposals advanced by PostCom Witnesses Glick and Pursley should be adopted.
- In its 2001 Decision, the Commission favorably recommended what amounts to a “fletter” rate category within First-Class, Standard Regular and ECR mail: letter-shaped pieces weighing between 3.3 and 3.5 ounces are no longer charged the full automation flats rate. Despite the candid admission by its witnesses that pieces meeting the dimension of a letter, but weighing more than 3.5 ounces, regularly are run on letter sorting equipment and despite the absence of any credible tests or surveys that might otherwise justify its position, the Postal Service

maintains its historic opposition to any increase in the weight limit of the flatters rate category in this case. It is both unfair and discriminatory, in violation of the basic precepts of the Postal Reorganization Act, to impose what amounts to an arbitrary weight limitation on mailings which can be and, in fact, are treated as letters and to charge mailers as if these pieces were flats. The maximum weight limitation applicable to Heavy Letters should be increased as PostCom has proposed.

- The Postal Service, for reasons which remain murky, has decided that certain mail heretofore meeting the definitions of automation flats should be recategorized and repriced as NFM's, with resultant rate increases of 97%. As a simple matter of law and public policy, the Postal Service's NFM proposal cannot be accepted as it stands. Indeed, the Postal Service's own pricing witness conceded that mitigation of the rates proposed for NFM's is appropriate. The record compels that outcome: changes in the definitions made during the case itself means that the Postal Service has no idea of the volume (or the mix by presort level) of mail that will fall into this category. The estimation of underlying revenues and costs related to NFM's is equally of little value because it relies on assumptions that were contradicted by the later-developed mail preparation rules. The Commission must, at the very minimum, substantially reduce the rates the Postal Service has proposed and align them with, or move them much more closely to, the rates proposed for

non-automation flats. Increases of 97% are not merely unsupported and irrational; they are unconscionable.

- The rationale underlying the rate increases that the Postal Service has proposed for Standard Parcels fares no better than its NFM proposal. Despite facing increases that approach and in some cases exceed 50%, the Postal Service makes no serious effort to deal with the problem of rate shock. To the extent that the Postal Service has attempted mitigation, it has done so only from the top down, it has ignored potential differences in price elasticity as between Standard Parcels and other Standard Mail and it has, of necessity, made arbitrary and utterly unrealistic assumptions as to the avoided costs the Postal Service will realize through presortation and drop entry. The result is the creation of perverse incentives for mailers to produce non-machinable parcels -- an outcome that the Postal Service itself recognizes that the Commission should not countenance. The Commission should accept the mitigation proposal advanced by PSA/PostCom Witness Glick and should provide mailers with sufficient presort and drop entry discounts to further mitigate the proposed rates.
- Although the Commission clearly expressed concerns regarding cost fluctuations in its decision in the 2005 Rate Case, the Postal Service has chosen not to investigate the year-over-year cost fluctuations that its costing system displays for both the Bound Printed Matter and the Media Services subclasses. Instead, it has recommended cost coverages for each of the subclasses that ignore the problem. The Commission should,

therefore, adopt the cost coverages proposed by PostCom. While this approach does not resolve the question that the Commission has quite properly raised, the PostCom cost coverages at least have the virtue of being consistent with precedent.

- A review of the rate design of Media Services is long overdue – and takes on added importance in light of the classification changes that the Postal Service has proposed for Standard Mail. PostCom has put forth a proposal under which the rates for eligible Media Services pieces weighing between 1 and 5 pounds would increase in half pound increments rather than being rounded off to the nearest whole pound, as is the case under the current rate design. The Postal Service offers no substantive grounds for opposing this proposal and ultimately concedes that the PostCom proposed Media Services rate structure is identical to the structure established by the Postal Service itself for single piece Bound Printed Matter. The Commission should adopt the PostCom Media Services rate design.
- The brief of National Association of Presort Mailers, *et al.*, – to which Postcom is a party – sets forth in detail the reasons why the Commission should reject the Postal Service’s proposed revamping of the Confirm Service. In the concluding section of this brief, we reemphasize reasons why the Commission should adopt the OCA counterproposal.

ARGUMENT

I. The Commission Should Recommend Rates Reflecting Worksharing Discounts That Fully Credit Mailers for the Cost Savings to the Postal Service Resulting from the Mailers' Worksharing Activities

In this case, the Postal Service proposes passthroughs of destination BMC, destination SCF, and destination DDU avoided costs of 87%, 85%, and 85% respectively for Standard Mail Regular letters, flats and Not Flat-Machinables (“NFMs”), and for Standard Mail ECR letters and flats. PostCom Witnesses Sander Glick and Anita Pursley present PostCom’s alternative proposal to base these Standard Mail destination entry rates on full (100%) passthroughs of destination avoided costs. PostCom-T-1 and PostCom-T-2. As Witness Glick explains (PostCom-T-1 at 3), fully passing through to mailers the costs avoided by the Postal Service for the mailers’ destination entry discounts encourages palletization by maximizing the amount of mail prepared on destination pallets. Palletization improves bundle integrity, and reduces Postal Service container handling costs and costs for handling broken bundles at the destination facilities. PostCom-T-1 at 1.

Witness Pursley points out in her testimony (PostCom-T-2 at 3), that both the Postal Service and the Commission have indicated their preferences for 100% passthroughs of avoided costs in determining destination entry rates, provided that such passthroughs are consistent with other pricing goals.¹ Despite these preferences, in recent cases the destination entry passthroughs

¹ See, e.g., Op. and Rec. Dec., PRC Docket No. R2005-1 at ¶ 5080 (Nov. 1, 2005).

have not approached 100%.² However, the past two cases have settled under unique circumstances, and this may explain why mailers have been unable to achieve more economically efficient workshare discounts.

In the 2005 recommended decision, the Commission did not explicitly comment on the size of the implied passthrough percentages associated with the destination entry discounts that were settled upon as a result of the across-the-board settlement, but, with regard to the Standard Mail Regular proposed rates, it observed:

It should be noted that if the next rate case follows a traditional approach to rate design whereby recommended rates more fully reflect efficient component pricing, i.e., passthroughs for all worksharing discounts and letter-flat differentials that would be closer to 100 percent, there may be substantial increases in some rates.³

Thus, the Commission recognized that passthroughs closer to 100% may create a potential push-up effect on other rates. Nevertheless, it did not yield the policy favoring efficient price signals.

In any event, the push-up issue does not arise in this case. With regard to PostCom's proposal to increase destination entry discounts in this case, Witness Glick points out that the pushup effect of his rate proposal on origin-entered mail is modest. PostCom-T-1 at 5. Thus, PostCom's proposal fairly balances the considerations of the value of worksharing with the impact of rate changes on the mail. Indeed, Postal Service Witness Kiefer does not even address PostCom's

² PostCom Witness Pursley reviews the percentages that have applied in the past several rate cases, and despite the expressed preferences, there appears to be no indications of a trend towards more efficient pricing. See PostCom-T-2 at 3.

³ Op. and Rec. Dec., PRC Docket No. R2005-1 at ¶ 6057 (Nov. 1, 2005).

destination entry rate proposal on rebuttal. See USPS-RT-11. Therefore, the Commission should provide destination entry discounts that maximize worksharing and take more costs out of the Postal Service system where there is opportunity to do so. The destination entry proposals of Witnesses Glick and Pursley should be adopted. Similarly, the Commission should recommend rates reflecting presort discounts that fully credit mailers for the cost savings to the Postal Service resulting from presort worksharing. PostCom-T-2 at 7-8.

II. The Commission Should Recommend a Rate for “Fletters” That Is Fair and Equitable, and Does Not Unnecessarily Constrain the Mail

PostCom Witnesses Robert J. Posch, Jr. and Godfred Otuteye essentially propose to expand the “fletter” category. Under the Postal Service's current and proposed rates, letters that weigh more than 3.3 ounces but not more than 3.5 ounces pay the flat piece and pound rates, but receive a discount of the difference between the letter and flat minimum piece rates. PostCom-T-3 at 2. PostCom proposes that the Postal Service increase the Standard Mail Regular and ECR 3.5 ounce breakpoint up to a maximum 4.0 ounces, such that the heavy letters continue to pay the fletter rates between the letter and flat minimum piece rates. Thus, pieces up to 4.0 ounces would pay additional postage in proportion to their additional weight, but would not pay the full rate applicable to pieces that exceed the dimensions of a letter and are processed on the flats automation equipment.

A. The 3.5 Ounce Breakpoint Unnecessarily Constrains the Use of the Mail as a Marketing Medium

In his testimony, Mr. Otuteye describes the obstacle that the “heavy letter surcharge” (the letter-flat differential) presents for its franchisees that are engaged in sales of coupon advertising. PostCom-T-8 at 10 *et seq.* Discontinuous postage pricing from letters to flats makes it difficult for Money Mailer to attract and serve larger national advertisers and direct response marketers that would bring to the Postal Service more mail volume in different classes of mail. As Mr. Posch explains, heavy Standard Regular solicitation letters generate additional mail volumes for the Postal Service, bolstering the mail stream's multiplier effect. PostCom-T-3 at 3. By arbitrarily restricting the weight of a letter, the Postal Service is unreasonably constraining the multiplier potential of solicitation letters.

B. The Evidence Demonstrates That Heavy Letters Are More Appropriately Classified and Rated as Letters Rather than Flats

The Postal Service has an obligation to provide service that is related to reasonably attributed costs. 39 U.S.C. 3622(b)(3). Attributable cost is, of course, a function of how a particular type of mailpiece actually is processed. The uncontested testimony of Godfred Otuteye shows that Money Mailer's heavy letters are handled as automation letters nationwide. The Postal Service does not dispute that it runs letters above 3.5 ounces on its letter automation equipment. Therefore, the Postal Service should provide service for heavier letters at “fletter” rates, rather than requiring such pieces to pay the steep letter-

flat differential that has no relationship to the way the Postal Service typically processes these letters.

PostCom acknowledges, as Mr. Otuteye explains, that running heavy letters may require Postal Service operations personnel to blend Money Mailer's heavier "manual" labeled envelopes with other lighter pieces as they are fed into the letter automation equipment. PostCom-T-8 at 9. There may be some unquantified – and possibly unquantifiable – slowing of automation equipment. Tr. 11/3214-15. It is understood that these pieces may be associated with marginally higher costs, but under PostCom's proposal, the heavier letters would pay additional postage in proportion to their additional weight. The record reveals absolutely no cost justification for why heavy letter pieces less than 4.0 ounces also should be required to pay the full rate applicable to pieces that exceed the dimensions of a letter.

C. There Is No Substantial Evidence That Dictates a 3.5 Ounce Breakpoint, Rather the Evidence Indicates That 3.7 Ounce Letters Can Be Automated; Therefore the 3.5 Ounce Limit Is Unduly Discriminatory

The Postal Service has attempted to characterize the issue regarding heavy letters as an operational one, but at its core, this issue is as much a rate issue as all other rate issues. PostCom does not propose to *direct* the Postal Service regarding how to handle heavy letters. Rather, PostCom asks the Commission to recognize how the Postal Service, in fact, handles heavy letters up to 4.0 ounces. There is no record evidence to suggest that these mailpieces are overwhelmingly handled as flats and therefore should pay the flats rate.

Rather the evidence indicates they should be rated as “fletters” by expanding the category that now extends from 3.3 to 3.5 ounces.

The Postal Service does not – and cannot – dispute the specific information provided by Mr. Otuteye that Money Mailer pieces are processing successfully. See USPS-RT-16 at 13. Indeed, upon cross-examination, Mr. McCrery specifically confirms that he does not refute Mr. Otuteye's claims. Tr. 34/11491. Moreover, Mr. McCrery acknowledges that there is no weighing of pieces before they are run on letter sorting machines. Tr. 11/3216. In short, while the eligibility limitations for Heavy Letters is expressed as an issue of weight, weight is not, in fact, the operational test applied in the field. Mr. McCrery specifically points out that the AFCS uses dimensions, not weight, to cull oversize pieces of collection mail. Tr. 11/2837; Tr. 11/3215-16. There is no explanation of why a different test is to be applied to Standard Regular or ECR letter-shaped pieces.

While there is evidently a thickness limitation, there is no weight limitation that requires pieces to be processed manually, either on the older machines, or on the upgraded or newer machines that were designed to handle pieces up to 6 ounces. Indeed, DMM 201.2.0 establishes no maximum weight criteria. Mr. McCrery specifically admits that “letters” that are labeled as “manual” are processed as automated letters. Tr. 34/11489-90. If such pieces are processed as automated letters, this is only because automated letter processing is more efficient than manual letter or automated flat processing. It was just such circumstances that led the Commission to approve the “fletter” piece and pound

rate proposal for prebarcoded letters weighing over 3.3 but less than 3.5 ounces in its 2001 decision.⁴

In short, the Postal Service is relying on a weight limit without any evidence that weight, independent of shape or thickness, causes a problem. Indeed, even in the 2000 and 2001 decisions, the Commission did not conclude that weight was a determinative processing characteristic.⁵

Postal Service Witness Laws argues that the proposed increase in the maximum weight of an automation mailpiece is “not operationally *realistic*.” USPS-RT-16 at 13. The primary obstacle appears to be the Postal Service’s prejudging of the matter. Witness Laws states only that there have been “countless instances” of heavy letters below the 3.5 ounce limit processing poorly. USPS-RT-16 at 13. But this claim is far too vague a basis upon which to reject PostCom's proposal because – among other things – there is no evidence that it was the weight of the pieces, rather than some other characteristic, that caused the problem or, more importantly, what exactly the problem was. If a conclusion is “based on operational realities,” as Mr. Laws argues (USPS-RT-16 at 13), it is incumbent upon the Postal Service to offer specific evidence of these “realities” to support its conclusion.

Instead, the Postal Service presents nothing more than an outdated test report, which does not even support the Postal Service’s case. The Field Evaluation Report of April 6, 2001 (beginning at Tr. 11/2844) states that the

⁴ Op. and Rec. Dec., PRC Docket No. R2001-1 at ¶ 3156 (March 22, 2002).

⁵ Op. and Rec. Dec., PRC Docket No. R2001-1 at ¶ 3156 (March 22, 2002); Op. and Rec. Dec., PRC Docket No. R2000-1 at ¶ 5397 (Nov. 13, 2000).

Postal Service's test objectives were "to do preemptive testing on 3.7 ounce mail for future reference." The choice of words is very revealing: the glaring use of the term "preemptive testing" indicates that the Postal Service was predisposed to conclude that the 3.7 ounce letters would not provide "acceptable" results. Tr. 11/2845; 3212-13. Yet, ironically, the report concluded that "the 2% seeded decks of 3.3, 3.5 and 3.7 ounce mail processed extremely well and were no cause for concern." This Postal Service test – inadequate that it is – corroborates Mr. Otuteye's explanation that running heavy letters on the automated equipment may require operations personnel to blend them in with other lighter pieces as they are fed into automated equipment. PostCom-T-8 at 9.⁶

The clear evidence of the Postal Service's testing bias in using the term "preemptive testing," and the sheer lack of *any* data reported regarding the performance differences between the 3.5 and 3.7 ounce mail together is enough to suggest that there may not have been significant performance differences to report. This test report is so obviously inadequate that, despite Postal Service Witnesses McCrery and Laws predispositions, it simply can not stand as sufficient operational evidence on which to base their "expert" opinions; nor can it stand as a sufficient evidentiary basis to reject PostCom's informed proposal.

⁶ The report also concludes that "[t]est decks of 100% 3.7 ounce mail caused excessive amounts of damage to the equipment." Yet the report offers no further information regarding the nature of the purported "damage;" nor does the report offer the throughput, accept rate, error rate, and jam rates for the 3.7 ounce mail that it reports for the 100% 3.3 and 3.5 ounce decks. The performance differences between the 100% 3.3 and 3.5 ounce decks were marginal. Tr. 11/2846.

D. In Conclusion, Recognizing the Limited Testing Performed to Date, the Commission Should Recommend That Standard Mail Rates Apply to Letters up to 3.7 Ounces

PostCom recognizes that the record shows that the heaviest weight letter that appears to have been tested (in 2001) is 3.7 ounces. Therefore, if the Commission does not find sufficient evidentiary basis to accept PostCom's proposal of 4.0 ounces, it should recommend that the Standard Mail Regular and ECR heavy letter automation rates apply to letters up to 3.7 ounces (without prejudice to increasing this weight in the future).

The Commission may well be reluctant to adjudicate matters that appear to concern postal operations, but the Commission should recognize that at issue here is a rate for service, and not Postal Service operations. The service for the heavy weight letters between 3.5 and 4.0 ounces is now only available at such a high incremental price (at flats) rate that the market cannot avail itself of it. The weight limitation imposed upon mailers is not followed by the Postal Service in its own operations; as we have pointed out, the AFCS culls collection mail by shape, not weight. The Commission should not allow the Postal Service to apply a double standard. That is both unfair under Section 3622(b)(1) and discriminatory under Section 403(c) of the Act. The maximum weight limit on letters should be increased.

III. The Commission Should Greatly Mitigate the Proposed Rates for Not Flat-Machinables

The Postal Service's proposal with regards to NFMs simply is not supported by the record and is based utterly on flawed, inconsistent and incomplete data. The Non-ECR Standard Mail Non-Letter Redefinition Study conducted by Witness Loetscher (USPS-LR-L-33) ("Non-Letter Redefinition Study" or "Study") is wholly unreliable because the definitions for NFMs are not consistent with the rate category definitions in the Postal Service's September 27 proposed Implementation Rules. 71 Fed. Reg. 56588. In addition, the Non-Letter Redefinition Study did not properly address actual costs or volumes.

The claims by Witness Kiefer that he mitigated the impact of the rates associated with the NFM category ring hollow. When Witness Kiefer created the rate structure for NFMs, he did not properly address several factors that should be considered when mitigating rates, including the avoided costs for destination entry discounts, sortation discounts, and the potential elasticities within the category. As a consequence, the proposed rates for NFMs could result in increases of as much as 97%. By any standard, the proposed rates will cause undue rate shock.

Because the Postal Service has failed to provide actual and reliable cost, volume, and revenue data associated with this new category, the Commission should, at a minimum, greatly mitigate the proposed rates. PostCom believes that more reasonable rates for NFMs are the non-automated flat rates, which are more than 40% lower than those proposed for NFMs.

A. The Non-Letter Redefinition Study Is Flawed and Should Not Be Relied upon to Develop NFM Volumes

Under current rules, a mailpiece may qualify as an automation flat if it meets either the definition of an AFSM100 flat (DMM 301.3.3) or a UFSM1000 flat (DMM 3.4). In order to qualify as an AFSM100 flat under the current DMM rules, a mailpiece must meet both the turning ability (DMM 301.3.3.4a) and deflection tests (DMM 3.3.4b).⁷ The criteria to qualify as a UFSM1000 flat does not include either a “turnability” or a deflection test. (DMM 301.3.4). Today, some rigid flats qualify as AFSM100 flats, and many rigid pieces that do not qualify as a flat under the AFSM100 definition qualify under the UFSM1000 definition and are mailed at flat rates. The Postal Service now proposes to eliminate the ability of a flat mailpiece to qualify as a UFSM1000 flat; instead, these pieces would fall into the new NFM category. USPS-T-36 at 10-11.

There is abundant confusion regarding what mailpieces will qualify as NFMs. Witness McCrery underscores the definitional inconsistencies in his rebuttal testimony when he concedes that the Postal Service used different definitions in developing its Implementation Rules (DMM provisions) than the ones used by Witness Loetscher in his Non-Letter Redefinition Study. Tr. 34/11501-03. Without clear standards about what mailpieces fall into the

⁷ The deflection test measures whether a mailpiece is rigid enough that when placed on a flat surface and extended unsupported, “no part of the edge of the piece that is opposite the bound, folded, or final folded edge deflects more than 1 ¾ inches (if the piece is less than 1/8 inch thick) or more than 2 3/8 inches (if the piece is from 1/8 to ¾ inch thick). In essence, the deflection test measures whether the mailpiece is too droopy to properly run on the AFSM100.

category, the underlying rationale and supporting data for the rates associated with NFMs collapses.

1. The Definitions Used in the Non-Letter Redefinition Study Bear No Relation to the Proposed Implementation Rules

Under the definitions in the Non-Letter Redefinition Study,⁸ hybrid flats are “[p]ieces that can be cased but are not AFSM100 compatible.” USPS-LR-33 at 4-5. To be cased, the study reports that a piece must either have one dimension (length or height) less than or equal to 6 inches OR the piece must meet BOTH the maximum rigidity requirement and the turning ability requirement. Hybrid flats are defined as having dimensions compatible with the UFSM1000 machines (DMM 301.3.4.2),⁹ but are limited to .75 inch in length. USPS-LR-L-33 at 4-5.

Hybrid parcels are defined as

[p]ieces that are UFSM1000 compatible (DMM 301.3.4), but can not be cased, and are not AFSM100 compatible. To be UFSM1000 compatible, the piece must meet the requirements specified in DMM section 301.3.4, except for the address placement and folded pieces rule (301.3.4.1).¹⁰

⁸ Witness Loetscher testified that Witness McCrery provided these definitions to him via e-mail. Tr. 7/1538-39.

⁹ Mailpieces are UFSM compatible if their height is no more than 12 inches or less than four inches; their length is no more than 15 $\frac{3}{4}$ inches or less than 4 inches; they are at least .009 inches thick for pieces that are at least 5 inches long or .25 inches thick for pieces that are at least 4 inches long but less than 5 inches long; and are no more than 1.25 inches thick for pieces 13 inches long or less or $\frac{7}{8}$ inches thick for pieces longer than 13 inches up to and including 15 $\frac{3}{4}$ inches.

¹⁰ USPS-LR-33 at 5. It should be observed that the Non-Letter Redefinition Study apparently fails to characterize the full range of Standard Mail non-letters. For example, the definitions apparently omit (1) mailpieces that are not caseable (e.g., that are rigid with one dimension greater than six inches), but are less than .75 inches thick; and (2) mailpieces that are caseable, but are more than .75 inches thick. Indeed, Witness Loetscher was unsure how these pieces were treated, if at all, in the Study. See Tr. 7/1546-47.

The Non-Letter Redefinition Study eliminates the existing deflection test and replaces it with a maximum rigidity test.¹¹ The maximum rigidity test measures whether a mailpiece is too rigid within certain dimensions when manual force is applied. Thus, the test used in Witness Loetscher's Study no longer measures whether a piece is too floppy, but instead whether it is too rigid.

The proposed Implementation Rules include a new and different maximum rigidity test and introduce a new deflection test not included in either the Non-Letter Redefinition Study or the current rules.¹² With regard to the rigidity test, the Non-Letter Redefinition Study measured whether "the *corner* opposite the bound, folder, or final folded edge" is able to be deflected at least *2 3/8 inches* when manual force is applied without damage to the mailpiece. In contrast, the proposed Implementation Rules test (for mailpieces 10 inches or longer) whether the mailpiece "with the length perpendicular to the edge of a flat surface" and bend at least *2 inches* when pressing down "on the piece at a *central point*" (emphasis added).

There are several differences between these tests. First, the point of measurement is not consistent – in the Non-Letter Definition Study rigidity is measured at the corner of the mailpiece; in the proposed Implementation Rules,

¹¹ Maximum rigidity is defined as follows: "when a flat-sized mailpiece is placed on a flat surface and extended unsupported 5 inches off that surface, the corner opposite the bound, folded, or final folded edge must be able to be deflected at least 2 3/8" when manual force is applied without damage to the mailpiece. If a piece is marked, 'do not bend' or something similar, the piece also fails this test. If a piece is less than 5 inches long, the piece is only extended as far as practical before the test is applied. USPS-LR-L-33 at n.1.

¹² With regard to the deflection test, which did not appear in the Non-Letter Redefinition Study, and which is introduced for the first time in the proposed rules, pieces that are 10 inches or longer may not droop more than 2 inches in order to qualify as an automation flat.

it is measured at a “central point.” Second, the Non-Letter Redefinition Study uses 2 3/8 inches as the cut off point for mailpieces of all lengths, versus 2 inches for pieces over 10 inches or more and 1 inch for pieces under 10 inches. In addition, the Non-Letter Redefinition Study does not draw a distinction for pieces less than 10 inches long.

Given these new tests, it is overwhelmingly evident that any Postal Service volumes derived from the Non-Letter Redefinition Study bear little or no relation to the pieces that will actually be categorized as NFMs due to rigidity under the proposed Implementation Rules.

The definitions and tests are in flux because the underlying rationale for the creation of this category, murky to begin with, is still changing. Under the definitions in the Non-Letter Redefinition Study, the rigidity requirement goes directly to the issue of caseability, not automation. According to the Study, a hybrid flat is a piece that can be cased but is not AFSM100 compatible. To test for caseability, the piece must either have one dimension less than or equal to 6 inches OR the piece must meet BOTH the maximum rigidity requirement and the turning ability requirement. USPS-LR-L-33 at 4-5. Yet, on rebuttal cross-examination, Witness McCrery concedes that caseability requirements are no longer part of the definition of what constitutes an NFM. Tr. 34/11504. The Postal Service states that it intends to monitor and track casing information internally. Tr. 34/11503-04. But, neither Witness McCrery nor any other Postal Service witness has explained how casing information will be collected internally through IOCS, MODS or the Billing Determinants.

In short, no one – including the Postal Service itself – knows what pieces will fall into the new category. And, without knowledge of how pieces will be categorized, it is difficult to see how reliable cost and revenue data can be captured.

The Non-Letter Redefinition Study is entitled to no evidentiary weight whatsoever. This, in turn, renders the pricing testimony of witness Kiefer highly suspect, as we discuss *infra* at section III.B.

2. The Non-Letter Redefinition Study Utilizes an Extremely Limited Sampling of Data and May Have Resulted in Undercounting or Overcounting of Mailpieces

Witness Loetscher’s Non-Letter Redefinition Study analyzed a sample of non-letter mail to measure the detailed physical characteristics of non-letters and was used to develop volume estimates for the rate categories for automation flats, nonautomation flats, hybrid flats, hybrid parcels, and parcels. The Study looked at a one day sampling of only 50 routes/box sections, and analyzed all non-letters in that sample for length, height, thickness, weight, deflection, and rigidity. According to Witness Loetscher, the sample data was used to “analyze the composition of non-letters based on piece compatibility with existing processing machinery and carrier casing practices.” USPS-T-28 at 4. As Witness Glick points out, the Study measured only 1,743 Standard Mail non-letter pieces.¹³ Thus, “the confidence intervals around the NFM volume estimates are large.” PSA/PostCom-T-1 at 12.

¹³ The Study may have failed to characterize all potential types of non-letters due to the limited sample. See n.10, *supra*.

In addition, the Non-Letter Redefinition Study is flawed because it is based only on limited data from just one day in January 2005. This specific day may not be representative of mail volume, thickness, or weight on an annual basis, but Witness Loetscher nonetheless admits that he did not adjust the Study to account for these factors. Tr. 7/1563-64. Standing alone, the limitations of the Study are fatal to its use as the basis for projecting the NFM volumes and revenues.

3. The Non-Letter Redefinition Study Does Not Identify Processing Method or Distribution Across Presort or Drop Entry Categories

During cross-examination, Witness Loetscher admits that the survey takers did not and, in fact, could not determine whether the sample mailpiece actually ran on a flat sorting machine. Tr. 7/1548-49. Indeed, even if a mailpiece did not have a label that indicates what type of machine it was run on, it may not mean that the mailpiece was manually processed. Tr. 7/1549. That is, the survey takers did not record any information about the mailpiece's originating mail stream. Tr. 7/1549. This tends to undercut – if it does not completely invalidate – the claim that the sample was used to “analyze the composition of non-letters based on piece compatibility with existing processing equipment.” USPS T-28 at 4.¹⁴

In addition, the Non-Letter Redefinition Study did not measure the distribution of the mailpieces by presort level or point of entry. Tr. 7/1550-61. Witness Loetscher admits on cross that Library Reference 92, which attempts to

¹⁴ Moreover, Mr. McCrery's explanation of the alleged incompatibility of NFMS with existing processing equipment (see USPS-RT-14 at 10) finds no support in the testimony from the earlier cases upon which he relies. Tr. 34/11494/95.

derivatively determine how the Standard Mail categories were sorted and containerized did not account for presort level or point of entry for hybrids or parcels. Tr. 7/1561. Indeed, in response to a question on this issue, Witness Loetscher states that:

no explicit assumptions were made concerning the presort requirements for hybrid parcels or hybrid flats. In the development of the hybrid distributions the two assumptions made were the use of FY 2005 entry discount distribution of Standard parcels for the entry discount distribution of hybrid pieces and the use of the presort distribution of Standards UFSM 1000 flats from USPS-LR-L-92 for the presort distribution of hybrid pieces.¹⁵

When asked about the rationale for using the destination entry discount distribution for Standard parcels rather than UFSM1000 flats, Witness Loetscher admits that the Postal Service does not “know much about how the pieces that will be hybrid will shake out and how large the mailings are, what type of entry that they will --.” Tr. 7/1569.

Thus, the Postal Service admits that of necessity, it ignored a very important factor in the development of the rates for NFMs – the mix of NFMs and changes in mix resulting from new sortation requirements and potential migration as a result of its proposals. This lack of knowledge about how mailers will respond to the proposed rates for NFMs is yet a further reason why the Study should not be relied upon for the development of rates.

¹⁵ Tr. 7/1496.

B. The Postal Service Does Not Have Reliable Cost or Revenue Data for the NFM Category

Beyond the problems created by vague and changing definitions and lack of reliable data as to mix of mail within the category, the Postal Service's own witnesses acknowledge that they do not have reliable data regarding the costs or expected revenues associated with hybrid pieces. Witness Kiefer admits that "many [NFM] pieces are counted as parcels for cost allocation purposes, but are counted as flats for volume purposes." USPS-T-36 at 22. He goes on to say that "it is difficult to get an accurate estimate of the unit revenue for Standard Mail parcel shaped pieces." Tr. 5/934. Also, while witness Miller (USPS-T-21) modeled the mail processing costs for these pieces, the accuracy of these costs estimates is doubtful: according to Mr. McCrery, "the [mail] flows [for these pieces] can not be mapped out until the preparation is finalized." Response to POIR No. 5, Question 1(e)-(1), Tr. 11/3009. The Postal Service never explains how reliable cost estimates can be achieved without mail flows.

The Postal Service has not determined what percentage of hybrid parcels and hybrid flats will be processed manually, what percentage will be processed on Postal Service sorting equipment, and what category of mail sorting equipment will be used. The cost models in USPS-LR-L-45 calculate costs based on how these pieces currently are being handled (which, of course, relies upon the flawed categorizations from the Non-Letter Redefinition Study), but may not reflect how they will be handled in response to the actual rates for NFMs. As Witness Glick points out, "[t]he Postal Service has no CRA unit cost data for [pieces that fall into the NFM category]. Rather, . . . these pieces often are

counted as parcels by IOCS and flats by RPW.” PSA/PostCom-T-1 at 11. The answer to this problem is less than compelling: according to Witness McCrery, “[w]hen hybrid pieces are identified and tracked through IOCS, we will have a reliable guide to their cost.” Response to PostCom/USPS-T-42-6(b). While Mr. McCrery’s candor is commendable, this is nothing less than a concession that the cost data upon which the NFM rates are based is highly conjectural, bordering on guesswork.¹⁶

Another significant failing of the Non-Letter Redefinition Study and the testimony regarding proposed rates for NFMs is that the Postal Service does not include any discussion regarding costs and revenues associated with NFM pieces weighing less than 6 ounces and those weighing 6 ounces or more. The reason is that the distinction did not exist when the study was performed. The proposed Implementation Rules provide -- for the first time -- distinct preparation guidelines for mailpieces in each of these categories under which NFMs weighing less than 6 ounces are deemed “non-machinable.” 71 Fed. Reg. 56608. Apparently, the Postal Service has concluded that some Not Flat-Machinables are not machinable!

More importantly, the Postal Service never provided any cost or revenue data with respect to the distinction. The fundamental problem in introducing different preparation rules for pieces under 6 ounces and pieces over 6 ounces, is that the Postal Service introduces further migration of volume among NFM

¹⁶ Given the changes in definition of an NFM, it is unclear exactly what cost data will be captured through the IOCS.

presort levels, rendering the NFM revenue estimates even more unreliable and the rates inexplicable.

C. The Postal Service Fails to Properly Mitigate the Rates Associated with NFMs

In sum, the Postal Service simply has not developed reliable data for either the volumes or costs associated with the new NFM category. The lack of accurate data about volumes, costs, revenues, the reaction of mailers to new sortation and drop-entry discounts, and the price sensitivity of customers related to the new NFM category should lead to greater mitigation of the proposed rates.

Despite Witness Kiefer's assertions that his proposed rates "reflect significant mitigation" (USPS-RT-11 at 6), he repeatedly admitted on cross-examination that lack of data about these factors "might [lead him] to mitigate a little bit more strongly." Tr. 33/11144. Indeed, Witness Kiefer concedes that he recognized "that, ultimately, the Commission will use its own judgment in determining the appropriate level of mitigation." Tr. 33/11147. If the Commission is willing to accept a category based on such scant data, it should greatly mitigate the rates until such time as there is a better body of data to support a distinct category.

In fact, Witness Kiefer employs a counterintuitive method for mitigating the rates associated with NFMs. According to his testimony, "I chose the piece rate and pound rate for the least workshared flats and then took discounts off this base rate." USPS-T-36 at 16. Yet this type of mitigation affects the most costly, least efficient type of mail in the NFM and parcel categories, and runs counter to efficient component pricing. Witness Kiefer further attempts to mitigate the

impact of the rate by offering a DDU discount for NFMs. He failed, however, to determine whether any mailers could qualify for the DDU discount. Tr. 5/1037.

Witness Kiefer also applies an arbitrary multiplier to estimate the avoided costs for destination discounts. He applies an 87 percent pass through for flats, and then multiplies it by 1.2. Tr. 5/1040-41. But he provides no quantitative or qualitative support for the use of this multiplier. A more reasoned approach would be to apply the 100% passthroughs for destination entry cost avoidances as proposed by Witness Glick. PostCom-T-1 at 4. See discussion in Section I, *supra*.

One of the most baffling aspects of the Postal Service's proposal is that as a result of the formal elimination of the caseability requirements and the retention of the deflection test, there is no discernible difference between a bundle of non-automation flats and a bundle of non-machinable NFMs (less than 6 ounces) from either a cost or operational perspective. Witness McCrery concedes that the Postal Service does not have functional mail flows for NFMs. Response to POIR No. 5, Question 1(e) – (l) (Tr. 11/3009). Instead, he simply states that NFMs will be run on parcel sorting machines ("PSMs"). Tr. 11/3236. By definition, however, *non-machinable* NFMs *cannot* be run on PSMs. If an NFM is non-machinable, the only machine upon which they can be run is the APPS machine.

In short, if non-machinable NFMs -- or some of them -- will be processed in the same manner as non-automated flats, NFMs should incur the same rates

as non-automated flats. This is even more evidence that the Commission should mitigate the proposed rates for NFMs to the non-automation flat levels.

D. The Commission Should Apply Non-Automation Flat Rates to NFMs

In order to avoid the dramatic negative effect the exorbitant rate increases will have on mailers, the Commission should, at a minimum, mitigate the NFM rates to, or close to, the non-automation flats levels. It is simply indefensible to force mailers to absorb such huge rate increases without an adequate record to support the rates. More importantly, given the continuing uncertainty regarding how the rules for NFMs will be implemented in the field, mailers should not be asked to absorb these astounding increases overnight and without any clear sense of how the Postal Service will actually treat their mailpieces.

As the testimony of PostCom Witness Knight demonstrates, the proposed rates for NFMs will cause significant rate shock to mailers who previously qualified for automation flat rates. Witness Knight estimates that the average unit increase in postage costs for the delivery of BMG Columbia House products that formerly qualified as automation flats will be approximately 97%. PostCom-T-7 at 7. By any measure, that is rate shock. As we have shown, it cannot be justified.

IV. The Rate Shock to Standard Parcels Is Inequitable; Given the Weaknesses in the Cost and Volume Data, the Proposed Rates Cannot Be Justified

As in the case of NFM's, the Postal Service's proposed rates for what will be the Standard Parcel category are punitive, unsupported and ill-conceived.¹⁷

A. The Severity of the Proposed Increase for Standard Mail Parcels Is Astounding; if Businesses Cannot Sustain the Increases, They Will Precipitate Alternative Business Approaches

As PostCom Witness Aaron Horowitz illustrates, the Postal Service's proposed rate increases for Standard Mail parcels will cause tremendous rate shock for mailers. For example, Cosmetique estimates that the postage bill for its product shipments alone will increase by approximately 47%. PostCom-T-6 at 6. Increases of this magnitude will lead to considerable uncertainty for businesses such as Cosmetique that currently rely on the mail for delivery of their products. Mr. Horowitz explains that the proposed price increases would accelerate his company's exploration of alternative marketing channels such as electronic media to obtain customers, and would require the company to explore other ways of delivering its products to its members, particularly for its expanding single-sale business. PostCom-T-6 at 7-9. The potential effects on the marketplace of implementing the rates as high as the Postal Service proposes are completely unknown. Cosmetique's expected response is representative of the concerns and reactions of PostCom's members. This does not bode well for

¹⁷ PostCom joined with the Parcel Shippers Association ("PSA") in the presentation of Witness Glick's testimony concerning NFM's and Standard Parcels. PSA/PostCom-T-1. We similarly join the PSA brief in urging the Commission not to accept the Postal Service's proposed rates for these two categories.

test-year volumes and cost forecasts of Standard Parcel relied upon by the Postal Service.

B. The Cost and Volume Data, and Revenue Projections Supporting the New Parcel Category Are Unreliable

The Postal Service concedes as much. Indeed, as PostCom Witnesses Glick and Horowitz both observe (PSA/PostCom-T-1 at 5; PostCom-T-6 at 9-10), the core justification that the Postal Service offers for creating a separate category for Standard Parcels is to allow better data to be collected in the future. USPS-T-36 at 17. But until this category has been in place for some time, the Postal Service is unable to measure historic or projected costs and volumes of a Standard Parcel with any degree of reliability.

1. The Postal Service's Base Year Cost and Volume Data Are Unreliable

The Postal Service acknowledges the evident disconnect between the volume and costing systems (Tr. 5/956), and this disconnect leads to anomalous Standard Parcel unit costs. With unit costs for First-Class Presort Parcels of \$3, and Standard ECR Parcels of more than \$24 (USPS-T-13, Attachment 14), Witness Glick rather conservatively concludes that “[s]uch results make it impossible to have complete confidence in the unit costs provided for parcels.” PSA/PostCom-T-1.

Exploring this anomaly, PostCom Witness Glick summarizes the observations of the Postal Service's own Witnesses Kiefer and Harahush. He explains that the data collection methods make it is possible for mailpieces that have the physical characteristics of parcels, but which are entered as flats to

have their costs included with other parcels by IOCS, and their volume included with other flats by the RPW. PSA/PostCom-T-1. These weaknesses mean that small errors in the classification of costs and volumes of the relatively small parcel category can result in a very significantly erroneous parcel unit cost calculation. See Response to POIR No. 5, Question 16b (Tr. 13/3631). In light of the undeniable weaknesses in the underlying costs and volume data upon which the Postal Service relied to develop its proposed rates, the severe rate shock described by Witness Horowitz cannot be justified.

2. The Elasticity Applied to Standard Mail Parcels to Calculate Test Year Volumes and Revenues Is Unreliable

The problems that the Postal Service has acknowledged in base year cost and volume data are compounded in the test year by the use of a Standard Parcel elasticity that is likely to be incorrect. In unrebutted testimony (PostCom-T-4), Witness Angelides explains that the Postal Service uses aggregated Standard Mail data to estimate the elasticity that applies to Standard Mail Parcels, yet he provides significant reasons to believe that Standard Parcels behave differently from Standard Regular letters or flats. As Dr. Angelides explains, there is insufficient data to estimate the elasticity of Standard Parcels by itself at this time. The use of an inaccurate Standard Parcel elasticity yields after-rates volumes that are also likely incorrect. PostCom-T-4 at 9. Because the Postal Service likely underestimates the effects of the proposed rate increase on after-rates volumes, it significantly overestimates the revenues that may be derived in applying the proposed rate increase. PostCom-T-4 at 10. Postal

Service Witness Thress, who presents the Postal Service model, does not address Dr. Angelides assertions regarding limitations of the model with respect to the elasticity of Standard Parcels. See USPS-RT-2.

Instead, Mr. Kiefer argues on rebuttal that “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).” Tr. 33/11127, l. 11-12. Mr. Kiefer offers no foundation for this principle whatsoever, Tr. 33/11143 *et seq.*, and at least with respect to the proposed reclassification of NFM's and Standard Parcels, the statement is counterintuitive. New rate categories have no historic volumes or prices. This absence of historic data makes it difficult, if not impossible, to project after-rates volumes and revenues. As the Postal Service's own Witness Thress explains, “in order to estimate a price elasticity, you need to have a history of volume and prices and at some point the prices need to change. . . .” Tr. 6/1288.

As with the NFM's, the Postal Service's attempt to cobble together a form of history for Standard Regular Parcels is fundamentally flawed because the definitions established to develop the historic volumes for the new rate categories do not relate to the definitions proposed to implement the new categories. See discussion in Section III, *supra*. While it is unclear what Witness Kiefer means by “broader” price changes, surely the Commission will agree that it would be irresponsible to introduce a very large price change without a reasonably reliable understanding of how the market is likely to react to that change.

3. Further Pricing Anomalies Suggest the Absence of Reliable Data

The Standard Parcel rate design exhibits yet another inexplicable pricing anomaly. Recognizing that parcels sorted to 3-digits are less costly for the Postal Service to process than a BMC sort, the Postal Service set the 3-digit presort rate lower than BMC presort rate. See Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services, Attachment A at 13 (May 3, 2006). But in doing this, it proposed a rate for 3-digit non-machinable parcels that is lower than the proposed BMC machinable rate. This creates a perverse incentive to make parcels non-machinable. The Postal Service's institutional response suggest that the BMC machinable rate and the 3-digit non-machinable rate should be the same (see Response to UPS/USPS-T36-1 (b), Tr. 180/6663); but on cross-examination, Postal Service Witness Kiefer declined to suggest which rate should apply, indicating the Postal Service has not fully considered the issue. Tr. 33/11149-50.¹⁸

Nor has Witness Kiefer considered the effect of the Postal Service's "special exception" provision. Because some parcels may be successfully processed on parcel sorting equipment even though they do not conform to general machinability criteria which include a 6 ounce minimum, the DMM

¹⁸ To encourage worksharing and provide more potential mitigation, the Commission should recommend that the proposed 3-digit non-machinable rate apply to BMC machinable parcels.

provides a procedure for companies to obtain “special exceptions” to the machinability criteria. DMM 401.1.5.3. But Mr. Kiefer acknowledged he did not consider these volumes in his rate design, further calling into question the volumes anticipated in the machinable/non-machinable categories. Tr. 33/11151-2.

The 3-digit/BMC pricing anomaly and the failure to consider special exceptions constitute further evidence that the Postal Service has not considered the Standard Parcel rate design any more than it has its NFM proposal.¹⁹

C. The Commission Should Mitigate the Rate Increases and Maintain Sufficient Presort and Drop Entry Discounts to Encourage Worksharing and Provide Mailers with Additional Opportunities to Mitigate the Rates

In the Postal Service’s rate design, Witness Kiefer determined to “mitigate” the non-workshared rates, and reduce the passthroughs on the workshared rates in order to avoid a revenue shortfall. He did not consider the potential migration of parcels between 3-digit and 5-digits or between DBMC DSCF or DDU entry. And, of course, he ignored the rate anomaly created by the Postal Service’s belated decision to establish different sortation rules for machinable as opposed to non-machinable parcels. To develop or expand a market for parcel consolidation and accompanying deeper drop entry of parcels, a sufficient discount needs to be available to justify the mailer’s additional expenses. Cf.

¹⁹ There is a comparable problem with NFMs. The proposed Implementation Rules require NFMs weighing more than 6 ounces to be prepared for the BMC. Indeed, the proposed Implementation Rules include instructions for “DBMC rate eligibility.” Proposed DMM 445.6.3.3(b). But the NFM category does not specify a BMC rate. When asked about the omission of a BMC rate, Witness Kiefer stated that if a mailer were required to presort a 6 ounce or more NFM to the BMC, it would qualify for the ADC rate. Tr. 33/11153-54. Yet nothing in the proposed rate schedules indicates that the ADC rate would apply to this piece.

PostCom-T-2 at 5. Yet Witness Kiefer inexplicably proposes to passthrough only 18-20% of the avoided costs (“presort savings”) associated with the proposed NFM and Parcel Non-machinable ADC and 3-digit rates, while he proposes 100% passthroughs for 5-digit rates. Witness Kiefer also proposes less than 100% passthroughs for the NFM and Parcel destination entry rates. See discussion at Section I, *supra*.

In defense of his proposal, and employing the same peculiar rationale that he employed with NFMs, Mr. Kiefer observes that “the mitigation was done at the highest level of the rates, and then subsequent price differences due to worksharing were perhaps shrunk a little bit because the cost differences could not then be fully pass through; otherwise we would have ended up with negative prices. . . .” Tr. 33/11146. But inexplicably, the discounts at the ADC and 3-digit levels were “shrunk” to 20%, while the discount at the 5-digit level remained at 100%. Witness Horowitz's representative testimony strongly suggests that mailers will not be able to reach the 5-digit sort levels. PostCom-T-6 at 6, I. 4-5.²⁰

In sum, as in the case of NFMs, the Commission cannot lawfully and should not as a matter of policy accept the punitive rate increases the Postal Service has proposed for Standard Parcels. PSA/Postcom Witness Glick's mitigation plan should be adopted. PSA/PostCom T-1 at 8-9.

²⁰ The Postal Service's independent decision to further classify NFMs by proposing different mail preparation requirements for pieces over 6 ounces versus pieces under 6 ounces (71 Fed. Reg. 56588 at 56608) also calls into question the ability of mailers to obtain sufficient NFM and parcel volumes to reach the deeper presort levels in each category.

V. The Commission Should Adopt PostCom's Proposed Cost Coverages for Media Mail and Bound Printed Matter

The Postal Service proposed cost coverage for Media Mail and Library Mail subclass is 109%, and the proposed cost coverage for Bound Printed Matter is 125%. USPS-T-31 at 31-2. The Postal Service states that it has evaluated these cost coverages in light of the nine pricing criteria in the Postal Reorganization Act, 39 U.S.C. § 3622(b), however, the Postal Service's testimony fails to illuminate the rationale behind the proposed increases in cost coverages. *See generally*, USPS-T-31 at 32-3.

As PostCom Witness Angelides describes, the Postal Service's cost data for both the Media Mail and BPM categories has fluctuated significantly over the last several years. PostCom-T-5 at 4-5 and 10-11. In past decisions, the Commission has expressed concern that the unit costs exhibit substantial year-to-year fluctuations.²¹ Most recently, in R2005-1, the Commission urged the Postal Service to explore why the unit costs for these subclasses continue to fluctuate. Yet in this case, the Postal Service simply chose to ignore the Commission's concerns and completely failed to examine or explain why the unit costs for these subclasses continue to fluctuate. Tr. 8/2067-69.

Ironically, there is one aspect of the underlying Postal Service so-called "costs" that has not fluctuated, which the Postal Service also should have examined. In developing her proposed rates, pricing witness Ms. Yeh simply failed to consider whether the rationale for the "standard two cent per pound

²¹ Op. and Rec. Dec., R2005-1 at ¶ 6143 (p. 162) (Nov. 1, 2005) (where the Commission expressed concerns with respect to the historically variable Media and Library Mail costs); Op. and Rec. Dec., R2000-1 at ¶ 4034-35 (p. 207-8) (Nov. 13, 2000) (where the Commission expressed concerns with respect to costs increases outside the norm in BPM).

allowance for weight-related non-transportation costs” should be reevaluated. Witness Yeh testifies that this standard allowance was first introduced in 1984, and upon cross-examination, did not dispute counsel for PostCom's suggestion that significant changes in the rate design (and related changes in cost allocation) have occurred since then. Tr. 8/2035-7. The effect of this unexplained “allowance” of two cents over the reported costs of service is to provide additional cost coverage. Therefore, Witness O'Hara's stated cost coverage percentages for BPM and Media Mail understate the actual cost coverage percentages.

As a result, the Postal Service has not adequately justified the proposed increases in cost coverages in Media/Library Mail and Bound Printed Matter. See Tr. 8/2067-69 and USPS-T-31 at 32-24. Dr. Angelides points out that historically the cost coverages for Media Mail and Bound Printed Matter have been significantly lower than proposed, and the Postal Service offers no rationale for increasing the cost coverages for these subclasses in this case. PostCom-T-5 at 5 and 11. In R2005-1, the Commission set the cost coverages for Media Mail at 100.2%.²² In Bound Printed Matter, the cost coverages were set significantly below the Postal Service's proposal of 124.1%. In the most recent litigated case, the Commission set the cost coverage at 114%.²³ On behalf of PostCom, Dr. Angelides proposes rates for Media/Library Mail and BPM that reflect these Commission-recommended cost coverages of 100.2% and 114%

²² Op. and Rec. Dec., R2005-1, ¶ 6142 (Nov. 1, 2005).

²³ Op. and Rec. Dec., R2000-1 at ¶ 4034-5 (p. 207-8) (Nov. 13, 2000).

respectively. PostCom-T-5 at 6 and 11. Given the Postal Service's inability or unwillingness to address concerns properly and carefully raised by the Commission, those cost coverages at least have precedential support and should be adopted.

VI. The Commission Should Adopt PostCom's Proposed Media Mail Rates

The Postal Service proposes to maintain the current rate design of Media Mail, which is priced in full pound increments. PostCom Witness Angelides proposes a rate design for Media Mail and Library Mail which includes the use of one-half pound price increments for presorted parcels that weigh over 1.0 pounds and less than 5.0 pounds.

As Witness Angelides explains, particularly at the lower weights, a one pound incremental rate structure results in packages of significantly different weights paying the same rate. Postcom-T-5 at 6-7. His proposed rate design reduces this effect by moving to half pound increments at the lower weights. *Id.* On rebuttal, Witness Kiefer suggests there is inconsistency in Dr. Angelides proposal, because differences among the relative weight variation within weight steps remain. USPS-RT-11 at 34. There is no inconsistency: Dr. Angelides' proposal reduces the magnitudes of these relative weight variations overall.

Witness Kiefer also argues on rebuttal that Witness Angelides does not prove that weight differences by themselves cause a change in costs. This argument is wholly without merit. Every Postal Service rate class incorporates a rate that increases according to some weight increment. As Mr. Kiefer himself

acknowledges on cross-examination, Witness Angelides choice of a half-pound increment is far from revolutionary. Tr. 33/11156. Indeed, the Postal Service's own rate design for non-presort Bound Printed Matter, which provided the model for Dr. Angelides' proposal, similarly goes up in half pound steps from one to five pounds.

Witness Kiefer further suggests that Dr. Angelides should not have exempted the first pound from his half-pound incremental rate design, but the Postal Service has not offered any serious analysis of the point. USPS-RT-11 at 34. PostCom has no objections to providing a half-pound rate under the Media Mail rate structure, nor would PostCom object to one-ounce increments such as those that exist in Standard Mail. Particularly in light of the shape-based classifications and rates proposed in Standard Mail, PostCom would welcome a Commission recommendation that the Postal Service further explore increments below the first pound in Media Mail.²⁴

Dr. Angelides' proposed redesign reflects only a modest deaveraging of rates for Media Services, and yields rates that are fair and equitable. The modest changes in rate design further ECSI values (criterion 8), while maintaining the simplicity of a familiar rate design (criterion 7). Therefore, the Commission should recommend that the Postal Service adopt PostCom's proposed Media Mail rates.

²⁴ The Commission may take official notice of the fact that what used to be distributed on diverse and heavier media (such as vinyl records, 16mm film reels, and even books) are now distributed on significantly smaller and lighter, uniform and ubiquitous compact discs. Smaller weight increments may well be necessary for the Media Mail subclass rates to be designed in a manner that continues to be relevant to the educational, cultural, scientific, or institutional media.

VII. The Commission Should Adopt the Office of Consumer Advocate's Alternative Proposal Regarding Confirm Service in Its Entirety

The Office of Consumer Advocate ("OCA") has demonstrated that the Postal Service's transaction-based fee schedule will both adversely affect Confirm subscribers and reduce usage of the service. OCA-T-5 at 7-10. In addition, as the OCA's witness points out, the Postal Service rejected a transaction-based fee schedule in MC2002-1 because it would discourage expanded use of Confirm Service. *Id.* at 12-13. As an alternative to a transaction-based approach, the OCA proposes to retain the existing three-tier fee schedule, which includes an unlimited top tier, and adjust current fees in order to produce a cost coverage of 127.3% that is consistent with the Postal Service's proposal. *Id.* at 14-18.

PostCom fully supports the OCA proposal. By lowering the rates for Confirm Service for smaller mailers, increased overall usage will be encouraged. The retention of the unlimited platinum tier will create enormous economies and benefits to the Postal Service by encouraging the highest levels of increased usage.

Moreover, retention of the platinum subscription will promote resale of the service, which benefits the Postal Service because it enhances the value of Confirm and makes it more accessible to additional users. The Postal Service and Commission's concerns about the potential negative effects from arbitrage of

Confirm Service are unfounded. As Witness Bellamy states, under the OCA proposal,

any opportunity for arbitrage is limited to a maximum gain by a purchaser of \$19,500, less what the purchaser would pay to the reseller for the scans. Given the upper bound on the arbitrage opportunity, it seems likely that a business model which does not include competing with other resellers to provide added value would be unsustainable.²⁵

Witness Bellamy identifies several benefits of resellers: “[e]ach reseller must find a way to distinguish itself, adding more choices in the market offerings, and by seeking economies of scale, contributing to lower prices for consumers of the service. Since there are multiple resellers competing against one another on both price and efficiency, this contributes toward the achievement of the lowest combined costs across the value chain.” GHS-T-1 at 5.

CONCLUSION

For the reasons set forth above, the Commission should recommend that the Postal Service adopt rates and classifications consistent with the above-described positions.

Respectfully submitted,

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²⁵ GHS-ST-1 at 3.