

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

POSTAL RATE AND FEE CHANGES, 2006

:
:
:
Docket No. R2006-1

JOINT REPLY BRIEF
OF THE
SATURATION MAILERS COALITION
AND
ADVO, INC.

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January 4, 2007

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INTRODUCTION AND OVERVIEW

The Saturation Mailers Coalition (SMC) and ADVO, Inc. (Advo) hereby submit their joint reply brief to the Commission in this proceeding. Our positions on the issues in this rate case, and our supporting arguments and evidence of record, are fully laid out in our Initial Brief. This Reply addresses only those issues raised by other parties that warrant some comment. These are as follows:

NAA's Institutional Cost Coverage Argument. NAA's proposal to shift institutional costs from First Class to the ECR subclass – filed at the rebuttal stage even though it challenges the Postal Service's proposed cost coverages and should have been presented at the direct-testimony stage -- is unsupported, ill-conceived, and will harm the Postal Service's financial condition to the detriment of all mail users. NAA's narrow focus on relative cost coverages and markup indices ignores many other more relevant factors that the Commission has recognized are equally important in setting rates: (1) that the Postal Service's proposed First Class rate increases are below the systemwide average and the lowest of any subclass; (2) that those rates are in line with longstanding inflation trends; and (3) that the First Class coverage and markup index trends it cites are skewed by dramatic changes in First Class mail mix, and substantially overstate the true changes in relative institutional cost burden over time. Moreover, its

“remedy” will not stem diversion of First Class mail to superior electronic alternatives, but will jeopardize price-sensitive ECR volumes in any meaningful way.

NAA’s Opposition To The USPS-Proposed Slight Reduction In The ECR

Pound Rate. The Postal Service’s proposal to decrease in the high 64.3-cent ECR pound rate by a mere 0.2-cents is reasonable and well supported. Both Valpak witness Mitchell and SMC witness Crowder agree that ECR weight-related costs are quite low. Crowder has additionally demonstrated that even the proposed pound rate is still too high. No other mailer party objects to the decrease and even NAA’s own member-newspapers that use ECR mail to distribute their TMC advertising programs would benefit from a pound rate reduction. NAA’s opposition on this issue is again aimed only at harming saturation flat competitors.

NAA’s Arguments and Analyses on the ECR High Density-Saturation Rate

Differential. NAA witness Sidak correctly laid out the appropriate concept for setting the density rate differential between high-density and saturation flats. NAA witness Ingraham, however, did not correctly implement that concept. His confused costing analysis grossly overstates the unit costs of saturation flats and the resultant rate differential between high-density and saturation flats. Because of its misunderstanding of the approach required under Sidak’s concept, NAA’s criticism of SMC witness Crowder’s approach is unfounded and misdirected. Crowder’s approach not only correctly implements Sidak’s Efficient Component Costing concept but also demonstrates that the Postal Service’s proposed rate differential between high-density and saturation flats is cost-based and correct.

Valpak's Misguided Approach To Rate Design Within The ECR Subclass.

Valpak's arguments in support of an increased saturation letter-flat rate differential are wrong in concept and application, and produce distorted rate relationships. Witness Mitchell's "product pricing" approach, focusing blindly on the letter-flat differential in isolation from the other ECR rate elements, ignores the interrelationships between those elements – particularly the pound rate. Valpak has also grossly overstated the impact of the DAL surcharge on rates for other ECR mail. Finally, Valpak witness Haldi's argument regarding the unit delivery costs of saturation letters and flats has already been discredited in Docket R2005-1, and he has added nothing new to that argument in this case. In sum, Valpak's proposal to increase saturation letter-flat rate differential, as well as its related arguments, should be rejected in favor of SMC witness Crowder's approach.

AAPS's Non-Record Assertions On Brief. AAPS did not present a witness in this proceeding. Instead, AAPS attempts to use its initial brief as a vehicle for making allegations that the slight proposed reduction in the ECR pound rate will harm private delivery companies and competition – allegations that have no foundation in the evidentiary record, and a tactic that thereby deprives other parties of their due process rights to test the allegations through cross-examination and rebuttal. Aside from these serious due process problems, AAPS's non-record allegations, even if taken at face value, do not come close to establishing the kind of harm that would warrant rejection of the Postal Service's exceedingly modest proposal. By law, the Commission is required to base its decision on evidence of record. For these reasons, AAPS's unsupported allegations must be disregarded.

I. NAA’S PROPOSAL TO SHIFT INSTITUTIONAL COSTS FROM FIRST CLASS TO ECR MAIL IS UNSUPPORTED AND WOULD BE COUNTERPRODUCTIVE, TO THE POSTAL SERVICE’S FINANCIAL DETRIMENT.

As noted in our Initial Brief, NAA’s direct testimony in this case was confined to ECR rate design issues, and made no mention of the Postal Service’s proposed cost coverages, either for ECR or other mail subclasses. At the rebuttal stage, however, NAA unleashed an attack on the ECR cost coverage, arguing that institutional costs should be shifted from First Class Mail to the ECR subclass. At the rebuttal hearing, NAA witness Sidak was asked whether NAA was now attacking the Postal Service’s cost coverage proposal in *this* proceeding.

Q: You are not, in this testimony here, rebutting the Postal Service’s proposed cost coverage, are you, for purposes of this case?

A: *No, I’m not.* My testimony is of a more qualitative nature. I’m not putting forward any specific numerical proposal for a rate.

Tr. 10848 (emphasis added).

NAA’s Initial Brief removes any ambiguity about its intentions. Although its rebuttal testimony was putatively styled as rebuttal to Valpak and MOAA, its true target was the Postal Service’s cost coverage proposals (and more specifically, ECR mailers with which NAA’s member-newspapers compete) – an issue that should have been presented at the direct testimony stage.

Our Initial Brief described the serious flaws with Sidak’s late-filed rebuttal to the Postal Service’s proposed cost coverages, particularly with respect to the ECR subclass that his testimony hardly mentioned -- even though ECR is clearly NAA’s intended victim. We also explained why his “remedy” would do nothing to recapture or stem further diversion of First Class Mail to electronic alternatives, but would drive away

price-sensitive ECR volumes – to the net financial detriment of the Postal Service.
Initial Brief at 21-26.

In the following subsections, we address the arguments NAA presented in its initial brief, and particularly its omissions of a number of key pricing and cost coverage factors that the Commission in past proceedings has recognized are critical considerations in setting rates.

A. The Postal Service's Proposed First Class Rates – With Increases Below The System Average And The Smallest Increase Of Any Subclass – Are Eminently Fair And Equitable.

In its preoccupation with cost coverages and markup indices, NAA has overlooked one critical ratemaking factor: Mailers don't pay cost coverages; they pay rates. In this proceeding, the Postal Service's proposed average rate increase for First Class is well below the system average. As USPS witness O'Hara testified:

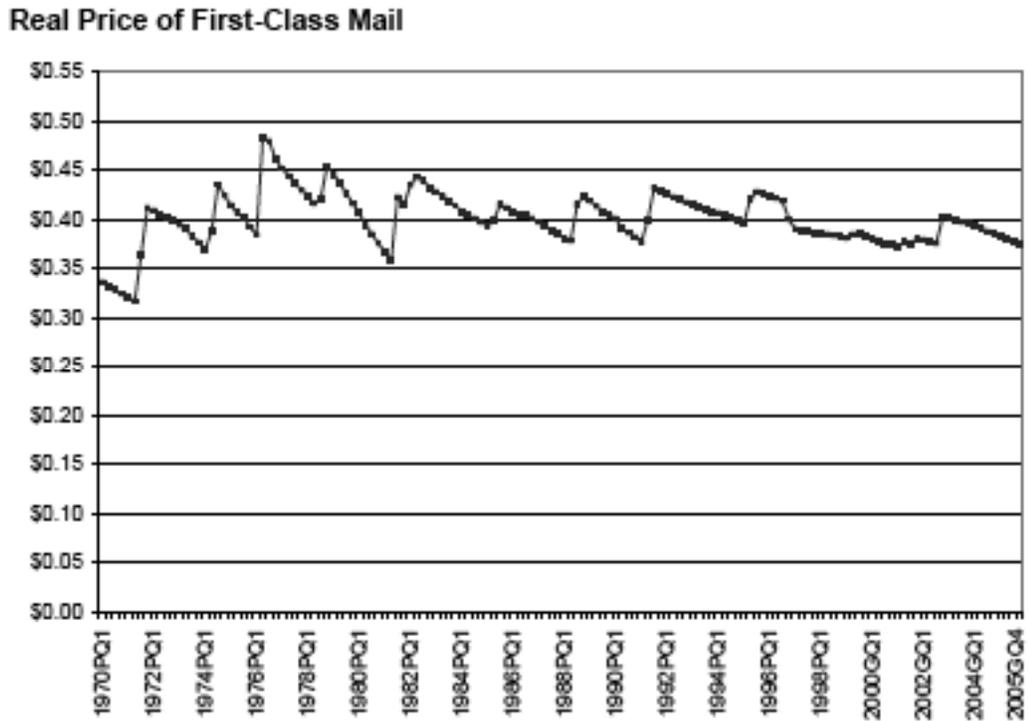
"The Postal Service is proposing a cost coverage of 229 percent for the First-Class Mail letters subclass. Consistent with that proposal, the rate for single-piece, one-ounce, letter-shaped pieces would rise from 39 cents to 42 cents, an increase of 7.7 percent. For the subclass as a whole, the proposed average increase is somewhat less at 7.1 percent, due to reductions in the additional-ounce rate. *This is well below the 8.5 percent system average increase proposed for this case, and it is the smallest increase for any subclass.*"
USPS-T-31 (revised) at 17 (emphasis added).

One will search in vain for any reference in NAA's brief to these most salient points. Contrary to NAA's implication that First Class mail is being overcharged (based on coverages and indices), the Postal Service's average proposed First Class rates are moderate in relation to other rates.

NAA's omission is not accidental. Its real interest is not in achieving lower rates for First Class mail *per se*, but in raising the rates for ECR mail with which its member-

newspapers compete. Its proposed shift of institutional costs from First Class to ECR is simply a means to that end.

The reasonableness of the Postal Service's First Class rates is also shown by their proximity to inflation. Over the last thirty years, the *real price* for First Class mail, adjusted for inflation, has been essentially unchanged, and has even declined slightly from earlier periods. This real-price trend is depicted in the following graph from USPS witness Bernstein's testimony (USPS-T-8 at 7):



The 39-cent single-piece rate implemented in January 2006 is precisely 200-percent greater than the 13-cent rate implemented in January 1976. Over that same period, the consumer price index (CPI-U) increased from 55.6 to 198.3, for an inflation

increase of 257 percent.¹ Thus, that 13-cent rate from 30 years ago, if adjusted for inflation, would be more than 46-cents in today's dollars! The Postal Service's proposed 42-cent rate is comparatively a bargain – even without factoring in the additional inflation that will occur between January 2006 and the start of the test year in October 2007.

In sum, the proposed First Class rates and average rate increases are clearly fair and equitable whether measured by the systemwide average increase or by the historic inflation-adjusted First Class rates.²

¹ Source: Department of Labor, Bureau of Labor Statistics, <http://www.bls.gov/cpi/>, "History of CPI-U U.S. All Items Indexes and Annual Percent Changes From 1913 to Present." The Consumer Price Index for All Urban Consumers, or CPI-U, is the inflation index specified by Congress for the new price cap regime under the Postal Accountability and Enhancement Act. See new section 3622(d)(1)(A). The CPI-U data published by DOL are subject to official notice.

² One aspect of NAA's argument warrants only brief mention. NAA opens its cost coverage argument with the bald claim that "there can be no denying that, historically, First Class Mail's status as the largest component and majority of the mailstream has underlined the Commission's decisions to assign it the majority of the institutional cost burden of the postal system." It then asserts (without citation): "*For that reason*, the cost coverage of First-Class Mail has consistently been set above the systemwide average..." NAA Brief at 25, 26 (emphasis added). This alleged linkage is false. At no time has the Commission ever held that the cost coverage for First Class should be set above the system average *because* First Class comprised the majority of mail volume. Even the cursory quotes NAA offers from prior decisions fail to support its proposition. Those citations merely state the obvious – that First Class mail has been the largest class in terms of volumes and revenues. Nowhere has the Commission cited these facts as a "reason" for setting the First Class cost coverage "above the systemwide average." Conversely, the relative First Class v. Standard class volume trends do not justify reducing the relative First Class cost coverage.

B. As The Commission Has Previously Recognized, Changes In First Class Coverages And Markup Indices Have Been Skewed By Dramatic Changes In Mail Mix, And Do Not Truly Represent An Increased Burden On First Class Rates.

Over time, First Class cost coverages and markup indices are affected not only by changes in rates, but even more importantly by changes in mail mix within the class. Because the Commission sets discounts for workshared (presort) First Class letters using efficient component pricing, which reflects less than the full attributable cost differences between presort and single-piece letters, workshared letters have a higher implicit cost coverage than single-piece letters. As the percentage of workshared letters increases within First Class, the mathematical result is a higher average cost coverage and markup index for the class as a whole *without regard to rate changes*. Such a mail-mix-related increase does not represent an increased “rate burden” on First Class. For this reason, as the Commission has recognized, simplistic reliance on historical trends in coverages and indices can produce grossly misleading conclusions.

NAA, in its narrow focus on trends in the First Class markup indices (Brief at 26), has ignored the Commission’s discussion and findings in its R2000-1 Decision concerning the impact that changes in First Class mail mix have had over time. There, the Commission observed:

“As workshared letters have become a greater proportion of total First-Class Mail volumes, cost coverage for the class has generally increased over time.... In turn, this has caused its markup to increase as well.... For example, from Docket No. R87-1 through Docket No. R97-1 coverage for First-Class letters has increased from 158 percent to 172 percent. Its markup index has also increased over that time, from 1.200 to 1.308. These results stem, in large measure, from setting the discounts consistent with efficient component pricing.”

R2001-1 R.D. at 203 (citations and footnote omitted).

Even without any rate change, a change in mail mix (i.e., a greater proportion of

workshare mail) causes the calculated First Class cost coverage and coverage index to increase – even though mailers are continuing to pay the same relative rates.

Obviously, this mail-mix induced change in markup indices, a mathematical phenomenon that has little to do with rates, does not impose a greater burden on First Class mailers.³

In its R2000-1 decision at page 202, the Commission presented a table showing the changing mix within First Class from 1988 through 1999. We have reproduced that table below, updated with RPW volume data through 2005.⁴

³ In the extreme hypothetical example, if all First Class single-piece letters converted to workshared letters, the resulting average cost coverage and markup index for the class as a whole would increase up to the higher implicit cost coverage of presort letters, even without any change in rates.

⁴ Source: FY 1988-99 from PRC R.D. R2000-1 at 202; FY 2000-05 from USPS RPW Reports.

First-Class Letter Mail

(Volumes in billions)

Fiscal Year	Single-Piece	Workshare	Total	Workshare as % of Total
1988	55.8	24.8	80.6	30.8%
1990	56.8	27.6	84.4	32.7%
1992	55.0	31.2	86.2	36.2%
1994	55.1	35.5	90.6	39.2%
1996	54.2	39.1	93.2	41.9%
1998	54.3	40.6	94.9	42.8%
1999	53.8	42.9	96.6	44.3%
2000	52.4	45.7	98.0	46.6%
2001	50.9	47.2	98.2	48.1%
2002	49.3	47.7	96.9	49.2%
2003	46.6	47.3	93.8	50.4%
2004	45.2	47.3	92.5	51.2%
2005	43.4	49.1	92.4	53.1%

This table clearly shows that the change in First Class mix is continuing, with the percentage of workshare mail increasing from about 31 percent in 1988 to 44 percent in 1999 at the time of the R2000-1 decision, and since then having grown to 53 percent in 2005 – now constituting the majority of First Class mail. This change in makeup alone is likely the major driving factor in the trends in First Class markup indices cited by NAA.

In elaborating on this mail-mix phenomenon, the Commission flatly eschewed slavish reliance on trends in coverages and indices in setting rates. In rejecting ABA/NAPM witness Clifton's proposal to shift institutional costs from First Class to Standard mail, the Commission stated:

“Third, the increase in First-Class cost coverage over time, absolutely and relatively, may manifest changed circumstances, e.g., in postal operations or mail mix. Indeed, notwithstanding the increase, it would appear that First-Class Mail's relative contribution to institutional costs has remained relatively stable since 1990.” R.D. at 204 (citation

omitted).

The Commission similarly rejected the OCA's analyses of contribution indices which purported to show increasing First Class contributions, stating that:

"OCA witness Callow shows through a variety of indices that the contribution to institutional cost by First-Class letter mail is increasing. Postal Service witness Mayes proffers a logical explanation that some of this increase may be due to a shift in the mail mix from higher processing cost single-piece mail to lower processing cost worksharing mail. *The net effect is that the contribution to institutional costs by single-piece mailers is not rising as rapidly as the aggregate of all First-Class letter mail.*"

R.D. at 234 (emphasis added).

The Commission summarized by emphasizing that setting cost coverages and rates requires a broader look at a number of factors, not just at trends in cost coverages and markup indices:

"The Commission examines rates from several different perspectives as a check on its rate analysis and recommendations. It is not illogical to look at trends in the indices as witness Callow has, or to use Commission recommended indices as an approximation during the intervening years. What Callow has successfully done is to depict a trend. However, this trend is only one factor to be examined in a very complex process. As the Postal Service suggests, *the Commission also looks at relative rate increases, and rate increases compared to the rate of inflation as other checks to its recommendations.*"

Id. at 234-35 (emphasis added). As the Commission concluded in recommending the Postal Service's proposed First Class rates:

"Recommending the single-piece First-Class rate entails balancing several unpleasant choices. As MMA noted, each penny of this rate affects hundreds of millions of dollars in Postal Service revenue that would otherwise be assessed to other mail classes. Balancing this is the already high institutional cost contribution of First-Class mailers. *On the other hand, the rate increase for First-Class Mail is in line with inflation, and is lower on a percentage basis than the system wide rate increase.* For these reasons, the Commission recommends the Postal Service's proposed first-ounce single-piece rate."

Id. at 235 (emphasis added).

That same conclusion applies here. The ostensible trends in coverages and markup indices cited by NAA are subject to the same continuing upward skewing due to changes in mail mix as in R2000-1, a mathematical effect that does not represent an increased rate burden on First Class. If anything, the true trend – normalized for changes in mix – may be downward. And here again, as in R2000-1, the Postal Service’s average proposed increase for First Class mail is below the systemwide average, and the lowest increase of any subclass.

C. The Postal Service Cannot Effectively Compete With Electronic Alternatives On The Basis Of First-Class Postal Prices; Trying To Do So By Shifting Institutional Costs To ECR Would Make Matters Worse.

NAA’s discussion of the relationship between price elasticities and electronic substitutes for First Class mail is simplistic and ill-conceived in the extreme. NAA claims, for example, that the emergence of the internet “would have been expected to increase, not decrease, the price elasticity of single-piece First Class letters.” NAA Brief at 37-38, citing Clifton. This contention, however, erroneously assumes that losses to electronic substitutes have been due to postal prices. If any thing is clear on this record, it is that such losses have been overwhelmingly due to substantially greater technological advantages of those substitutes – unrelated to postal prices. See Bernstein, USPS-T-8 at 9-27; *and* Thress, USPS-RT-2 at 11-15 and Tr. 38/13144-45.

Even worse, citing witness Sidak’s observation that the price of electronic substitutes has “fallen substantially” in recent years, NAA jumps to the conclusion that:

“The problem is that the Postal Service has not attempted to compete with this price decline in its own price of First Class letters.” NAA Brief at 38, fn. 32. The truth, which even Sidak conceded, is that the Postal Service *can’t compete* with electronic alternatives by lowering First Class rates. Sidak’s own “bill-payer example” illustrated this point. Postage is only a relatively small component of the total opportunity cost of the mail compared to the substantial technology and service advantages of electronic alternatives. Chopping a penny off the First Class rate barely puts a dent in the opportunity cost differential, as shown in our Initial Brief at 23-24 and fn. 4.

NAA’s “solution” is worse than futile. Lower rates for First Class mail will not only fail to regain lost volumes or stem further diversion to electronic alternatives, but would be achieved by shifting the institutional cost burden to ECR mail – a highly price-sensitive and competitive subclass where postal rates do, indeed, have a major impact on volumes.

II. CONTRARY TO NAA’S CLAIM, THE POSTAL SERVICE’S PROPOSED SLIGHT REDUCTION IN THE ECR POUND RATE IS FULLY JUSTIFIED.

The Postal Service has proposed to reduce the ECR pound rate from 64.3 cents down to 64.1 cents, a reduction of only 0.2 cents per pound. NAA nevertheless opposes this ever-so-slight change as “unsupported on the record and unfair in a case where other mailers are facing large rate increases.” NAA Brief at 20. It is NAA’s contentions that are unsupported.

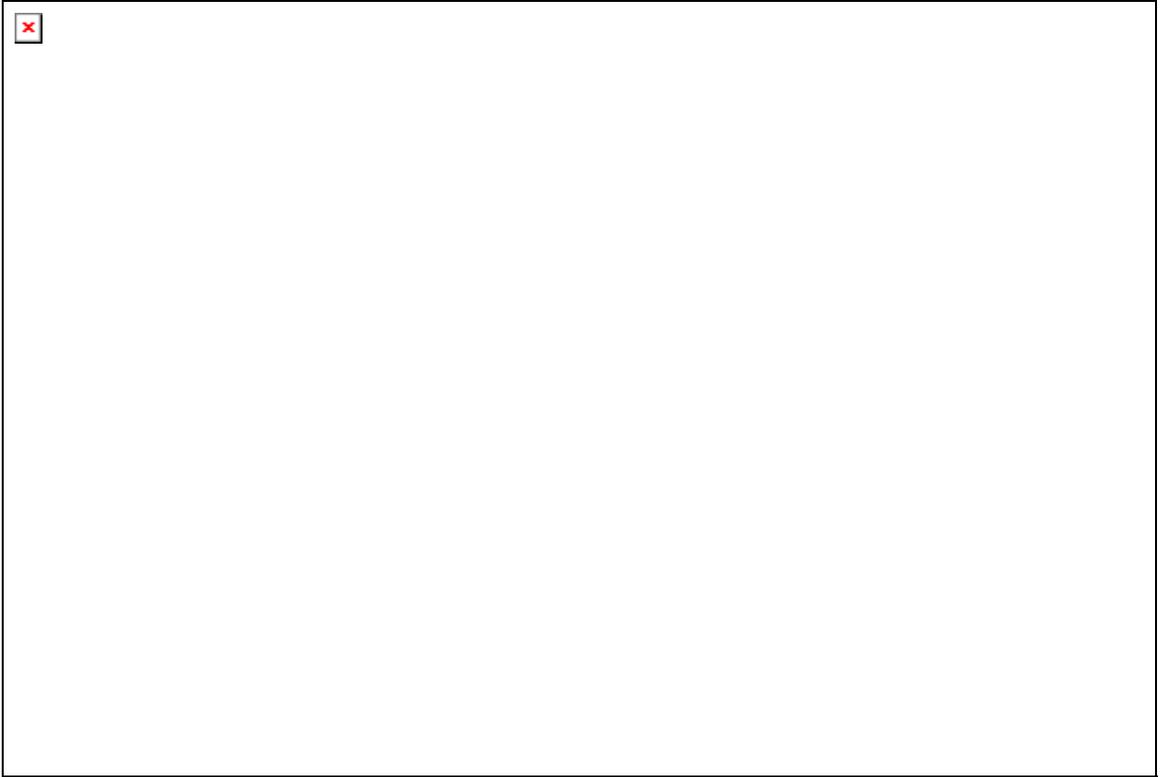
As to the contention that the change is “unfair” to “other mailers ... facing large rate increases,” suffice it to say that no such “other mailers” oppose the Postal Service’s proposal. The only mailer party that opposes is NAA. Yet its member-newspapers use

the mail for distribution of their Total Market Coverage advertising programs to nonsubscribers at ECR high-density rates, and will benefit from the slightly lower pound rate, since those TMC mailings on average weigh significantly more than saturation flat mailings.⁵

There can be no doubt that weight-related costs in ECR are quite low. So low, in fact, that Valpak witness Mitchell used the “presumption that the effects of weight on costs is not large” as justification for a 100-percent or higher passthrough of the letter-flat cost difference (VP-T-1 at 179) – ignoring the corollary that if weight-related costs are low, then the pound rate is too high. Crowder, SMC-RT-1 at 16, fn. 23.

Ironically, the evidence of low weight-related costs cited by Mitchell was the Postal Service’s response to an NAA interrogatory requesting a breakout of ECR unit costs by ounce increment. NAA/USPS-1, Tr. 9/6295. That cost data for ECR flats, as requested by NAA, is reproduced in graphic form below:

⁵ According to USPS billing determinants, high-density flats drop shipped to destination delivery units (the rate used by newspaper TMC programs) have an average weight of 4.8 ounces, compared to only 3.3 ounces for DDU saturation flats. USPS LR L-36 (WP-STDECR-R0621.xls, ECR Commercial BDs).



This extremely flat cost pattern, evidencing low weight-related costs, is hardly new. It is the same pattern that has been found in every prior proceeding where the pound rate has been litigated.⁶ Compared to this cost pattern which shows unit costs under 20 cents all the way out to the last ounce increment, the current pound rate of 64.3 cents is clearly excessive.

On brief, NAA attempts to discredit the ounce-increment data it asked for, claiming that “it appears that those data are based on IOCS tallies.” NAA Brief at 20-21, fn. 18. That is incorrect. The unit cost data presented in NAA/USPS-1 include *total*

⁶ The large increase in the 15-16-ounce increment is also not new. However, that last ounce increment accounts for an infinitesimally-small portion of ECR volume. In Docket R2000-1, for example, this last increment represented less than 0.04% (four *ten-thousandths*) of total ECR volume. R2000-1, Tr. 1207.

ECR attributable costs, not just IOCS costs.⁷ NAA also cites the Postal Service's statement that unit costs for individual ounce increments "may be subject to substantial sampling variability, particularly higher ounce increments for letters and flats, and for parcels generally," which NAA mischaracterizes as a "concession" that the data "are unreliable." Yet for ECR flats, the pattern of unit costs does not exhibit the kind of wild and random gyrations one would associate with substantial sampling variability. The only aberrational unit cost that is clearly out of line is for the last 15-16-ounce increment, which as noted above accounts for less than four ten-thousandths of total ECR volume. Focusing on that single miniscule data point for purposes of assessing overall ECR weight-related costs would be an extreme example of "the tail wagging the dog."

The Postal Service's proposal to reduce the rate by a measly 0.2 cents down to 64.1 cents is the tiniest step in the right direction, and is fully supported by the evidentiary record. See *also*, Crowder, SMC-RT-1 at 14-16, *and* SMC Initial Brief at 26-33.

We anticipate that, on reply brief, NAA or Valpak may challenge witness Crowder's assessment of weight-related costs on the ground that, in setting the ECR pound rate, weight-related costs should be "marked up" by the ECR cost coverage factor. Valpak, for example, apparently believes that this is the Commission's established approach in setting the pound rate, based on statements in the Commission's Docket R2000-1 recommended decision. There, the Commission said:

"It should also be noted that Val-Pak, et al. enhanced the record by emphasizing that the *cost per pound should be marked up* when it is

⁷ This is clear from the spreadsheet that accompanied the USPS's response, NAA.USPS.1.ECR-by-oz.xls.

used as an input to the rate design formula. They noted that *pound costs in other subclasses are marked up* in the rate design process, including First-Class, Priority, Periodicals, and Standard B.”

PRC R.D. 2000-1 at 365, ¶5462 (emphasis added).

But this is not, in fact, how the Commission sets the ECR pound rate. Rather than starting with weight-related ECR costs and then marking them up by the subclass cost coverage factor, the Commission explained that the pound rate is *selected without regard to true weight-related costs*, a process which the Commission said results in an “implicit cost coverage” for pound-rate mail:

“Including a markup in the pound rate is logical since all the rates should recover attributable cost plus markup. Thus, when the Postal Service proposes a pound rate and when the Commission recommends a pound rate, there is *an implicit cost coverage attached* to both the piece rate and pound rate for mail above the breakpoint.” *Id.* (emphasis added).

The resulting “implicit cost coverage” has no logical relation to the ECR subclass cost coverage, and is not even a true cost coverage at all – because it is not applied to “costs” in order to establish the “rate.” It does not even qualify as the obverse of a true cost coverage -- i.e., the resulting cost coverage that “falls out” from the selected rate – again because the pound rate is selected without regard to weight-related costs. The “implicit cost coverage” nomenclature is instead merely an *ad hoc* and unquantified rationalization for setting a pound rate that greatly exceeds any reasonable estimate of even marked-up weight-related costs, casting an aura of rationality where none exists.

Given the extensive evidence in this case of the low weight-related costs of ECR pound-rated mail -- evidence consistent with that presented in past cases and acknowledged in this case even by Valpak witness Mitchell -- if those true weight-related costs were marked up by the ECR cost coverage, the resulting pound rate would

be far below the current rate.⁸ The Commission should therefore recommend an ECR pound rate no higher than that proposed by the Postal Service.

III. VALPAK'S ECR RATE DESIGN CONCEPTS AND PROPOSALS, AND ITS RELATED ARGUMENTS, ARE ILL-CONCEIVED, MISAPPLIED AND SHOULD BE REJECTED IN FAVOR OF CROWDER'S APPROACH.

A. Witness Mitchell's "Product Pricing" Approach For Setting The Letter-Flat Rate Differential Is Incorrect In Concept And Application, Ignores Interrelationships With Other ECR Rate Elements, And Produces Distorted Results.

A significant focus of debate in this proceeding has been the appropriate economic approach to pricing of the rate differential between letters and flats. Valpak witness Mitchell advocated that ECR letters and flats are "separate products" for which Efficient Component Pricing on the basis of cost differentials is inappropriate, arguing that the rate differential should "optimally" be set by marking up the cost differential by the subclass cost coverage. SMC witness Crowder strongly disagreed with Mitchell's

⁸ See our Initial Brief at 30-33. Crowder presented other evidence corroborating these low weight-related costs, showing, for example, that even under the absurd assumption that the *entirety* of ECR costs were purely weight-related, with no piece- or shape-related costs whatsoever, the resulting cost would be only 45.7 cents per pound, far below the proposed 64.1-cent pound rate. SMC-RT-1 at 16. Because there are, in fact, substantial piece-related costs within ECR (as Mitchell claimed in support of his high proposed letter-flat passthrough), Crowder's hypothetical-based 45.7-cent pound cost far exceeds true weight-related costs. As she emphasized, this "extreme" estimate is "well above an upper bound on the origin-entry pound cost," and that she was "absolutely convinced that even the pound rate I include in my sample rates includes a huge cost contribution to institutional costs." *Id.* and Tr. 35/11839-41 (re-direct). Valpak, as it did in R2005-1 with a similar extreme hypothetical cost estimate, will likely argue on reply that Crowder's "estimated pound cost," when marked up by the ECR cost coverage, would produce a pound rate higher than the existing rate. The Commission should not be fooled by such tactics. True weight-related costs are undoubtedly far below Crowder's hypothetical "100% weight-related cost" scenario, and even after application of a markup would be below the proposed pound rate.

approach within the ECR-subclass context, and advocated the use of ECP principles where price elasticities of products within a subclass were unknown. SMC-RT-1 at 22-25; Tr. 35/11829-31 and 35. Valpak claims that Mitchell's approach improves efficiency more so than does ECP. Brief at IV-9-13. To the contrary, Crowder has clearly explained that this is untrue for ECR where Mitchell's simplistic assumptions regarding relative price elasticities and competitive interactions are completely incorrect. SMC-RT-1 at 25-29. She also clearly explained and demonstrated that Mitchell's product pricing approach, as he improperly applies it, would reduce efficiency relative to ECP, the opposite of Valpak's claim. SMC-RT-1 at 29-32.

However, Crowder noted that if the Commission were to adopt "product pricing" for rate elements within ECR, the most appropriate "product grouping" based on both cost and demand/market factors is saturation/high-density flats – an extremely competitive product group that (unlike other ECR categories) is highly susceptible to and makes extensive use of private delivery, and is the most price-sensitive grouping that would be most harmed by Valpak's mechanistic proposal to mark up the letter-flat cost differential. SMC-RT-1 at 28-29.

In many respects, the most interesting approach to this issue was adduced from USPS rebuttal witness Kiefer in cross-examination – an approach that is fully consistent with Crowder's. Kiefer's written rebuttal (USPS-RT-11 at 15-19) could have been construed as siding with Mitchell, that Standard Mail flats could appropriately be charged a markup over their cost difference. In cross, though, he clarified his position and sharply disagreed with Mitchell's robotic approach to the pricing of flats. He emphasized that his rejection of ECP for letters versus flats did *not* mean that flats

should therefore be charged a passthrough of 100-percent-or-more of cost differences as Mitchell advocated, but could also justify a less-than-100-percent passthrough depending on circumstances. Tr. 33/11161.

In particular, Kiefer acknowledged that ECR subclass flats call for different treatment than Regular subclass flats, and that a passthrough of less than 100 percent is justified in ECR.⁹ He also noted that ECR flats are likely more price sensitive than ECR letters – warranting a low passthrough under principles of product pricing. Tr. 33/11163-64.

Finally, Kiefer explained that a fundamental flaw in Mitchell’s approach was his myopic focus on just one rate element within the ECR rate structure – the letter-flat rate differential – ignoring the interrelationship between that rate element and the others, particularly the ECR pound rate. He agreed that in setting rates within ECR, all the rate elements must be looked at together, because rate changes in one element require offsetting adjustments in others, and that Mitchell’s failure to consider these interrelationships can produce rate distortions. He emphasized that setting rates is not a mechanical process that should be done by plugging inputs into a rigid “presort tree” computer program, but instead requires a great deal of flexibility and judgment that balances all the rate elements and all the ratemaking factors. USPS-RT-11 at 20-24, and Tr. 33/11158-64.

⁹ Tr. 33/11157-58. The letter-flat relationship in Standard Regular is substantially different from that in ECR. However, both Mitchell in VP-T-1 (e.g., at 114-17) and Valpak on brief (at IV-4-5) address the flawed Standard Regular relationship and then incorrectly imply the same flaw in the ECR relationship

Kiefer's points in cross-examination are the same as Crowder's. Her rebuttal testimony thoroughly exposed the fallacies of Mitchell's misplaced preoccupation with a single rate element within ECR – the letter-flat rate differential – to the exclusion of other equally or even more important elements such as the pound rate. She also explained in cross that regardless of the economic concept chosen as a benchmark, pricing within a subclass is still an art that requires a balancing of many factors, the same point Kiefer made. Tr. 35/11835-36. As described at length in our Initial Brief, Crowder's rebuttal testimony, along with cross-examination of Mitchell on rebuttal, demonstrate beyond question that (1) Mitchell's product pricing approach is conceptually flawed, incorrectly applied, and produces absurd results; and (2) the letter-flat differential and the pound rate are intrinsically interrelated, and that unlike Mitchell's tunnel-vision approach to pricing which generates economically-inefficient and illogical rate relationships, the correct approach must consider and balance all the ECR rate elements and all the pricing factors – including marketplace factors. Initial Brief at 26-30, 34-45.

For these reasons, we urge the Commission to reject Valpak's flawed approach to pricing within the ECR subclass, and to recommend rates in conformance with the sound pricing principles and factors set forth in Crowder's testimony.

B. Valpak Exaggerates The Impact Of Crowder's DAL Rate Design Proposal And Ignores the Major Contributions That DAL Flats Have Made To Institutional Cost

Valpak's discussion of Crowder's DAL rate design proposal vastly exaggerates its impact on other ECR mail, and its counter-proposal ignores the impact on saturation flat mailers who are eliminating their DALs. Valpak Brief at IV-7-9. As we anticipated in our Initial Brief, Valpak bases its claim on the assumption that with

implementation of the DAL surcharge, fully half of all DALs will continue to remain in the system and pay the surcharge. *Id.* at IV-8. This, as Valpak well knows, is preposterous. As explained in our Initial Brief, the saturation mail industry agrees that with the surcharge, only an extremely small number of DALs will remain in the system. Initial Brief at 16-18. NAA agrees as well. (NAA Brief at 7-8, citing the “overwhelming evidence” that nearly 90 percent of DALs will convert, and that the volume of DALs in the test year “will be quite small compared to today.”). Thus, the impact claimed by Valpak will be negligible.¹⁰

There is, however, one additional point that warrants comment. Valpak claims that DALs have never benefited letter mailers. Valpak Brief at IV-9. This is a very narrow viewpoint. In truth, the DAL option has permitted a number of saturation flat mailers to enter the system and even grow. SMC-T-1 at 5-6. Historically, without that option, the substantial institutional cost contribution made by saturation flat mail would have been lost. And, some of that would undoubtedly have been made up by all other ECR mailers.

Now, recent technology improvements have enabled many of these same saturation flat mailers to commit to eliminating their DALs in order to generate postal cost savings and achieve a more reasonable postal rate. Their commitment, however,

¹⁰ This is a familiar Valpak tactic. In her testimony, witness Crowder used an extremely conservative 50-percent conversion assumption *solely* for purposes of conservatively estimating aggregate USPS cost savings and the effect on its proposed revenue requirement and ECR institutional cost contribution targets. She made clear that the *actual* DAL conversion percentage will unquestionably be far higher – and Valpak itself has never suggested otherwise. Valpak’s use of that assumption for an entirely different purpose is an intentional distortion of the record. See our Initial Brief at 16-18.

entails considerable continuing expense and risk. They should not also be burdened by having to continue to cover DAL costs they are working so hard to eliminate and are no longer causing. But, that is precisely what Valpak recommends.

C. Contrary To Valpak's Assertions, The Postal Service's City Carrier Costs Do Reflect Costs Caused By The Delivery Of More Than One Sequenced Mailing At A Time.

Valpak incorrectly argues that the Postal Service's city carrier cost systems do not accurately capture the costs associated with constraints on carrier capacity to handle sequenced bundle mail. It reiterates witness Haldi's arguments from R2005-1 on this matter and claims that new information has come to light. Valpak Initial Brief at III-1-10. We have explained in our initial brief that no new information has been uncovered by Valpak and that Valpak's assertions are both wrong and self-serving. We have also dealt with Valpak's completely wrong arguments on the impact of DPSing saturation letters. Initial Brief at 49-51.

Although our Initial Brief dealt with most of Valpak's arguments on this issue, Valpak makes two incorrect and extremely misleading assertions in its Initial Brief. First, it implies that because the fronts of postal delivery vehicles have room for only three trays, only three "bundles" can be handled by a carrier. It argues that this is "new" information and means that a carrier has capacity for only one sequenced bundle (the other two bundles being the DPS and the Vertical Flat Case bundles) on motorized routes. Valpak Brief at III-6-7. But Valpak knows better. City carriers organize the mail for delivery in many different ways within those three trays. They can take multiple sequenced bundle mailings out even within the "constraint" of having only three trays in the front of the vehicle, next to the driver-carrier. This has been repeatedly explained by

both Postal witness Lewis in R2005-1 and Postal witness Coombs in this case. Indeed, Coombs has directly stated that arrangement in response to Valpak cross-examination.¹¹

Second, Valpak confuses the terms “conflicts” and “constraints.” Valpak Brief at III-6, fn. 9. Both Lewis and Coombs use the term “conflict” to mean that more than one saturation mailing must be carried out in one day. However, they explain that rarely are there conflicts but even when there is a “conflict,” those mailings can often still be carried out as sequenced mailings.¹² “Conflicts” clearly are not absolute constraints as Valpak describes them.

Valpak implies, that when there is a “conflict,” an additional cost is caused that is not measured in the Postal Service cost system. Valpak Brief at III-6, fn. 9. However, this is wrong. Carrier preparation of mail – either casing, collation, or arrangement within trays – is captured in both the IOCS and CCSTS data. Thus, even when there is a “conflict,” the additional cost it causes is reflected in the total unit cost of saturation flat mail. This can be seen in the UDC unit cost model presented by USPS witness Kelley. Clearly some saturation flats are handled as cased mail and Kelley has explained to

¹¹ See witness Coombs’ responses to VP-USPS-T44-5, 9, 17; and to cross-examination, Tr. 13/3745-54. See *also* witness Lewis’ responses to cross-examination in R2005-1, Tr. 6/2420-21 and 11/5995-98.

¹² See Coombs, USPS-T44 at 13 and responses to VP-USPS-T44-3, 13, 17, 18, 21. See *also* Lewis, R2005-1 at Tr. 13/3750. As Lewis stated in response to Valpak cross on how a motorized carrier could handle multiple sequenced bundle mailings: “It’s a housekeeping thing, that’s all. You wouldn’t necessarily have to have the whole route mailing A in the same tray and have a separate tray for every mailing. I could set my trays up so that this tray was Pine Street and have all of the mail for Pine Street in a tray or in two trays. It’s just housekeeping. It’s how you manage the inventory as you’re working your way through the route.” Tr. 11/5997-98 in R2005-1.

Valpak that collation (and all other sequenced mailing preparation) costs are correctly included in the saturation flat delivery cost.¹³

Valpak's mischaracterized arguments on this issue should be ignored.

IV. NAA'S ANALYSIS OF THE ECR HIGH DENSITY-SATURATION COST DIFFERENTIAL IS BOGUS, AND DOES NOT SUPPORT REDUCING THE COST-BASED RATE DIFFERENTIAL PROPOSED BY THE POSTAL SERVICE.

A. We Agree With NAA's Standards For Setting The High-Density/Saturation Flat Piece Rate Differential But Disagree With Its Botched Cost Analysis.

In concept, NAA has correctly laid out the appropriate standards for setting the piece rate for ECR saturation flats that do not use DALs, as well as for setting the piece rate differential between saturation flats and high density flats. As it states:

“[T]he amount of the DAL surcharge should not influence the ‘base’ saturation rate paid by all saturation mailers.” NAA Brief at 7.

NAA further elaborates that:

“The proper way to price DALs is through a separate surcharge that does not distort the correct relationship between the ‘base’ rates for high density *and on-piece addressed saturation flats*. Only by doing so can the Commission set the relationship between high density and saturation rates in a cost-based manner.” *Id.* at 12 (emphasis added).

We fully agree with that statement, which is consistent with the efficient component pricing principles endorsed by both NAA witness Sidak (NAA-T-1) and SMC witness Crowder (SMC-RT-1). The rate paid by mailers of on-piece-addressed saturation flats should reflect their costs, and should not be “averaged” with the costs of

¹³ USPS LR L-67 (UDCModel.USPS.xls, 2. summary TY); VP/USPS-T30-21 and 28; see *also* USPS-RT-3 in R2005-1 (Bradley).

DALs that they do not use. Similarly, in NAA's words, "the correct relationship between the 'base' rates for high density and on-piece addressed saturation flats" should not be "distorted" by imposing DAL costs on the latter through an averaged rate.

The real problem is that NAA totally botched its analysis of the correct cost differential between on-piece-addressed high density and on-piece-addressed saturation flats. Among other things, in NAA witness Ingraham's simplistic but convoluted cost analyses (NAA-T-2):

- He incorrectly and grossly underestimated the unit incremental cost of a DAL.
- For DALs that will be eliminated from the system, he drastically understated the extent to which the DAL costs will be saved, and then he shifted those phantom "unsaved" costs to on-piece-addressed saturation flats.¹⁴ SMC-RT-1 at 9, see also fn. 10 at 9.
- For DALs that will remain in the system, he allocated the DAL cost to on-piece-addressed saturation flats that will not use DALs. SMC-RT-1 at 9.
- He made no attempt to deaverage the high-density/saturation averaged mail processing cost, although the argument for deaveraging the mail processing cost is exactly the same his argument for deaveraging the delivery cost. SMC-RT-1 at 17, fn. 27.
- Even though the record shows that high-density flats also use DALs, he made no attempt to adjust the unit cost of on-piece-addressed high-density flats to reflect that fact. SMC-RT-1 at 9.

Thus, contrary to ECP principles, Ingraham constructed an "averaged" unit cost for on-piece addressed saturation flats that includes a great amount of DAL cost that will vanish in the test year, and then he compounded his error by comparing that excessive

¹⁴ He assumed that no DAL mail processing or city carrier in office cost would be saved and only 80% of DAL city and rural delivery cost would be saved. SMC-RT-1 at 9.

saturation unit cost to an on-piece-addressed high-density saturation flat that excludes all relevant DAL costs.

Because of this botched analysis, NAA incorrectly implies that Ingraham properly excluded DAL costs from its proposed rate for on-piece-addressed flats by assuming that the Postal Service “will capture 80 percent of the cost savings that would accrue from a 75 percent reduction in the number of DALs in the system,” which it claimed “produced an estimate of 0.751 cents as the incremental cost of a DAL.” NAA Brief at 17. That calculation and its results are absurd. According to USPS data, the cost of a DAL alone exceeds 3.9 cents. NAA’s DAL cost estimate of 0.751 cents represents *less than 20 percent* of the USPS-estimated 3.9-cent DAL cost! Even worse, it is this greatly-understated *cost of DALs* that Ingraham used as his *rate differential* between high density and on-piece-addressed saturation mail.

The illogic of Ingraham’s methodology is underscored by NAA’s own characterization:

“Dr. Ingraham illustrated the flaw in the Postal Service’s analysis by calculating the proportion of saturation flats mailers that would have to use DALs for the price of a saturation mailing to maintain, on average, the current 0.9 cent difference between high density and saturation flats. NAA-T-2 at Table 4. Dr. Ingraham determined that more *than 85 percent of all ECR saturation flats* would have to use DALs before the differential paid by high density and saturation flats would, on average, equal 0.9 cents. Given that the record suggests that the proportion of DALs will be LESS than 15 percent, one can only conclude that the average differential between high density and all saturation flats (even factoring in the DAL surcharge) would likely exceed 1.6 cent per piece, compared to 0.9 cents today, under the Postal Service’s proposal.” NAA Brief at 8 (emphasis in original).

This comparison of averaged *rate* differentials (without reference to costs) is meaningless for purposes of setting a cost-based rate differential. This also makes

clear that Ingraham's rate differential is based on the *averaged* cost of saturation flats with and without DALs, not on the cost of on-piece-addressed flats that Sidak (and NAA at page 12 of its brief) acknowledged as the correct benchmark.

Moreover, Ingraham's rate differential calculation was offered for the purpose of arguing that, for saturation mailers that currently use on-piece addressing rather than DALs, the Postal Service's proposal would "increas[e] from 0.9 cents to 2.2 cents the rate advantage enjoyed by the majority of saturation mailers over their high density competitors without their making any changes in their addressing practices." NAA-T-2 at 9. What this ignores is that on-piece saturation mailers *currently* are paying a rate that is too high, *precisely because* the current rate averages-in the high cost of DALs that they do not use. The *very purpose* of deaveraging the saturation rate – with a lower rate for on-piece addressed flats and a surcharge for DALs – is to bring the rate for on-piece addressed flats down, in line with their lower costs, correcting the overcharging that currently exists. Ingraham's approach turns rational cost-based pricing on its head, arguing that those on-piece address mailers that are currently paying too much should continue to do so – without regard to costs – in order to maintain a less-than-cost based rate differential with high-density mail.

SMC witness Crowder, by contrast, correctly applied the principles of efficient component pricing by estimating the correct unit cost differential between on-piece addressed saturation and high-density flats, and applying that cost differential as the piece rate differential. As Crowder showed:

- The on-piece-addressed saturation flat cost (and likewise, the correct rate) is substantially lower than assumed in the Postal Service's filing, and

- At the origin-entry level, the high density-saturation flat cost difference, based on the correct high-density and saturation on-piece-addressed flat unit costs, is 2.2 cents – precisely the rate differential proposed by the Postal Service.

Accordingly, NAA's proposal to reduce the Postal Service's proposed piece-rate differential between high-density and saturation flats is not cost-based, would bias postal rates against saturation flat mailers, and would cause inefficient market decisions. It should, therefore, be rejected.

B. NAA's Skepticism Of Crowder's On-Piece-Addressed Saturation Flat Cost Is Due To Its Misunderstanding Of The Delivery Cost Analysis And Its Mischaracterization Of The Postal Service's Testimony.

On the carrier delivery cost side, NAA's skepticism about Crowder's estimate of the unit cost for on-piece-addressed saturation flats stems from its fundamental misunderstanding of the distinction between "addressed flats" as used by Postal Service witness Kelley and "on-piece-addressed" flats as used by Crowder. Kelley used the term "addressed flats" to identify all non-DAL flats while Crowder used the term to apply to flats that will be subject to the "on-piece-addressed" saturation flat rate once the DAL surcharge is implemented. Crowder's unit cost is appropriate for two reasons:

- First, it is the average unit cost for all flats that will be charged the "on-piece-addressed" saturation flat piece rate. SMC-RT-1 at 9-10.
- Second, for saturation flats that convert from DALs to on-piece-addressing, the method and cost of handling the flat itself will remain unchanged. SMC-RT-1 at 10-12.

The first reason is rational on its face. NAA, however, misconstrues Kelley's higher "addressed" flat cost estimate, claiming it is the appropriate basis for the "on-piece-addressed" saturation flat rate. On cross, Crowder explained the difference

between her unit cost estimate and Kelley's estimate. Kelley in his spreadsheet attempted to separately break out "addressed flats" and "DAL flats" using the simplistic and patently incorrect assumption that *all* DAL flats are carried out as low-cost third bundles, and conversely, that addressed flats are the *only* saturation flats that are ever cased rather than carried out. In fact, while the vast majority of all saturation flats (both DAL and addressed) are carried out as third bundles, and while Kelley's *aggregate* estimate of total third-bundle flats is correct, his breakout of third bundles between DAL versus addressed flats is unquestionably wrong – ignoring that some DAL flats are cased rather than carried out, and likewise overestimating the proportion of addressed flats that are cased rather than carried out. Thus, Kelley's addressed flat cost is overstated, and his DAL flat cost is understated. As Crowder explained, Kelley's breakout was unnecessary even in that particular spreadsheet, and his breakout numbers and assumptions were not used anywhere else in Kelley's carrier cost analysis – and are certainly not appropriate for estimating the cost of saturation flats once the DAL surcharge is instituted, which was Crowder's purpose. Tr. 35/11777-83.¹⁵

Crowder's method directly develops the true cost of on-piece addressed flats, avoiding Kelley's unnecessary and judgmental breakout problem, and is the correct method and estimate of that cost.

¹⁵ With respect to NAA's cross-examination exhibit NAA-X-EX-1, Tr. 35/22786, NAA's caption indicates that the breakout cost data came from Crowder's spreadsheet – but as Crowder emphasized, it was Kelley, not Crowder, who made those simplistic and incorrect breakout estimates. Crowder neither used nor validated those figures. To the contrary, she explained to NAA's counsel that Kelley's separate "addressed" and "host" flat unit costs shown in Exhibit NAA-X-ES-1 were based on incorrect assumptions that were not questioned because those costs were never used for anything. Tr. 35/11777-83.

The second point – that elimination of DALs will not affect the handling of the saturation flats -- is well-supported by record evidence. Currently, the great majority of saturation flats (both on-piece-addressed and DAL flats) are carried directly to the street as low-cost third bundles – the Postal Service’s preferred method of handling saturation flats. As USPS witness Coombs explained, eliminating DALs by conversion to on-piece addressing will not cause a change in the method of delivery, and therefore will not change the unit delivery cost of the saturation flat:

“For example, consider a scenario where all of the ECR saturation flats that are currently employing the use of the DAL converted to addressed flat-shaped pieces. There is no reason to believe that eliminating the DAL would change the behavior of those delivery units that are currently taking the flat bundles directly to the street.” USPS-T-44 at 13.

It was for this reason that Kelley in cross-examination emphasized that the Postal Service expects to save the “vast majority” of DAL costs. Tr. 3515-16.¹⁶ Moreover, for rural routes, Crowder has stated that the Postal Service has committed to establish do-not-deliver arrangements for saturation flats so that saturation flats can continue as low-cost simplified flats, even after they have been converted from DAL to on-piece-addressed. SMC-RT-1 at 11-12.

¹⁶ In footnotes 15 and 16 at page 17 of its brief, NAA refers to Kelley’s responses to POIR No. 8 (Tr. 12/3430-32) and VP/USPS-T30-17 (*id.* at 3465) for the proposition that the Postal Service was not confident that DAL costs could be recovered. At the subsequent hearing, however, Kelley clarified his responses based on witness Coombs operational testimony, stating that the vast majority of DAL costs will be recovered – a clarification NAA neglected to mention. Yet ironically, NAA correctly acknowledged Coombs testimony earlier in its brief, stating at “[m]ost saturation flats typically are taken directly to the street *and the presence or absence of a DAL does not affect how these mailings are handled.*” NAA Brief at 13 (emphasis added). What NAA refuses to acknowledge is that this means the elimination of DALs will not affect how the flats are handled as third bundles taken directly to the street, as Coombs testified.

Crowder's unit cost for saturation on-piece-addressed saturation flats is the appropriate unit cost to use in establishing (1) the piece rate for saturation flats, and (2) the piece-rate differential between high-density and saturation flats.

V. AAPS'S NON-RECORD ASSERTIONS ON BRIEF ARE NOT EVIDENCE OF HARM AND MUST BE REJECTED.

Unlike prior fully-litigated rate proceedings, AAPS in this proceeding chose not to present any witness to testify about alleged impact of the Postal Service's proposed ECR rates on private delivery companies. We suspect that AAPS's reluctance to present a witness may have more to do with the fate of its witnesses in past proceedings, where discovery and cross-examination revealed their claims of harm to be greatly overblown.

The Commission is required by section 3624 of the Postal Reorganization Act to base its decisions on record evidence. The very purpose of presenting evidence through the sworn testimony of a witness is to satisfy the "hearing on the record" requirement, with opportunity for other parties to test the probative value of that testimony through discovery, cross-examination, and rebuttal testimony.

Parties claiming harm have the burden of coming forward with *evidence on the record* to support their claims. AAPS has not bothered to do so, thereby avoiding the inconvenience of having its claims tested on the record, and freeing its counsel to fashion wildly overblown and unsubstantiated assertions on brief.¹⁷

¹⁷ The only references to AAPS testimony in its brief are from testimony it presented six or more years ago in Dockets R97-1 and R2000-1. AAPS Brief at 2-3 and fn. 4. No one has designated that earlier testimony for inclusion in the record in this case, and it therefore cannot be considered in this proceeding. Had AAPS designated
(footnote continued next page)

AAPS asserts, for example, that the Postal Service's slight 0.2-cent proposed reduction in the ECR pound rate "will *by definition* adversely affect competition and adversely affect alternative delivery companies." AAPS Brief at 2 (emphasis added). "Such weight gains, *AAPS submits*, would consist to a significant extent from pieces now in alternate delivery shifting to a shared mail piece...." *Id.* at 3 (emphasis added). AAPS's brief concludes by asking the Commission to consider "the *obvious impact* that a rate reduction for heavier weight ECR mail will have on competition for the carriage of such mail." *Id.* at 6 (emphasis added). These allegations of harm on brief, however, are without factual foundation in the record.

Moreover, even if these identical statements had been made by an AAPS witness subject to cross-examination, they do not come close to satisfying the burden of proof for an allegation of harm. They are not even "factual statements" or "evidence of harm" in any real sense, but are instead unsubstantiated assertions. Aside from the clear and serious due process problems with considering these untested non-record assertions, AAPS's assertions even at face value fall far short of demonstrating harm as required by section 3622(b)(4) and the courts.

The crux of AAPS's non-record claim of harm is what might be called its "balance" argument. It asserts:

"The constant, which requires no specific cost data for support, is that the relationship between alternate delivery costs and prices, on the one hand, and postal costs and prices, on the other, *creates a balance*

(footnote continued)

such testimony, we would have counter-designated rebuttal testimony from those proceedings, as well as relevant discovery responses and cross-examination of its witnesses. Its attempt on brief to slip that earlier testimony in through the back door cannot be countenanced.

of some type among alternate delivery, newspaper inserts and mail.”
Id. at 4 (emphasis added).

AAPS goes on to claim that “[a]ny change in the balance of the equation” will cause shifts, and that the proposed pound rate “will tip the balance in more [sic] to the benefit” of the Postal Service and mailers.” *Id.* (emphasis added).

This “balance” argument amounts to the contention that ECR rates and rate elements should never be adjusted downward because *any such change* would “upset the balance” with private delivery. Section 3222(b)(4), however, does not require that the Commission preserve some precise (but ill-defined) “balance” in the market. Rather, the statute states that, among other factors such as the desirability of cost-based rates, the Commission must take into account “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.” (emphasis added). By its plain language, the (b)(4) criterion is not intended to protect private delivery companies from competition, but rather requires consideration of the effect upon *both* mail users and competitors. And as the courts have held,

“In evaluating competition-related arguments under section (b)(4), it must be remembered that the PRC’s task is to protect *competition*, not particular competitors.”

Direct Marketing Association v. U.S. Postal Service, 778 F2d 96, 106 (2nd Cir. 1985)
(emphasis in decision).

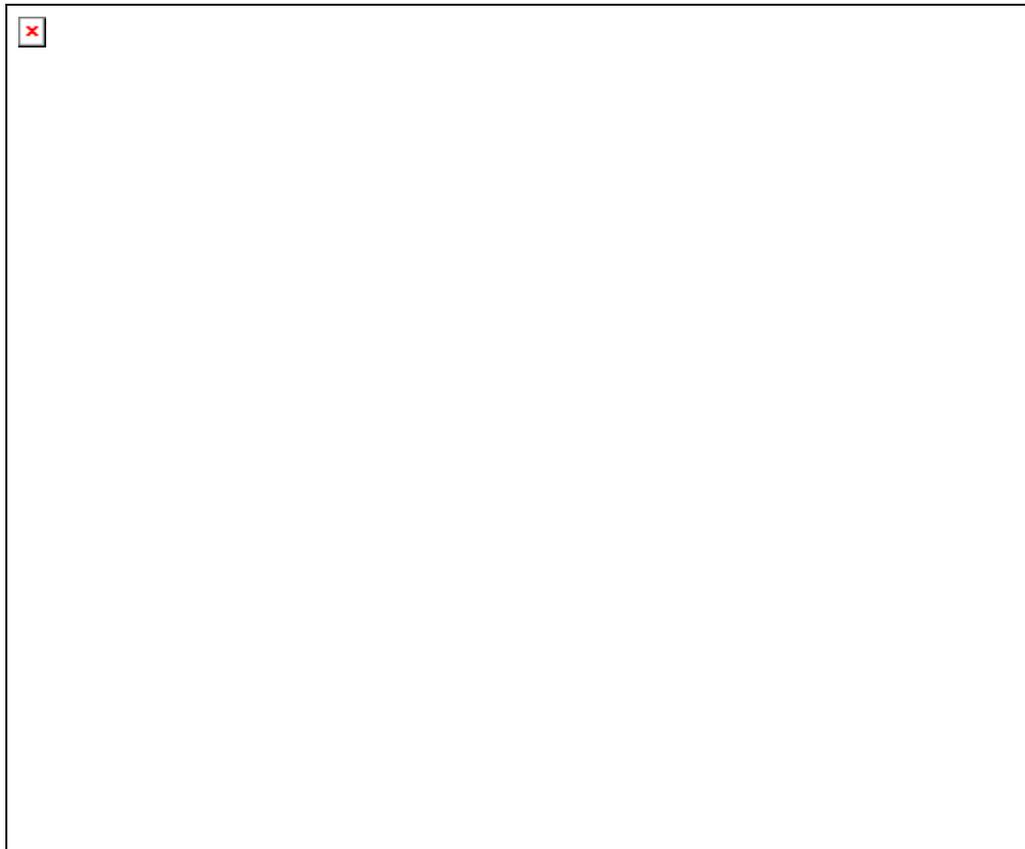
AAPS’s argument boils down to the preposterous notion that criterion (b)(4) bars *any* reduction in *any* ECR rate element -- even without an evidentiary showing of harm on the record -- on the theory that any such change “by definition” will “adversely affect competition” by tipping the market “balance” in some unknown and unproven way. To

state the proposition is to refute it. Had this been the Commission's policy and interpretation of (b)(4) over the years, there today would be no ECR subclass, no dropship discounts, no density discounts, a stratospheric pound rate, and not even carrier route presort discounts. And, there would be no need to litigate these issues, because there would be no saturation mail left in the postal system – to the detriment of the Postal Service and all other mail users that have benefited from ECR's substantial contribution to institutional costs.

Not surprisingly, AAPS assiduously avoids discussing whether the current ECR pound rate is too high in relation to true weight-related costs. This silence, like its choice not to present evidence of harm on the record, is consistent with its view that postal costs don't really matter. All that matters is that the "existing balance" must be maintained under any circumstance, whether or not the pound rate is excessive in relation to costs. This argument is protectionism at its worst, designed not to protect competition but to shelter competitors through artificially high postal rates – in this instance by maintaining an excessive pound rate that is dramatically out of line with weight-related costs that even Valpak witness Mitchell acknowledges are low.

Finally, we would point out that AAPS's "industry balance" argument for opposing even the slightest cost-based reduction in ECR rates is, in AAPS's perverse theory, a one-way street. AAPS has no qualms arguing that it is okay to "upset the balance" in the other direction by increasing the institutional cost burden on ECR mail. AAPS Brief at 6-7 (supporting the testimonies of NAA and GCA to shift institutional costs from First Class to ECR mail).

AAPS alleges, for example, that “Postal Service data show that *Standard mail* volumes continue to grow in the face of declines elsewhere, so it is clear that the present rate/cost relationships are not unfavorable for the Postal Service and the mailers that use it to deliver advertising.” *Id.* at 4 (emphasis added). This broad reference to growth in aggregate Standard Class volumes (when AAPS’s real interest is the narrower ECR subclass) is the same false comparison NAA witness Sidak used in his rebuttal testimony. Since 1998, the growth in Standard mail volume has come entirely from the Regular subclass, *not the ECR subclass* with which AAPS’s members compete. As shown in the following graph based on witness O’Hara’s LR L-74 volume history, ECR volume has actually declined since 1998.



Indeed, ECR volumes in 2005 are only marginally higher than in 1988, seventeen years ago.

This not only refutes AAPS's false factual premise, but even undermines its non-record assertions about the "balance" in the market. ECR volume trends over a long span of time have been erratic and anemic, a function of the high sensitivity of ECR mail to postal rates, including the excessive pound rate. On the "evidence of record" in this proceeding, there is not only no evidence that the tiny proposed reduction in the ECR pound rate will harm competitors within the meaning of the statute, but there is compelling evidence that even with the modest reduction, the pound rate will still remain excessive by any measure.

AAPS's bare, non-record allegations of harm must be rejected.