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Before the

UNITED STATES POSTAL RATE COMMISSION

In the Matter of: POSTAL RATE AND FEE CHANGES

Docket No. R97-1

VOLUME 23

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BEFORE THE

POSTAL RATE COMMISSION

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In the Matter of: :

POSTAL RATE AND FEE CHANGES : Docket No. R97-1

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Third Floor Hearing Room
Postal Rate Commission
1333 H Street, N.W.
Washington, D.C. 20268

Volume 23
Friday, February 20, 1998

The above-entitled matter came on for hearing, pursuant to notice, at 9:31 a.m.

BEFORE:

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HON. W. H. "TREY" LeBLANC, III, COMMISSIONER
HON. GEORGE W. HALEY, COMMISSIONER
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EXHIBITS AND/OR TESTIMONY	IDENTIFIED	RECEIVED
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P R O C E E D I N G S

[9:31 a.m.]

CHAIRMAN GLEIMAN: Good morning. Today we continue hearings in Docket R97-1 to receive direct cases of participants other than the zPostal Service including their rebuttal to the Postal Service.

Scheduled to appear today are Association of Alternate Postal Systems Witnesses Bradstreet and Green; Saturation Mail Coalition Witness Buckel; Witness Haldi appearing on behalf of Nashua Photo, Inc., District Photo, Inc., Mystic Color Labs, Seattle Filmworks; and Merck Medco Managed Care; Office of Consumer Advocate Witness Callow; and Advertising Mail Marketing Association Witness Schick.

Yesterday I issued two procedural Presiding Officer's rulings that may be of interest. Ruling 101 established the date for submitting designations of institutional responses for this round of hearings. Extra copies of the rulings are available over on the hearing table in the front of the room.

Ruling Number 102 revised the schedule of the appearance of witnesses in response to requests that we had received from parties and also scheduled additional witnesses relative to responses to certain NOIs.

Does any participant have a procedural matter to raise before we begin today?

We are going to change the previously announced order of the witnesses as long as there is no objection and we will hear from Witness Green on behalf of AAPS first, and then we will follow with Witness Bradstreet.

Does this cause anyone in particular any heartburn?

[No response.]

CHAIRMAN GLEIMAN: If not, Ms. Blair, would you identify your witness so that I can swear him in.

MS. BLAIR: Good morning, Mr. Chairman. I would like ask Mr. Joe Green to take the stand.

CHAIRMAN GLEIMAN: Mr. Green, before you settle in, if I could ask you to raise your right hand.

Whereupon,

JOE GREEN,

a witness, was called for examination by counsel for the Association of Alternate Postal Systems and, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MS. BLAIR:

Q Would you state your name, please?

A My name is Joe Green.

Q And Mr. Green, did you prepare testimony on behalf of the Association of Alternate Postal Systems dated December 30th, 1997?

A Yes, I did.

Q If I were to ask you the questions set forth in that testimony this morning, would your answers be as shown?

A Yes.

MS. BLAIR: Mr. Chairman, I request that Mr. Green's testimony be accepted and copied into the record.

CHAIRMAN GLEIMAN: Are there any objections?

Hearing none, Mr. Green's testimony and exhibits are received into evidence and I direct that they be transcribed into evidence at this point.

[Direct Testimony and Exhibits of Joe Green, AAPS-T-2, was received into evidence and transcribed into the record.]

AAPS-T-2

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

POSTAL RATE AND FEE CHANGES, 1997	)))	Docket No. R97-1

DIRECT TESTIMONY
OF
JOE GREEN
ON BEHALF OF
ASSOCIATION OF ALTERNATE POSTAL SYSTEMS

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December 30, 1997

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

POSTAL RATE AND FEE CHANGES, 1997) Docket No. R97-1

DIRECT TESTIMONY OF JOE GREEN ON BEHALF OF THE ASSOCATION OF ALTERNATE POSTAL SYSTEMS

My name is Joe Green and I am the primary owner of R-J Delivery, in business in Pekin, Indiana for the past 20 years. We are a member of the Association of Alternate Postal Systems. R-J Delivery is a sister company to Green Banner Publications, a publisher of seven weekly, community newspapers which I own. I served on the board of directors of the Association of Alternate Postal Systems (AAPS) for nine years and had the privilege of serving as president of this association in 1991.

R-J. Delivery is an alternative delivery company that was born out of the concept of being able to control the delivery of Green Banner Publications' newspapers. R-J has also delivered, in the past, items ranging from a partial ounce sample of hand cream to a 9.5 pound phone book and has done this in several states, including New York, California, Minnesota, Texas and Florida. Our primary business has been and remains the distribution of free newspapers and standard mail type circulars to the 48,000 residences in the area of Southern

Indiana we call home. Other than the affiliated newspapers, we deliver about 12.5 million pieces per year, mostly for local merchants.

Though I have never before testified before the Postal Commission, my relationship with AAPS Executive Director Ken Bradstreet and our attorneys, as well as my personal experience in my small business over the past 20 years, gives me a perspective that I would like to share.

I understand that the rate making process is a complicated process, and I leave it to Mr. Bradstreet and our attorneys to debate the allocation of attributable and institutional costs of the Postal Service and how these affect the rates in each sub-class. What I understand better is the effect that these rates have on competition and that this is part of the consideration in setting the rates.

The Postal Service has managed to limit our participation in the delivery business to only what would be classified today as a portion of Standard mail and magazines. We employ twelve full and part time employees and work with approximately 100 independent contractors, who deliver our products. These people work in our limited scope of available business that we can deliver without running into the portions of the market that the Postal Service claims are protected.

The problem that we have faced in the past, and fear facing today, is that the part of the mail stream we are allowed to compete for has continually been held down in terms of rate increases. As a result, the Postal Service is doing deliveries for less money, in real dollars, then they were receiving fifteen years ago.

This would be understandable if all classes of mail were receiving the same treatment, but I understand that the rates for mail where we cannot compete have risen more rapidly than those where we are allowed to compete. The current proposal not only will continue this trend but will also reduce the rates for the heavier pieces, adversely affecting our ability to compete.

As a result the Postal Service continues to do more for less in areas where we are allowed to compete. The impression is that the areas where we are not allowed to compete are subsidizing the areas where the Postal Service actually has to compete. We are not asking for a portion of the market to be handed to the private sector. What we are asking is that the protected portions of the mail stream not be used to crush competition in the areas where competition is allowed.

We are concerned that if this is allowed to continue, our small business will be faced with a difficult decision of continuation. This will not only affect us and our colleagues in this business but will affect the thousands of carriers our industry employs. These are people who may be able to work only part time or are using their part time position to help them get caught up or ahead.

This rate proposal will also affect our customers who have been able to take advantage of services and opportunities that the private sector offers. They sometimes find that they cannot take advantage of the shared mail packages (when they are even available) due to the nature of other pieces in the package, and they find the costs of direct, solo mail to be prohibitive. We can and do provide an alternative.

Businesses like ours are very important to the marketplace. We must make a profit, and we pay taxes on that profit. We also provide competition and choice in the marketplace. The continuation of unfair pricing on the part of the Postal Service that seems targeted at competitors goes against the concept of a competitive market place. Without that competition, jobs will be lost, income opportunities will be lost, selection will be lost and innovation and ingenuity, the building blocks of our economy, will be severely stifled.

R-J Delivery, in itself, is not a major player in the market. It would be a stretch to say that we have an effect, as one company, in the market outside of our small distribution area. But we are representative of hundreds of companies in the United States that can be very adversely affected by Postal Service efforts to use revenues from noncompetitive mail services to cover costs for services that face competition.

CHAIRMAN GLEIMAN: I do not have any designated written cross examination for this witness, which is unusual and concerns me.

Did anyone designate any written cross examination?

[No response.]

CHAIRMAN GLEIMAN: Is there anyone here today who wants to designate any written cross examination?

[No response.]

CHAIRMAN GLEIMAN: If that is the case, then we will proceed. There doesn't appear to be any -- we will proceed with oral cross examination.

Only one participant, the Postal Service, has requested oral cross examination of Witness Green.

Does any other participant wish to cross examine this witness?

[No response.]

CHAIRMAN GLEIMAN: If not, then Mr. Cooper, when you are ready, you can begin.

MR. COOPER: Thank you, Mr. Chairman.

CROSS-EXAMINATION

BY MR. COOPER:

Q Good morning, Mr. Green.

A Good morning.

Q I am Rick Cooper for the Postal Service and I just have a few questions for you this morning.

As I understand your testimony, you run a delivery company, RJ Delivery?

A Yes, sir.

Q And according to your testimony, it is your opinion that the Postal Service is keeping your delivery company out of portions of the delivery market, isn't that right?

A Well, it is the Private Express Statutes that have limited our participation.

Q Now you are not suggesting that the Postal Service ignore the Private Express Statutes, are you?

A No. My testimony addresses saturation mail.

Q So it is your testimony that one of the ways in which the Postal Service limits your company's participation in the delivery market is by enforcing federal law, is that right?

A I think that that might be a little out of context. It is relevant to the fact that we are limited to participating in saturation mail.

It is not a major part of my testimony that I am complaining about being limited by federal law, no.

Q All right. Well, let's look at the portion of the delivery market where RJ Delivery may legally compete.

With respect to these competitive services, it is your testimony that the Postal Service has restricted its rate increases in such a way as to inhibit competition, isn't that right?

A Where are you referencing to?

Q Well, look at page 2, lines 18 and following.

A Okay.

Q Where you say the problem that we have faced in the past is, and fear facing today, is that the part of the mail stream we are allowed to compete for has continually been held down in terms of rate increases.

A That appears to be the appearance of what is happening, yeah. I mean, in reality, that appears to be -- that the rates for that particular part of mail seems to not have risen as quickly as the rates for the other mail streams, or other parts of the mail.

Q And you are not saying, are you, that the Postal Service is restricting rate increases in those segments of its business to inhibit competition, are you?

A There is an appearance that that particular form of mail, or that particular rate in the rate scheme of the Postal Service has not risen correspondingly with the other rates in the postal stream. The First Class rate, for example, and other rates have risen much quicker than the Third Class or the saturation rates.

Q Well, in fact, on page 3, starting at line 2 of your testimony, you said that you understand that the rates for mail where we can not compete have risen more rapidly than those where we are allowed to compete. Is that the impression you are talking about?

A That's the impression, yeah. Really, Mr. Bradstreet that is the one that is the individual that really understands the rate structures much better than I do.

Q Well, what is the basis of your understanding of the rate structure?

A My understanding is from a standpoint of a small business person, and see what is happening with the rate that I am competing against it, and seeing that it really is not raising, it is staying flat, has stayed pretty much flat for a long time, and in real dollars, I guess, has basically gone down, become less expensive. As a small business person, I see that rate is flat and yet I see my First Class rate that I send my bills out with -- rising a great deal. And, so, as a result, the appearance is that the rate that I can compete with has stayed flat, or gone down in real dollars, and the rate that I can't compete with has risen quite rapidly.

Q But you didn't do a systematic, any kind of systematic analysis of competitive versus non-competitive services to compare those rates?

A No, I don't -- I don't have the resources to do that.

Q Now, your company delivers magazines, is that right?

A No.

Q Okay. So on page 2, where you say the Postal Service has managed to limit our participation in the delivery business to only what would be classified today as a portion of Standard mail and magazines, you are not referring to your company, you are referring to "our" in a larger sense?

A I am not sure of the question there.

Q Well, here is what your testimony says, "The Postal Service has managed to limit our participation -- 'our' participation in the delivery business to only what would be classified today as a portion of Standard mail and magazines." Now, I am asking you who is the "our" in that sentence?

A Well, the "our" is my company, that is the -- that is what I am limited to. I did not state that I did magazines. I am stating that I am limited to -- that is the only thing I am limited to being to able to deliver.

Q Under the Private Express statutes?

A Correct.

Q Okay. So your company has deliberately chosen not to participate in the magazine market for other reasons?

A Correct.

Q Okay. Does your company deliver parcels such as -- of the type that might be carried by parcel post?

A We have done a few jobs in the past where we have delivered phone books, large phone books, to specific addresses that, theoretically, could have gone parcel post. But that is just a couple of jobs and was very minimal.

Q Are you aware the parcel post rates increased by 18 percent following Docket R-90-1?

A No, I am not aware of that. And, you know, again, I am not -- you know, I don't -- parcel post really doesn't effect me in my business, I don't think.

Q So you, likewise, wouldn't be aware of how much the parcel post rates increased after Dockets No. R-94 or MC-95-1?

A No, because parcel post really is not a part of my business.

Q Okay. Would you turn to page 3, line 6, of your testimony? Now, the sentence which begins on line 6 reads, "The impression is that the areas where we are not allowed to compete are subsidizing the areas where the Postal Service actually has to compete." Do you see that sentence?

A Yes.

Q Is this your impression?

A That is my impression, yes.

Q Is it your testimony that the rates recommended by the Postal Rate Commission and adopted by the Postal Service in recent cases were marked by illegal cross-subsidy?

A No, I am saying that the impression is that the rates where we can compete have stayed down, and the rates where we cannot compete have risen substantially greater than the rates where we cannot compete, and that is my impression of what seems to be happening.

Q What do you mean by cross-subsidy?

A Where do you -- where do you refer to that?

Q I am sorry, you don't say the word cross-subsidy. You say some rates are subsidizing others. Can you tell me what you mean by that?

A Well, it appears -- again, Mr. Bradstreet is better versed at allocated and unallocated costs and so forth. But what it appears is that the cost burden is being shifted -- it appears that that cost burden is being shifted into areas where we are not allowed to compete. The Private Express statutes protect those portions of mail, and it appears that those portions of mail are rising much faster in their rates in order to produce greater income and, again, saturation mail does not rise, it seems to stay pretty much flat, or go down in real dollars. And so the appearance is that one is rising faster than inflation, one is not. And so it appears that costs are being covered in one area where it is a protected market in order to hold down an unprotected area.

Q Is it your opinion that the Postal Service, in its competitive service offerings, is charging rates which fail to generate enough revenues to cover the costs caused by those classes?

A I don't have access to those figures. I really couldn't answer that question. I just -- I know that part of the ratemaking process is to take into consideration the effects that the Postal Service has on competition. I know that, I would admit, probably justifiably so, the Postal Service has certain protected areas of the market to guarantee service across the country in an equal and equitable fashion. And I know that we are limited to a certain area of the mail stream.

And so, you know, the big thing that I want to bring to the table today is that, as a small business person, I am very much effected by the rates that you are setting for saturation, and that you have requested for saturation. And, as a small business person, you know, I think my position needs to be taken into consideration.

Q But on the issue of cross-subsidization, or subsidization of one class by another, if it can be shown that every class is covering its own costs, then there wouldn't be any subsidization of one class by another, would there?

A The problem with doing that is that I have to cover all my costs with one class of mail, and I don't have multiple classes to cover my overhead. And so to say that the Postal Service, who does have all these classes of mail to cover their overhead, can cover their costs in the area where you have to compete with me and, therefore, that is fair, that is not fair. I have to cover all my costs with one class of mail. You have multiple classes of mail to cover your costs. So just because you can verify and show that you can cover your costs in one of those multiple classes of mail, to me, is not justification to lower your rates to the point where you drive me out of business.

You have a certain specific franchise in with the Private Express statutes give you, and that franchise is given to guarantee service, equitable service across the country, and that is fine. But to take that and use those multiple classes of mail to justify your lower costs in one class where I am allowed to compete, does me in, because I can only -- I only have one class of mail to cover my overhead.

So I would say just because you can cover your costs in that one class of mail, no, that does not justifying maintaining a rate or lowering a rate. I think you have to take into account other factors of that same law that created the Postal Service that says you have to look at the effects that you have on competition, and that is my point that I need -- would like to make, and that is that that has to be factored in also.

Q You would agree, though, that if every class is covering its own costs, then every class is making a contribution to the Postal Service's overhead, isn't that right?

A I'm sorry, say that again.

Q If each class of service offered by the Postal Service has rates that generate revenues in excess of the costs caused by each class, each of those classes, then every one of those classes is making a contribution to the Postal Service's overhead, isn't it?

A It is making a contribution, but whether it is making an equitable contribution, I have no idea. I don't have the resources to delve into that study. It is making a contribution, but whether it is a relevant one and an equitable one, I don't know.

Q Okay. So when you refer to subsidizing of one class by another, you are talking about some kind of fair distribution of the overhead?

A No. I am not talking about a fair distribution of the overhead.

Q Then are you talking about classes of mail not covering their own costs?

A Again, you are delving into an area I don't know. I can not -- I mean, you know, what I have is the impression that the rate that I compete with is staying low and the rate that I cannot compete with because of Private Express statutes is going up. And to -- you know, it depends on what numbers you use, and I just don't have the resources to generate, you know, combatant data to compare with the data that you have. And I, you know, I don't know. Just because a class of mail is making its contribution to the overhead, as determined by the way you keep your books, is one factor, and the other factor is how it effects the private enterprise and the business people, or the business industry out there, is another factor. And the point I hear to make is that factor needs to be taken into consideration.

MR. COOPER: I have no further questions.

CHAIRMAN GLEIMAN: Is there any follow-up? Questions from the bench? Commissioner LeBlanc.

COMMISSIONER LeBLANC: Mr.Green, I am trying to understand exactly what it is that your business does. Now, you deliver what now?

THE WITNESS: We have -- we publish free weekly newspapers that are delivered saturation through multiple communities.

COMMISSIONER LeBLANC: This is Green Banner Publications?

THE WITNESS: Yes, sir. And RJ Delivery is a sister company that was initially established to perform the distribution of those publications.

COMMISSIONER LeBLANC: And I take it then that you can't use shared mail or solo mail, or choose not to do that?

THE WITNESS: We have certain quality issues in the distribution and publication, and we also are not welcome in shared mail packages. We are actually direct competitors of shared mail.

COMMISSIONER LeBLANC: Can you elaborate on that for me?

THE WITNESS: Well, our publications carry inside of them a lot of printed inserts. These printed inserts are the exact same pieces that shared mail is after. The other problem is the shared mail is in the post office and it is mailed. And so, as a result, when I drop in 40 pages of tabloid newsprint, along with six inserts, it drives that cost up substantially to where I don't really fit in their package. I would have to pay, you know, the incremental cost of putting my piece into their package would make it prohibitive.

COMMISSIONER LeBLANC: And please do not

misunderstand this next statement, but one of our jobs is to try to balance these criteria that you were talking about with counsel, discrimination, anti-competitive, et cetera, et cetera. There are basically nine of them, or eight of them, depending on how you look at it. But you seem to be saying, with all due respect, that we should give you deference over somebody else.

And I mean I am just -- I don't mean that in a negative sense, I am just trying to understand. You talked about unfair distribution of overhead a minute ago with the counsel. So, I am just trying to find out exactly here, are we talking about making a choice here, on our standpoint, of possibly you over, say, somebody else? And if so, that's fine. I am not trying to put words in your mouth here.

THE WITNESS: I am not sure that that is exactly -- that is actually not what I am trying to say. The point that I am trying to make is there is a specific area in the mail stream in which we are allowed to compete. And there are certain -- there's other areas of the mail stream where we can not compete. And, again, it is understandable that those areas have to be protected in order to provide what the initial concept of the Postal Service was, and that was fair distribution of information to everyone, and whether they live in the middle of Colorado or downtown D.C.

And my point is that we are allowed to compete in only a specific area and yet the Postal Service is allowed to spread their costs over a large, multiple classes of mail, and, therefore, their economics of scale kick in and we get -- we get clobbered with that. We get hit with that. And that's the point. And one of those criteria is the effect of competition has to be there. Now, the law states that they are protected in those areas, and so they are not facing competition in those areas, so they are guaranteed a certain amount of economics of scale when they get to the classes where they are competitive, they have to compete.

COMMISSIONER LeBLANC: Do you have any idea what kind of -- maybe Mr. Bradstreet will get into this also, but do you have any idea what type of volume your industry has?

THE WITNESS: Oh, gosh.

COMMISSIONER LeBLANC: I mean volume as a percent, as a number, as anything that you may have available to you?

THE WITNESS: No, I don't have that figure.

COMMISSIONER LeBLANC: Okay.

THE WITNESS: That's a little larger scope than I have looked at before.

COMMISSIONER LeBLANC: Fine. Thank you, sir.

Thank you, Mr. Chairman.

CHAIRMAN GLEIMAN: I don't have a question, just a comment. If you had been asking for some deference relative to other participants in the case, that certainly wouldn't be novel. I think that that is probably what these proceedings are all about.

[Laughter.]

CHAIRMAN GLEIMAN: So don't be shy if you want to ask for deference.

Follow-up as a consequence of questions from the bench?

Mr. McLaughlin?

CROSS-EXAMINATION

BY MR. MCLAUGHLIN:

Q I'm Tom McLaughlin, representing the Saturation Mail Coalition.

You mentioned mail as an alternative for your publication. What is the typical weight of your publication, including inserts?

A That's a difficult question, because we haven't been concerned with weight for so long since we're in the hand delivery. It's -- our publications range from 24 tab pages to 48. I know that 30 -- I believe 32 tab pages is where the pound rate is, which would be approximately about 3.3 ounces. So I would say we're probably ranging -- and this is really of the top of my head -- we're ranging from two to five or six ounces just for the publication.

Q And then --

A Then within that publication are multiple inserts which fluctuate from a 20-pound bond piece of paper that size to 24-page tabloid insert.

Q So -- and a 24-page tab insert would be two ounces or so, wouldn't it?

A Right.

Q So if you have seven or eight inserts for a typical week, you could have seven, eight ounces even?

A Possibly.

Q And on the low side would it be four to five ounces, or --

A The low side probably would go down to two to three ounces.

Q Even with inserts?

A There are weeks when we only have maybe one or two.

Q Okay. If -- you mentioned -- so if you were to mail that publication yourself --

A Um-hum.

Q You would be paying in general at the pound rate?

A For the most part, yes, the bulk of it.

Q And likewise you mentioned the possibility of putting it into a shared mail package. If it were put in the shared mail package, that would almost certainly all have to pay the pound rate, the current pound rate?

A Yes.

Q Okay.

MR. McLAUGHLIN: I have no further questions.

CHAIRMAN GLEIMAN: Is there any further followup? Redirect?

MS. BLAIR: No. Thank you, Mr. Chairman.

CHAIRMAN GLEIMAN: If there's no redirect, then, Mr. Green, I want to thank you. We appreciate your appearance here today and your contributions to our record, and if there's nothing further, you're excused.

THE WITNESS: Thank you.

[Witness excused.]

CHAIRMAN GLEIMAN: Ms. Blair, you may call your next witness.

MS. BLAIR: Mr. Chairman, the next witness on behalf of the Association of Alternate Postal Systems is Mr. Kenneth L. Bradstreet. I ask that he take the stand.

Whereupon,

KENNETH L. BRADSTREET,

a witness, was called for examination by counsel for the Association of Alternate Postal Systems and, having been first duly sworn, was examined and testified as follows:

CHAIRMAN GLEIMAN: Ms. Blair.

DIRECT EXAMINATION

BY MS. BLAIR:

Q State your name, please.

A My name is Kenneth L. Bradstreet.

Q Mr. Bradstreet, did you prepare testimony dated December 30, 1997, in this proceeding?

A Yes, I did.

Q And if I were to -- if you were to testify today, would your testimony be as shown in that prepared material?

A Yes, it would.

MS. BLAIR: I'd ask that Mr. Bradstreet's testimony be accepted and copied into the record, Mr. Chairman.

CHAIRMAN GLEIMAN: Are there any objections?

Hearing none, Mr. Bradstreet's testimony and exhibits are received into evidence, and I direct that they be transcribed into the record at this point.

[Direct Testimony and Exhibits of Kenneth L. Bradstreet, AAPS-T-1, was received into evidence and transcribed into the record.]

AAPS-T-1

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

POSTAL RATE AND FEE CHANGES, 1997	Docket No. R97-1

DIRECT TESTIMONY
OF
KENNETH L. BRADSTREET
ON BEHALF OF
ASSOCIATION OF ALTERNATE POSTAL SYSTEMS

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Attorney for
Association of Alternate Postal Systems

December 30, 1997

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

POSTAL RATE AND FEE CHANGES, 1997) Docket No. R97-1

DIRECT TESTIMONY OF KENNETH L. BRADSTREET ON BEHALF OF ASSOCIATION OF ALTERNATE POSTAL SYSTEMS

I. INTRODUCTION

My name is Kenneth L. Bradstreet. I am the Vice President and General Manager of Advertisers Postal Service (APS) in Gaylord, Michigan. APS is a private enterprise delivery system in rural northern Michigan. In addition to private delivery, APS also operates a mailing service which does mail preparation for various shopping guides, newspapers, and retailers in the area.

I joined APS in April of 1977 as Assistant District Manager. I worked at that position until September 1977, at which time I was asked to coordinate special projects for APS. In September of 1978 I was promoted to Assistant General Manager. I became General Manager in 1982 and Vice President in 1985.

In August of 1983, APS joined the Association of Private Postal Systems (APPS), which is a trade association made up of private delivery companies similar to APS. In February 1984, I was appointed to the Postal Affairs Committee of APPS.

Also, in early 1984 I helped to establish the Coalition of Non-Postal Media (CNPM), and I served as its Vice-Chairman. In that capacity I submitted testimony to the Postal Rate

Commission in Dockets R84-1 and R87-1. CNPM was a common interest group of publishers, alternate delivery companies, and other media that compete with the USPS.

In February 1987, I was elected to the Board of Directors of APPS. In February 1989, I was elected President of APPS, and I served two terms as President of APPS. In February 1990, the name, Association of Private Postal Systems, was changed to the Association of Alternate Postal Systems (AAPS). AAPS participated in R90-1 as a limited participant. In R90-1 I submitted testimony on behalf of AAPS. AAPS again participated in the MC95-1 classification case, and I submitted testimony in that case.

In addition to personal participation in three rate cases and a classification case, I have also represented the alternate delivery industry on various panels at a number of conferences and forums. I participated as a speaker at the Cato Institute forum on postal privatization in April 1988. In March 1990, the morning following the filing of R90-1, I appeared opposite Postmaster General Anthony Frank on a morning news show produced by WWOR in the New York City market, and broadcast to cable systems throughout the United States. The segment was a discussion of the 1990 postal rate proposal.

On June 1, 1995 I assumed the duties of Executive Director of AAPS, a position which carries with it the responsibility for representing the interests of the alternate delivery industry. It is in that capacity that I offer testimony in this proceeding.

My 20 years of experience as a competitor of the Postal Service, as a mailer, and more recently as president and representative of a trade association of private delivery companies, has given me a great deal of exposure to postal issues, particularly as they affect private delivery companies throughout the country. Given that one of the criteria for the establishment of postal rates is the consideration of the effect of rates on, among others, "enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters," I consider it essential that competitors of the U.S. Postal Service participate in the ratemaking process.

Our industry learned in 1981 that we could not afford to sit back and assume that the Postal Service will deal fairly with us. As a result of the 1981 rate decision, the third class rates with which we compete were reduced precipitously, putting many of our number out of business. Since that time, the well-being of the alternate delivery industry has been tied more to postal rates than to any other factor.

II. PURPOSE AND SUMMARY OF TESTIMONY

My testimony is not technical. It is written almost exclusively by me -- not by a group of consultants and attorneys -- from the perspective of certain competitors of the USPS, many of them very small businesses. My testimony is written to remind the United States Postal Service, and the Commission, of the basic mission of the USPS as defined by Congress. It is written to remind the USPS, and the Commission, that the rate-setting criteria established by Congress include the consideration of competition and competitors, something that, in my experience, the USPS has not been doing appropriately.

It is clear to me as a layperson, from a reading of the Postal Reorganization Act, that the USPS was intended by Congress to be a public service, not an aggressive competitor. It is also clear from observing the USPS over the past eighteen years that in many regards it considers itself more a competitor than a public service.

My testimony will encourage the Commission to view the USPS as Congress viewed it - as a public service. It will encourage the Commission to shape rates for monopoly mail and for competitive mail accordingly, following carefully the criteria of the Postal Reorganization Act.

And it will encourage the Commission to follow not only the letter of the Act, but to catch the spirit of the Act as well, and to shape postal rates accordingly.

More specifically, I will first address the importance of the Postal Service monopoly. Next, I will address the great pride the Postmaster General has taken in driving a "competitor" out of business, and then turn to a discussion of the Postal Reorganization Act and its ratemaking criteria. I will next discuss the proposal in this case, including "Ramsey Pricing," the over-reliance upon cost coverage, the inadequate weight/cost study, the anticompetitive and unsupportable proposal to lower the ECR pound rate, the failure to attribute all attributable costs, the failure to recognize cost differences between letters and non-letters and between loose and bound pieces, and the proposed shape surcharge as an inappropriate justification for the pound rate reduction. I conclude with an appeal to the Commission to again reject an anticompetitive, unjustifiable rate proposal.

III. THE ASSOCIATION OF ALTERNATE POSTAL SYSTEMS

The Association of Alternate Postal Systems is a trade association of approximately 100 private, door-to-door delivery companies located in 30 states. Many of these member companies are solely private postal systems; that is, they are independently owned and are not an affiliate of any particular publication. A number of member companies are owned, and are an operating division of, a weekly or daily newspaper. Still others are owned and operated by publishers of shopping guides or "penny-savers."

By far the majority of items delivered by AAPS members would qualify as saturation or near saturation Standard A flats. Therefore, AAPS members, all of whom compete with the USPS for the delivery of Standard ECR saturation or high density advertising, are vitally concerned with any USPS proposal that affects Standard ECR rates.

AAPS members are mainly engaged in the delivery of weekly TMC shopping guides, saturation shopping guides and accompanying preprinted inserts. In addition, most AAPS members distribute community and telephone directories and product samples. The USPS proposal would significantly harm these businesses, especially in competing for those items weighing 4 ounces and above. Some AAPS members also distribute second-class magazines and periodicals to specific addresses.

IV. THE UNIQUE NATURE OF THE POSTAL SERVICE'S MONOPOLY POSITION

When it comes to operating a business in the private sector, there are, or at least should be, few restrictions on the operating environment. Businesses should be free to set their own rates. They should be free to enter or withdraw from new markets, new products, new services. As long as a business operates within the framework of the law and does not operate in an anticompetitive manner, a business is, or at least ought to be, free to compete unrestricted in the open marketplace of goods and services.

While this is true of private business operating in a free market economy, the same cannot be said of legal or natural monopolies. This freedom to operate unencumbered carries with it the presumption that the business in question enjoys no special advantages such as a legal monopoly, or special treatment with respect to governmentally granted advantages. On the other hand, utilities that provide an essential service and that have a monopoly on that service are not, and should not be, allowed to set rates independently or to compete unrestrained in other areas of the open market. The opportunities for abuse are too great, and therefore utilities are, and have historically been, highly regulated businesses.

The United States Postal Service has a monopoly on the carriage of "letters." This monopoly is mandated by federal law embodied in the Private Express Statutes. Moreover, the

USPS has the power to define what a letter is. No private company may compete with the USPS in the delivery of letters. This monopoly represents about $42 billion per year of protected revenue for the USPS (if you consider First Class and Regular Standard to be protected).

Further, the USPS enjoys special pricing advantages that go far beyond its protected monopoly, advantages that even private sector regulated utilities do not enjoy. First, regulated utilities must build a profit margin into their rates, even if that margin is regulated. The dollars of profit are dollars in the rates collected from customers.

Second, privately owned utilities pay real estate taxes, income taxes, all the taxes to which a business in the private sector, like APS, is subject. This cost factor increases the rates a regulated utility must charge by the collective amount of the taxes payable.

The USPS is virtually unique among organizations, companies or utilities. The USPS rates do not reflect either of the factors mentioned above. The USPS operates on a break even basis, so USPS rates are significantly lower than they would be if the USPS were obligated to factor in, say, a 10% profit margin. Also, the huge amount of taxes that the USPS would otherwise pay if it were not tax exempt is also absent from USPS rates. As a result of these and other unique advantages (does USPS get and pay parking tickets, business licensing fees?), USPS rates are substantially lower than they would be without these special privileges.

Beyond the advantages of a utility-type monopoly, its tax exempt status and rates that reflect no need for a profit margin give the USPS an advantage far beyond its mere monopoly advantage. Therefore, the USPS must be regulated far more carefully than if its only advantage were a monopoly privilege. Tax exempt status, added to non-profit status, added to a monopoly revenue base of $42 billion create a potential for abuse unique only to the U.S. Postal Service.

Persistent USPS cries, both at the Commission and before Congress, for relaxation of rate controls reek with the likelihood of abuse. These cries are ominous to competitors and should be just as ominous to most mailers and to the general public. With a $42 billion base guaranteed by law, with tax exempt status, and with non-profit status, even if there is no evidence of abuse present, certainly the *potential* for abuse is ever present. It is important that the Commission constantly evaluate the USPS with respect to its competitive performance.

Most importantly, the Postal Reorganization Act places solely upon the Commission the responsibility to assure that the interests of the public, of mailers, and of competitors are protected. Small competitors of the USPS have no other recourse but to rely on the Commission to prevent abuses that, as we shall see, have characterized the actions of the USPS over the past fifteen to twenty years.

V. "ONE HELL OF A COMPETITOR"

It is clear from USPS declarations and actions that the USPS chafes under this necessary regulation. It is equally clear, and understandable, that it does not agree with a high level of regulation. Certainly no entity appreciates regulation that prevents it from doing what it is otherwise inclined to do. Utilities no doubt would prefer to set rates independently of public service commissions. But the Postal Service has been more than persistent in attempting to free itself of accountability. From friendly customer "blue ribbon" task forces, to pressure on Congress to let it set its own rates, the Postal Service has done everything it can think of to escape PRC review.

The USPS obviously views itself more as a private business, and yearns for the opportunity to compete freely without any restraint. This self-perception is evident in the USPS treatment of Third Class/Standard mail since the late 1970s. It is further demonstrated by the USPS special treatment of Advo Corporation, and of other shared and saturation mailers.

It is clear from observing the USPS over the past 16 years, and from participating in several rate and classification cases, that the USPS views itself as an aggressive competitor. While that self-view is not what Congress intended for the USPS, as I will discuss below, it has nonetheless shaped Postal Service's mission, rates and proposals since the early 1980s at least.

Saturation Third Class/Standard mail has been targeted by the USPS for special treatment since the late 1970s. ECR saturation and high density mail are the only significant part of the Standard Mail mailstream open to competition. It is interesting to track the history of First and third class rates since the mid-1970s. Saturation advertising has time after time been the recipient of favorable proposals and favorable rates, albeit (thanks to the Commission) less favorable rates than proposals.

Following is a chart that tracks the history of the rates paid by saturation third class/Standard mailers. The chart compares the lowest rate for saturation flats, typically the most competitive, with the highest (or least sorted) rate for regular bulk third class, typically those third class/Standard mailers with few or no options. It also compares the rate for monopoly First-class letters and the rate for subsequent ounces for First-class mail.

Table A
A Rate Trend Comparison
Saturation Flats VS. Monopoly Mail

Year	1c letter	1c Add Wt	3c / Stand Basic	3c / Stand ECR-sat	3c Add Wt ECR-sat
1978	.15	.13	.084	.084	2.25 (36.0)
1979	.15	.13	.084	.069	2.25 (36.0)
1980	.15	.13	.084	.067	2.25 (36.0)
1981	.18	.17	.104	.064	2.06 (33.0)
1981	.20	.17	.109	.079	2.81 (45.0)
1983	.20	.17	.110	.074	2.81 (45.0)
1985	.22	.17	.125	.083	2.38 (38.0)
1988	.25	.20	.167	.101	3.00 (48.0)
1991	.29	.23	.223	.105	3.10 (49.6)
1995	.32	.23	.266	.120	3.55 (56.8)
1996 (current)	.32	.23	.306	.114	3.45 (55.2)
Current Total	113%	77%	264%	36%	53%
1998 (prop)	.33	.23	.300	.118	2.63 (42.0)
Proposed Total	120%	77%	257%	40%	17%

It should be fairly plain that there has been for many years a favored type of mail, a type (now a subclass) that has been protected from any significant rate increases, and a type that would cost even less today had the Commission granted the rates requested by the USPS.

In the late 1970s the Postal Service began the systematic separation of third class rates into rate categories that had more to do with competition than with anything else. In R84-1 I testified about the trend of the USPS to "polarize" the rates for the competitive portion from the monopoly portion of third class mail. Since that time, and especially with the advent of Standard mail, rates for advertising have been structured more in relation to the number of competitive options, if any, than any other factor.

There are two key elements in the rates for competitive advertising. These are the minimum piece rate and the pound rate. As shown above, the piece rate separation between competition and monopoly advertising matter has been dramatic. The rates in 1978 were the same for all third class mail, except for that which was "bound." Though the lower rate for bound materials made sense from a cost standpoint, it didn't make competitive sense, to be sure. Most bound material had no alternatives. That rate distinction disappeared in 1981.

The first key element that affects the competitive balance is the minimum piece rate. As you can see from Table A, the piece rate for the most competitive saturation advertising has increased just 36% since 1978. The slight increase in R97-1 proposed piece rate would increase that 20-year spread to 40%

The other key element of postal rates that affects the competitive balance is the pound rate for saturation advertising. Shopping guides and free distribution newspapers make choices based more upon the pound rate than on the piece rate. This is because the typical publication weighs between 3 and 6 ounces. However, publishers, like shared mail companies, sell the delivery of preprinted inserts to advertisers. With one or more regular inserts, the combined weight of the publication and its inserts is in the 4 to 10 ounce range, and often higher. The cost of the incremental weight is a major consideration on the part of a publisher whether to use the Postal Service, to use an alternate delivery provider, or perhaps even whether to start a delivery system of his own. The cost of weight determines, to a large extent, the cost of handling preprinted inserts.

Certainly the U.S. Postal Service is aware of this key rate, as it clearly explained in MC95-1, and acknowledges again in R97-1. That the proposed pound rate is only 17% higher than the rate paid by saturation advertisers in 1978 shows just how protected this rate has been. By way of comparison, the pound rate for mailers with the fewest competitive alternatives, or perhaps none, is now 67.7 cents, 88% higher than in 1978. The proposed rate of 65 cents would bring that 20 year increase to 81%, compared to the 17% increase for the most competitive of saturation advertising over that same 20 years. Indeed, the US Postal Service has been so intent on making this pound rate the focus of its attack on alternate delivery competitors that it has rigged at least three separate weight studies to give its rate preference the appearance of legitimacy from a cost standpoint.

I would venture to guess that if the public were generally aware that the U.S. Postal Service were proposing a change whereby major advertising interests, which had experienced cumulative rate increases over the past 19 years of only 53%, would now get a reduction, there would be some serious pressure for change. I suspect that the reaction would not favor the USPS or saturation advertisers.

I can't include a discussion of the history of such favored treatment without pointing out that it could be worse, and it indeed would have been worse had the USPS gotten all that it had asked for. In R90-1, the USPS proposed to reduce the lowest saturation rate from $0.101 to $0.091 per piece, a 10% reduction. The Commission recommended instead that the low rate be .105 for saturation flats, an increase of only 4%, but an increase none-the-less. In 1995 during the re-classification case, the USPS proposed a pound rate for saturation advertising of as little as 39.9 cents per pound. The Commission recommended instead the current rate of 55.2 cents and above.

In spite of the positive contributions of the Commission over the past several cases, this highly competitive class of mail has escaped the large increases experienced by other mailers. Not content, however, the Postal Service once again is proposing substantial *decreases* in the rates paid by this privileged class of mailers, decreases of as much as 18%. We urge the Commission to consider the history of rates for this privileged class, and to consider that it is one of the most highly competitive classes in the mailstream.

Probably by far the largest shared mail company in the United States is Advo. For its fiscal year ending September 27, 1997, Advo mailed 3.11 billion shared mail packages (representing more than 10% of commercial ECR) containing more than 26.5 billion pieces. It is therefore understandable that the USPS greatly values Advo as a customer. Advo has been a regular active participant in postal matters, and you will have to pardon me for observing that the USPS and Advo are generally on the same side of most issues. That may even qualify as a gross understatement.

In R84-1 it was revealed by us that USPS officials had been ordering mail handlers to give Advo mailings special treatment, far above the service standards for third class mail. In a memo authored by then MSC Postmaster Cooper McCauslen in Grand Rapids, Michigan, individual postmasters were ordered, "Delivery of the [Advo] mailing <u>MUST</u> be made on Tuesday and Wednesday, each week Delivery <u>MUST NOT</u>, under any circumstances, be made on or before Monday. It is for Tuesday and Wednesday delivery only." (Emphasis in original)

McCauslen went on to say, "The intent of this program is to recapture the advertisement that was lost to the newspapers, as supplements to their papers several years ago. In many cities the program has been quite successful and the potential for the USPS to recapture significant advertising business rests with our ability to handle the job well."

Efforts to get the USPS and its witnesses to comment on this memo, or the "program" described in it, were fruitless. The USPS refused to answer our questions about the memo or program, and the USPS defied an order from the Commission to produce answers.

The infamous memo, and supporting personal experience from newspapers and alternative delivery companies throughout the United States, established clearly that Advo was getting a value of service that often exceeded the service standards for First class mail. An exchange between Chairman Gleiman and USPS witness Moeller in MC95-1 demonstrated that Montgomery Ward was getting similar special treatment. (MC95-1;Tr. 4352-55)

The current competitive drive of the USPS is well illustrated by a speech made by Postmaster General Marvin Runyon shortly after the results of the MC95-1 case were in. In that case, the Postal Service made it abundantly clear that its prime targets were alternate delivery companies that through the early 1990s were gaining a small foothold in the delivery of subscriber magazines.

In the early 1990s, Time Warner started a company named Publishers Express (PubEx) to organize the private delivery of subscription magazines. At that time another company, Alternate Postal Delivery (APD) of Grand Rapids, Michigan, had demonstrated the feasibility of delivering subscription magazines, and had developed delivery capability in a number of major markets. With the addition of Publishers Express, by 1994 more than 80 markets were being served by either APD or PubEx affiliates, most of which were members of AAPS. The fact that the volumes delivered outside the mail were extremely small did not stop the Postal Service's search and destroy mission.

Thus, the USPS proposal in MC95-1 would have split regular rate periodicals into two subclasses, producing rate reductions for favored large magazine publishers (those whose density made them prospects for APD and PubEx) at the expense of large rate increases for small magazines that did not produce the density to make alternate delivery viable for them. Although the Rate Commission rejected this aspect of reclassification, it did order rate decreases for the mass circulation periodicals, leading to the abandonment of alternate delivery by several major magazine publishers. As a result, Publishers Express announced in mid-February, 1996, that it would cease operations.

Just days later, on February 20, Postmaster General Marvin Runyon, in a speech to the NAPUS Leadership Conference in Washington, DC addressed the demise of Publishers Express with unmistakable glee:

> I would like to close with a story that tells it all. Remember the alternate delivery company called Publishers Express? They came on the scene a few years back with a lot of fanfare and tough talk. They said they were going to deliver magazines and advertisements faster and cheaper than us. Eleven days ago, they quietly went out of business. They said that they were no longer needed. They had no more customers. We ran them out of business, by improving service and keeping costs low!
>
> I can't say that I am sorry to see them go. But they taught us two valuable lessons. First, if we don't do our jobs, somebody else will. And, second, when we get our act together, we can be one hell of a competitor.

Certainly, that doesn't "tell it all." Actions say it all - not speeches. Those actions say loudly and clearly that the Postal Service is intent on manipulating rates in such a way as to lower rates for competitive mail and increase rates for mail that has no competitive options. It would be comic, if it were not so serious, that when the Postal Service succeeds by creative pricing in driving a competitor out of business, the PMG publicly seizes the credit - chalking it up to "improving service and keeping costs low." I wasn't there, but I wonder if he delivered that line with a straight face. I wonder if he cared about the jobs he "ran out," and about the investment by small companies in magazine delivery that the Postal Service wiped out. Apparently, people in our industry contributed to the millions of dollars of bonuses paid to postal executives.

Clearly the Postal Service has embraced a mission of aggressive competition. It views itself as "one hell of a competitor" first and foremost. It proposes rates and classifications purely for competitive reasons, and for the purpose of harming its competitors. It seeks postal "reform" that would free it from PRC accountability, so that it can compete even more effectively. Its cost computations are not trustworthy. It computes rates in such a way as to make monopoly mail seem expensive and to make competitive mail seem inexpensive. In short, it does not accept the mission and the public service role established for it by the U.S. Congress.

VI. THE POSTAL SERVICE ACCORDING TO CONGRESS

In the private sector, companies respond all the time to pressures from customers. They make concessions to valued customers, they lower rates, they add free services. What's wrong with the Postal Service doing the same thing?

The answer to that question should be obvious, but in view of the current proposal, and the recent MC95-1 case, it appears that the answer has gotten lost somewhere in the jumble of detail. Quite simply, any entity that enjoys governmentally protected monopoly revenue of $42 billion dollars, non-profit status, and tax-exempt status must be carefully regulated both in areas inside as well as outside the parameters of its monopoly. That is the main purpose of the Postal Rate Commission, and that was one of the main concerns of Congress as manifested in the Postal Reorganization Act.

Certainly the potential for abuse in the competitive areas is obvious, and it was obvious to Congress when it wrote the Postal Reorganization Act. In light of the Act, I am baffled by the trend of the USPS toward aggressive competition and the increased talk in recent years at the USPS concerning the need to be more competitive. It is clear from the Act that Congress did not intend for the USPS to be aggressively competing with the private sector.

From the beginning of the Republic, the postal service was regarded as a vital governmental service. It was the purpose of the postal system (the Post Office Department) to provide the nation with a common, universally accessible medium of communication. In a far less technical environment, without the postal service, communication would come to a standstill, and it was not feasible for private enterprise to provide that service.

Communication was essential in order for freedom of expression and enterprise to flourish. It was particularly vital as the western expansion increased the boundaries of the nation. And to make the postal service more viable, private individuals and companies were prohibited from delivering letters in the limited areas where it might be economically feasible to do so.

There was no hint or suggestion then that the purpose of the postal service was to compete with and destroy private businesses. In those days, government did what private enterprise would not or could not do, for the common benefit of all. The postal service was regarded as an essential service. It was not a profit making entity, but a necessary medium of communication, virtually the only medium of personal communication out of earshot.

But by the late 1960s the Post Office Department was in serious condition. Far from the lofty ideals that viewed the service as a vital service, the post office had become the means of repaying political debts. Postal management jobs were rewards for political loyalists. Service broke down as labor morale suffered, and management accountability was non-existent. In 1970 Congress decided that the postal service needed reform.

It is clear from reading the Postal Reorganization Act that Congress's goal was threefold. First, it sought to restore the high view of the postal service in its historic sense, free of political favors and considerations. Second, it sought to provide a framework within which the postal service could operate in an orderly, efficient manner, with accountability throughout. Third, throughout the Act are numerous protections from the potential abuse by the USPS of its position of special privilege. The USPS described in the Postal Reorganization act was never meant by Congress to be "one hell of a competitor."

A. The Historical View

It is obvious that the Postal Reorganization Act was written to regain that historical view of the postal service, wherein the service is viewed as an essential service of government. To establish that view of the USPS, Congress began the entire Act with the following definitive statement, Section 101;

> (a) The United States Postal Service shall be operated *as a basic and fundamental service provided to the people by the Government of the United States*, authorized by the Constitution, created by Act of Congress, and supported by the people. The Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people. It shall provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities. The costs of establishing and maintaining the Postal Service shall not be apportioned to impair the overall value of such service to the people. (emphasis added)

Needless to say, there is not a hint of reference to a competitive role for the USPS. Certainly this opening, definitive statement has all the marks of the historic postal service role as essential government service. It would be incorrect to suggest that the absence of a reference to competition in the introductory section of the Act should be automatically construed to suggest that competition was not anticipated or was non-existent. Certainly competition existed at that time, and before that time. But it is clear from the Act that the USPS was expected to act cautiously in that area.

B. A "Business-Like" Postal Service

The second objective of Congress was to create an efficient postal service. I have often heard it said that Congress intended to create a more "business-like" postal service. I have no problem with the concept of a "business-like" postal service. "Business-like" to me suggests efficiency, careful accounting and accountability. But over the past years it has come to mean more than that.

"Business-like" in discussions of USPS issues has come to imply a competitive posture, and I take issue with that implication. First, an aggressive, competitive USPS contradicts the spirit and the letter of the Postal Reorganization Act. As I have pointed out, Congress viewed the new USPS as a government service in the historic sense of the old postal service. The criteria for establishing rates require the Commission to go to some length to assure that neither captive postal customers nor the USPS's competitors are intentionally harmed by postal rates.

Second, despite the oft-repeated phrase that Congress wanted a "more business-like postal service," it is worth noting that Congress never stated in the law itself that it wanted a "business-like" postal service. References to speed and efficiency are plentiful, but never is the concept of an aggressive, competitive USPS even hinted at. To the contrary, we shall see that Congress took special precautions to guard against such a competitive postal service.

One aspect of this more "business-like" service was the USPS's new responsibility to determine the timing of its own rate increases. Prior to the Act Congress itself established postal rates and changed rates as it saw fit. Of course if it is Congress's desire that the Postal Service operate efficiently, with better accountability, and with more direct responsibility for its own success or failure, the USPS would need to have the capability to increase its overall revenue as overall economic conditions required.

A few years ago a segment on public radio detailed how the U.S. Marine Corps was studying Wal-Mart's inventory control system, in order to enable the Marines to operate in "a business-like manner." Does that suggest that the USMC needs to be more competitive? Of course there is no such thing as a free enterprise competitor to the Marine Corps. In this case it had nothing to do with competition. It simply meant to borrow some good ideas from a successful business for the purpose of increasing efficiency.

C. Special Protections Against Competitive Abuse

The current, popular self-view of the USPS as an aggressive competitor in the open market clearly runs counter to the Act. Quite to the contrary, Congress understood that a tax exempt postal service, operating without a profit margin, and possessing a legally mandated monopoly has the potential for abuse. Because of this, in 1970 it established three specific criteria to protect competitors and to protect mailers from suffering the results of anticompetitive rate structures. Implied clearly is that Congress did not view the USPS in a competitive role.

The Postal Reorganization Act, Section 3622,(b), lists the criteria for the development of postal rates. In this section of the Act, the Postal Rate Commission is directed to "make a recommended decision on the request for changes in rates or fees in each class of mail or type of service in accordance with the policies of this title and the following factors..." There follow nine specific criteria for setting rate and service levels. Of those nine, Criteria 3, 4, and 5 taken together reveal Congress's view and its clear intent with respect to competition. These three criteria are as follows:

> (3) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type.
>
> (4) the effect of rate increases upon the general public, business mail users, and *enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters*; (emphasis added)
>
> (5) the available alternative means of sending and receiving letters and other mail matter at reasonable costs.

It is significant to note that these specific criteria were new concepts. There were no such specific protections for competitors in the former Title 39, which the Postal Reorganization Act rewrote. The former Title 39 was very general in its rate criteria, Congress being the rate setters.

The general concept contained in Criterion 3 wasn't entirely new, but the specificity was. Sections 2302 and 2304 of the former Title 39 in a very general sense provided for cost review every two years, and specific adjustment recommendations were to come from the Postmaster General to Congress every two years. Further, the law was very general (in Section 2304) as to attributable costs or coverage of costs by rates for each class. There was no specific requirement that each class or subclass pay at least its own costs.

Similar to the current Criterion 4 above, the former law also contained a general "protection" clause, but the protection was only for mailers. The old law declared that Congress would consider "the effect of postal services and the impact of postal rates and fees on users of the mails." (former Title 39; Section 2302,(c),(1),(D))

Finally, there was nothing to correspond with the present Criterion 5 protection. Nothing in the former Title 39 specifically addressed the need to protect mailers that had few or no alternatives.

It should be obvious that the protections being extended for the first time to the USPS's competitors, and to mailers with no alternatives, were added in 1970 as a counterweight to the increased freedom and independence being granted the USPS by the Postal Reorganization Act. With the newfound level of independence, and armed with the letter monopoly, the resulting new potential for abuse was to be tempered by new protections for those most likely to be victims of that abuse.

The language of Criterion 4 is especially interesting. It directs the Commission to consider the effect of "increases" upon, among others, competitors of the USPS. The implication clearly is that "increases" for competitive classes of mail that are so low (or negative) as to hurt competitors are to be avoided. Within the context of these criteria, there can be no other logical inference. In other words, not only is the USPS not allowed to lower rates for the purpose of hurting fair competition, it is clearly instructed to consider the impact of "increases" to avoid hurting competitors.

The word "increases" is certainly significant. It should be clear from the spirit and the context of the Act that Congress did not consider the possibility that the USPS would go out of its way to *reduce* competitive rates for competitive purposes. The implication is unmistakable that Congress assumed that periodic rate changes would take the form of an increase, and that the increases should be high enough so as not to harm fair competition.

In the present case, the USPS has apparently taken the novel, and ludicrous, position that the Criterion 4 consideration of competitors is dropped from the Act in the event of a rate *decrease*. AAPS was required to file a motion with the Presiding Officer to compel USPS to answer AAPS/USPS-6, which asked whether the Postal Service had conducted or commissioned a study or report on alternative delivery since the Strategic Analysis, Inc. (SAI) report that had been dragged into the light during MC95-1. The Postal Service, after admitting that such work had been done, strenuously objected to providing it or revealing what it contained.

One of the subjects that the USPS ultimately acknowledged is contained in the new study is information that analyzed the "reaction" of the alternate delivery industry to price change. AAPS contended that this is exactly the kind of information that must be considered under Criterion 4. The Postal Service incredibly responded that while the Act required that the effect of *increases* on competitors had to be considered, the effects of *decreases* could be ignored! "The (b)(4) criterion only requires an evaluation of 'rate increases' on alternative delivery; the statute is silent with respect to rate *decreases*." (Emphasis in original). Supposedly the new, super-aggressive Postal System can now lower competitive rates with impunity without any consideration of Criterion 4.

To whatever extent the attempts to satisfy the rate setting criteria were altruistic, the USPS never made any serious attempt to apply Criterion 4 to its proposals. We raised the Criterion 4 issue repeatedly in R84-1, in R87-1, and in R90-1. Though attempting to satisfy the other criteria, USPS conducted itself as if the competition clause of Criterion 4 did not exist.

Yet when it served its own purpose before the U. S. Court of Appeals for the Second Circuit in Time Inc. v. USPS in 1982, the USPS, in a specific reference to alternate delivery, correctly pointed out in its January 20, 1982 initial brief that Criterion 4, "mandates that the effect on competing businesses is an additional factor to be considered in establishing postal rates." Note use of the word "mandates" and reference to "establishing" rates, not just "increasing" them.

Even though the USPS demonstrated its familiarity with the competitors' clause in Criterion 4, in R84-1 Criterion 4 received no attention, not even lip service. USPS witnesses admitted that they made no effort to study the alternate delivery industry (Tr. 1251, Docket R84-1) and that they did not even discuss private delivery among themselves in preparing the rate proposal (Tr. 2004-05, Docket R84-1).

R87-1 was no better. In his initial testimony, USPS witness Lyons suggested that the proposal considered "the continued competitiveness of newspapers and private delivery firms." When questioned about that consideration, Lyons referred to an article he had read in Advertising Age which did mention newspapers but did not mention private delivery (see Tr. 3844, Docket R87-1).

In R90-1 witness Lyons proposed a rather novel interpretation of Criterion 4. It was apparently his testimony that Criterion 4 was automatically satisfied as long as Criterion 3 was satisfied. The new doctrine was that as long as rates covered their direct cost (direct testimony at 39 and 41), and as long as rates are not specifically designed to hurt competitors (Tr. 4293-94), then that amounted to due consideration of competitors and satisfied Criterion

4. (This is similar to Donald J. O'Hara's view in the present case. He concludes, "Given the very high cost coverage of the ECR sub-class, this rate increase *[decrease?]* does not result in unfair competition for its competitors." Testimony, page 35.)

Of course, making Criterion 4 dependent upon Criterion 3 writes Criterion 4 out of the Act. It should go without saying that if Congress did not mean something additional to Criterion 3 in writing Criterion 4, then Criterion 4 is redundant and unnecessary. Obviously, since it was added as a separate criterion, it means (and requires) something additional.

In MC95-1 the Postal Service proposed rates under new classification headings that it freely admitted were developed for competitive reasons. Its "consideration" of competitors was apparently a consideration of how to put them out of business. It was to some extent successful, as the PMG's speech concerning Publishers Express cited above demonstrates.

In R97-1, the Postal Service, with tongue firmly planted in cheek, claims that none of the rate proposals has been made for competitive reasons. Nowhere in R97-1 have I discovered the USPS witnesses referring to Standard ECR rates as competitive, as they did in MC95-1. They mention only vaguely that there is competition for Standard ECR mail.

Indeed, in the same objection cited above concerning AAPS/USPS-6, the Postal Service states, "Nowhere in the Postal Service's testimony is there a claim that the existence of a 'competitive threat' from alternative delivery forms the basis for any of the rate and classification proposals in this docket." Two years ago, competition was the driving force behind reclassification. Now it's gone from the radar screen.

That being the case, or alleged as the case, it is curious that the USPS is so secretive about its new SAI study with regard to alternate delivery competitors. While it has steadfastly refused to disclose the contents, beyond the highly censored and therefore useless version produced, it claims to be unaffected by these competitors in requesting new, more competitive rates.

The USPS fought hard to avoid releasing the complete new SAI study. The study was apparently so controversial - and perhaps inconsistent with the testimony of its witnesses - that the Postal Service didn't even let the witness that testified about impact on competition and competitors (O'Hara) see it or learn of its existence! O'Hara was to "describe what efforts the Postal Service made to determine whether the rate decreases proposed will have an adverse impact on competitors or on competition." He responded, "...A quantitative assessment of the effects on competitors would require information on competitors' costs, prices, and volumes, and as far as I am aware this information is not available... ." TR. 116. Unbeknownst to Mr. O'Hara, this type of information was indeed available. The powers that be just decided not to tell him.

Witness Moeller, who was charged with the rate design for the highly competitive ECR rates, was obviously not aware of the SAI study either. He acknowledged that he had not reviewed competitors' rates for two and a half years. He thought he might have logged onto some web sites for information, but couldn't remember seeing any rate information. He had acknowledged studying competitive rates, however, in preparation for MC95-1. One cannot help but question the integrity of a process that collects information vital to a key rate-setting consideration and then fails to disclose not only the actual data but the fact that it even exists to those charged with setting the rates. Combine this disgraceful behavior by a governmental public service with gloating by its leader when it crushes a private sector competitor, and it becomes apparent why the alternate delivery industry is so skeptical about Postal Service data, claims and motives.

In this regard, why should we, or the Commission believe that what was a serious competitive threat in MC95-1, a threat that formed the very basis of reclassification, is no longer a threat in R97-1. And what credibility can be given to the assertion that the competitive basis for a huge pound rate reduction for Standard ECR in MC95-1 is presumably not a factor in proposing another huge pound rate reduction for Standard ECR in R97-1.

I encourage the Commission to view the USPS as Congress viewed it in the Postal Reorganization Act. It is not a competitor first and foremost. It is first and foremost a government service charged with serving the public good. I encourage the Commission to apply all the criteria of the Act, including Criteria 3, 4, and 5, to each USPS rate proposal.

VII. ANOTHER PROPOSAL WITH SERIOUS FLAWS

In early December the US Postal Service announced that it would earn a surplus of $1.3 billion for fiscal 1997. Because the present rate request proposed fairly low average increases to begin with, it seemed that the proposed rates were more opportunistic in terms of adjusting the competitive balance than they were necessary in raising needed revenue.

Add to that good news the continuing volume increases – particularly in advertising mail – and a rate case at this time is curious to say the least. It does make sense, however, if we consider that the USPS mailstream consists mainly of two large classes of mail, First Class and Standard Mail, and any significant effect on the USPS, good or bad, will be the result of First Class and Standard Mail rate shifts. It goes without saying that First Class mail is safe, that whatever the rate being charged, mailers will have to pay it since only the Postal Service can legally deliver "letters." I recognize the possibility of substantial diversion to electronic media, but submit that such diversion is much more a function of technological change than First Class rates

The current proposal calls for a one -cent increase in the price of First Class letter stamps, and no increase in the rate for additional First Class ounces. Standard mail is a mixed bag. Most of Standard Mail Regular is part of the letter monopoly, but most of Standard Mail ECR is mail for which the Postal Service must compete. So it is no surprise to find the USPS proposing moderate increases for Standard Mail Regular, and decreases for much of the highly competitive Standard Mail ECR in this proceeding, decreases of as much as 18%.

Certainly the engine that drove MC95-1 was the desire to drive an even larger wedge between the competitive portion of third class mail and the monopoly portion, and to make the rates for the competitive porttion of third class mail more "competitive." Witness Joseph D. Moeller's direct testimony (MC95-1, at 14) confirmed that a major purpose for reclassification was to develop "more competitive rates for local, high-density advertising." The concept of competition and the need to address the serious problem of the "Diversion of Mail Volume" to "alternative hard-copy delivery [companies]" were paramount in the MC95-1 testimony of Charles C. McBride.

The USPS-sponsored testimony in R97-1 is different from the MC95-1 testimony in one respect. In MC95-1, McBride and Moeller made no bones about the purpose of reclassification. They made it surprisingly clear that competitive considerations were driving the whole process. By way of contrast, the R97-1 testimonies of Moeller and O'Hara are certainly better disguised. But the results of a major decrease are just as damaging to competitors as if they had again fully described their intentions.

A. Ramsey Pricing and Rate Elasticity

This rate case breaks some new ground with respect to competition. The introduction by the USPS of Peter Bernstein's testimony officially praising the application of Ramsey Pricing to postal ratemaking speaks as loudly to competitors as would a formal cover letter from the PMG himself accompanying the rate case testimony declaring that his objective it to put our whole industry out of business (not just the subscription magazine part).

I am certainly not an economist, but it is clear to me from what I have read in this case (and in prior cases) that sponsoring Ramsey Pricing in a postal context is tantamount to ignoring Congress and tossing nearly the entire ratemaking criteria section out of the Postal Reorganization Act. While Ramsey pricing concepts have been introduced by other witnesses in the past, and have been debated and discussed in past cases, this is the first time the Postal Service has officially endorsed and sponsored Ramsey Pricing testimony.

No one from the USPS is actually proposing any rates based upon Ramsey Pricing, going only so far as to say that it is a useful guide. That's what makes the sponsorship of Mr. Bernstein's testimony a bit curious. The effect of Bernstein's testimony appears to be simply to lurk in the background, perhaps to be relied upon by others, and to serve as a basis for lower competitive rates when the USPS can't support them through application of proper postal ratemaking criteria.

And of course the bottom line is that Mr. Bernstein has concluded that highly competitive Standard ECR mail *should really* be priced at about an average 8 cents per piece, roughly one half its current average rate. In that event, according to Mr. Bernstein, Standard ECR mail volumes would grow by 36%, from 31 billion pieces to over 42 billion pieces (Tr. 5088). Mr. Bernstein would venture no guess publicly where that volume increase would come from (TR. 5089-90). What is obviously difficult for a highly trained economist to figure out, however, is fairly simple for an AAPS member competing for its small share of those 12 billion pieces that are up for grabs.

Naturally the Postal Service has generously decided not to cut these competitive rates in half. Armed with this ideal, however, it has decided to cut the rate for some of the most competitive of Standard mail as much as 18%. While this is consistent with past proposals, Mr. Bernstein has given the Postal Service some intellectual cover this time.

The USPS's semi-embracing of the Ramsey Pricing is no surprise. Ramsey Pricing is the product of calculating price elasticity, one of Postal Service's favorite ratemaking tools. Much postal rate elasticity results from the artificial result of the Private Express Statutes, so that Ramsey Pricing calls for high rates for monopoly mail and low rates for competitive mail. And that result is consistent with what the USPS has been trying to do with only limited success during the past several rate and classification cases.

B. An Over-Reliance on Cost Coverage

AAPS has been critical of the Postal Service's over-reliance on percentage cost coverage since it began participating in these rate cases. For example, as we stated at page 33 of our initial brief in R90-1, the saturation mailers will argue that the rates for saturation mail "are too high because the 'attributable cost coverage' is higher for that particular type of mail than for other particular types of mail."

It was AAPS's position then, and it is AAPS's position now, that the USPS's embrace of percentage cost coverage (whether attributable, incremental or volume variable) has "elevated a convenient but misleading tool of comparison into the exclusive rate making tool." In fact, in the words I used while testifying in R90- 1 (Tr. 18490), the percentage attributable cost coverage concept has "evolved into a rigged system where first-class mailers are forced to pay a hugely disproportionate share of institutional costs, whereas third-class mailers pay a meager share of the total."

In his dissent in R84-1, Commissioner Crutcher (at page 3) was critical of a "strict adherence to percentage markups" which, he said, "ignores absolute unit cost contribution to institutional costs." Mr. Crutcher was simply reiterating what the Commission found in R80-1. There it explained (at page 455, footnote 1) that use of percentage cost coverage "can misrepresent" institutional cost burdens where there are substantial differences in attributable costs and that, consequently, the Commission "must be guided more by the per piece cost contributions than by percentage cost coverage" in comparing first-class letters and third-class bulk mail.

To its credit, the Commission recognized this important concept in evaluating the Postal Service's proposals in recent rate cases, and, as a result, has tempered the first-class increases and rejected USPS attempts to impose either small or negative rate increases on Third Class/Standard ECR saturation mailers. The Commission should consider the disproportionately low burden now being borne by Standard ECR in assessing the USPS's proposal to reduce even further the rate for many saturation flats.

As AAPS, and I, have contended in previous cases, the shortcomings of the percentage markup analysis become more pronounced as mailers bypass attributable costs and, therefore, attempt to free themselves from institutional costs burdens as well. I repeat below footnote 16 from page 36 of the AAPS initial brief in Docket No. R90-1, which predicted the dilemma that the Postal Service is just beginning to recognize here:

> In earlier cases, the Coalition of Non-Postal Media had hypothesized a class of mail handed to the letter carrier on the way out the door, in which the attributable costs are to be extremely low and which would, therefore, be 'assigned' a very low percentage of institutional carrier street time, contrary to all logic. The Postal Service's deep discounts in this case for walk-sequenced, delivery office mail show that our earlier hypothetical analogy is becoming frightfully real.

With today's rates, First Class mailers now must pay about 63% of the institutional cost load, despite the fact that First Class makes up only about 52% of the volume. Standard A mail collectively represents about 41% of USPS pieces but only 21% of the contribution to institutional costs. Standard, Commercial ECR mail, comprising an estimated 15% of the volume and a higher percentage of the total weight, picks up only about 9% of the total institutional cost burden. As "attributable" costs continue to be bypassed, the concept of coverage is becoming nearly meaningless. Stated otherwise, assessment of cost coverage is difficult for mail that typically uses little more than the Postal Service's delivery function, especially because 60-65% of those costs are deemed to be institutional. See Tr. 3151-52, where the Presiding Officer raised this point with Witness Moeller.

The unit contribution to institutional costs will continue to show a much more severe burden on First Class than on Standard mail pieces. According to witness O'Hara, Tr. 190, under the R97-1 proposal, each piece of First Class mail will make a contribution of between 17.17 cents and 18.04 cents toward institutional costs. Standard Regular will contribute 7.52 cents, and Standard ECR will contribute 8.43 cents per piece, both less than half the First Class per piece contribution.

Add to these per-piece contributions the fact that the average Standard Commercial mail piece weighs approximately three times what the average First Class piece weighs, and you have a First Class per-pound contribution of about six times the per-pound contribution of Standard Commercial. Yet despite these glaring discrepancies, the USPS continues to rely on attributable cost coverage percentages to try to widen these gaps still further.

C. Still Another Very Selective Weight Study

Of course it should come as no surprise that the USPS makes invalid comparisons to pursue its rate objectives. It is even understandable that the USPS would rely on favorable, albeit illogical, cost coverage numbers in proposing competitively beneficial rates. However it seems somewhat inappropriate to engineer a weight study in an incomplete, selective manner that tends to fulfill the desired ends at the price of distorting the truth.

In MC95-1 we made this point concerning the weight study performed by Christensen Associates, referred to there as Library Reference MCR-12. This study presumed to measure the relationship between weight and cost for third class regular rate mail. The study was, without question, incomplete. Page one of the study listed the factors considered, "The costs included in the analysis are those associated with mail processing, window service, and city carrier in-office activities."

If the USPS really wanted to determine the relationship between weight and cost, this study had no value. It ignored obvious weight driven cost segments, and it relied instead on cost segments that were entirely in-house and were only affected minimally by weight.

This is not said in order to impugn the integrity of Christensen Associates. Without doubt the study was conducted as ordered by the USPS. I point out only that the USPS-ordained scope of the study was inadequate for anything other than to serve as a pretext for still lower competitive rates.

In MC95-1 USPS witness Moeller, though relying on this weight study for his proposed rate of 51 cents per pound for Enhanced Carrier Route mail, recognized the incomplete nature of the study, and the fact that the Commission has repeatedly asked for better information. "The Commission has repeatedly expressed its desire for a study of the weight-related costs in third-class. . . The Postal Service shares this desire, but a study of weight that excludes the effect of other cost-causing factors has been difficult to conduct." (Direct Testimony, Page 12)

Moeller was at least in part correct. The Commission has pressed for a weight study since at least 1983, when AAPS (then APPS) participated in the Joint Postal Service/ Postal Rate Commission/Mailers Study Group on Third Class Bulk Mail. In a letter written to this study group, dated September 26, 1983, James Anderson, then the APPS Director of Governmental Affairs, stated the following:

> We are vitally concerned with the approach to this study because as competitors to the Postal Service it is very important that the Postal Service properly identify and assign its operating costs. If the Postal Service properly identifies its costs and structures rates to adequately cover those costs, private sector competitors like ourselves can fairly compete for the business.
>
> Our experience tells us that weight and shape have a significant impact on costs even though we are not involved in the areas of sortation and processing that this study is focusing on.
>
> We have heard from the Postal Service that weight and shape are not significant factors in other cost segments. We are here to testify that weight and shape have an eminently significant impact on operating costs. It is difficult for us to understand how the Postal Service can move these same products and not recognize that impact.
>
> Our objections to this study as presently proposed are as follows: *First, the study focuses only on in-house processing and sorting functions that are largely bypassed by the carrier route presorted mail that is subject to competition from the private sector.* As presently structured this study will reveal nothing about the effect of rate (sic) and shape on that portion of the mail stream that is subject to competition. (emphasis added)

This was written more than fourteen years ago. Despite our efforts and the efforts of the Consumer Advocate that date back at least as far as 1983, the USPS has refused to identify costs for weight driven cost segments other than those segments that furthered its purpose. The result in 1983 was a study that included only in-office costs. A similar study was conducted in MC95-1 by Christensen Associates. And now, for a third time, the USPS in R97-1 has commissioned the Christensen Associates once again to conduct another carefully controlled study (R97-1; LR-H-182, Exhibit 44B) which, like the 1983 study and the Christensen Study in 1995, are preordained to produce the desired answer: weight has little effect on cost for highly competitive Standard ECR mail.

In private delivery, and I submit from personal experience, in any delivery, there is a significant weight/cost relationship at the point of delivery. Another weight/cost relationship is experienced in transporting materials. A third is in the warehousing and handling element. It has been my experience that weight drives in-office costs very little, if at all. Most in-office handling costs are piece related, not weight related, and certainly the Postal Service is aware of that. An over-reliance on in-office costs only discredits the USPS's cost data.

Any weight/cost study that fails to study the impact of weight on the most obvious weight driven costs, but simply assumes there is none, is a rigged study. Understandably, it does serve the purpose of proving that Enhanced Carrier Route rates should be low by comparison. The only costs the USPS selected for study are those which are low to begin with, and which disappear with local entry and route pre-sorting and pre-sequencing.

Imagine two postal employees. One works at a work station in a postal facility. He sorts pieces of mail. The other is a walking carrier who services 600 houses on his route.

The first handles pieces of mail. He moves skids or carts of mail to his work station, and he sorts through the pieces. Some of the pieces are heavy and some of the pieces are light. But the weight makes little difference, other than the small amount of his time that he spends moving the skid or cart to his work station. In sorting pieces, he can move through a stack of Standard Mail catalogs about as quickly as he can a stack of Standard Mail letters. His speed is predominately piece related. More importantly to the Postal Service, most highly competitive ECR mail avoids this first employee.

Consider the city carrier with those 600 stops on his route. That carrier cases his mail before delivering the route. He sits in front of a sorting rack and he sorts pieces of mail into that rack. At this point it doesn't really matter very much if the pieces weigh 1 ounce or 8 ounces. Since he is sorting one piece at a time, he can sort heavier pieces just about as fast as he can sort light pieces. It would seem logical that this part of his job will take about twice as long if he has twice as many pieces to sort.

The carrier finishes the sorting process. At this point the piece-related work is done. Unfortunately, at this point the Christensen Associates study ends as well. What remains for the carrier is by far the greater part of his labor hours. Any variability from this point on from the normal amount of labor hours is dependent not upon pieces but upon weight and bulk. The individual pieces have all been put in order. The only question concerning whether this carrier can accomplish his normal loops is whether he can carry all the load to complete each loop or whether he will have to make extra trips due to extra weight or bulk. It has nothing at all to do with the number of pieces.

However, in response to an interrogatory concerning the most recent Christensen Associates study, "Please explain why city carrier street costs are distributed to weight increment in proportion to mail volume," witness Moeller answered, "This assumption was made in interests of simplifying the analysis. Although there may be some weight related costs in city carrier street time, it is believed that the majority of costs are piece related." (Tr. 7708) How can that be? The piece work at this point has been finished. The number of stops and regular loops are fixed - the same every day. The only variables now are weight and bulk. (It seems also that simplicity, rather than accuracy, was the primary goal of the study. See also Tr. 7778.)

Witness Moeller appears far less than certain in this answer, probably because it is so counterintuitive. Indeed the next question was, "Is it your opinion that weight has no effect on city carrier street costs?" Moeller answered, "No." Yet carrier street time was not calculated or considered in the Christensen Associates study once again.

Back to our street carrier. Once sorted, the pieces are loaded into his vehicle for delivery to the 600 homes. Consider that a carrier may comfortably carry only about 30 to 35 pounds of mail at a time. Consider also the difference in 600 ECR saturation pieces that weigh 1/4 ounce each, and 600 ECR saturation pieces that weigh even a modest 3.3 ounces each. These two different pieces collect the same amount of postage.

The 1/4 ounce piece represents 9.4 pounds of mail, easily absorbed into the carrier's delivery routine. However, the 3.3 ounce pieces add an extra 124 pounds of mail. That 124 pounds is not quite so easily absorbed. It means slower progress and likely some extra trips to the vehicle. Simply put, extra weight translates into extra time, which translates into extra labor cost.

If we can assume 10 minutes to go to the vehicle and replenish the pouch, 4 trips means 40 added minutes. If we can assume the carrier earns $25 per hour in wages and benefits, which may be low, that's 2.8 cents per piece more in direct labor cost, roughly one cent per ounce. Yet, the USPS proposes that the 1/4 ounce piece and the 3.3 ounce piece should be priced the same.

As if to add insult to injury, the USPS has suggested, through its current weight study, Exhibit 44B, that if the piece weighs 13 ounces (meaning that this piece will add 487 pounds to a typical carrier), that carrier will presumably find it easier to handle than if it weighs 4 ounces. The R97-1 Christensen Associates study has concluded that it costs 7.1 cents to handle a 4 ounce ECR piece, and 6.6 cents to handle a 13 ounce ECR piece. Moreover, that 14th ounce is the back-breaker. According to this study, it costs 13.0 cents to handle a 14 ounce piece, about twice as much as the cost to handle a 13 ounce piece. This and other strange results of the study could not be explained (See Tr. 7699-7700 and 7790-7793). Perhaps the study's flaws result from the very thin data (Tr. 7797-7798; 7800).

Of these two postal employees, the USPS has made the calculated decision to consider the first one, the guy at his work station inside the postal facility, and to consider the second one only for that portion of his day that he is sorting mail at his case rack. But once the carrier leaves the post office and actually begins to lug the weight around his route, the cost experts stop watching.

The Postal Service tried to argue around these obvious problems. In response to AAPS/USPS-T36-8, redirected from witness Moeller (Tr. 7654-7655), the USPS described a similar city carrier but loaded this carrier not with 14 ounce pieces but with non-credible assumptions.

Question: "Assume that on day one a carrier delivers 500 identical Standard pieces each weighing 1 ounce, for a total of 31.25 pounds, and on day two he delivers 500 standard pieces each weighing 7 ounces, for a total of 218.75 pounds. Assume further that all other mail to be delivered is identical. Will there be any difference in carrier street costs on the two days? Please explain."

The USPS didn't like the realistic assumption posed by AAPS, so it substituted its own assumptions before answering the question. "In interests of simplicity, let us further assume that both the one ounce pieces and the seven ounce pieces are the same shape, say flats. *[fair enough]* Also assume that the carrier has no other mail on these two days *[we had asked him to assume that other mail was identical, not non-existent!]*, and that the 500 pieces on each day are addressed to the same 500 stops."

After loading the assumptions to produce a scenario that this carrier delivers no mail except 500 one-ounce pieces the first day, and no mail except 500 seven-ounce pieces the second day, a scenario that could never happen in the real world, the Postal Service concludes that there will be no difference in the carrier street costs.

Any reasonable observer will notice the obvious - that it is not the seven ounce pieces by themselves that are likely to increase the carrier's street time, it is the seven ounce pieces in addition to the other mail that would normally be delivered at the same time that causes additional dismounts and extra trips back to the vehicle, thus increasing carrier street time.

The point is that the USPS continues to base its conclusions about weight on untested, unproven, and unquestionably incorrect assumptions about street time.

When AAPS/USPS-T36-10 pointed out several serious anomalies in the study, such as that the cost for a 13-ounce piece was the same as the cost for a one-ounce piece, that the cost per piece actually declines from one ounce to three ounces, that a 4-ounce piece costs 39% more than either a 3-ounce piece or a 5-ounce piece, that a 9-ounce piece costs 14% less than an 8-ounce piece, the Postal Service responded that "the study presented in Library Reference H-182 was not intended to measure specific cost relationships between individual weight cells, but rather to provide the overall relationship between weight and cost for Standard Mail(A)." (Tr. 7657)

If a study intended to establish weight/cost relationships cannot even come close to measuring "specific cost relationships between individual weight cells" without more questionable cost numbers than realistic numbers, and if it can't even produce a clearly discernable graphic trend between 1-ounce and 13-ounce pieces, *what good is it!* Why would the Postal Service be so anxious to embrace such results?

Asked to explain some of the anomalies of the weight study, USPS Witness McGrane could not come up with any real explanation (Tr. 7699,7700). Asked whether there was any point at which he might begin to get uncomfortable with such anomalous results, McGrane answered (Tr. 7792), "It depends on what you mean by uncomfortable. I think that you can make a solid conclusion from the study that the relationship weight with cost for ECR mail is not nearly as great as what the current pound rate is set at," which, of course, is exactly the preordained result of the study.

A study that ignores obvious weight related factors and addresses only in-office costs would be an inadequate basis for any "solid conclusion," even if it were accurate and had the appearance of a logical progression. A study that ignores obvious weight related factors and is illogical at the same time would hardly qualify as the basis for solid conclusions.

Certainly it would be speculative on my part to try to assume or estimate the unknown costs. I freely admit I do not know the exact level of costs involved for additional weight for carriers, just as I don't know how much Advo's (and others') odd-shaped, loose sets add to carrier time and cost, compared to bound or enclosed material (although as the Presiding Officer surmised (Tr. 7831-7832), they are considerable). But certainly there are costs involved, and I doubt that anyone, other than the Postal Service, would argue seriously that there are none. In fact, even witness McGrane (who is not a postal employee) admitted that bulkiness and "openness" could have an effect on unit costs (Tr. 7788-7789).

My own experience with U. S. postal carriers confirms this conclusion. In developing private delivery in a number of communities, our employees involved in development are commonly aided by postal carriers who are anxious to help us with routing information. Their attitude is that they will do anything they can to help us, hoping that we will transfer material from their route out of the mail first.

Normally, when we succeed, we are taking a weekly newspaper or shopping guide out of the mail. With printed inserts, these typically weigh 10 to 12 ounces per set, representing an additional 300 to 500 pounds of mail for that carrier one day each week. The reason Postal carriers tend to be very helpful is because they want to get rid of the extra load and extra work. It is safe to say that if this material did not represent extra time and effort they would not care, nor would they volunteer their assistance to a competitor.

Carrier street time is not the only missing cost segment. I could add vehicle service drivers and rural carriers. I could add the obvious capital cost for purchasing additional vehicles, or vehicles capable of hauling heavier loads. I could add the cost of maintaining a larger fleet of vehicles.

The Commission should disregard the Christensen Associates' weight study and the USPS conclusions that rely on it. It inappropriately includes only in-office cost segments, and it continues a fourteen year trend of avoiding a complete study that could provide some accurate cost data for the Commission's consideration. A misleading study is worse than no study at all.

D. 42 Cents Per Pound vs. $3.68 Per Pound

One thing is certain with respect to the study of weight-related costs. The in-office personnel who were studied by the Christensen Associates had to be different postal employees than those studied to justify the $3.68 pound rate for First Class mail. Based on the 23 cent charge for the second ounce of First Class mail, other postal employees must have found it was nearly twice as difficult and took nearly twice as long to handle a First Class piece weighing 2 ounces as a piece weighing 1 ounce.

Currently the basic pound rate for Standard ECR mail ranges from 55.2 to 66.3 cents per pound, depending on Destination Entry Discounts. Although this is slightly lower than the pound rate that was being paid for comparable saturation Third Class prior to MC95-1, it was far more favorable than what the USPS had proposed. We owe the Commission a debt of thanks for that. The USPS proposal in MC95-1 was for a huge reduction in the Third Class pound rate, to an ECR range of 39.9 to 51 cents. That proposed reduction was based upon the first Christensen Associates weight study, which had the same basic flaws as the more recent study.

It is beyond question that Standard ECR mail is more subject to competition than is Standard Regular. Witness Moeller confirms (Tr.2799) that the weight reduction for Standard is 4% (65 cents) and the weight reduction for ECR is 20% (53 cents). He further confirms that he *selected* rather than calculated the 53 cent rate. He confirms that his reasons for proposing this reduction in this case were about the same reasons he proposed similar reductions in MC95-1, which the Commission rejected. He confirms (Tr.. 2791) that, "the rates for other advertising media were an additional consideration in the pound rate proposal." Perhaps this is witness Moeller's way of considering competitors under Criterion 4.

There is no rational cost justification to support an incremental weight rate of $3.68 per pound for First Class mailers and an incremental rate of $.42 to $.53 for mailers of saturation advertising. The First Class "pound" rate is an obvious effort to generate excessive revenues from those who have no delivery alternatives. This huge discrepancy exists despite Congress' clear instruction to give special rate consideration to mailers with no alternatives. The equally extreme (extreme on the low side) pound rate for saturation advertising is an obvious effort to generate volume in a highly competitive subclass of mail.

Small delivery companies have been successful over the past ten years in building business volumes on weekly newspapers, TMC advertisements, phone books, and product samples. USPS volume and profit figures demonstrate that these privately delivered materials have not negatively impacted the USPS. There is more advertising mail volume than ever. Certainly a reduction of as much as 18% per piece for this type of mail would have a severe impact on the private delivery of these heavier pieces. How many more notches does the Postmaster General need on his gunstock?

E. Attributable Costs That Are Not Attributed

Over the past several cases I have mentioned a number of costs related to direct-mail advertising that go un-attributed. In the present case, another example has surfaced and is worth mentioning.

According to witness Takis, in response to a UPS interrogatory, of the $235 million spent in advertising, only $66 million is attributed to a specific class of mail. Tr. 4732. Presumably the other $169 million is regarded as an institutional cost. It's been a long time since I saw an advertisement from the Postal Service to use its services for my one-ounce First

Class mail - in fact I have yet to see one. However, First Class mailers get to pay the bulk of this $169 million advertising expense, as they pay the lion's share of institutional costs.

As for direct advertising mailers, they are charged with a whopping $1.5 million of that advertising expense (0.6% of the total). Tr. 4702. According to witness Takis, advertising directed to "direct mail" or "advertising mail" can refer to more than one subclass, so the costs are not assigned to any class, Tr. 4703, which means in reality the costs are predominately borne by First Class mailers. I think we all understand that pitches for more advertising mail, such as the fancy, multimedia collection discussed at Tr. 4783-85, is a pitch for Standard mail even though, of course, ads may be sent as First-Class mail. In fact, in my experience, the predominant use of First Class for advertising is by mailers that insert ads to "use up" their one ounce, a practice that produces greater postal costs without greater revenues.

F. Failure to Recognize Cost Difference Between Letters and Non-Letters

Even though there are substantial differences in the cost of handling flats compared with letters, the USPS has elected to pass through only 35% of the difference to mailers of ECR letters. Indeed, the differential at the basic level is 0%. Saturation flats are the most competitive of the ECR volumes, and anything that results in a more competitive rate for saturation flats seems to play well at the Postal Service.

The USPS in MC95-1 proposed no difference between letters and flats for the ECR subclass. It maintained that ECR mail was intended to be a category predominately for flats, so there should be no difference. The Commission rejected that reasoning and established a difference between the two. Now the USPS is intent on minimizing that difference. It tends to be quick to recognize discounts and cost factors (not to mention studies) that result in lower rates for saturation flats. Real cost data that would drive the rate for saturation flats higher tend to be ignored.

G. The Proposed Shape Surcharge

Once again the Postal Service has proposed a competitive rate shift that will cost it a little volume in exchange for a lot of volume. By a huge margin, most of the volume being carried outside the mailstream by alternate delivery is saturation or high density flats. This is a highly competitive type of mail, and it makes up most of the Postal Service's Standard ECR volume as well. That is where the volume and the dollars are.

Occasionally an alternate delivery company will carry a product sample, and even though such samples are important sources of revenue, they usually come no more frequently than once or twice a year. The flats, on the other hand, are distributed every single week and are the lifeblood of our industry. Our systems could not exist to deliver samples if we did not have to flats to deliver on a regular basis. In some more rural markets, there are rarely if ever product samples to deliver. In my own rural market in Northern Michigan, we deliver printed advertising every Saturday evening. In addition, several times during the year we do special deliveries in the middle of the week. We have delivered no parcels or samples for several years.

The Postal Service is now proposing a 10 cent surcharge for pieces that are neither letters nor flats. No doubt this will offset some of the proposed pound rate reduction for the odd-sized pieces, but alternate delivery companies are already getting quite a bit of sample business in the more major markets under the current rate structure. Therefore, with an appropriate pound rate, the surcharge is not necessary to assure fair competition at the higher weights. While a higher effective rate for product samples is appealing to alternate delivery, that appeal is lost if the surcharge is used to reduce an inadequate and anticompetitive pound rate.

As with the selective weight study, the surcharge proposal is competitively selective as well. It is interesting that the Postal Service does not differentiate between flats that are difficult to handle and those that are easy to handle, as it once did. Throughout the 1970s the Postal Service charged a lower third class rate for pieces that were "bound" than it charged for pieces that were clumsy to handle.

From my experience handling and delivering both, this distiction made good sense from a cost standpoint, but it didnt make sense from competitive standpoint. Loose, clumsy advertising was charged a higher rate, but it accounted for considerable volume that could be lost to alternate delivery. Bound catalogs were charged a lower rate, but they were pretty much low-volume, address specific matter not susceptible to a competitive threat. The favorable rate for bound third class mail was dropped in the early 1980s as the Postal Service became increasingly obsessed with competing and competition.

AAPS would be supportive of a surcharge that recognizes the difference between a bound catalog and a shared mail set containing several odd-sized slippery pieces that can fall all over the place when handled. Such a surcharge would be more appropriate in that it would at recognize the cost of handling all different kinds of ECR mail.

However, we're not holding our breath waiting for the Postal Service to conduct a shape study that explores the difficulty in handling some of the Postal Service's most competitively favored customers. Since the Commission directed the Postal Service fourteen years ago to study the weight issue, it has have yet to produce anything other than a competitive pretext.

AAPS therefore supports rejection of the surcharge in conjunction with significant increase in the pound rate.

VIII. AN APPEAL TO THE COMMISSION

As I have pointed out, the USPS was established by Congress as a public service. The Commission is instructed in numerous places in the Postal Reorganization Act to apply criteria to rates and classifications that protect mailers with no alternatives, consider the value of content of the mail, and consider the impact of rates on, among others, the USPS's competitors.

As I have also pointed out, the USPS does not view itself as Congress viewed it. While it insists on retaining all its advantages, it views itself as a competitor in the open market that should have every right to compete, with little restraint.

Unfortunately, the playing field will never be level under the present arrangement. Tens of billions in guaranteed business, tax exempt status, no profit margin, these all make for a very tilted playing field. In view of these USPS advantages, Congress has entrusted to the Commission the responsibility of making the playing field as level as possible.

We urge the Commission to apply all the criteria of the Postal Reorganization Act to this current rate proposal, and in particular, Criteria 3, 4, and 5 as they pertain to competitors of the Postal Service. Clearly the present proposal by the Postal Service utterly fails to consider Criteria 4 and 5, and its supporting studies cast doubt on Criterion 3 as well.

The Postal Service has become obsessed with competition. It has exploited its monopoly customers for competitive purposes. Our survival as an industry will largely be determined, over this and the next few rate cases, by the proper application of these ratemaking criteria.

We ask that the Commission recognize the USPS proposal to reduce a highly competitive rate for what it is - an overt attempt by the Postal Service to grab additional volumes from its competitors. We ask that the Commission, at the very least, maintain the present level of rate relationships, and that any new attempt to lower the highly competitive Standard ECR pound rates be denied. We don't want our demise to be the subject of the next Postmaster General speech.

CHAIRMAN GLEIMAN: Mr. Bradstreet, have you had an opportunity to examine the packet of designated written cross-examination that was made available earlier today? Those are the responses that you previously submitted in writing.

MR. STRAUS: Is 18 corrected?

THE WITNESS: Yes, I have.

CHAIRMAN GLEIMAN: If these questions were asked of you today, would your answers be the same as those you previously provided in writing?

THE WITNESS: Yes, they would.

CHAIRMAN GLEIMAN: That being the case, I'm going to provide two copies to the reporter and direct that the designated written cross-examination of Witness Bradstreet be accepted into evidence and transcribed into the record at this point.

[Designation of Written Cross-Examination of Kenneth L. Bradstreet, AAPS-T-1, was received into evidence and transcribed into the record.]

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 1997

Docket No. R97-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF ASSOCIATION OF ALTERNATE POSTAL SYSTEMS
WITNESS KENNETH L. BRADSTREET
(AAPS-T1)

Party	Interrogatories
Advo, Inc.	MOAA/AAPS-T1-2-11 USPS/AAPS-T1-5, 8, 18 VP-CW/AAPS-T1-2-3
Mail Order Association of America	MOAA/AAPS-T1-1-11 USPS/AAPS-T1-1-18 VP-CW/AAPS-T1-1-3
Newspaper Association of America	MOAA/AAPS-T1-3, 6-7, 11 USPS/AAPS-T1-1, 6-14, 18 VP-CW/AAPS-T1-3
United Parcel Service	MOAA/AAPS-T1-3, 8 USPS/AAPS-T1-10
United States Postal Service	USPS/AAPS-T1-1-18 VP-CW/AAPS-T1-2-3
Val-Pak Direct Marketing Services, Val-Pak Dealers Association, and Carol Wright	VP-CW/AAPS-T1-1-3

Respectfully submitted,

Margaret P. Crenshaw

Margaret P. Crenshaw
Secretary

INTERROGATORY RESPONSES OF ASSOCIATION OF ALTERNATE POSTAL SYSTEMS WITNESS KENNETH L. BRADSTREET (T1) DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory:	Designating Parties:
MOAA/AAPS-T1-1	MOAA
MOAA/AAPS-T1-2	ADVO, MOAA
MOAA/AAPS-T1-3	ADVO, MOAA, NAA, UPS
MOAA/AAPS-T1-4	ADVO, MOAA
MOAA/AAPS-T1-5	ADVO, MOAA
MOAA/AAPS-T1-6	ADVO, MOAA, NAA
MOAA/AAPS-T1-7	ADVO, MOAA, NAA
MOAA/AAPS-T1-8	ADVO, MOAA, UPS
MOAA/AAPS-T1-9	ADVO, MOAA
MOAA/AAPS-T1-10	ADVO, MOAA
MOAA/AAPS-T1-11	ADVO, MOAA, NAA
USPS/AAPS-T1-1	MOAA, NAA, USPS
USPS/AAPS-T1-2	MOAA, USPS
USPS/AAPS-T1-3	MOAA, USPS
USPS/AAPS-T1-4	MOAA, USPS
USPS/AAPS-T1-5	ADVO, MOAA, USPS
USPS/AAPS-T1-6	MOAA, NAA, USPS
USPS/AAPS-T1-7	MOAA, NAA, USPS
USPS/AAPS-T1-8	ADVO, MOAA, NAA, USPS
USPS/AAPS-T1-9	MOAA, NAA, USPS
USPS/AAPS-T1-10	MOAA, NAA, UPS, USPS
USPS/AAPS-T1-11	MOAA, NAA, USPS
USPS/AAPS-T1-12	MOAA, NAA, USPS
USPS/AAPS-T1-13	MOAA, NAA, USPS
USPS/AAPS-T1-14	MOAA, NAA, USPS
USPS/AAPS-T1-15	MOAA, USPS

Interrogatory:	Designating Parties:
USPS/AAPS-T1-16	MOAA, USPS
USPS/AAPS-T1-17	MOAA, USPS
USPS/AAPS-T1-18	ADVO, MOAA, NAA, USPS
VP-CW/AAPS-T1-1	MOAA, VP-CW
VP-CW/AAPS-T1-2	ADVO, MOAA, USPS, VP-CW
VP-CW/AAPS-T1-3	ADVO, MOAA, NAA, USPS, VP-CW

RESPONSE OF AAPS WITNESS BRADSTREET TO INTERROGATORIES MOAA/AAPS-T1-1-11

MOAA/AAPS-T1-1

With respect to page 5 of your testimony, is it correct to conclude that AAPS members compete with the USPS directly only for the delivery of pieces eligible for entry as ECR or high density within Standard Mail A?

<u>Answer</u>

No. As I said in by testimony, "by far the majority" of what we deliver can be so described.

RESPONSE OF AAPS WITNESS BRADSTREET TO INTERROGATORIES MOAA/AAPS-T1-1-11

MOAA/AAPS-T1-2

With reference to your testimony on page 6, please provide the total volumes of magazines and periodicals delivered by AAPS members and the volumes of other pieces (1) weighing 4 ounces and above and (2) pieces weighing less than four ounces.

Answer

AAPS does not collect or maintain this information.

RESPONSE OF AAPS WITNESS BRADSTREET TO INTERROGATORIES MOAA/AAPS-T1-1-11

MOAA/AAPS-T1-3

On page 7 of your testimony you recite certain factors which you characterize as USPS "pricing advantages." Would you agree that the fact that the USPS cannot independently set its own rates or product lines, but only pursuant to recommended decisions of the PRC represents a "pricing" disadvantage? If you disagree, please explain fully.

<u>Answer</u>

Yes. I fully elaborated on that in my testimony. The pricing advantages that I mentioned in my testimony result in a huge competitive advantage for the Postal Service. Having to submit to PRC review is necessary to help offset these advantages and to help assure that the Postal Service competes honestly and fairly.

RESPONSE OF AAPS WITNESS BRADSTREET TO INTERROGATORIES MOAA/AAPS-T1-1-11

MOAA/AAPS-T1-4

Would you agree that the fact that the Postal Service has no independent ability to establish wages for rank and file employees, but only pursuant to binding arbitration represents a competitive disadvantage?

Answer

It could be, depending upon how the arbitrators rule and how its competitors' wages are set.

RESPONSE OF AAPS WITNESS BRADSTREET TO INTERROGATORIES MOAA/AAPS-T1-1-11

MOAA/AAPS-T1-5

What wage rates are paid to the employees of APS to perform the delivery function?

Answer

Because we operate in a very competitive market, that information is proprietary and confidential. However, for you purposes, I can state that the wages we pay are substantially lower than those paid by the Postal Service.

RESPONSE OF AAPS WITNESS BRADSTREET TO INTERROGATORIES MOAA/AAPS-T1-1-11

MOAA/AAPS-T1-6

Are AAPS member companies able to set prices for their delivery services without review by any regulatory agency?

Answer

Of course, owing to the fact that we have no volume of business that is guaranteed by law.

RESPONSE OF AAPS WITNESS BRADSTREET TO INTERROGATORIES MOAA/AAPS-T1-1-11

MOAA/AAPS-T1-7

Is it your testimony that the rates for saturation and high density ECR Standard Mail A should be set at levels higher than proposed by the USPS based solely on the competitive concerns expressed in your testimony?

Answer

No.

RESPONSE OF AAPS WITNESS BRADSTREET TO INTERROGATORIES MOAA/AAPS-T1-1-11

MOAA/AAPS-T1-8

Is is (sic) your testimony that the members of AAPS have suffered significant competitive harm from competition from the USPS? If your answer is anything other than an unqualified no, please provide complete support for any claim of harm by providing a statement of collective volumes, revenues and profits for AAPS members for the years 1995 through 1997.

Answer

It is my testimony that many members have suffered significant competitive harm from the Postal Service. Unfortunately, AAPS is a small organization. I am the only person who receives any remuneration, just over $5,000 per year. I work for AAPS on a very limited, part-time basis. AAPS does not collect the data which you request, and I certainly do not have the time or the resources to attempt to put together such information. Besides, collective information would not be relevant to my statement about "many" members.

RESPONSE OF AAPS WITNESS BRADSTREET TO INTERROGATORIES MOAA/AAPS-T1-1-11

MOAA/AAPS-T1-9

Please provide the schedule of rates charged by APS.

Answer

APS does not have a publicly available schedule of rates.

RESPONSE OF AAPS WITNESS BRADSTREET TO INTERROGATORIES MOAA/AAPS-T1-1-11

MOAA/AAPS-T1-10

Please provide copies of rates charged by AAPS members.

Answer

We do not have this information. See my answer to MOAA/AAPS-T1-8

RESPONSE OF AAPS WITNESS BRADSTREET TO INTERROGATORIES MOAA/AAPS-T1-1-11

MOAA/AAPS-T1-11

On page 18 of your testimony you include the text of Section 101 of the Postal Reorganization Act. Would you not agree that the obligation of the Postal Service to "provide prompt, reliable, and efficient services to patrons in all areas and . . . to all communities" is facilitated by the Postal Service's ability to offer services for which there is private sector competition? If your answer is anything other than an unqualified yes, please explain completely.

Answer

Yes, but it would also be "facilitated" by USPS engaging in non-postal business where it could use its enormous size and monopoly revenues to hurt competitors and competition. Should Post Offices become mini Seven-Elevens if that "facilitated" its ability to serve postal customers? Or, a little closer to home, should the Postal Service enlarge its offices into department stores and compete with MOAA members if it determined that that would facilitate its ability to serve postal customers?

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/AAPS-T1-1. In your Docket No. MC95-1 testimony, you described the proposed pound rate as "an overtly competitive move designed to shift privately carried advertising and a growing sample delivery market into the mailstream." (Docket No. MC95-1, AAPS-T-1, page 43, lines 16-17).

a. Is it your testimony that the USPS-proposed pound rate for ECR in this docket is an overtly competitive move to divert samples into the mainstream? If yes, explain fully, specifying how the proposed rates (including the proposed residual shape surcharge) will shift samples to the mainstream. If no, explain fully.

b. Would you characterize the current sample delivery market as growing? Please explain fully, providing the complete basis for your opinion.

Answer:
a. Not samples per se, but eventually it would have that effect. Most samples are delivered by companies who deliver flats every week and deliver samples a few times per year. If the company goes out of business because it cannot compete for flats at the proposed pound rate, there will be one less private delivery option for the delivery of samples. Soon there would be fewer private delivery options, and eventually there would be markets in which former private delivery options for samples no longer exist. The end result is that sample producers are left with fewer options, and in some cases no options other than using the mail.

b. Yes. That is what I am hearing from our members.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/AAPS-T1-2. Please see your testimony at page 45, line 22 through page 46, line 2.

a. Is it your understanding that the residual shape surcharge is being used to reduce the pound rate? Please explain fully.

b. If the answer to part a. is anything other than an unqualified "no", please explain fully how the surcharge is being used to reduce the pound rate.

c. If the answer to part a. is anything other than an unqualified "no", please quantify the extent to which the pound rate is proposed to reduce due to the surcharge.

Answer:

a. Perhaps my testimony would have been more precise if I had said that the surcharge is used to support a reduced pound rate.

b. Because it is used as a justification.

c. I have no idea.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/AAPS-T1-3. Please provide an estimate of the weight of the typical sample delivered through alternate delivery and provide the complete basis for your estimate.

Answer:
I am not sure what in meant by a "typical sample." The weight range for samples could be anywhere from one ounce to more than a pound.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/AAPS-T1-4. Please describe the contents of a typical sample delivered through alternate delivery.

Answer:
The contents of a sample are the same as the contents of the substance that the sample is a sample of - typically either a liquid or a solid.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/AAPS-T1-5. Please see your testimony at page 13, lines 11 through 16.

a. Do alternate delivery firms usually deliver advertisements on the day or days specified by the advertisers? Please explain fully.

b. Do newspapers usually print the advertising in the paper, or insert the inserts into the newspaper, on the day or days specified by the advertisers? Please explain fully.

Answer:
a. They certainly try, and usually succeed.

b. Not personally being in the newspaper business, I would only guess that the answer to part "a" above would also apply to the newspaper business.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/AAPS-T1-6. Please see your testimony at page 12, line 6.

a. Please provide a complete definition of term "rigged" as used in this passage.

b. Is it your position that there are no legitimate reasons for lowering the pound rate? Please explain fully.

c. In your view, under what conditions (actual or hypothetical) would a lowering of the pound rate be legitimate? Please explain fully.

Answer:
a. I'll stick with Webster on that one: rig vt rigged; rigging [rig (swindle)] 1: to manipulate or control usu. by deceptive or dishonest means <~an election> 2: to fix in advance for a desired result <~a quiz program>

b & c. I suppose, hypothetically, if the Postal Service had proposed a reduction of 25% in the weight rate for first class letters, and 25% in the weight rate for Standard Regular, I would have to agree that they might be generally overcharging for weight, and across the board reductions would be appropriate. I can only compare pound rates for mail which has no competition and for mail which has serious competition. In this case, the Postal Service proposes a token reduction in the pound rate of Standard Regular, no change in the weight rate for First Class mail, (both of which are non-competitive classes) and a huge reduction in the pound rate for competitive ECR. In MC95-1 the Postal Service witnesses freely admitted that the proposed reduction in the ECR pound rate was competitive in nature. Even though the witnesses in this case were not quite so open about the motive for the huge reduction in the ECR pound rate (perhaps their openness about the competitive nature of the proposed rate in MC95-1 contributed in part to its failure), the pound rate reduction in this docket has clearly been proposed for the same competitive reasons. While there might be hypothetical instances where a reduction would be appropriate, as in the example above, based upon the rate setting criteria in the Postal Reorganization Act, which is the law, it is my opinion that there is no legitimate reason for any selective reduction in a highly competitive rate. The proposed ECR pound rate, when compared with the pound rate for monopoly First Class mail (and the Standard Mail Regular pound rate, even given the token reduction), appears to be a purely competitive proposal.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/AAPS-T1-7. Please see your testimony at page 16, lines 2-3.

a. Is it your testimony that the proposed pound rate for Enhanced Carrier Route has been proposed by the Postal Service "purely for competitive reasons, and for the purpose of harming its competitors?" Please explain your answer fully, providing all bases for your opinion.

b. Is it your testimony that the residual shape surcharge has been proposed by the Postal Service "purely for competitive reasons, and for the purpose of harming its competitors?" Please explain your answer fully, providing all bases for your opinion.

Answer:
a. It is my testimony that the lowering of the pound rate is for these purposes, as the Postal Service admitted in MC95-1. The bases for my opinion are included throughout my testimony.

b. I believe I addressed that in my testimony as well (see pages 45, line 3 - page 47, line 2).

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/AAPS-T1-8. Please see your testimony at page 22, lines 18-20.

a. Please confirm that there have been instances in the past ten years in which domestic postal rates were lowered for categories which you deem as competitive with alternate delivery. If you do not confirm, please explain fully.

b. Please confirm that in Docket No. MC95-1, the rate for saturation non-letter mail was lowered from 12.0 to 11.4 cents. If you do not confirm, please explain fully.

c. Is it your position that the rate lowering referred to in part b., above, is "not allowed" under applicable law? If yes, provide the relevant legal standards upon which you rely and explain your answer fully, providing the complete basis for your opinion.

Answer:
a. confirmed

b. confirmed, if you are referring to the piece rate for locally entered ECR.

c. Certainly any rate change must pass the scrutiny of the Postal Rate Commission, which applies the rate-setting criteria. The Commission allowed the reduction.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/AAPS-T1-9. Please see your testimony at page 28, lines 4-6.

a. Please define "much" as used in line 5 of this passage.

b. Given that the overall increase for ECR is 3.2 percent, is there a certain threshold percentage of ECR volume for which you believe it is inappropriate to lower rates? If so, what is that percentage? Please explain fully.

Answer:

a. Certainly saturation mail would constitute "much" of the Standard ECR mix.

b. I don't know how the "given" portion of the question affects the remainder. "Given" that the Postal Service is proposing substantial reductions for the most competitive ECR mail matter, I'm not sure what any percentages or averages have to do with it. It will be small consolation for the alternate delivery company owner or manager or carrier who is forced to look for another job because of this reduction to be able to say, "At least the average ECR change was an increase, and at lease some of the ECR mailers had to pay more." I doubt that he will find that comforting.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/AAPS-T1-10. Please see your testimony at page 29, lines 16-23.

a. Please confirm that it is your understanding that witness Bernstein says a Ramsey Pricing framework would suggest a average rate decrease for the ECR subclass of roughly 50 percent. If you do not confirm, please explain fully.

b. Please confirm that the proposed average rate increase for ECR is 3.2 percent. If you do not confirm, please explain fully, stating what you believe to be the proposed average rate change.

c. Please confirm that it is your understanding that witness Bernstein says a Ramsey Pricing framework could result in a volume increase of 36 percent. If you do not confirm, please explain fully.

d. If, indeed, the Postal Service were trying to harm the interests of competitors, why would it not propose rates more in line with the results of a Ramsey pricing analysis? Explain your answer fully.

Answer:
a. confirmed

b. I can confirm that the Postal Service claims it is (see my answer to USPS/AAPS-T1-9). I have not done an independent analysis of the Postal Service's arithmetic.

c. I say exactly that in the testimony to which you refer. I confirm it again.

d. If indeed the Postal Service did not intend to move in the direction of Ramsey Pricing, why would it sponsor such testimony? The Postal Service knows that as long as the Postal Rate Commission must review rate proposals, it would be futile to propose rates resembling those resulting from the application of Ramsey Pricing. Under the current rate-making structure the Postal Service will have to content itself with moving toward this type of rate structure a piece at a time. Also, knowing that the Commission protects small mailers and competitors, the Postal Service is seeking legislation under which it in fact could implement rates in line with Ramsey Pricing because the Commission would largely be excluded from the process.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/AAPS-T1-11. Please see your testimony at page 43, lines 3-6. Is it your testimony that heavier First Class pieces have fewer alternatives than lighter First Class pieces? Please explain fully, providing the complete basis for your opinion.

Answer:
No. As a practical matter there is little if any difference. Probably there are pieces mailed at first class rates which would fall outside of the Postal Service's definition of a "letter". I would guess that this probably is more common at heavier weights, but I don't know that for sure. My point was not a comparison of light versus heavy first class. The point was that most heavy first class is captive to the postal service, either directly or indirectly. Some is captive by virtue of the Postal Service's direct application of the Private Express Statutes in defining the contents as letters. Some is captive as a practical matter because the application of the Private Express Statutes to most of the first class mailstream restricts the volume that would be available to a competitor. That lack of available volume eliminates private delivery as a viable concept, which in turn eliminates any alternative to the mail. I have to conclude that there is no practical difference in a lack of alternatives caused by the direct application of the Private Express Statutes, and a lack of alternatives caused indirectly by the Private Express Statutes. Either way, it's still a lack of alternatives.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/AAPS-T1-12. Please see your testimony at page 11, lines 16-20.

a. Is it your testimony that the pound rate be set so as to remove the use of the Postal Service from consideration on the part of a publisher? Please fully explain your response.

b. What do you mean by the "cost of weight" in line 19? Please explain fully.

Answer:
a. No. I was simply pointing out that a huge reduction in the pound rate will have a severe effect on alternate delivery companies. Many publishers have declared by their actions that the Postal Service is a good deal and the current pound rate is at an acceptable level. A number of publishers over the past five years, former AAPS members, have "voted with their feet" as it were, and have begun using the mail. Obviously they think the current rate is at an acceptable level as well. The Postal Service has a substantial volume of publication type business - the type which I described in the testimony cited above. Other witnesses in this case represent publishers who have chosen the mail, for whatever their reasons. On the other hand many publishers have opted for alternative delivery. Right now there appears to be a balance between Postal and alternative delivery where postal volumes are growing and where alternate delivery, though in many instances struggling, is able to compete somewhat effectively. A substantial reduction in the pound rate will tip that balance heavily toward the Postal Service at the expense of alternative providers.

b. The cost of weight for a publisher is the added cost to the publisher for producing a heavier piece.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/AAPS-T1-13. Please see your testimony at page 45, line 17-20, where you state, in part, that "alternate delivery companies are already getting quite a bit of sample business in the more major markets under the current rate structure." Confirm that, all other things being equal, imposition by the Postal Service of any positive residual shape surcharge would make alternate delivery companies more attractive to sample senders. If you cannot confirm, please explain fully.

Answer:
Confirmed, noting that "all other things being equal" assumes that the pound rate remains unchanged.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/MPS-T1-14. Please see your testimony at page 48, line 4. Please fully define "highly competitive" as it is used in this passage.

Answer:
Highly competitive obviously means mail matter for which there is vibrant competition between the Postal Service and private enterprise, in the passage cited, ECR saturation.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/MPS-T1-15. Please confirm that the study of the cost/weight relationship for Standard (A) mail presented in exhibit USPS-44B included the vehicle service driver and transportation costs segments directly in the analysis. If you do not confirm, explain fully.

Answer:
They appear to be included, though to what degree and with what assumptions I do not know.

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/MPS-T1-16. Please confirm that the study of the cost/weight relationship for Standard (A) mail presented in exhibit USPS44B assumed that transportation costs were directly related to weight. If you do not confirm, please explain fully.

Not confirmed. The study notes that highway transportation "costs are distributed in proportion to estimated cubic volume."

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

USPS/MPS-T1-17. Please confirm that the study of the cost/weight relationship for Standard (A) mail presented in exhibit USPS44B assumed that vehicle service driver costs were directly related to weight. If you do not confirm, please explain fully.

Not confirmed. The study notes that costs for vehicle service drivers "are distributed in proportion to estimated cubic volume."

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

(corrected February 4, 1998)

USPS/AAPS-T1-18. Please refer to the discussion of city carrier street time costs on page 37 of your testimony. Most of the discussion centers around what the Postal Service calls a park and loop route.

a. Are you assuming that the standard operating procedure for a park and loop route is to carry all of the mail for a route in one circuit without returning to the vehicle? Please explain fully, describing any assumptions you employ.

b. Please discuss how the hypothetical situation described at page 37 lines 7 -21 would change if the normal park and loop route consisted of 10 separate circuits, with the carrier returning to the vehicle before each circuit.

c. Please describe how your analysis of the effect of weight on the cost of delivery would be different for mounted routes (routes where the carrier makes each delivery form her vehicle).

d. What percentage of deliveries by the members of your association are made by carriers on foot? What percentage are made from a vehicle?

Answer:
(a) No. Note that I referred to "extra" trips to the vehicle. My assumptions are that the Postal Service has designed routes efficiently, and that the established parks and loops accommodate normal mail volume while allowing for some residual capacity. I assume that some loops are established based upon volume and some are established based upon the unique geography involved. I assume that there are some light-weight pieces of saturation mail which could be absorbed within that residual capacity for most loops, some heavier pieces which could be absorbed within fewer loops, and some very heavy pieces which would require substantial alterations of the route on a given delivery. For instance, how would a carrier accommodate a 12 ounce publication with inserts, or a 15 ounce telephone directory in addition to his normal load? Certainly this would require modifying a number of loops from the normal delivery pattern.

(b) The hypothetical situation to which you refer assumes a postal street carrier route of 600 addresses, and compares the delivery of a ¼ ounce saturation piece with the delivery of a 3.3 ounce saturation piece, both of which are charged the same postal rate. Using your assumption of 10 separate circuits, the carrier would average 60 deliveries for each circuit. Carrying an extra saturation piece weighing .25 ounces would add an average of 15 ounces to each circuit, some more or less. If each circuit had the residual capacity available, it would require no additional trips back to the vehicle. Compare this to the same carrier delivering a 3.3 ounce saturation piece. In this instance, the carrier must add an average 12+ pounds for each circuit, more or less based upon the actual number of stops on each circuit. This would require one extra trip back to the vehicle for each circuit which did not have the residual capacity to absorb this extra 12+ pounds. Now lets consider the carrier above who has the 12 ounce publication with inserts, and which the publisher has been assured a certain day of

ANSWERS OF AAPS WITNESS KENNETH L. BRADSTREET
TO INTERROGATORIES USPS/AAPS-T1-1-18

delivery – a situation which happens all the time. The carrier has to absorb an average additional 45 pounds on each established circuit, more than the total capacity of the carrier if he had no other mail to deliver. With the other mail considered, the carrier would have at least one additional trip for each circuit, and in some instances two additional trips. How much extra time would an extra 15 trips take? In the case of the 15 ounce telephone directory, the carrier would be adding an average 56+ pounds for each circuit, probably close to 20 additional trips.

Certainly a mounted route would experience some effect for heavier pieces, though probably not to the same extent as the foot carrier. My own experience in delivering routes from a vehicle is that adding weight does add a considerable amount of time. If a delivery set weighs 3 ounces or less, the pieces can be put in bundles of 100 pieces. The carrier delivering to 600 addresses would have to stop and replenish his supply 6 times. However, a delivery set weighing 10 ounces would likely be tied in no more than 25 per bundle. This requires the driver to make 24 stops to replenish his supply. I assume that a mounted postal carrier experiences some of the same problems in blending into his normal mail volume saturation pieces of varying weights.

Operating within this hypothetical route, it is possible to ascertain a cost difference for these pieces. Assuming that the 3.3-ounce pieces can be accommodated within the residual capacity in eight out of the ten circuits, this would cause two extra trips. Assuming 15 extra trips for the 12-ounce piece, there is a difference of 13 trips, each consuming between five and ten minutes of time. Assuming conservatively an average of seven minutes per additional trip, we have 91 extra minutes which are entirely weight related. At $40 per labor hour, we have an added cost of $60, or 10 cents per peice. The difference in weight between the two pieces being 8.7 ounces, this calculates into a direct weight-related cost of 18.4 additional cents per pound, an additional weight-driven cost, the existence of which the Postal Service refuses to admit.

(c) Based upon our 1997 directory, I have calculated that 89% are delivered on foot, and 11% are delivered from a vehicle.

RESPONSE OF AAPS WITNESS BRADSTR4EET TO INTERROGATORIES VP-CW/AAPS-T1-1-3

VP-CW/AAPS-T1-1

Please see your testimony at page 16, lines 2-5, where you state that the Postal Service's "cost computations are not trustworthy." In view of your statement at page 4, line 10, that your testimony is not technical, why should the Commission believe your statement that the Postal Service's cost computations are not trustworthy?

Answer

I think I have presented some non-technical reasons. You may want to refer to USPS/AAPS-T1-18 for a non-technical example.

RESPONSE OF AAPS WITNESS BRADSTREET TO INTERROGATORIES VP-CW/AAPS-T1-1-3

VP-CW/AAPS-T1-2

Please see your testimony at page 22, lines 18-20, where you state that "not only is the USPS not allowed to lower rates for the purpose of hurting fair competition, it is clearly instructed to consider the impact of 'increases' to avoid hurting competitors."

a. Is it your testimony that the Postal Service may not propose competitive rates, in order to ensure competitors can charge more for their services?

b. Is it your testimony that any rate change that cause a Postal Service competitor to lose business to the Postal Service violates the statute, because the Postal Service has not avoided hurting competitors?

c. Is it your testimony that the Postal Service must raise its rates when its competitors raise their rates, in order to avoid hurting competitors?

<u>Answer</u>

a. No

b. No

c. That would be nice, but no.

RESPONSE OF AAPS WITNESS BRADSTREET TO INTERROGATORIES VP-CW/AAPS-T1-1-3

VP-CW/AAPS-T1-3

a. What percentage of your customers demand day-certain delivery?

b.What percentage of your customers receive day-certain delivery?

c. What percentage of your volume comes with a demand for day-certain delivery?

d. What percentage of your volume receives day-certain delivery?

Answer

I assume that the questions refer to APS as opposed to AAPS. Most APS customers are interested in a time range. APS offers a weekly delivery beginning late Saturday afternoon, with a mid-night deadline. Most customers who use our regular weekly delivery are happy with the timing, or I assume they would go elsewhere for delivery services. APS also does special deliveries at other times in the week as contracted. Special deliveries are usually time-sensitive and are more expensive, as the cost is usually borne by a single customer or very few customers. Special deliveries account for about 3% of our volume. Concerning the regular weekend deliveries:

a. Some customers are satisfied with a 24 hour window (estimated 25%). Some need a narrower time-span such as an 8 hour window (estimated 50%). Some indicate no real preference (25%).

b. I believe that all of our customers receive delivery within a satisfactory time-frame.

c. Estimated 75%

d. Estimated 75%

CHAIRMAN GLEIMAN: Does any participant have additional written cross-examination for the witness?

[No response.]

CHAIRMAN GLEIMAN: There doesn't appear to be any.

Three participants requested oral cross-examination of Witness Bradstreet: ADVO, Inc., Val-Pak Direct Marketing, Inc., and Val-Pak Dealers' Association and Carol Wright promotions, all one party, and the United States Postal Service.

Does any other participant have oral cross-examination for the witness?

[No response.]

CHAIRMAN GLEIMAN: If not then, Mr. McLaughlin, if you're prepared.

MR. McLAUGHLIN: Mr. Chairman, we have no questions.

CHAIRMAN GLEIMAN: We'll move right on with Val-Pak, et al.

MR. OLSON: Mr. Chairman, we also have no questions.

CHAIRMAN GLEIMAN: Think we should go for a three-peat?

[Laughter.]

CHAIRMAN GLEIMAN: I don't think we're going to make it.

Mr. Cooper, you don't have any questions; is that correct?

MR. COOPER: I think I'll try a few and see how it goes.

CHAIRMAN GLEIMAN: Proceed when you're ready.

CROSS-EXAMINATION

BY MR. COOPER:

Q Mr. Bradstreet, good morning.

A Good morning.

Q I'm Rick Cooper, for the Postal Service.

I'd like to ask you first about your response to Postal Service Interrogatory No. 2.

Now in this response you say that the residual shape surcharge sought by the Postal Service is used to support a reduced pound rate; is that correct?

A As I stated in the answer, I perhaps should have said that it's used to support or to justify a reduced pound rate.

Q Okay. Now in your responses, are you referring to the ECR pound rate?

A That's correct.

Q Can you tell me where in the Postal Service's direct case its testimony or interrogatory responses such a justification appears?

A No, not right off the top of my head.

Q I'd be happy to give you as much time as you'd like to look for it.

A No, I can't.

Q Would you also look at your response to Postal Service Interrogatory 6? Actually, turn first to page 12 of your testimony, but keep that Interrogatory response handy.

Okay. Now, starting at line 4, you state that the Postal Service has been so intent on making this pound rate the focus of its attack on alternate delivery competitors that it has rigged at least three separate weight studies to give its rate preference the appearance of legitimacy from a cost standpoint, is that right?

A That is correct.

Q Now, would you clarify for us what the three weight studies are that you are talking about?

A Back in, I think it was 1984, we appeared in connection with a proposed study. It is my understanding, and my memory is a little foggy going that far back, but, as I recall, the Commission had asked the Postal Service to do a study which would determine what impact weight would have on costs and, if I recall correctly, the Postal Service did a study which included only in-house costs shortly after that period of time.

And we had appeared before the Commission in discussing what that study, or what form that study should take, to argue that carrier street time was one obvious example where, we believe, that weight had more -- more of an impact on costs than any other factor, and that the Postal Service had determined and that carrier street time costs were predominantly piece-related and they were going to confine their study to in-house handling and sorting, as I understand it.

Subsequent to that, in the reclassification case, the Postal Service commissioned a study from, I believe it was Christensen & Associates, which essentially did the same thing and ignored carrier street time as a factor in their study. And the most current study by Christensen & Associates has again done the same thing.

Q Did you at any time speak to the people working on these studies regarding their intentions or goals in conducting the studies?

A You mean after the study is all finished?

Q At any time?

A No, I wasn't aware that there was a study in progress until it was finished.

Q Now, in your testimony, at page 12, you say that the Postal Service analysts working on these studies deliberately rigged the results. That is your choice of words, right?

A That is correct.

Q In your response to Interrogatory No. 6 from the Postal Service, you define "rigged" as "to manipulate or control, usually by deceptive or dishonest means," and you also define as "to fix in advance for a desired result," isn't that correct?

A That's -- I copied that out of the dictionary.

Q Well, that is the definition you chose to provide to us when we asked you to define the term as you used in this passage, right?

A That is correct.

Q So it is your sworn testimony that the Postal Service analysts were deceptive or dishonest in conducting these studies, is that right?

A It's hard to accuse them of being deceptive and dishonest, but when they ignore what I believe is the major weight-related cost in a weight study, it is hard to conclude that their motives are altruistic.

Q So you are saying that they were biased, that they were --

A Certainly.

Q -- trying to reach a pre-determined result?

A Certainly, at the least, yes.

Q Now, in your response to Part B, Parts B and C, you refer to a reduction of 25 percent in the weight rate for First Class letters and 25 percent in the weight rate for Standard Regular, do you see that?

A Yes.

Q How did you compute that percentage?

A The 25 percent?

Q Yes. How did you arrive at that?

A I just used it as a hypothetical, as I point out here.

Q Okay. So you are not saying that is the actual reduction?

A No. No, I am not.

Q Would you turn to your response to Postal Service Interrogatory No. 7? Here you were asked, in Part B, whether the residual shape surcharge proposed by the Postal Service was being proposed purely for competitive reasons and for the purpose of harming its competitors, and I am not sure you have answered that question. Are you saying that the sole basis for this proposal is to harm competitors?

A No.

Q There are other reasons, --

A Yes.

Q -- more legitimate reasons, isn't that correct?

A More legitimate reasons?

Q Yes.

A I am not sure of that. But there are other reasons.

Q There are no legitimate reasons, you are stating, for this proposal?

A No, I didn't say that either. I said there -- you said, Are there more legitimate reasons? I say, no, not more legitimate reasons, there are probably some other reasons.

Q I didn't mean to suggest that crushing competition was a legitimate reason.

MR. COOPER: Thank you very much. I have no further questions.

CHAIRMAN GLEIMAN: Is there any follow-up? Questions from the bench? Commissioner LeBlanc.

COMMISSIONER LeBLANC: Mr. Bradstreet, just very briefly, you seem to be going on and on about being an aggressive competitor, the Postal Service is an aggressive competitor to your industry.

THE WITNESS: Yes.

COMMISSIONER LeBLANC: You talk about where Marvin Runyon made the speeches, putting Publishers Express out of business, and you talk about all that through here. Then you talk about, on page 13 of your testimony, where -- on line 13, or page 13, it says that MSC Postmaster Cooper McLaughlin -- McClausen in Grand Rapids, Michigan, individual Postmasters were ordered to deliver the Advo mail, must be made on time, must not under any circumstances be made on or before Monday.

Then on the next page, you talk about Chairman Gleiman's exchange between he and Witness Molar on Montgomery Ward.

THE WITNESS: Yes.

COMMISSIONER LeBLANC: And you go on and on about this for a couple, three or four pages in here, and I guess what I am really wanting to ask here is do you see any kind of deliberate approach, a deliberate attempt, if you will, any kind of forcefulness against you?

THE WITNESS: Oh, certainly.

COMMISSIONER LeBLANC: I mean you seem to be indicating that Advo, Montgomery Ward, all the ECR mailers, some of the other people in here, were, in a lot of ways, a product of the Postal Service's own making, if you will.

THE WITNESS: Let me -- if I could expand on that. You asked me about a memo that the Postmaster in Grand Rapids issued to his Postmasters in the various Post Offices.

COMMISSIONER LeBLANC: Well, I am just saying that was on page 13 of your testimony --

THE WITNESS: Right.

COMMISSIONER LeBLANC: -- where you talked about that. And then you talked about Chairman Gleiman's exchange and so forth and so on.

THE WITNESS: Yes.

COMMISSIONER LeBLANC: So it seems to be that your are indicating that there's some kind force out here that is actually pushing this on.

THE WITNESS: Well, they refer in the memo to a program. I'll read the quote, "The intent of this program is to recapture the advertisement that was lost to the newspapers as supplements to their papers several years ago. In many cities, this program has been quite successful, and the potential for the United States Postal Service to recapture significant advertising business rests with our ability to handle the job well."

Now, if there is a program --

COMMISSIONER LeBLANC: Now, excuse me, that comes off of where?

THE WITNESS: That is in my -- that is my testimony. I am quoting --

COMMISSIONER LeBLANC: On what page? On what page?

THE WITNESS: On page 13.

COMMISSIONER LeBLANC: That's on page 13.

THE WITNESS: Page 13.

COMMISSIONER LeBLANC: That was on the bottom of it right?

THE WITNESS: Yeah, beginning on line 17.

COMMISSIONER LeBLANC: Yes.

THE WITNESS: And I think we asked back in -- I think this was 1984, we asked what program are you referring to? The Postal Service would not respond to those questions. And, in fact, when the Commission compelled an answer they even, as I recall, refused to answer the question.

COMMISSIONER LeBLANC: Now, changing gears on you, you talk about cost coverage and contribution per piece.

THE WITNESS: Correct, yes.

COMMISSIONER LeBLANC: Why is contribution per piece so important to you?

THE WITNESS: Contribution per piece. Well, --

COMMISSIONER LeBLANC: I mean that is as I understood it. Correct me if I am wrong.

THE WITNESS: Yes, that's correct. We theorized, and in my testimony on page 31, I list a quote from one of our previous briefs, in R-90. If I could take that a step further. What if the Postal Service were to propose a 2 cent per piece discount for people who were willing to bundle saturation mail? Not just take it to the post office, but actually load it in the carrier's jeep, so that there's -- it avoids almost entirely any attributable costs because carrier street time is predominantly considered institutional cost. You have nothing to base -- if you determine that if you are willing to bring the mail down and load it in the carrier's jeep, that you have avoided virtually all the attributable costs, and so you can -- you can identify one penny worth of cost, a 200 percent cost coverage would be at a rate of 2 cents.

That really doesn't -- at some point, you have to start looking at unit contribution, because the percentages, if you are relying on a service that is almost entirely institutional cost, you have to start to looking at unit contribution as opposed to percentage mark-up.

COMMISSIONER LeBLANC: Okay. Now, you almost mentioned about Ramsey pricing.

THE WITNESS: Yes.

COMMISSIONER LeBLANC: And you say, I believe, it ignores the pricing criteria.

THE WITNESS: As I understand Ramsey pricing --

COMMISSIONER LeBLANC: How do you -- please elaborate on that one for me.

THE WITNESS: Yes. And I am not an economist. As I understand it, it is a means of trying to arrive at the most efficient type of pricing, and within that framework, the only criterion is efficiency. It does not include impact on competitors. It doesn't include available alternatives. It doesn't include anything except efficiency. And what I am saying is Ramsey pricing would replace the criteria of the Postal Reorganization Act with one criteria which is efficiency.

COMMISSIONER LeBLANC: Because -- the reason I am asking this is because at the bottom of page 28, top of page 29, where you are talking about that in your testimony, you talk about the introduction by Peter Bernstein's testimony, I am paraphrasing now, "officially praising the application of Ramsey pricing to Postal Ratemaking speaks loudly to competitors as would a formal letter of the PMG himself."

So you seem to be, in effect, saying that there, again, is some kind of push out there to make this work.

THE WITNESS: Yes, I believe that is the case.

COMMISSIONER LeBLANC: Right. I think I'll stop there. Thank you very much, sir.

Thank you, Mr. Chairman.

CHAIRMAN GLEIMAN: Does any participant have follow-up as a consequence of questions from the bench?

[No response.]

CHAIRMAN GLEIMAN: If not, that brings us to redirect. Would you like some time?

MS. BLAIR: None, Mr. Chairman.

CHAIRMAN GLEIMAN: If that is the case, then, Mr. Bradstreet, I want to thank you. We appreciate your appearance here today and your contributions to our record. And if there is nothing further, you are excused.

THE WITNESS: Thank you.

[Witness excused.]

CHAIRMAN GLEIMAN: Mr. McLaughlin, when you are ready, you can identify your witness so that I can swear him in.

MR. McLAUGHLIN: Mr. Chairman, the Saturation Mail Coalition calls as its witness, Harry J. Buckel.

Whereupon,

HARRY J. BUCKEL,

a witness, was called for examination by counsel for the Saturation Mail Coalition and, having been first duly sworn, was examined and testified as follows:

CHAIRMAN GLEIMAN: Please be seated.

DIRECT EXAMINATION

BY MR. McLAUGHLIN:

Q Mr. Buckel, I am handing you two copies of a document captioned "Direct Testimony of Harry J. Buckel on Behalf of the Saturation Mail Coalition," designated as SMC-T-1. Was this testimony prepared by you or under your direction and supervision?

A Yes, it was.

Q Is it true and correct to the best of your knowledge and belief?

A Yes, it is.

Q And if you were to testify orally today, would your testimony be the same?

A Yes, it would.

MR. McLAUGHLIN: Mr. Chairman, at this point I move that SMC-T-1 be received into evidence and transcribed into the record.

I am handing two copies to the reporter.

CHAIRMAN GLEIMAN: Thank you, sir.

Are there any objections?

[No response.]

CHAIRMAN GLEIMAN: Hearing none, Mr. Buckel's testimony and exhibits are received into evidence. I direct that they be transcribed into the record at this point.

[Direct Testimony and Exhibits of Harry J. Buckel, SMC-T-1, was received into evidence and transcribed into the record.]

SMC-T-1 12076

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

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

POSTAL RATE AND FEE CHANGES, 1997 : Docket No. R97-1

DIRECT TESTIMONY

OF

HARRY J. BUCKEL

ON BEHALF OF THE

SATURATION MAIL COALITION

Communications with respect to this document should be sent to:

John M. Burzio
Thomas W. McLaughlin
BURZIO & McLAUGHLIN
1054-31st Street, N.W.
Washington, D.C. 20007

Counsel for the
Saturation Mail Coalition

December 30, 1997

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TESTIMONY OF HARRY J. BUCKEL

AUTOBIOGRAPHICAL SKETCH

My name is Harry J. Buckel. I am Chief Executive Officer of Newport Media, Inc., the publisher of several shopper publications in Long Island, New York. I have held this position since 1996 when I purchased the company. I have been involved in the community newspaper and advertising shopper industry for over twenty years.

I received a BSBA Finance from Xavier University in 1966 and an MS degree in Regional Economics from Michigan State University in 1970.

From 1970-72, I served as Assistant to the President and Vice President for Finance and Development for the Michigan Chamber of Commerce.

From 1972-1978, I held several management positions for the Panax Corporation involving the publication of various community newspapers:

Director of Marketing;

General Manager of the Community News of Suburban Detroit (100,000 circulation);

Group Vice President, Southeast Michigan Newspapers;

Vice President, Corporate Staff and Assistant to the President;

Vice President, Publisher of the Miami Beach Sun Reporter

I joined Harte-Hanks Communications, Inc. in 1978 and served in the following positions prior to becoming President of the PennySaver, a Harte-Hanks shopper in Southern California:

President and Publisher, San Francisco Progress

President and Publisher, Ypsilanti Press

President and Publisher, Glouchester County Times

President and Publisher, Journal Publishing Company, Hamilton, Ohio

In 1982, I became Publisher of the PennySaver, a position I held until 1996 when I left the company to form Newport Media, Inc. In addition, I served as a Corporate Vice President and Senior Vice President of Harte-Hanks Communications (1986-1996; 1991-96) and President of Harte-Hanks Shoppers (1987-1996).

Throughout my career, I have participated actively in advertising and shopper industry affairs. In 1989, I served as Industry Co-Chairman of the Postmaster General's Worksharing Task Force. I served as Executive Vice Chairman of the Third Class Mail Association from 1989 to 1991, and as Chairman of the Advertising Mail Marketing Association from 1991 through 1993. In addition, I presented testimony to the Postal Rate Commission on behalf of Harte-Hanks Shoppers in Dockets R90-1 and R94-1. Recently, I have been involved in forming and organizing the Saturation Mailers Coalition, working closely with other saturation mailers.

PURPOSE OF TESTIMONY

I am testifying on behalf of the Saturation Mailers Coalition, a recently-formed coalition of local, regional, and national companies involved in the saturation mail advertising business. The Coalition supports the Postal Service's proposed rates and rate structure for Standard A Enhanced Carrier Route (ECR) Mail. The purposes of my testimony are to:

- Describe the Saturation Mailers Coalition and the characteristics of its members;
- Describe the nature of the saturation mail advertising market and the customers our industry serves, particularly the many small businesses that use and depend upon saturation mail to reach their customers;
- Describe the highly competitive nature of our business, particularly in relation to non-postal competition;
- Explain the importance to our industry and our customers of maintaining affordable postal rates for saturation mail, and the benefits of the Postal Service's proposal to moderate the current high pound rate for ECR mail.

In addition, my testimony describes the operation of Newport Media Inc., including its production and distribution; the markets it serves, its customers and competitors; and the significance and growing success of alternate delivery in our markets.

THE SATURATION MAIL COALITION

I have long believed that mailers in the saturation mail industry, despite being competitors with one another, have strong common interests on postal issues, both as an industry and as representatives of our small business advertising customers. Over the last several years, I and other leaders in the industry have informally discussed the idea of forming a coalition to cooperate and participate in postal matters of mutual interest. These discussions ultimately led to a meeting of industry representatives earlier this year and formation of the Coalition. The Coalition is co-chaired by Norman Schultz, President and CEO of Mail Marketing Systems in Jessup, Maryland, and Richard Mandt, owner of The Flyer in Tampa, Florida.

Currently the Coalition has 36 members, listed in the appendix to my testimony. The membership reflects the diversity of the industry. It includes publishers of free community papers and shopper publications, shared mail programs, companies that also do solo saturation mailings, and organizations whose members are primarily interested in saturation mail issues. Although many of the members operate programs that are 100% mailed, a number also distribute a portion of their circulations via private delivery. The diversity is also reflected in the sizes of the members' programs and their markets, ranging from large national or regional mailers like Advo and Harte-Hanks who serve major metropolitan markets and provide total weekly circulation to millions of households, down to small local mailers like the Antigo Shoppers Guide in Antigo, Wisconsin who serve rural markets with weekly circulation to less than 20,000 households.

THE SATURATION MAIL INDUSTRY

From my experiences with Harte-Hanks, mailer trade associations, and prior postal cases, I am aware of the common misperception that the saturation mail industry consists of only a few large mailers. In fact, the industry has a great diversity of companies offering a variety of mailing programs that, in total, reach virtually every household in the nation. The industry serves hundreds of thousands of advertisers, including not only large national retailers but predominantly small local businesses and individual entrepreneurs throughout the nation.

There are more than a thousand local and regional free community papers and shopper publications in the United States, serving over 50 million households. Roughly half are distributed by mail, and of those, virtually all are mailed at Enhanced Carrier Route rates. Although many of these are 100 percent advertising publications, many, like ours, contain local community news, free announcements, and other non-advertising reader services and editorial matter. These publications typically have a newspaper tabloid or booklet format, and many also carry preprint advertising inserts.

The saturation mail industry also includes many saturation shared mail programs. While Advo is the largest of these, with programs in major metropolitan markets, there are a number of others that serve local or regional markets throughout the country. In addition, there are a number of saturation coupon programs serving local markets, either independently or through regional or national franchise programs.

Regardless of the type or size of their programs, all saturation mailers share many common market characteristics:

- The focus of all saturation mail programs, even those of regional or national companies, is on individual local markets.
- All are geared toward serving local retailers, service businesses, and other advertisers who need to reach potential consumers who reside near their stores or businesses, typically within a radius of 2-5 miles.
- The primary advertising appeal of saturation mail programs is for goods and services with potential appeal to a broad segment of consumers, such as groceries, fast food, local retailers, auto sales and services, and home-related services.
- Small local business advertisers are an essential element of saturation mailers' success, and vice versa.
- All operate in a highly competitive market, competing with each other, and with newspapers and private delivery companies for distribution of retail preprint inserts.

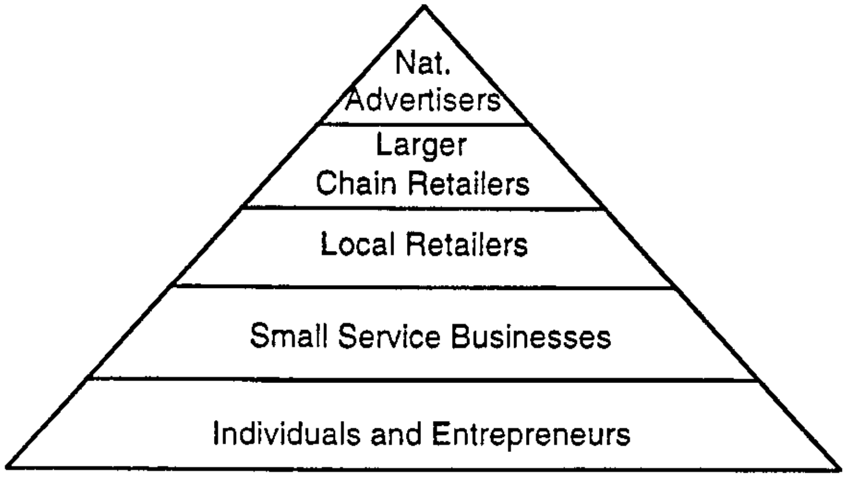
- Saturation mail programs are mailed on a regular, predictable schedule, usually weekly or monthly, and are highly workshared.
- Postage is typically their largest single cost item, and affordable postage rates play an important role in their ability to survive and grow.

The essential common element of saturation mail programs is that they offer accessible advertising targeted by geographic area, at affordable prices, to small local businesses that do not have cost-effective media alternatives. For many small businesses, the cost of advertising is second only to the owner's draw as a cost of doing business. Saturation mail is a vital component for small businesses that need to advertise their goods and services.

SATURATION MAIL CUSTOMERS

Saturation mail customers represent a wide range and size of businesses. They include a mixture of many small local service and retail businesses who have limited advertising resources and alternatives; and larger regional or national chains who have a number of competitive alternatives for distribution of preprint inserts, or even non-print media. While the precise mix of advertisers will vary from one saturation mailer to another, depending on the nature of its program and the specific markets it serves, this blending of large and small business advertisers is characteristic of saturation mail programs.

The customers that use saturation mail, regardless of size, all have a common objective: to reach consumers that live near their businesses. The makeup of these customers is quite diverse, but consists predominantly of small local businesses. If viewed as a pyramid, the foundation of saturation mail is individual service providers, entrepreneurs, and small "mom and pop" service businesses that constitute 60 to 80 percent of all saturation mail users:



The next tier is small to mid-size local retailers, such as local grocers, fast food and restaurants, hardware, and auto dealers and services, that comprise 15 to 20 percent of all saturation mail users. Larger chain retailers, both regional and national, constitute 5 to 10 percent of saturation mail users, but because of their broad advertising coverage and frequency they are often critical to the success of a saturation mail program. The final category of saturation mail users, comprising perhaps less than one percent of total saturation advertisers, is national advertisers, primarily food and consumer product manufacturers using the mail to distribute coupons.

The small business focus of saturation mail is reflected in Newport Media's programs. The core of our business is the small retailer/service provider/ individual entrepreneur trying to sell goods or services in a limited geographic area around a single location. The majority of our ads are mailed to five or fewer zones (less than 60,000 households), reflecting the fact our advertisers are typically small businesses.

In a typical week, a single zoned edition of our book will carry over 600 advertisements, adding up to more than 12,000 ads weekly across all our zones. Although display ads account for more than half of the pages in our books, they represent less than 20% of our total advertisers. Even our full-page display advertisers tend to be independent local businesses such as neighborhood grocery stores and car dealers, rather than national chain stores. Our partial-page display advertisers are even smaller businesses, like local home improvement contractors, dry cleaners, and auto repair businesses.

The smallest of our customers -- classified advertisers -- account for more than 80% of the ads we carry. Our classified ads include employment, real estate, auto, personals, and our largest single advertising category, service businesses and small entrepreneurs. This latter category is a small business potpourri: lawn and garden services, gutter, window and chimney cleaning, tree services, trash hauling, moving and storage, professional services, and every variety of home improvement and repair services from general contractors to handymen. Many of these ads are from the smallest of small businesses, individuals like a one-truck trash hauler whose livelihood depends on business generated by ads in our publication.

NEWPORT MEDIA INC. - SHOPPERS

Newport Media Inc. was formed in August of 1996. We are located in a single plant in Hicksville, New York, with five sales and marketing locations throughout the market area, currently employing over 650 people. We have now acquired six publications, five of which are home-delivered, saturation-targeted shoppers. Four of those publications are mailed, one is delivered by hand. Our publications reach over 2 million households weekly, of which 1.6 million are mailed. Our total annual mail volume is over 80 million, all mailed at Enhanced Carrier Route saturation rates.

Our shopper publications are local saturation advertising booklets mailed (and in some cases hand delivered) to 2 million addresses in the New York Metropolitan and Southern New Jersey markets, reaching approximately 98% of the homes in the areas served. Our market covers Nassau and Suffolk Counties on Long Island, Brooklyn, Staten Island in New York, and the counties of Burlington, Camden and Gloucester in southern New Jersey, across from Philadelphia.

Our market is divided into 150 zones. Each zone contains approximately 12,000 residences. A separate and unique book is printed for each zone each week. An advertiser can choose to run an ad in any one zone, any combination of zones, or all 150 zones.

The content of our books is about 90% advertising, with 10% devoted to free community announcements, personal financial advice and history columns, horoscope, crossword and other puzzles, and reader contests. Advertising is in the form of display ads (picture ads) or reader ads (comparable to classified ads). The mailed books measure 11 x 7 inches and average 68 pages, with an average weight of about 2.6 ounces. Preprinted advertising circulars, commonly called "retail preprints" or "preprint inserts," are also inserted in the books. We average about 3 to 4 preprint inserts per book, mostly light-weight 1-4 page inserts from local or regional advertisers.

Our operations begin with the solicitation of advertisements by our sales force. We then prepare the graphics and layout work to design each zoned version of the books, and do our own printing. The books then go to the distribution area of our plant where the appropriate preprint inserts for each zone are inserted. The books are then strapped in bundles of 25, each with a facing slip denoting the carrier route number, the bundle number, and the total number of bundles and pieces for the route. The bundles are placed on wheeled containers as required by the Postal Service. Trays of carrier walk sequenced detached address labels for each zone are placed with the corresponding containers, together with a placard containing identifying information required by the Postal Service. We then truck the mail directly to the destination post offices, stations and branches for delivery, using our own transportation.

The services that we provide go far beyond simply taking an order for advertising and producing mailings. The great majority of our customers, due to their small size and limited resources, have little or no advertising or marketing expertise. We work closely with them to define their marketing needs and objectives, to target their advertising coverage and frequency, and to design their ads to maximize effectiveness and response.

First, we help our customers understand and define their targeted marketing zones. We look at the nature of the customer's business in relation to advertising needs. We review the customer's sales records to determine the areas where most of its past business has come from, and recommend ways of obtaining additional sales data such as recording address or ZIP code information from sales. We use maps and demographic data by zone to identify the primary marketing area surrounding the customer's business location, matching the customer's business characteristics to demographic data, and taking into account other factors such as locations of the customer's competitors and areas for potential market expansion.

Second, we help to design an advertising program tuned to the customer's needs and resources. A lawn service with a seasonal business, for example, may require different ad frequencies and messages during the year, and we will even recommend additional services that they might offer and advertise during the off-season, such as leaf, mulching, and winter landscaping/cleanup services. For a small painting business that needs a steady stream of jobs, we may recommend a less expensive but weekly classified ad rather than a more expensive monthly display ad. Conversely, for a construction contractor that does larger projects, the monthly display ad may be the better choice.

Third, we help our customers create a strong advertising message to consumers that will drive a good response. In the case of a shoe store that was offering small discounts on selected shoes, we showed them that a stronger offer of "$10 off on any shoes" would generate greater sales. For a tire store whose ads focused on sales of low-margin tires, we showed that advertising specials on their much higher-margin car services (oil changes and lube jobs) would generate higher profits. For a small grocer whose ads offered modest specials, we showed how offering super-bargain prices on selected items could generate more store traffic and sales. For a restaurant with a successful evening dinner business, we showed that advertising "early bird" specials for its off-peak 5-7pm period would generate business from senior citizens and price-conscious diners without diminishing their evening business.

Like all saturation mail programs, we know that our success as a business is linked to the success of our customers, and vice versa. The more affordable and effective their advertising is, the better their chances are to survive and grow as a business, and to continue or expand their use of saturation mail advertising.

THE NEED FOR AFFORDABLE SATURATION MAIL ADVERTISING

Over my years in the saturation mail business, I gained a growing appreciation for the importance of affordable saturation advertising for small businesses. Now that I am running my own company, I have more contact with our customers and have seen even more closely how critical our form of advertising can be to the small business person or struggling entrepreneur. Many of our advertisers are one-person service businesses like the gutter cleaner or the handyman, or the entrepreneur trying to get started. These are not "pinstripe and briefcase" entrepreneurs, but hard working people trying to make a living. Their modest business is their primary or sole source of income. For them, effective advertising can be the difference between success or failure, and the term "affordable" advertising has a real pocketbook meaning.

Unlike larger businesses with multiple locations, high sales volumes, substantial advertising budgets, and advertising competitors clamoring for their business, the great majority of our customers have limited advertising choices. Broad coverage mass media like television and radio may work for the large retailer with stores through the market area, but not for the typical small business whose potential customers reside within a few miles of the store. Even the small service provider needs to generate nearby customers, as the time lost in traveling to jobs across the metro area increases costs and limits the number of jobs that can be done in a day. Similarly, advertising in newspapers may only reach subscribers, omitting an important segment of consumers, and may not be zoned finely enough to match the business's primary market area.

Many of these individuals and small businesses need to advertise frequently. The freelance plumber doing small jobs needs a steady flow of customers, perhaps four or five each day. Every day without work is a day without pay. The cost of advertising on a regular weekly or monthly basis becomes a major financial decision. Our typical small commercial classified ad customer, advertising weekly, may spend $3,000 to $4,000 annually. A business using our small display ads may spend $10,000 to $12,000 annually. These are very substantial amounts for such small businesses. For many of our customers, their advertising expenditures with our publications are their single largest cost of doing business.

In a broader sense, the ultimate customers of our mailing programs are consumers. I know that our publications are highly valued by recipients. Based on independent surveys, over 70 percent of adults in our New York market area read our publication, a readership that is higher than our competitors. This readership is also confirmed by the high response we get from recipients to various contests and promotions that we run in our publications. The ultimate test of consumer acceptance is advertising response. We know from our customers that consumers do use and respond to the advertising in our programs. The significant repeat business from our existing customers and growth from new customers is the best indication of consumer responsiveness to our product.

The value to consumers goes beyond simply responding to ads. For value-conscious consumers (which today encompasses far more than just lower and middle-income households), saturation mail is an effective way to comparison shop and find good values. It also offers consumers the benefit of finding goods and services that are located in or near their neighborhoods, a convenience that for many time-pressed consumers is as valuable as a bargain price.

SATURATION MAIL COMPETITION

Although small business advertisers are the heart of our publications, the long-term viability of our industry and customers depends in large measure on the extent to which we can compete for distribution of retail advertising preprints. The competition for these larger, highly sought retail advertisers is fierce. Daily newspapers, most of which offer total market coverage (TMC) programs to reach nonsubscribers via mail or private delivery, are generally the dominant competitors, although private delivery companies are also significant competitors in a number of markets, including the New York and Philadelphia markets we serve.

The single largest and dominant competitor for insert business in the Boroughs of New York is Distribution Systems of America (DSA), a hand delivery (alternate delivery) program which distributes to over 6 million households in the New York Metropolitan area. Every major retail preprint customer in the market (K-

Mart, Sears, all retail food and drug, etc.) delivers their preprints to households in the Boroughs of New York through this program, not in the mail. In fact, since the 1987 postal rate increase, there have been no weekly or monthly saturation mail programs serving the New York City boroughs. This is a growing and vibrant private delivery program and a significant threat to direct mail programs since its cost is dramatically lower than the use of mail.

In the Philadelphia market, there is a combination of direct mail and hand delivery (the hand delivery portion is growing) again offering significant cost advantages to the advertiser, to the detriment of the mail. Like the New York market, virtually all retail, food, drug and hard goods retailers inserts in the Philadelphia market are delivered by a combination of hand delivery and mail. The south Jersey market also has three suburban dailies, the Camden Courier Post, the Gloucester County Times, and the Burlington County Times, as well as the New Jersey edition of the Philadelphia Enquirer -- all with strong TMC programs.

THE NEED FOR A LOWER, MORE REASONABLE POUND RATE.

The cost disadvantage of mail distribution vis-a-vis newspaper or hand-delivery services is due largely to the current rate structure for Enhanced Carrier Route mail, specifically the high pound rate above the 3.3-ounce breakpoint. Under current rates for Saturation ECR mail, postage for pieces above the breakpoint increases in a direct 1-to-1 ratio with increased weight, with postage doubling as the weight doubles. Although I am not a postal costing expert, I cannot imagine that postal handling costs above the breakpoint are purely weight-related, or even anywhere near the steep slope of the current pound rate.

The effect of this high pound rate on our ability to compete for inserts is dramatic. Unlike preprint insert rates of our non-postal competitors that increase only moderately as preprint weight increases, rates for mailed inserts must increase steeply with weight to cover the high linear pound rate postage cost. The Postal Service's proposed pound rate will moderate, but not eliminate, this disparity. For traditional retail preprints, such as a 2-or-more-ounce circular typical of the major retail preprints carried in newspapers, even the lower pound rate would still leave us priced out of the market. The lower pound rate, however, would at least enable us retain the preprint business we currently have and help us compete at the margin for some portion of the lighter-weight preprint business, particularly under 1-ounce.

I know from discussions with others in the saturation mail industry that the high pound rate is an impediment not only to attracting insert volumes but to expanding circulation in existing and new markets. The ability to generate preprint inserts is often a critical "go or no-go" factor in expanding or opening new markets.

I also believe that reduction of the pound rate to a more reasonable level will encourage free community papers and shoppers and perhaps even newspaper TMC programs that are currently hand delivered to consider returning to the mail. Ironically, a number of shoppers and free community papers that use private delivery previously used the mail, but were driven away by increased postal rates. The 1987 postal rate increase, in particular, had a dramatic impact on the saturation mail business. That increase caused the diversion of many previously-mailed newspaper TMC programs and shoppers from the mail into private delivery, and rapid growth of private delivery operations. Most if not all of the programs that shifted to private delivery were those with piece weights above the 3.3-ounce breakpoint, where the high pound rate created an artificially high cost spread between mail and hand delivery.

CONCLUSION

The Postal Service faces growing competition for many segments of its business, including saturation mail. In other segments, such as portions of First Class mail, the competition comes primarily from new communications technologies that offer greater speed or convenience, where price is less likely to be a decisive factor. In the case of saturation mail, the competition is a function of postal pricing.

The Postal Service's future in the saturation mail market depends on postal pricing decisions. The current saturation mail volumes and contribution cannot be taken for granted. Without affordable rates that allow mailers to compete in the marketplace, the Postal Service risks losing this price sensitive volume to newspaper competitors and to new or expanded private delivery operations. Existing mailers may also be forced to shift to private delivery, just as occurred following the Docket R87 rate increase. With affordable rates, saturation mail growth from existing mailers, and from former mailers that previously switched to private delivery due to increased postal rates (particularly the high pound rate), can offset declines in other volumes due to changes in communication technology.

On behalf of the Saturation Mail Coalition and the hundreds of thousands of businesses and individuals that use saturation mail advertising, I urge the Commission to recommend rates that will enable saturation mail to remain a vital and competitive advertising medium.

Saturation Mail Coalition Members

Mail South, Inc.	Helena, AL 35080
Arizona Pennysaver Group	Tempe, AZ 85281
Tucson Shopper	Tucson, AZ 85745
Harte-Hanks Shoppers	Brea, CA 92621
ValuMail, Inc.	Hartford, CT 06103
ADVO, Inc.	Windsor, CT 06095
The Flyer	Tampa, FL 33619
Today's Advantage	Alton, IL 62002
PennySaver Publications	Tinley Park, IL 60477
National Mail It	Shreveport, LA 71118
Action Unlimited	Concord, MA 01742
Berkshire Penny Saver	Lee, MA 01238
Market America Corporation	Baltimore, MD 21244
Impulse Publications	Bel Air, MD 21050
The Maryland Pennysaver	Hanover, MD 21076
Mail Marketing Systems, Inc.	Jessup, MD 20794
Target Marketing Maine, Inc.	Rockland, ME 04841
Metro Marketing Associates	Eagan, MN 55121
Alliance of Independent Store Owners and Professionals	Minneapolis, MN 55402
Advertising Preprint Distributors	Jackson, MS 39289

Saturation Mail Coalition Members

Advantage Mail Network	Charlotte, NC 28208
PAGAS Mailing Service, Inc.	Tarboro, NC 27886
Focus On Results	Weddington, NC 28173
Eastern Marketing Services	Durham, NH 03824
Target Direct NH, VT	North Havehill, NH 03774
Independent News	Pompton Lakes, NJ 07442
Decker Advertising, Inc.	Delhi, NY 13753
Newport Media	Hicksville, NY 11801
Yorktown Pennysaver Group	Yorktown Heights, NY 10598
Rural Advertising Mail	Philadelphia, PA 19134
Market Select Inc.	Reading, PA 19605
The Reminder	Coventry, RI 02816
CAP Medica Network	Memphis, TN 38018
Coupon Concepts	Waco, TX 76702
Winmill Publishing Corp.	Brattleboro, VT 05302
Antigo Area Shoppers Guide	Antigo, WI 54409

CERTIFICATE OF SERVICE

I hereby certify that I have on this date served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

Thomas W. McLaughlin

December 30, 1997

CHAIRMAN GLEIMAN: Mr. Buckel, have you had an opportunity to examine the packet of Designated Written Cross-Examination that was made available earlier today?

THE WITNESS: Yes, I have.

CHAIRMAN GLEIMAN: And if these questions were asked of you today, would your answers be the same as those you previously provided in writing?

MR. McLAUGHLIN: Mr. Chairman, there is -- let me, first of all, explain -- a general correction, and then, secondly, there is a specific amendment that Mr. Buckel has. On all of the Designations of Interrogatories by AAPS, we inadvertently copied a misspelling in the caption from them onto all of our responses. They are all designated as AAPS-SCM-whatever, and it should be SMC for Saturation Mail Coalition.

We have, in fact, corrected all of those copies, all those responses to have that SMC corrected, and they have been incorporated into the packets for the record.

CHAIRMAN GLEIMAN: Thank you, sir.

MR. McLAUGHLIN: And I believe there is also one correction that Mr. Buckel has of a substantive nature.

THE WITNESS: We have a correction on the NAA Interrogatories, and it is, I believe, --

MR. McLAUGHLIN: I believe is No. 4.

THE WITNESS: Page 4, yeah, page 4. The response to the question of destination, delivery to destination SCF, or the destination delivery office, in fact, should be 3 percent to the SCF and 97 percent to destination delivery office.

CHAIRMAN GLEIMAN: Has that correction been made in the packages?

MR. McLAUGHLIN: No, in fact, it hasn't, but I do have corrected copies right here with me. I can do either now or in a few minutes, whenever we are finished.

CHAIRMAN GLEIMAN: I think we had best do it now. I never know when these packages are going to disappear from the room. So --

MR. McLAUGHLIN: You want me to do it right now. Okay.

CHAIRMAN GLEIMAN: Mr. McLaughlin, thank you for your help there.

Mr. Buckel, with the changes that have been noted, if the questions were asked of you today, would your answers be the same?

THE WITNESS: They would.

CHAIRMAN GLEIMAN: Okay.

Mr. McLaughlin has provided two copies of the corrected designated written cross-examination of Witness Buckel to the reporter, and I direct that they be accepted into evidence and transcribed into the record at this point.

[Designation of Written Cross-Examination of Harry J. Buckel, SMC-T-1, was received into evidence and transcribed into the record.]

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 1997 | Docket No. R97-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF SATURATION MAILERS COALITION, THE
WITNESS HARRY J. BUCKEL
(SMC-T1)

Party	Interrogatories
Mail Order Association of America	AAPS/SMC-T1-2-3, 6, 11-12, 14, 16, 18 NAA/SMC-T1-1-5
Newspaper Association of America	AAPS/SMC-T1-2, 7, 13, 19 NAA/SMC-T1-1-2, 4-8
United States Postal Service	AAPS/SMC-T1-1, 3-4, 7-8, 10, 12-15, 18 NAA/SMC-T1-1-8

Respectfully submitted,

Margaret P. Crenshaw

Margaret P. Crenshaw
Secretary

INTERROGATORY RESPONSES OF
SATURATION MAILERS COALITION, THE
WITNESS HARRY J. BUCKEL (T1)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory:	Designating Parties:
AAPS/SMC-T1-1	USPS
AAPS/SMC-T1-2	MOAA, NAA
AAPS/SMC-T1-3	MOAA, USPS
AAPS/SMC-T1-4	USPS
AAPS/SMC-T1-6	MOAA
AAPS/SMC-T1-7	NAA, USPS
AAPS/SMC-T1-8	USPS
AAPS/SMC-T1-10	USPS
AAPS/SMC-T1-11	MOAA
AAPS/SMC-T1-12	MOAA, USPS
AAPS/SMC-T1-13	NAA, USPS
AAPS/SMC-T1-14	MOAA, USPS
AAPS/SMC-T1-15	USPS
AAPS/SMC-T1-16	MOAA
AAPS/SMC-T1-18	MOAA, USPS
AAPS/SMC-T1-19	NAA
NAA/SMC-T1-1	MOAA, NAA, USPS
NAA/SMC-T1-2	MOAA, NAA, USPS
NAA/SMC-T1-3	MOAA, USPS
NAA/SMC-T1-4	MOAA, NAA, USPS
NAA/SMC-T1-5	MOAA, NAA, USPS
NAA/SMC-T1-6	NAA, USPS
NAA/SMC-T1-7	NAA, USPS
NAA/SMC-T1-8	NAA, USPS

RESPONSES OF SATURATION MAIL COALITION WITNESS HARRY BUCKEL TO INTERROGATORIES OF ASSOCIATION OF ALTERNATE POSTAL SYSTEMS

AAPS/SMC-T1-1. At page 2, you state that you have been involved in forming and organizing the Saturation Mailers Coalition. Please identify the other individuals involved in forming and organizing the Coalition and provide a copy of the Coalition's mission statement or other descriptive material identifying its membership and purposes.

In addition to myself, the other representatives that were directly involved are Pete Gorman of Harte-Hanks, Dick Mandt of The Flyer, Carol Toomey of Action Unlimited, Kam Kamerschen of Advo, Jim Deroy of Advantage Mail Network, Donna Hanbery of AISOP, Gary Webb of Metro Marketing Associates, and Norm Schultz of Mail Marketing Systems. In addition, there were several other representatives who supported the formation of a coalition but were unable to participate directly. The mission of the Coalition is to advocate for and represent the interests of saturation mail. A membership list is attached to my testimony as Appendix A.

AAPS/SMC-T1-2. Of the 36 members of the Coalition, please identify any that predominantly mail low-weight (that is, under the breakpoint) standard mail pieces.

Specific information from individual members is proprietary and not available. However, to the best of my knowledge, all of the Coalition's members predominantly mail pieces that are near or under the breakpoint.

AAPS/SMC-T1-3. At page 4, lines 22-23, you identify a "misperception" that a few large mailers dominate the saturation mail industry. Please provide an estimate of the percentage of saturation mail currently mailed by the single largest mailer, by the five largest mailers, and by the ten largest mailers.

You have not accurately characterized what I said. My statement was that I am aware of the common misperception that the saturation mail industry "consists of only a few large mailers." As I explained in the following two paragraphs of my testimony, the saturation mail industry consists of hundreds of companies of varying sizes that mail a variety of saturation mail publications and programs.

I do not have specific volume information for other saturation mailers. My best estimate is that the single largest saturation mailer accounts for a little over 40% of total saturation volume, the five largest mailers account for about 50%, and the ten largest mailers account for well less than 60%. I would estimate that the hundreds of mailers smaller than the top ten account for more than 4 billion saturation mail pieces annually, comprising more than 40% of total saturation mail volume.

AAPS/SMC-T1-4. Please identify the source of the data found at page 6, lines 23-25, where you refer to "mom and pop" businesses constituting 60 to 80 percent of saturation mail users. Also, is this reference to "users" a reference to those whose advertisements are being mailed or a reference to those that are doing the mailing?

My statement was not confined to "mom and pop" businesses, but also included individual service providers and entrepreneurs. In the context of this statement, the reference to "users" is to those whose advertisements are being mailed.

There is no industry wide "source" for this information. My statement is based on my own experience over many years in the industry working with a number of community papers and shoppers, my knowledge of other saturation mail programs, and my contacts and discussions with others in the industry. For Newport Media's shopper programs, the percentage of small business advertisers is even higher than my 60-80 percent figure. On a typical week, our program includes 8,000 to 12,000 classified advertisers and 3,500 display advertisers (90 percent of which are small businesses), compared to about 300 to 400 insert advertisers (some of which are also relatively small businesses). This is not unique, but is a common characteristic of shoppers.

AAPS/SMC-T1-6. At page 8, lines 16-23, you describe Newport Media Inc. You state that four of your five home-delivered shoppers are mailed, and one is delivered by hand. Please identify these shoppers and explain why those mailed are not delivered by hand, and why that delivered by hand is not mailed.

The Yankee Trader, Huntington Pennysaver, Results Media, and Shopper's Guide South Jersey are all mailed. The Marketeer in Brooklyn and Staten Island is hand delivered.

Our shoppers that are mailed have been mailed in most cases since their inception and as a matter of customer demand. The Shopper's Guide was converted to the mail in January 1997 due to customer demand.

The Marketeer is hand delivered. Our preference would be to mail the product, but the current postal rates make it prohibitive from a cost perspective due to the weight of the publication and inserts.

AAPS/SMC-T1-7. You state at page 9, lines 13-14, that your average mailed book weighs 2.6 ounces. You state at lines 15-11 that you average 3-4 preprint inserts per book.

(a) With the inserts, what is your average weight per book?

(b) What percentage of your mailed pieces exceed the breakpoint?

(a) Our records are not maintained in a manner that allows the average total weight to be readily calculated, but I would estimate that the average weight including inserts is near 4 ounces.

(b) About half.

AAPS/SMC-T1-8. At page 10, you describe a range of services you provide to your advertising customers. Do you provide these services only for your customers whose ads are in your mailed product, or do you provide the same services to customers whose ads are in your hand-delivered product?

We offer these services to all customers.

AAPS/SMC-T1-10. At page 14, lines 2-6, you state that there is no weekly or monthly saturation mail program serving New York City. Please describe briefly the quality of mail service in New York City and state whether, in your opinion, quality of service has anything to do with the alleged absence of a saturation mail program.

I am not aware that quality of service has anything to do with the absence of such saturation mail programs, but I do know that cost has a lot to do with it.

AAPS/SMC-T1-11. You state at page 14, lines 4-6, that the cost of private delivery in the New York City area "is dramatically lower than the use of mail." Please provide the data upon which you relied to support that statement.

My statement is based in part on my knowledge of our own privately delivered program. Although our cost data are proprietary, I can assure you that the cost of private delivery for this program is substantially below what it would cost us to mail the program at the current Postal Service pound rates.

AAPS/SMC-T1-12. Please provide the data upon which you relied to support your statement at page 14, lines 7-9, that private delivery offers a significant cost advantage in the Philadelphia market.

Information on Advo's private delivery operation in the Philadelphia market is contained in Docket MC95-1. There, witness Kamerschen stated that:

> "The postage costs for a shared mail package range from a minimum of 12¢ to over 16¢, depending on weight. Our private delivery distribution costs range from less than 9¢ to roughly 11¢ per hand delivery package. The differential between our postal and private delivery distribution costs widens as piece weight increases." MC95-1 Transcript at p. 10171.

Kamerschen also stated that the lower cost of private delivery compared to the high postal pound rate enabled Advo to offer customers a blended rate. Other statements from newspaper industry sources, cited by Kamerschen, confirm that the postal rate structure is out of line with private delivery costs. See the MC95-1 Transcript at pp. 10161-62.

Our own experience is consistent with this. When we acquired the Shopper's Guide, which serves the South Jersey portion of the Philadelphia metropolitan market, it was hand delivered. The cost differential was very similar to that described by witness Kamerschen. We purposefully converted the program to mail delivery despite the higher mail distribution cost due to customer demand.

AAPS/SMC-T1-13. At page 14, lines 16-18, you blame the "high pound rate" for ECR mail for the "cost disadvantage of mail distribution . . . ." Please confirm that the pound rate does not affect pieces such as, for example, those described at page 9 of your testimony that contain 68 pages with an average weight of 2.6 ounces.

It depends how you look at it. If you are looking in isolation at one of our books that weighs 2.6 ounces and ignoring additional inserts, that item is not, by itself, directly affected by the pound rate. However, if looked at from the standpoint of the actual postage we pay to mail a 2.6 ounce book with its accompanying inserts, then the pound rate does have an effect.

AAPS/SMC-T1-14. You state at page 14 that you are not a postal costing expert but that you cannot imagine that postal handling costs above the breakpoint are purely weight-related or that the cost slope isn't nearly as steep as that contained in the current pound rate. Do you believe that the cost of delivering 14-ounce pieces exceeds the cost of delivering 4-ounce pieces?

For a 4-ounce saturation flat piece drop shipped to the destination delivery office, the current postage rate is 13.8 cents. For a 14-ounce piece, the rate is 48.3 cents. The 14-ounce piece is 3-1/2 times heavier than the 4-ounce piece, and is charged exactly 3-1/2 times the postage. I believe the 14-ounce piece may have a higher cost than the 4-ounce piece, but surely nowhere near 3-1/2 times as much.

Your example actually highlights the absurdity of the current high pound rate. At the current rates, a mailer is charged substantially more to mail a <u>single</u> 14-ounce piece than to mail <u>three</u> 4-ounce pieces (48.3¢ for a single 14-ounce piece v. 41.4¢ for <u>three</u> 4-ounce pieces).

The Postal Service's proposal would moderate this effect somewhat. At its proposed rates, a 14-ounce flat piece would still be charged 2.9-times more than a 4-ounce piece (39.95¢ v. 13.7¢). In essence, the proposed rate for the 14-ounce piece consists of a 3.2¢ piece charge and a 36.75¢ pound charge, so that the pound element represents 92% of the total postage -- compared to 100 percent under the current rates. I think that this still overstates the weight effect, but it is certainly a step in the right direction compared to the current 100% weight-related postage charge.

AAPS/SMC-T1-15. You testify at pages 14-15 that rates for mailed inserts must increase steeply with weight to cover the high pound-rate postage cost. What is the additional postage cost to your company of adding a "light-weight l-4-page insert" to your typical 2.6-ounce book? How much would you typically charge the customer for your mailing of that 1-4-page insert?

The context of my statement was that: "Unlike preprint insert rates of our non-postal competitors that increase only moderately as preprint weight increases, the rates for mailed inserts must increase steeply with weight to cover the high linear pound rate postage cost." (pages 14-15). As I further explained (page 15, lines 3-8), this steep pound rate generally prices saturation mail out of the market for traditional preprints weighing over one ounce, while the lower proposed pound rate would "enable us to retain the preprint business we currently have and help us compete at the margin for some portion of the lighter-weight preprint business, particularly under 1-ounce."

The example of a "light-weight 1-4-page insert" which would typically weigh less than half an ounce represents the segment of the preprint market that we are largely confined to currently because of the steep pound rate. For a 4-page insert weighing 0.4 ounces, the incremental postage cost at the current pound rate is about $14 per thousand pieces, compared to an incremental postage cost of $69 per thousand for a two-ounce insert. The insert rates that we charge customers are proprietary, but must cover not only postage costs but also our production/insertion costs, sales commissions and related costs, variable overhead costs, and make some contribution to fixed overhead costs and profit.

AAPS/SMC-T1-I6. You testify at page 15, lines 13-15, that a reduction of the pound rate will encourage free newspapers and shoppers and perhaps newspaper TMC programs that are hand delivered to consider returning to the mail. Assuming that you believe that such return to the mail is a desirable result of a lowering of the pound rate, please explain why you believe that the movement of material from private delivery to the mail is a good thing.

I am not advocating movement of material from private to postal delivery just for the sake of expanding postal volumes (although I believe that would be beneficial to the postal system). My point is that the current rate structure with its excessive pound rate has unnecessarily driven profitable mail from the postal system, and that a more reasonable pound rate could help to recapture some of that lost volume.

The irony of the current high pound rate is that the more successful a saturation mail program becomes, the greater the incentive to convert that program to private delivery.

AAPS/SMC-T1-18. Please confirm that, based upon your experience, most saturation advertising mail has been walk sequenced by the mailer over the past ten years for service reasons even though, during some of that time, walk sequencing was not a prerequisite to obtaining the lowest available postal rate. If you cannot confirm, please provide your opinion on this subject.

Not confirmed. A Postal Service survey presented in Docket R90-1, reflecting volume data prior to the introduction of the walk sequence discount, showed that only about 40 percent of total saturation volume was delivery (or walk) sequenced. See USPS Library Reference F-199, Appendix 10, Table II-A Revised, Docket R90-1.
I suspect that this substantial volume of non-walk sequenced saturation mail came primarily from the many smaller-volume saturation mailers referred to in my response to your interrogatory 3. Even in the case of mailers that did walk sequence prior to the discounts, such walk-sequencing was not done solely for "service reasons." In many cases, mailers were strongly urged by local post offices to sequence their mail as a means of reducing postal handling costs.

AAPS/SMC-T1-19. (a) The Postal Service has proposed an average increase of 3.2% for ECR mail. Under the proposed rates that you support, by how much will the postage bill of Newport Media increase if the proposal is approved as filed (assuming volume remains constant)?

(b) If the proposed ECR rates would produce a decrease in Newport Media's postage bill, please state by how much that bill would be reduced annually, both in dollar terms and in terms of percentage of profits.

(a-b) Based on our current volume profile, and under your assumed constraint that the lower proposed pound rate would result in no increase in either pieces or weight mailed, our annual postage bill would hypothetically decrease by about 0.9 percent, or roughly $90,000. Our profits are proprietary information.

However, in the real world, I fully expect that our total postage bill will increase, probably significantly, if the USPS proposed rates were adopted. This is because the lower pound rate will enable us to generate new inserts that will pay additional incremental postage at the pound rate. For example, every extra one-tenth of an ounce in average weight added to our volume will produce new incremental postage in excess of $100,000 annually. In addition, the lower pound rate will enhance our ability and desire to expand geographically, generating new volumes and postage.

RESPONSES OF SATURATION MAIL COALITION WITNESS HARRY BUCKEL TO INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA

NAA/SMC-T1-1. At page 8, lines 5-6 of your direct testimony, you state that the smallest of your customers account for more than 80 percent of the ads your carry. What percentage of your revenues are accounted for by these ads?

My statement referred to our classified advertisers, who account for about one-fourth of our total revenues. In addition, most of our display ad customers and a portion of our insert customers are also small local businesses, although typically not as small as those that depend on classified advertising. Advertising orders of less than $500 account for about 40 percent of our total revenues.

NAA/SMC-T1-2. Please define the term "saturation-targeted" as used at page 8, line 19 of your direct testimony.

Our publications reach every household (saturate) in specific geographic zones of approximately 12,500 households each (targeted).

NAA/SMC-T1-3. Please refer to page 8, line 20 of your direct testimony. Please explain why you hand-deliver one of the five saturation-targeted shoppers.

We acquired a publication that was hand delivered since its inception in 1981. The size and weight of the publication, with its inserts, make it cost prohibitive to distribute with the Postal Service under the current rate structure.

(Revised Response)

NAA/SMC-T1-4. Please provide the following information regarding your annual mail volumes. (If precise data are not available, estimates are sufficient.)

a. What proportion of your total annual volume of over 80 million is dropshipped to:

 i. the destination BMC,

 ii. the destination SCF,

 iii. the destination delivery office.

b. What proportion of your total annual volume is entered at the non-letter rate?

c. What proportion of your total annual volume exceeds the breakpoint weight of 3.3 ounces?

d. What proportion of your total annual volume, if any, would be subject to the proposed parcel surcharge if approved by the Postal Rate Commission?

a. i. None.

 ii. 3%.

 iii. 97%.

b. 100%.

c. About one-half.

d. None.

NAA/SMC-T1-5. Please list your principal competitors in the Philadelphia markets.

a. Which of these competitors rely on the Postal Service delivery of their product?

b. Shouldn't you and your competitors want to have available a viable private delivery alternative to the Postal Service?

Our principal competitors in the Philadelphia market are the Philadelphia Inquirer, The Gloucester Times, The Camden Courier Post, The Burlington Times, ADVO, and several smaller rack and mail publications.

a. Both the Courier Post and ADVO use a mixture of mail and private delivery in this market. The Courier Post uses non-postal delivery to deliver its publication to subscribers, and uses the mail to deliver its TMC program to nonsubscribers. ADVO uses both mail and private delivery to distribute its shared mail program.

b. There already are viable private delivery alternatives in our markets, and I do not expect this to change, other than to expand. If you are suggesting that postal rates should be raised to make private delivery even more viable, then I would strongly disagree. Our preference is to remain in the mail, so long as postal rates allow us to remain competitive. Artificially driving up postal rates for the competitive benefit of private delivery companies and newspapers would be a disservice to the many businesses, especially small businesses, that rely upon saturation mail advertising, and would be detrimental to the Postal Service and other mail users who benefit from the contribution saturation mail makes.

NAA/SMC-T1-6. Please refer to page 9 of your testimony. Do any of the six Newport Media Inc. publications to which you refer at page 8 of your testimony publish news and sports reporting?

No, but we do publish useful consumer information such as free community announcements, consumer and personal financial advice columns, history columns, and items of general reader interest such as free birth announcements, horoscopes, crosswords and other puzzles, and reader contests.

NAA/SMC-T1-7. Do you believe that your customers get a better response rate when their advertisements are mailed than when they are delivered with a newspaper?

Our customers generally do, although response can vary depending on the kind of business, the profiles of the business's consumer audience compared to mail and newspaper editorial environment and distribution coverages, and other factors. A fashion retailer selling designer dresses, for example, might get a higher response rate from display ads in a more editorially-driven environment like a newspaper than in our saturation mail program, whereas a neighborhood delicatessen would likely get a higher response rate in our publication targeted to one or two zones near the store. In any event, response rate is only one of several factors that advertisers must consider, along with total advertising cost and advertising efficiency (i.e., cost per customer acquired).

NAA/SAC-T1-8. Do you believe that the prices that you charge customers are usually more or less than the prices charged to them by newspapers?

It varies and depends on the types of businesses and ads that are being compared, and on how the "price" is viewed. In many cases the more important factor from the advertiser's standpoint is not the unit price but the total advertising cost and effectiveness. For example, an advertiser wanting to cover only one zone of 12,000 households may pay a higher rate per thousand than with a newspaper but have a lower total advertising cost because the newspaper's minimum zone for classifieds may be much larger than ours. Moreover, the newspaper classified ad may not reach every household in the area the advertiser wants to cover, and may reach well beyond the advertiser's prime market area.

CHAIRMAN GLEIMAN: Does any participant have additional written cross-examination for the witness?

There doesn't appear to be any, and as best I can tell, Mr. Buckel, it doesn't appear that anyone had requested oral cross-examination.

Does anyone here today who had not previously done so wish to cross-examine the witness?

If not, then the question becomes are there questions from the bench.

COMMISSIONER LeBLANC: No, I'll get a reputation.

CHAIRMAN GLEIMAN: I don't think you have to worry about getting a reputation.

COMMISSIONER LeBLANC: Nor do you, Mr. Chairman.

CHAIRMAN GLEIMAN: If there are no questions from the bench then, Mr. Buckel, I want to thank you. We appreciate your appearance here today and your contributions to the record, and it was good to see you again, if only for a moment.

THE WITNESS: Good to see you.

CHAIRMAN GLEIMAN: If there's nothing further, you're excused.

THE WITNESS: Thank you.

[Witness excused.]

CHAIRMAN GLEIMAN: Our next witness is Dr. John Haldi, who is already under oath in this proceeding, and he is appearing today to present testimony on behalf of Nashua Photo, District Photo, Mystic Color Labs, Seattle Film Works, and Merck-Medco Managed Care.

I'm going to let everybody get settled in, and I think that it probably would be a good idea to take our short break right now before we begin with Dr. Haldi, so we'll come back in ten minutes at roughly 25 of the hour or thereabouts and pick up.

[Recess.]

CHAIRMAN GLEIMAN: When last we met, counsel, you were about to proceed with your witness' testimony.

MR. OLSON: Thank you, Mr. Chairman. William Olson, representing Nashua, District, Mystic, Seattle and Merck-Medco Managed Care. And on their behalf we would call to the stand Dr. John Haldi.

CHAIRMAN GLEIMAN: Dr. Haldi's already under oath, so you can proceed to introduce his testimony, if you wish.

Whereupon,

DR. JOHN HALDI,

a witness, was called for examination by counsel for Nashua Photo, Inc., District Photo, Inc., Mystic Color Lab, Seattle Filmworks, Inc., and Merck-Medco Managed Care, L.L.C. and, having been previously duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. OLSON:

Q Dr. Haldi, I'd like to hand to you two copies of what is identified as the direct testimony of Dr. John Haldi concerning the proposed Standard A mail parcel surcharge on behalf of Nashua-District-Mystic-Seattle and Merck, identified as NDMS-T-3, and ask you if this is your testimony prepared by you or under your direction.

A Yes, it is.

Q And do you adopt this as your testimony in these proceedings?

A Yes, I do.

MR. OLSON: Mr. Chairman, we have some minor errata.

BY MR. OLSON:

Q Dr. Haldi, would you identify the errata for us?

A Yes, I'd be happy to.

The first one, if you turn to page 11, footnote 9, the first sentence should remain, and the remainder of the footnote should be struck.

The second change is on page 20, footnote 18. At the end of the footnote in the parentheses it says "emphasis in original." That should be changed to say "emphasis added." Strike the words "in original" and put ~~"emphasis~~ "added."

The third change is at page 27, line 8. The words "it is no secret" are in quotation~~s~~ marks. The quotation marks should be removed.

The last change, at page 37, line 15, the fourth word in the sentence is "any." That word should be struck and insert at that place "18 percent of the" and then make "parcels" -- change the word "parcel" to "parcels." Make it plural. So it reads "were the only measurements available for 18 percent of the parcels in the study."

Q And with those changes, does your testimony now conform to the responses to discovery of the Postal Service that you filed earlier?

A Yes, it does. Those changes were all noted in interrogatory responses filed earlier. They have also been made in the copies which are here before me.

MR. OLSON: Mr. Chairman, with that we'd move the admission of this document into evidence.

CHAIRMAN GLEIMAN: Are there any objections?

Hearing none, Dr. Haldi's testimony and exhibits are received into evidence, and I direct that they be transcribed into the record at this point.

[Direct Testimony and Exhibits of Dr. John Haldi, NDMS-T-3, was received into evidence and transcribed into the record.]

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

POSTAL RATE AND FEE CHANGES, 1997) Docket No. R97-1

Direct Testimony of

DR. JOHN HALDI

Concerning

THE PROPOSED STANDARD A MAIL PARCEL SURCHARGE

on Behalf of

NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, SEATTLE FILMWORKS, INC., AND
MERCK-MEDCO MANAGED CARE, L.L.C.

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December 30, 1997

CONTENTS

AUTOBIOGRAPHICAL SKETCH

My name is John Haldi. I am President of Haldi Associates, Inc., an economic and management consulting firm with offices at 680 Fifth Avenue, New York, New York 10019. My consulting experience has covered a wide variety of areas for government, business and private organizations, including testimony before Congress and state legislatures.

In 1952, I received a Bachelor of Arts degree from Emory University, with a major in mathematics and a minor in economics. In 1957 and 1959, respectively, I received an M.A. and a Ph.D. in economics from Stanford University.

From 1958 to 1965, I was assistant professor at the Stanford University Graduate School of Business. In 1966 and 1967, I was Chief of the Program Evaluation Staff, U.S. Bureau of Budget. While there, I was responsible for overseeing implementation of the Planning-Programing-Budgeting (PPB) system in all non-defense agencies of the federal government. During 1966 I also served as Acting Director, Office of Planning, United Stated Post Office Department. I was responsible for establishing the Office of Planning under Postmaster General Lawrence O'Brien. I established an initial research program, and screened and hired the initial staff.

I have written numerous articles, published consulting studies, and co-authored one book. Included among those publications are an article, "The Value of Output of the Post Office Department," which appeared in *The Analysis of Public Output* (1970); a book, *Postal Monopoly: An Assessment of the Private Express Statutes*, published by the American Enterprise Institute for Public Policy Research (1974); an article, "Measuring Performance in Mail Delivery," in *Regulation and the Nature of Postal Delivery Services* (1992); and an article, "Cost and Returns from Delivery to Sparsely Settled Rural Areas," in *Managing Change in the Postal and Delivery Industries* (1997; with L. Merewitz).

I have testified as a witness before the Postal Rate Commission in Docket Nos. MC96-3, MC95-1, R94-1, SS91-1, R90-1, SS86-1, R84-1, R80-1, MC78-2 and R77-1. I also submitted comments in Docket No. RM91-1.

I. PURPOSE OF TESTIMONY

The purpose of my testimony is to subject to critical evaluation the Postal Service's newly-proposed residual shape surcharge in Standard A Mail (hereinafter "proposed Standard A parcel surcharge" or "proposed surcharge"). I show that imposition of the surcharge would likely lead to extensive repackaging of mailpieces, an expenditure by mailers that could perversely **reduce Postal Service revenues, while increasing handling costs**, thus producing the opposite of the outcome sought by the proposal. I further demonstrate that the cost basis underlying the proposed surcharge is gravely defective, and that de-averaging of transportation costs used to justify the surcharge is inconsistent and inequitable vis-a-vis destination entry discounts. As proposed, the surcharge should be rejected.

Should the Commission nevertheless decide to impose a surcharge, then at the very least, the same averaging principles that are used to estimate shipping costs avoided for destination entry discounts should be used to estimate shipping costs **incurred** for parcels subject to the surcharge. It would violate principles of fairness and equity to reflect the **incurrence** of the higher shipping cost of parcels by imposition of a parcel surcharge, while not reflecting the **avoidance** of the same higher shipping costs of parcels in developing destination entry discounts for parcels.

II. INTERVENORS' MAILING PRACTICES AND INTEREST IN THE PROPOSED STANDARD A MAIL PARCEL SURCHARGE

This testimony is presented on behalf of five intervenors. Four are photofinishers: Nashua Photo Inc. ("Nashua"), which does business as York Photo Labs, District Photo Inc. ("District") which does business as Clark Color Lab, Mystic Color Lab ("Mystic"), and Seattle FilmWorks, Inc. ("Seattle"), collectively referred to as "NDMS."[1] Each firm is a through-the-mail film processor which receives exposed film through the mail, and uses the Postal Service to return developed film and prints to its customers. The fifth intervenor is Merck-Medco Managed Care, L.L.C.

Overview of the Film Processing Industry

Collectively, through-the-mail film processors account for approximately 6 percent of the domestic film processing market. The remaining 94 percent of the market is divided among a large number of local, regional and national (*e.g.*, Eastman Kodak, through Qualex, Inc., and Fuji Photo Film, through Fuji Trucolor Inc.) film processing companies that rely on the general public taking its film to a drop-off location and then returning

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[1] Although not an intervenor herein, another through-the-mail film processor, Skrudland Photo Inc., has joined with and supports the position of NDMS.

to the drop-off location to pick up the finished prints. In some localities, competitors do on-site developing and printing, and offer turn-around times as short as one hour.

Turn-around time and service are critical considerations in the direct mail photofinishing business. All four companies operate their respective processing plants up to 24 hours a day, seven days a week, as demand warrants. Their goal is to have finished pictures back into the mail within 24 hours after customers' film arrives at the plant.

Nashua, District, Mystic, and Seattle compete vigorously with each other, but they compete even more with the multitude of local, regional and national film processors described above.

Mailing Practices of Nashua, District, Mystic and Seattle

Exposed rolls of film are received from customers accompanied by orders to develop the film and make prints. Most rolls of film have 24 or 36 exposures, and customers may order a single or double set of prints. The flat strips of developed film, cut into suitable lengths and enclosed in protective jackets, are placed inside paper, Tyvek®, or plastic envelopes, together with any prints or enlargements which are stacked inside. The resulting envelopes are then dropshipped via expedited service to the appropriate SCF, where they are entered as Standard A Mail. Envelopes containing sets of prints are either flat- or parcel-shaped, a packaging decision that is currently not driven by postage costs. Parcel-shaped mailpieces are almost always mailpieces that would be classified as flats if they did not exceed the maximum flat thickness of 3/4". Standard A Mail envelopes mailed by NDMS that are parcel-shaped currently constitute about 30-40 percent of NDMS's Standard A Mail pieces.

Mailing Practices of Merck-Medco Managed Care, L.L.C.

Merck-Medco Managed Care, L.L.C., is a subsidiary of Merck & Co., Inc., and is the leading pharmacy benefits manager in the United States. Merck-Medco manages pharmaceutical care for millions of Americans covered by employer-funded health plans, major insurance carriers, labor unions, public sector programs, and managed care plans. It uses Standard A Mail to distribute pharmaceuticals to its customers. Many of these mailpieces would be classified as flats except for exceeding the maximum flat thickness of 3/4".

III. BACKGROUND INFORMATION ON THE PROPOSED STANDARD A MAIL PARCEL SURCHARGE

The Postal Service's Standard A Mail rate design witness has proposed a surcharge of 10 cents per piece for all parcels.[2] The surcharge would apply to all pieces which exceed any of the following dimensions: height of 12", width of 15", or thickness of 3/4".[3] The surcharge would apply to all Standard A Mail parcels, so defined, without exception, and without any consideration of whether such parcels were machinable. It would also apply to any other Standard A Mail "prepared as parcels" (*e.g.*, flats).[4]

The proposal to impose a surcharge on Standard A parcels appears to have been prepared by the Postal Service in response to the concern expressed in the Commission's decision in Docket No. MC95-1, which discussed whether parcels should be charged a higher rate based upon their unit costs. Commissioner LeBlanc's dissenting opinion observed that:

> Parcels come in many shapes and sizes. It is not likely that any rate schedule can be devised to account for the attributable costs of each possible shape or size of parcel. The Commission does know, however, that parcels are not letters or flats, and thus, by definition, they are a residual element of third-class. The

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[2] USPS-T-36, pp. 11-15.

[3] These are the maximum dimensions of a flat, as defined in DMM §C050.3.1.

[4] USPS Request, Attachment A, pp. 25-26.

> Commission also knows, since the Postal Service tells it, that, on average, regular third-class parcels are subsidized at approximately 10 cents per piece and enhanced carrier route parcels are subsidized at approximately 7 cents per piece. This is enough information to establish a surcharge for parcels. [*Op. & Rec. Dec.*, Docket No. MC95-1, Dissenting Opinion of Vice-Chairman W.H. "Trey" LeBlanc, pp. 1-2.]

Supporting Cost and Revenue Data

The only data supporting the proposed surcharge in this docket are those supplied by witness Crum.[5] Revenue and volume data for parcels supplied by witness Crum are summarized here in Table 1. As shown in this table, almost nine-tenths (88.5 percent) of all parcels which would be subject to the surcharge are in the Standard A Mail Regular subclass. The volume of nonprofit parcels is comparatively small, less than 5 percent of all Standard A parcels (and less than 0.4 percent of all nonprofit bulk mail). The volume of commercial rate ECR parcels is likewise comparatively small.

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[5] USPS-T-28 (revised 10/1/97), Appendix K, pp. 10-12.

Table 1

FY 1996 Bulk Standard A Mail IPPs and Parcels
Revenues and Volumes
(000)

	Revenue	Volume	Dist. (%)
ECR			
Commercial Rate	10,992	69,464	7.07%
Nonprofit	178	1,389	0.14%
All ECR	11,170	70,853	7.21%
REGULAR			
Commercial Rate	403,812	869,434	88.48%
Nonprofit	11,232	42,360	4.31%
All Regular	415,044	911,794	92.79%
All Standard A	426,214	982,647	100.00%

Source: USPS-T-28 (revised 10/1/97), Exhibit K, Tables 1 and 2.

The per-piece revenue and cost data for parcels provided by witness Crum are shown in Table 2, along with the average weight per piece. The average weight of Standard A Mail Regular parcels is 8.9 ounces. The average revenue is 46.4 cents. Using the Postal Service's costing approach and data, the average cost is 51.3 cents. Finally, according to these Postal Service estimates, on average, costs exceed revenues by **4.9 cents** per piece.[6]

[6] Witness Moeller refers to this difference as the "below cost rate problem." USPS-T-36, p. 12, l. 9.

Unit cost data for the other subclasses are seen to vary considerably, probably because of the small volumes involved, and should be considered as highly unreliable.[7] Aggregating these unreliable data, for all parcels in all four subclasses of Standard A, the Postal Service estimates that average parcel revenues amount to 43.4 cents, while costs average 51.6 cents. These estimates thus imply that (i) parcels are being "cross-subsidized" at approximately 8.2 cents per piece, and (ii) the proposed 10-cent surcharge would eliminate completely any such cross-subsidy.

Projected Volumes and Revenues of Standard A Parcels

Without the surcharge, rate increases proposed for Standard A Regular nonletters (the subclass with almost 90 percent of all Standard A parcels) range up to 7 percent. For pieces subject to the surcharge, however, rate increases for non-destinating entry pieces range from 12 percent (for a piece that weighs between 15 and 16 ounces) to 51 percent (for a piece that weighs less than 3.3 ounces). The proposed surcharge would impose an increase of 55.6 percent on minimum-per-piece 3/5-digit presort parcels entered at a DSCF.[8]

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[7] *See* Section VI, *infra*, for a critique of the cost data used to support the surcharge.

[8] *See* witness Moeller's response to NAA/USPS-T36-4 (Tr. 6/2777).

Table 2

FY 1996 Bulk Standard A Mail IPPs and Parcels
Average Revenues, Cost and Weight
($ per piece)

	Revenue	Cost	Weight (oz.)
ECR			
Commercial Rate	0.158	0.455	2.77
Nonprofit	0.128	1.382	3.06
	--------	--------	
All ECR	0.158	0.473	2.78
REGULAR			
Commercial Rate	0.464	0.513	8.90
Nonprofit	0.265	0.659	6.40
	--------	--------	
All Regular	0.455	0.520	8.78
	--------	--------	
All Standard A	0.434	0.516	8.35

Source: Cost: USPS-T-28 (revised 10/1/97), Exhibit K, Table 3.
Average revenue computed from Table 1.

Despite the high percentage rate increases proposed for parcels, witness Moeller estimates that test year after-rates volume of Standard A parcels will amount to 1.2 billion,[9] an increase of 22 percent over the reported 1996 volume of 982 million (shown in Table 1). This rather substantial

[9] Response of witness Moeller to PSA/USPS-T36-8 (Tr. 6/2886). ~~This statement is somewhat at variance with witness Moeller's statement that the Postal Service had not calculated Test Year After Rates volume, attributable cost, or revenue-per-piece data for Standard A flats or residual pieces. *See* response of witness Moeller to PSA/USPS-T26-1 (Tr. 6/2887).~~

percentage increase in volume seems implausible, given that the own-price elasticity for all Standard A Mail is -0.382.[10]

Overview of Testimony

As indicated above, the only revenue, volume and cost data supporting the surcharge proposal are those presented by witness Crum. Those data are discussed in more detail in Section VI. First, however, it is important to note that the Postal Service fails to examine certain immediate and foreseeable consequences that are likely to result from the surcharge as proposed. These are discussed in Section IV. In addition to a study of obvious consequences which ought to have been performed and submitted, the Postal Service presentation is also noticeably lacking in a number of other important respects. These shortcomings are discussed in Section V. My recommendations are contained in Section VII.

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[10] USPS-T-6, p. 115. Separate own-price elasticities are not computed for letters, flats, and parcels.

IV. THE PROPOSED SURCHARGE WOULD CREATE UNINTENDED PERVERSE INCENTIVES

As shown in Table 1, *supra,* the Postal Service estimates that approximately 982 million Standard A Mail mailpieces were classified as parcels in 1996, and witness Moeller projects 1.2 billion Standard A parcels will be subject to the surcharge in Test Year. Should all of these pieces continue to be mailed as parcels, a surcharge of 10 cents per piece would cost mailers an additional $98 to $120 million each year. Postal Service revenues, of course, would increase by the same amount. For many industries, including (but not limited to) through-the-mail film processing, the proposed 10-cent surcharge represents a staggering added expense.

In highly competitive industries, firms are under constant, tremendous pressure to reduce any expense that does not add value. In the case of the proposed Standard A parcel surcharge, the additional expense could be avoided by repackaging the contents of a parcel-shaped package into a mailpiece with flat-shaped dimensions.[11] Parcel-shaped packages are often used currently because the cost of postage and envelopes are lower than

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[11] Witness Moeller observed that certain mailpieces meet the definitions of both parcels and flats. (Tr. 7/3161, ll. 8-19). In fact, he said that it was no secret that "some parcel mailers may ... be able to avoid the surcharge by mailing their smaller parcels as flats." (Tr. 7/3162, ll. 7-11).

repackaging such mailpieces as flats. Aside from economy, however, parcel-shaped mailpieces generally *do not* provide mailers with any added value over a flat-shaped mailpieces. Therefore, one can predict with a high degree of confidence that virtually all parcel mailers whose product gives them a repackaging option will in fact seek to repackage their products into flat-shaped mailpieces if confronted with a significant surcharge for parcels.

Moreover, packaging firms and design consultants will have a field day if the proposed Standard A parcel surcharge is implemented as proposed. For such suppliers, the proposed surcharge will create a veritable host of new marketing opportunities. Thus, one immediate and highly predictable result of the Standard A parcel surcharge would be a massive repackaging of mailpieces now classified as parcels. In light of this consideration, the consequences of possible repackaging would appear to fall into the category of readily foreseeable but nevertheless "unintended consequences," which must be examined carefully.

Unintended Consequences

The proposed Standard A parcel surcharge is extremely poorly conceived. It would be imposed on every mailpiece that exceeds any one of the limits for a flat-shaped piece, and it would not be imposed on any mailpiece that conforms to those dimensions.[12]

It is essential to recognize, however, that "flat-shaped" is not necessarily synonymous with "easy-to-handle" or "low-cost." As discussed in more detail below, some flat-shaped mailpieces can be more awkward to handle than many parcels in their existing shape, and can present carriers with new problems in delivery. Yet the proposed surcharge neither recognizes nor gives any incentive for machinability or other characteristics to promote ease of delivery.[13] Consequently, it contains no incentive to reduce the Postal Service's cost — except, perhaps, by reducing volume mailed.[14]

This is a serious shortcoming. What needs to be recognized is that **the surcharge may increase the Postal Service's costs far more than ever thought,** while failing to produce the forecasted revenues. These unintended consequences are likely to result from repackaging of a substantial proportion of Standard A Mail now classified as parcels. Such

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[12] The maximum dimensions for a flat are 15" width, 12" height and 3/4" thickness (DMM §C050.3.1).

[13] *See* response of witness Moeller to NDMS/USPS-T36-4 (Tr. 6/2819).

[14] The Postal Service regularly takes account of own-price elasticity in its forecasts. As noted previously, however, the only effect predicted by witness Moeller is an astounding 22 percent increase in volume. *See, e.g.*, witness Moeller's response to PSA/USPS-T36-8 (Tr. 6/2886), where he estimates a bulk Standard A parcel volume subject to the surcharge of 1.2 billion in Test Year 1998.

repackaging will involve items now packaged by mailers in parcel-shaped pieces that resemble flats except that they are more than 3/4" thick. Many of these pieces can now be sorted mechanically on an SPBS, and fit easily into ordinary residential mailboxes.

Whenever pieces contain multiple stacked items (*e.g.*, photographic prints, Christmas cards, checks, compact disks, etc.), the contents could be repackaged readily through side-by-side placement into thinner stacks. So long as the resulting package is less than 3/4" thick, it would meet the definition of a flat, thereby avoiding the surcharge and reducing revenue below that forecast. The resulting package might be (i) a rigid box, or (ii) an envelope with internal compartments designed to maintain thickness below the 3/4" limit for a flat. Either of these repackaging strategies could impose significant extra costs on the Postal Service, compared with the costs incurred in handling parcels in their present shape, especially when the existing parcel is readily machinable and the repackaged piece is non-machinable.

The Rigid Box Option

If mailers chose to repackage the contents into a rigid box, the size of the box could go up to the current maximum dimensions allowed for flats, *i.e.*, 12" x 15" x 3/4" without incurring the parcel surcharge. Whether FSM 881s or FSM 1000s could handle boxes of such dimensions is not known. Such boxes presumably could be sorted manually into a vertical flat case, or perhaps on an SPBS.[15] In terms of the delivery function, maximum size flats may cause extra costs because they would not fit inside the standard "rural" mailbox (about 9" to 10" high), which is common in many suburban and rural locations, nor into a standard post office box or the typical apartment house mailbox, all of which can readily accommodate many more than 3/4" thick "parcels" in their existing form. Thus, repackaging into large rigid boxes could make mail processing and/or delivery tasks more cumbersome, more time consuming, and therefore more costly to the Postal Service.[16]

The Compartmentalized Envelope Option

Alternatively, should mailers choose to repackage into an envelope with compartments, this would result in the same incentive to approximate the maximum dimensions for flats, with consequences perhaps even more adverse than the rigid box option. For example, envelopes, especially highly flexible ones such as those of the plastic Tyvek® variety, when divided into internal compartments, would be inclined to flip-flop about a horizontal or

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[15] If the contents in their present parcel form (*i.e.*, before repackaging) are being sorted on the SPBS, the Postal Service would not gain any cost reduction in mail processing cost from the repackaging. It would simply have some amount of flat-shaped pieces added to the parcel mailstream.

[16] These extra costs would of course be charged to "flats." Although a quite real added expense, it would be virtually impossible for the IOCS to distinguish and identify the extra costs that would be loaded onto flats.

vertical dividing axis while being processed, not only defeating machinability but also making manual sortation into vertical flat cases more cumbersome and costly.

The added costs imposed on the Postal Service by the more cumbersome handling of either close-to-maximum size rigid boxes or compartmentalized envelopes created by repackaging could very well exceed any added revenue obtained from the parcel surcharge on those packages that do not convert or are simply not sent. In that event, everyone would lose. Thus, although some mailers would pay the added surcharge, others would engage in a perverse **negative cost sharing** by incurring additional packaging expenses that, instead of reducing Postal Service total handling costs, would actually increase those costs. And the Postal Service's gain in extra revenue from the surcharge may not be sufficient to offset the extra costs of handling the perversely-created cumbersome flats.

In addition, imposition of the surcharge might have a negative societal impact, even in the event that the Postal Service managed to recoup from the surcharge its extra costs of handling more cumbersome flats created by repackaging. This outcome would result if the extra repackaging costs for the mailers, plus the extra handling costs for the Service, jointly exceeded revenues from the surcharge.

Summary

The Standard A parcel surcharge, as proposed by the Postal Service in this docket, is extraordinarily myopic. It contains no incentives for reducing Postal Service costs, either via increasing the machinability of parcels or by other increased worksharing. As indicated above, mailers' only incentive would be to repackage, which could lead to unintended and counterproductive effects on the Postal Service's bottom line. Should such mischief result, the net incentive effect of the surcharge could turn out to be highly perverse, and certainly not revenue-enhancing. The surcharge is not even intended, as I show in the next section, to deal with the balance between revenues and costs; it is narrowly focused on cost differences whose conceptual underpinnings are seriously defective.

V. SHORTCOMINGS OF THE POSTAL SERVICE'S PROPOSED SURCHARGE FOR STANDARD A PARCELS

The Proposal Focuses Myopically on Costs

In Docket No. MC95-1, the Commission was concerned that revenues from parcels were less than the costs attributed to parcels. Witness Moeller testifies that the proposed Standard A residual shape surcharge was developed in response to concerns expressed by the Commission in Docket No. MC95-1 about costs exceeding revenues, and mentions in passing the "below cost" problem.[17] Presumably this refers to the 8.2 cent difference between average revenues and costs developed by witness Crum.

Nevertheless, witness Moeller states that "the difference between revenues and costs" incurred by parcels "is **not relevant** to the rate design" underlying the residual shape surcharge.[18] He further explains why the comparison between the average revenue and the average cost incurred by the average Standard A parcel is not relevant to the surcharge: "[t]he point of the surcharge isn't to assure cost coverage or that the revenues exceed the costs; it is to recognize cost differences between these two groupings of

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[17] USPS-T-36, p. 12.

[18] *See* responses of witness Moeller to NDMS/USPS-T36-1-2 (Tr. 6/2816-17) (emphasis ~~in original~~).
added

mail."[19] In other words, the sole basis of the Postal Service's justification for the surcharge is on (i) the **cost** of handling parcels, and (ii) the **difference in cost** between parcels and flats — not the difference between parcel revenues and costs.

Cost Models are Woefully Deficient

In light of the expressed concern about the cost of handling parcels, it is remarkable that the Postal Service has not presented one single cost model showing how any parcel is handled. This lacuna in the cost presentation stands in sharp contrast to the detailed cost models for letters and flats presented by witnesses Daniel and Seckar.[20] The Postal Service's direct case is silent regarding:

(i) productivity achieved by processing parcels on a Small Parcel and Bundle Sorter ("SPBS");

(ii) productivity rates of the SPBS with and without a barcode reader;

(iii) which characteristics prevent certain parcels from being sorted on a SPBS;

(iv) the extent to which parcels could be processed on the FSM 1000; and

[19] Tr. 6/2947, ll. 22-24 and Tr. 6/2948, ll. 7-11 and 19-22.

[20] USPS-T-29 and USPS-T-26, respectively.

> (v) any plans to improve mechanization and the way small (under 16 ounce) parcels are handled.[21]

Instead, the Postal Service's entire case relies solely on an IOCS-based cost study.

The Causative Roles of Shape and Weight Are Ambiguous

That parcels cost more, on average, to handle than flats would seem to be a reasonable proposition, notwithstanding various problems with witness Crum's cost study. For example, on average, parcels weigh more than flats. Consequently, since Standard A rates above the breakpoint are weight-based, the average parcel pays a higher rate than flats. The first issue that needs to be addressed is the extent to which weight is a causal factor, as opposed to shape. To his credit, witness Moeller recognizes the importance of developing evidence documenting what drives or causes a cost difference. Where two hypothetical mailpieces of different shapes and weights have identical cost and revenue differentials, he observes[22]

> that's a good thing that the revenue is being obtained for this additional cost of 33 cents but **ideally you would want to**

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[21] The silence is all the more noteworthy since the Commission in Docket No. MC95-1 explicitly took note of RIAA's criticisms regarding the lack of data supporting a separate Standard A parcel rate, including: **no definition** parameters of affected mailpieces, **no identification** of the different procedures (and resultant costs) for machinable and nonmachinable parcels, and **no analysis** of potential volume shifts among classes and subclasses of mail. *Op. & Rec. Dec.*, Docket No. MC95-1, para. 5544.

[22] Tr. 7/3158, 11. 12-21 (emphasis added).

> **know what's causing that cost difference.** The pound rate is the right mechanism for getting that additional revenue if it is indeed weight that was causing the cost difference in that hypothetical. To the extent it was shape that was driving that difference, then there would be a basis for a shape surcharge and a lowering of the pound rate because weight would not have been what was causing the cost difference of 33 cents.

Witness Moeller went on to state that, "I think we have a study that shows that shape is a big cost determinant."[23] His reference, presumably, is to witness Crum's cost study, discussed in Section VI, *infra*.

The role of cost drivers, as they affect the relative costs of letters, flats, and parcels of different subclasses, will be taken up in more detail in Section VI in connection with the discussion of the adequacy of cost data used to support the proposed parcel surcharge. It is necessary, however, to comment here further on the role of cost drivers *within* parcels; *i.e.,* within the residual category of mailpieces known as parcels and IPPs, which in itself comprises the largest variations of shape within all Standard A Mail.

Cost Differences and Cost Drivers Within Parcels Are Not Studied

A major failure of the Postal Service's filing in this case is the lack of any study demonstrating how the cost of handling various types and shapes of parcels varies with different cost-driving characteristics. In Docket No. MC95-1, the Commission cited RIAA's observation that "the calculation of the

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[23] Tr. 7/3159, ll. 1-2.

'average cost' of a 'parcel' proves nothing about the range of costs that made up that average."[24] For example, do rolls, other odd shapes, and "outsides" have extremely high unit costs, which drive up the average cost of all parcels? The IOCS-based cost study sponsored by witness Crum exhibits remarkable, virtually unbelievable, cost differences for parcels of similar weight. Are these cost differences based on real cost-driving characteristics? Or do they simply illustrate the futility of relying exclusively on IOCS tallies to study parcel costs?

On the one hand, if the substantial cost differences developed by witness Crum are real, they need to be investigated in order to identify cost-drivers and quantify their impact. But no information is forthcoming on this important issue. Witness Crum appears indifferent to potentially important questions raised by his own study.

On the other hand, if the cost differences are spurious, and amount to nothing more than statistical outliers caused by small sample size, of course they should be disregarded. But how much weight can the Commission, or anyone else for that matter, give to a study if it produces statistically meaningless results and literally begs to have disregarded the important differences which it surfaces?

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[24] *Op. & Rec. Dec.*, Docket No. MC95-1, para. 5547.

The Postal Service presentation totally lacks any suggestion or insight — such as how to reduce costs or improve worksharing — that might be helpful to either the Commission or mailers. The proposal is simply an across-the-board surcharge based on the limited information provided by IOCS tallies. The study is extremely limited, as well as disappointing, because of its failure to examine any aspect of the "parcel problem," except to manipulate IOCS tallies. And, since the IOCS-based study is all that is available in this docket, and could be the sole or principal source of cost information in future dockets, one problem deserves special mention — namely, the collection of cost data pertinent to the proposed parcel surcharge.

The Definition of a Standard A Parcel Presents Fundamental Problems

By definition, parcels are neither letters nor flats. This is not to say, however, that a meaningful distinction exists between parcels and flats in Postal Service practice As will be seen, for example, identical size and shape mailpieces can be flats or parcels, depending on the context. Consequently, vagaries of Postal Service practices and procedures promote the conclusion that the terms "parcel" and "residual shape" may not provide meaningful criteria for purposes of determining accurate costs, or cost differentials, or for the design of cost-based rates.

The Rural Carrier Cost System Definitions of Letter, Flat and Parcel

Witness Crum observed that "the way rural parcels are counted in the rural carrier cost system there [are] different dimensional criteria".[25] In the rural carrier cost system, all mailpieces with a height exceeding 5" are considered parcels, especially if the item is rigid and cannot be folded.[26] In other words, a rigid greeting card or Christmas card between 5" and 6⅛" high that would ordinarily be classified as a "letter" under the DMM is identified as a **parcel** in the rural delivery system.[27] Obviously, a rigid flat in any of the most common sizes (*i.e.*, 8½" x 11", 10" x 13", 11" x 14", and 12" x 15") also would be identified as a parcel. Perhaps unsurprisingly, this is not the only instance where flats and parcels can have identical dimensions.

The Surcharge Would Apply to Flat-Shaped Mailpieces That Are "Prepared As Parcels"

The Postal Service's filing in Docket No. R97-1 requests the following changes to the Domestic Mail Classification Schedule:[28]

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[25] Tr. 17/8092, ll. 2-4.

[26] *See* Tr. 17/8098, ll. 16-17.

[27] Tr. 17/8098, l. 12 to 17/8099, l. 19.

[28] USPS Request, Attachment A, pp. 25-26. The language here reflects a conscious change by the Postal Service from similar provisions proposed in Docket No. MC97-2, which would have based the surcharge solely on dimensions of the mailpiece.

321.25 **Residual Shape Surcharge.** Regular subclass mail is subject to a surcharge if it is prepared as a parcel or if it is not letter or flat shaped.

321.37 **Residual Shape Surcharge.** Enhanced Carrier Route subclass mail is subject to a surcharge if it is prepared as a parcel or if it is not letter or flat shaped.

As noted above, witness Moeller stated "it is no secret" that flats and parcels can have the same dimensions. Yet witness Moeller repeatedly commented that mailpieces of identical weight and dimensions (length, width, and height) incur different costs depending on how they are characterized — as parcels or flats.[29]

Witness Moeller's testimony characterized the surcharge as applying to every "piece of Standard A Mail that is neither letter- nor flat-shaped."[30] However, as counsel for RIAA discussed with witness Crum, under the Postal Service's proposals some flat-shaped (but "parcel-prepared") mailpieces would also be subject to the surcharge.

Evidently, witness Crum was unaware that the surcharge would apply to mailpieces prepared as a parcel, regardless of shape. He stated that his definition of a parcel, undergirding his testimony supporting the surcharge, was drawn from the IOCS-defined categories of IPP Machinable, IPP

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[29] *See* responses of witness Moeller to DMA/USPS-T36-3 (Tr. 6/2740), DMA/USPS-T36-9 (Tr. 6/2747), and NAA/USPS-T36-5 (Tr. 6/2778).

[30] USPS-T-36, p. 12, ll. 15-16.

Nonmachinable, Parcel Machinable, and Parcel Outside, which definitions parallel that of DMM §C050.[31] Yet, as counsel for RIAA pointed out, and witness Crum confirmed, the definitions of a parcel defined by IOCS and DMM §C050 — and relied upon by witness Crum in his analysis — do not reflect a mailpiece's "preparation as a parcel."[32]

In fact, witness Crum confirmed the overlap between the dimensions of flat-shaped pieces and of nonletter, nonflat-shaped pieces.[33] Witness Crum noted that flat-shaped pieces may well have been identified as parcels by IOCS tally takers (whose data formed the basis for witness Crum's analyses in Exhibit K).[34]

Volume and Cost Data for Parcels Need To Be Consistent

The Postal Service uses separate data systems for collecting information on (i) revenues and volumes, and (ii) costs. In order to obtain meaningful data for rate making purposes, it is essential that in each of the two systems mailpieces be identified in the same manner. That is, all pieces subject to the parcel surcharge should be identifiable as a parcel under the

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[31] *See* responses of witness Crum to NDMS/USPS-T28-3 (Tr. 5/2200) and NDMS/USPS-T28-13 (Tr. 5/2226).

[32] Tr. 5/2375 l. 17 to 5/2376, l. 4; Tr. 5/2380, l. 9 to 5/2381 l. 8.

[33] Tr. 5/2377, ll. 5-10; Tr. 5/2381, ll. 4-13.

[34] Tr. 5/2384, ll. 2-7.

IOCS.[35] Otherwise, there could be, and to a certain extent there may be, chaos. In light of the Postal Service's current procedures and practices, it is submitted that neither the concept of "parcel" nor "residual mail" are meaningful criteria from which to estimate costs or design rates. In this docket, RIAA's oral cross-examination of witness Crum has drawn out the fact that the Postal Service's current residual shape surcharge proposal expressly would treat identical mailpieces differently, if one identical mailpiece is prepared as a flat and the other identical mailpiece is prepared as a parcel. Moreover, no mechanism exists by which the Postal Service has been able to identify correctly the actual shape of such mailpieces when collecting the data used to compute cost allocations. The IOCS instructions used to identify flats and parcels in the mailstream rely on DMM §C050, which does not refer to preparation as a criterion distinguishing flats from parcels.[36]

Conclusion

Although the proposal for a Standard A parcel surcharge is narrowly — indeed, myopically — focused on costs, the conceptual foundation of the cost data used for rate making is gravely deficient. Cost models are lacking:

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[35] *See* ANM-T-1 for further discussion concerning problems that arise when revenues and volumes are not identified in the same manner as costs.

[36] Tr. 6/2372-84.

the causative roles of shape, weight, and other potentially important factors are ambiguous; cost differentials and cost drivers within the category of parcels have not been subjected to statistical study; and even the identification of mailpieces as parcels as between the RPW system and IOCS is problematic. Instituting a surcharge, which will result is rate increases of up to 50 percent, on a conceptual foundation shot through with such defects would be questionable in the extreme.

VI. ANALYSIS OF COST DATA USED TO SUPPORT THE STANDARD A PARCEL SURCHARGE

The testimony of witness Crum presents a detailed breakdown of cost segment data (i) by subclass and (ii) by shape (letters, flats and parcels) to de-average the cost of parcels.[37] Using data in witness Crum's tables, the volume-variable unit cost for mail processing and delivery of parcels has been computed; *see* Table 3.

Mail Processing Costs Exhibit Wide Differences

Examination of Table 3 reveals extremely wide variation in mail processing unit costs. Bulk Rate Regular ("BRR") ECR parcels have the lowest unit cost, 14.62 cents, and the lowest average weight, 2.77 ounces.[38] This is the only rate category with a rational correlation with weight. Bulk Rate Nonprofit ("BNP") ECR parcels have the highest unit cost for mail processing (about 37 cents), while their average weight is somewhat less than

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[37] USPS-T-28 (revised 10/1/97), Exhibit K, Tables 3A(1), 3A(2), 3B(1) and 3B(2).

[38] Reclassification changes were implemented for the former third-class regular rate mail on July 1, 1996. For the former third-class nonprofit rate bulk mail, reclassification changes became effective on October 6, 1996, after the end of the 1996 fiscal year.

BRR Other. With respect to the high volume-variable unit cost for nonprofit parcels, witness Crum states:[39]

> Please refer to my response to NDMS/USPS-T28-19,.... One might expect unit cost fluctuations when volumes are of that level. **I can not definitively vouch for the stability or one year accuracy of the results for Nonprofit ECR parcels in isolation** particularly when they are broken out into even smaller pieces not specifically referred to in my testimony. The Nonprofit specific results were included separately only in response to intervenor requests and in the interest of providing a complete record.... **I am unaware of any difference in processing steps that would explain the difference in unit costs.** (Emphasis added.)

Table 3

Volume-Variable Unit Costs and Average Weight for Parcels FY 1996

	Mail Processing Cost *(cents)*	Delivery Cost *(cents)*	Average Weight *(ounces)*
Bulk Regular Rate (BRR)			
ECR	14.62	28.43	2.77
Other	29.01	12.61	8.90
Bulk Nonprofit (BNP)			
ECR	36.72	99.42	3.06
Other	37.05	22.29	6.40
All Parcels	28.35	14.27	8.35

Source: USPS-T-28 (revised 10/1/97), Exhibit K, Tables 3A(1), 3A(2), 3B(1) and 3B(2).

[39] *See* response of witness Crum to NDMS/USPS-T28-31 (Tr. 17/8012, 8033).

Presort Cost Savings From Parcels Are Underestimated and Not Studied

As noted above, the different rate categories exhibit wide differences in mail processing costs for parcels. Aggregating mail processing costs over all parcels yields an average figure of 28.4 cents. This is almost six to seven times more than the average mail processing cost of letters or flats, which amount to 4.1 and 4.9 cents, respectively. Witness Crum indicates that the lower unit costs for letters and flats in part reflect a higher degree of presortation; he estimates that adjusting parcel unit cost for both presort and dropship differences accounts for about 5.1 cents of the difference.

Clearly, if mail processing costs are as high as estimated by witness Crum, then presortation of parcels would (and does) result in cost avoidances that are far greater than those that result from presortation of flats. In other words, the more it costs to sort something, the greater is the cost avoidance from presortation. Presorted parcels are thus being "short-changed" when the Postal Service uses cost avoidances based on flats. Moreover, since parcel presort discounts are grossly understated with respect to full cost avoidance, the Postal Service is failing to provide desirable incentives and price signals that would encourage parcel mailers to undertake more presortation.

As pointed out in Section V, *supra*, the root of the problem is that the Postal Service has (i) no detailed models of parcel processing flows comparable to those presented on the record for letters and flats, (ii) no productivity figures for SPBSs, with or without barcode readers, and (iii) no downflow density data, all of which are necessary to develop accurate presort discounts.[40]

Delivery Costs Exhibit Even Wider Differences Than Mail Processing Costs

The volume-variable unit costs for delivery in Table 3 are the sums of all costs in segments 6, 7 and 10 divided by the respective volumes. The results for delivery costs are even more disparate than for mail processing costs. BRR Other has the **lowest** unit cost (12.61 cents), but the **highest** average weight (8.9 ounces). BRR ECR has a unit cost of 28.43 cents, and an average weight of 2.8 ounces. With respect to the cost difference (15.82 cents) between BRR ECR and Other parcels, witness Crum offers a few conceivable reasons why there might be "slightly higher costs for ECR parcels."[41]

The average weight of BNP ECR (3.1 ounces) is almost two-thirds less than BRR Other, while the unit cost, **99.42 cents**, is almost **8 times greater**. When asked to explain the dramatic cost difference between BRR and BNP (70.99 cents), witness Crum simply referred to his previous

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[40] The absence of so much critical data and other pertinent information can be easily overlooked, which is reminiscent of Sherlock Holmes' case of the "dog that didn't bark."

[41] *See* response of witness Crum to NDMS/USPS-T28-32(b) (Tr. 17/8036).

response, quoted above, which provides no insight or explanation whatsoever.

Cause of Mail Processing and Delivery Cost Differences Are Not Identified

The data supplied by witness Crum raise troubling questions. Parcels with a comparatively low unit mail processing cost have a comparatively high delivery cost, and variations in unit cost appear uncorrelated, or even inversely correlated, with weight differences. For parcels under 16 ounces, weight may or may not be a significant cost driver with respect to mail processing and delivery costs. But treating weight as of minor importance raises significant questions that call for answers. That is, are these cost differences meaningful at all? Do these cost differences **reflect real characteristics that differ among the various shapes of different parcels?** Or do they represent nothing more than statistical variation arising from small sample size?

The cost differences are so enormous as to render the data worthless. Some unit costs appear to be several standard deviations from the average. If they reflect real, shape-driven causality (*e.g.*, rolls, spheres or other unusual shapes), then the Commission and the Postal Service need to know far more about them, and mailers deserve to have them quantified in a statistically reliable manner. A simple one-size-fits-all 10-cent surcharge would barely begin to recover the unusually large costs caused by such odd-shaped parcels, if such parcels are driving these costs, while imposing an unjust burden on parcels whose handling costs differ only slightly, if at all, from those of flats. To make things worse, the proposed surcharge may potentially create substantial problems in the category of "unintended consequences," as discussed previously in Section IV of this testimony.

Uncertainties and Inconsistencies Associated with Transportation Costs

Witness Crum de-averages the volume-variable transportation costs of Standard A Mail by distributing those costs using estimates of the cubic density of letters, flats and parcels. The de-averaging of transportation costs presents two important difficulties:

- The estimated density for parcels is subject to considerable uncertainty; and
- Destination entry discounts are inconsistently based on cost avoidances that have not been de-averaged; *i.e.*, that are averaged over letters, flats and parcels.

Different Density Estimates for Standard A Mail Parcels

The estimates of density for Standard A Mail parcels are subject to great uncertainty, as cross-examination of witness Crum by counsel for AMMA and other parties has established. The two most recent studies undertaken by the Postal Service have resulted in parcel densities that differ by a ratio of almost 2:1. A density of 14.93 pounds per cubic foot was developed in a previous study.[42] In this docket, witness Crum relies on a slightly more recent study. Using an entirely different methodology, this second study yields a figure of 8.01 pounds per cubic foot for commercial parcels, and 8.12 pounds per cubic foot for commercial and non-commercial parcels combined.[43]

In the prior study, average density was derived by weighing containers that had been filled with a random sample of parcels, then dividing the weight by the volume of the container.[44] Potential for error with this method is inherent in how the container is packed.

In the later study, average density was derived by weighing parcels individually and estimating the volume from measurements of length and girth. Potential for error with this method is inherent in how the individual volume of each parcel is calculated, since length and girth were the only measurements available for ~~any~~ 18 percent of the parcels in the study.[45] Taken together, length and girth are insufficient to determine the volume of even a fairly regular–shaped parcel, let alone one that is of irregular shape. To estimate

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[42] Docket No. MC95-1, LR-PCR-13.

[43] Tr. 17/8059-8060, ll. 5-8.

[44] Tr. 17/8061, ll. 15-16.

[45] Tr. 17/8066-67.

volume, it was necessary for witness Crum to make additional assumptions so obscure that he was unable to explain them on the witness stand.[46]

For the present docket, witness Crum uses the density of 8.1 lbs/cubic foot for parcels, which was derived by the second method described above.[47] The variance between the two very different estimates of density is startling. Cross-examination brought out witness Crum's lack of awareness that the methodology of the earlier study was less subject to human error of measurement for different samples of parcels than the later study.[48] Clearly, this raises serious doubts, especially in regard to sources of error in measurement, as to whether the later estimate that witness Crum uses in this docket is not in fact inferior to the earlier estimate.

Using a parcel density of 15 pounds per cubic foot, rather than 8 pounds per cubic foot, would almost halve the estimate of attributable transportation costs, a major cost component for parcels, thereby reducing significantly the estimated cost difference between flats and parcels. For all parcels, the average cost for vehicle service drivers (cost segment 8) and transportation (cost segment 14) is 8.84 cents. The vast majority of these costs are distributed by cube. Using the higher density in the previous Postal

[46] *See* Tr. 17/8067-68.

[47] USPS-T-28, Exhibit K, Table 3 (revised 10/1/97).

[48] Tr. 17/8062-63.

Service study would reduce this average cost by about 4 cents per piece, which is approximately one-half of the revenue shortfall now asserted by witness Crum.

Destination Entry Discounts Are Based On Average Transportation Costs

Destination entry discounts for Standard A Mail are developed in LR-H-111. That study assumes throughout that all Standard A Mail has the same density. That assumption is acceptable when all other costs for Standard A Mail are developed by averaging together letters, flats and parcels in the customary top down approach to cost development and rate design. However, it is completely inconsistent with the de-averaging of costs carried out by witness Crum. Not only is it totally inconsistent, but it would also be unfair and inequitable to parcel mailers to charge them extremely high transportation costs based on a tenuous Postal Service estimate of density, on the one hand, while denying them destination entry discounts based on the exact same Postal Service estimate, however tenuous it may be, on the other.

Two Ways to Resolve the Inconsistency

Should the Commission decide to impose a surcharge, it can resolve the inequity discussed above in one of two ways:

- Estimate the cost of parcels using average transportation costs for letters, flats and parcels combined, consistent with the average transportation costs used to develop destination entry discounts; or

- De-average the destination entry discounts for parcels, using the same density that is assumed when estimating bottom up transportation costs of parcels.

If the Commission opts to use the average transportation cost for letters, flats and parcels, which amounts to approximately 0.5 cents, the average cost of parcels will be reduced by about 6.6 cents, and unit cost will exceed average revenue by only about 1.6 cents. Witness Moeller proposes a 10-cent surcharge to cover a purported deficit of 8.2 cents. Witness Moeller's "margin" is thus 1.8 cents, which exceeds the purported deficit by about 22 percent. Using the same 1.8-cent margin, the surcharge would be reduced to 3.4 cents, while setting the surcharge at 122 percent of the deficit would result in a surcharge of 2.2 cents. This option has several merits.

- First, it leaves the established method of determining destination entry discounts in place, untouched.

- Second, it does not require separate destination entry discounts to be derived and assessed for different shapes; hence, it is simple.

- Third, it avoids all controversy and uncertainty concerning the correct density of parcels.

- Fourth, a more modest surcharge will invite far fewer unpleasant surprises arising from any unintended consequences, such as widespread repackaging.

Further, all of these results could be obtained while better data would be collected, as mailing statements would be prepared more accurately in specifying shape, since parcel shape, for the first time, would have Standard A Mail rate consequences. Therefore, in the future, these data on parcels would be more reliable than at present, when forms may be filled out which carelessly mis-identify shape, because there are no rate consequences whatsoever.

On the other hand, should the Commission disagree with my proposal, and instead decide to de-average transportation costs for parcels using either of witness Crum's density estimates, fairness would require the Commission to recompute separate de-averaged destination entry discounts for parcels. The parcel discounts will of course be larger (significantly so, if the lower Postal Service estimate of density is used). While separate discounts for parcels are a more complex option than a lower surcharge, larger destination entry discounts for parcels would have the merit of promoting more dropshipment (*i.e*, greater worksharing), which not only would save transportation costs, but would also avoid some mail processing functions. Since the discounts for presortation and destination entry of parcels are both understated, giving parcels a destination entry discount that fully reflects cost avoidance would seem both fair and desirable in allowing mailers of parcels the opportunity to offset that portion of the surcharge being imposed.

VII. CONCLUSIONS AND RECOMMENDATIONS

Conclusions

The Postal Service proposal for a Standard A Mail parcel surcharge lacks merit in four critical respects.

1. **Unintended consequences.** As proposed, the surcharge is poorly formulated, with even the most obvious issues not even touched upon.

- It creates a powerful incentive to repackage parcels into flats wherever feasible. Inescapably, that will reduce revenues from the surcharge.
- More importantly, the costs of handling repackaged parcels could increase sharply over existing costs for handling the same contents in their existing form.
- The contribution to overhead, instead of being increased, may actually be reduced.
- The net impact on the Postal Service, as well as the mailing public, taken together, could very well be negative.

2. **Lack of desirable incentives.** As proposed, the surcharge:

- gives mailers no incentives to reduce Postal Service costs by any known method; *e.g.*, by increased machinability, barcoding, presortation, or destination entry; and
- fails to distinguish between parcels that have dimensions, handling, and cost characteristics similar to flats, and truly awkward irregular packages with inherently high handling costs.

3. Defective cost estimates.

- The cost estimates proffered are shot through with critical shortcomings and fail to support the proposed rates.

4. Inconsistency and inequity.

- Cost incurrences are de-averaged, while cost avoidances are not.
- To be consistent and equitable, handling and shipping costs used to support the parcel surcharge should be reflected in symmetrical fashion in the structure of presort and destination entry discounts. The proposed parcel surcharge fails this simple test.

Primary Recommendation

For the foregoing reasons, I strongly suggest that the Commission defer recommending any parcel surcharge based on the Postal Service's proposal in this docket. As proposed, the surcharge is not well thought out. In fact, it may well create far more problems than it solves.

Secondary Recommendation

Should the Commission feel that some action is necessary at this time, it should consider recommending a shell classification, without any specific rate, and request the Postal Service to submit a new proposal which addresses the more important deficiencies of the current proposal.

Should the Commission nevertheless feel compelled to go beyond a shell classification, and should it adopt witness Crum's de-averaged bottom-up costs as the basis for a surcharge at this time, then I suggest that the surcharge not exceed 2 to 3 cents, for the reasons set out herein.

CHAIRMAN GLEIMAN: Dr. Haldi, have you had an opportunity to examine the packet of designated written cross-examination that was made available earlier today?

THE WITNESS: Yes, I have.

CHAIRMAN GLEIMAN: And if these questions were asked of you today, would your answers be the same as those you previously provided in writing?

THE WITNESS: Yes, they would.

CHAIRMAN GLEIMAN: That being the case, I'm going to provide two copies of the designated written cross-examination of Witness Haldi to the reporter and direct that they be accepted into evidence and transcribed into the record at this point.

[Designation of Written Cross-Examination of Dr. John Haldi, NDMS-T-3, was received into evidence and transcribed into the record.]

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 1997 — Docket No. R97-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.
WITNESS JOHN HALDI
(NDMS-T3)

Party	Interrogatories
Parcel Shippers Association	USPS/NDMS-T3-1-2, 6, 11, 14, 17, 19, 23, 25-28, 30-31, 33-37, 41-42
United States Postal Service	USPS/NDMS-T3-1-42

Respectfully submitted,

Margaret P. Crenshaw

Margaret P. Crenshaw
Secretary

INTERROGATORY RESPONSES OF
NASHUA PHOTO INC., DISTRICT PHOTO INC., MYSTIC
COLOR LAB, AND SEATTLE FILMWORKS, INC.
WITNESS JOHN HALDI (T3)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory:	Designating Parties:
USPS/NDMS-T3-1	PSA, USPS
USPS/NDMS-T3-2	PSA, USPS
USPS/NDMS-T3-3	USPS
USPS/NDMS-T3-4	USPS
USPS/NDMS-T3-5	USPS
USPS/NDMS-T3-6	PSA, USPS
USPS/NDMS-T3-7	USPS
USPS/NDMS-T3-8	USPS
USPS/NDMS-T3-9	USPS
USPS/NDMS-T3-10	USPS
USPS/NDMS-T3-11	PSA, USPS
USPS/NDMS-T3-12	USPS
USPS/NDMS-T3-13	USPS
USPS/NDMS-T3-14	PSA, USPS
USPS/NDMS-T3-15	USPS
USPS/NDMS-T3-16	USPS
USPS/NDMS-T3-17	PSA, USPS
USPS/NDMS-T3-18	USPS
USPS/NDMS-T3-19	PSA, USPS
USPS/NDMS-T3-20	USPS
USPS/NDMS-T3-21	USPS
USPS/NDMS-T3-22	USPS
USPS/NDMS-T3-23	PSA, USPS
USPS/NDMS-T3-24	USPS
USPS/NDMS-T3-25	PSA, USPS
USPS/NDMS-T3-26	PSA, USPS

Interrogatory:	Designating Parties:
USPS/NDMS-T3-27	PSA, USPS
USPS/NDMS-T3-28	PSA, USPS
USPS/NDMS-T3-29	USPS
USPS/NDMS-T3-30	PSA, USPS
USPS/NDMS-T3-31	PSA, USPS
USPS/NDMS-T3-32	USPS
USPS/NDMS-T3-33	PSA, USPS
USPS/NDMS-T3-34	PSA, USPS
USPS/NDMS-T3-35	PSA, USPS
USPS/NDMS-T3-36	PSA, USPS
USPS/NDMS-T3-37	PSA, USPS
USPS/NDMS-T3-38	USPS
USPS/NDMS-T3-39	USPS
USPS/NDMS-T3-40	USPS
USPS/NDMS-T3-41	PSA, USPS
USPS/NDMS-T3-42	PSA, USPS

USPS/NDMS-T3-1.

Please see your testimony at page 3, line 5-8, where you state that the residual shape surcharge will likely lead to extensive repackaging of mailpieces.

(a) Please quantify "extensive" in terms of the percentage of pieces which would otherwise be subject to the surcharge without repackaging. Provide any documentation supporting your contention.

(b) Please explain how such expenditures would lead to a reduction of revenues.

(c) Are there any other rate implications for some of those mailers who repackage their mailpieces? If so, please list those implications.

(d) If the answer to part (c) is yes, please confirm that these rate implications would lessen the likelihood of the mailer repackaging.

(e) Are there any preparation implications for those mailers who repackage their mailpieces? If so, please list those implications.

(f) If the answer to part (e) is yes, please confirm that these preparation implications could lessen the likelihood of mailer repackaging.

(g) If the answer to part (e) is yes, please confirm that these preparation implications could lower the cost to the Postal Service of processing these pieces.

Response:

(a) The attachment to the response to RIAA/USPS-T7-4 (Docket No. MC97-2) indicates that a sample of 68,895,941 Standard A parcels included the different types of items shown in the table below, which I have classified here as (i) clear candidates for repackaging (*e.g.*, the typical plastic container for a CD disk is less than 0.5" thick), (ii) possible candidate, because the description does not provide sufficient information (*e.g.*, an "other box" or "other" could be a box of greeting cards, which could readily be repackaged), and (iii) non-candidates, based on the description provided and the likelihood that the contents could not easily be repackaged into a container that meets the flat-sized dimensions of the DMM.

	Volume		Share of Total
Clear Candidates:			
CD Box	20,925,143		
Check Box	10,290,773		
Film Envelopes	3,295,638		
Subtotal		34,511,554	50.1%
Possible Candidates:			
Other Box	8,991,132		
Other	17,364,062		
Subtotal		26,355,194	38.3%
Non-Candidates:			
Video Box	3,277,929		
Roll/Tube	86,093		
Clothing Bag	1,381,531		
Prescription Drug	682,354		
Sample	2,601,286	8,029,193	11.7%
Total		68,895,941	100.1%

Total adds up to more than 100 percent due to rounding.

You will note that approximately 50 percent of the sample falls into the category of clear candidates for repackaging, while another 38 percent are classified here as possible candidates. I consider such potential for repackaging to be extensive.

(b) Parcels that are transformed to pieces with a flat-sized dimension via repackaging will not have to pay the surcharge, thereby reducing Postal Service revenues from those requested by the Postal Service in this docket.

(c) and (e)

Pieces with flat-sized dimensions must be presorted to 3-digits in order to qualify for the 3-digit presort discount. Any mailer who converts machinable parcels to flats but does not have sufficient density to qualify for the 3-digit presort discount would have to pay a higher rate, thereby offsetting some of the savings from avoiding the surcharge.

(d) and (f)

Confirmed that it could reduce the incentive for those mailers of machinable parcels that do not have sufficient density to presort to 3 digits.

(g) Finer presortation should reduce Postal Service handling costs.

USPS/NDMS-T3-2.

Please see your testimony at page 6, lines 4-5, where you state the percentage of Standard Mail (A) envelopes mailed by NDMS that are parcel-shaped. Please provide the number of pieces represented by this percentage.

Response:

The range provided was an estimate only, and the number is estimated to be in excess of 5 million.

USPS/NDMS-T3-3.

Please see your testimony at page 6, line 12.

(a) Please confirm that prescription drugs are being mailed at Standard Mail (A) rates.

(b) Please estimate the monetary value of the contents of a typical mailing by Merck-Medco Managed Care.

Response:

(a) Confirmed

(b) I am advised that the mailings vary from a few dollars to in excess of $100. No mailing is typical, as they vary widely.

USPS/NDMS-T3-4.

Please see your testimony at page 7, lines 14 through page 8, line 7, where you cite Commissioner LeBlanc's dissenting opinion in Docket No. MC95-1 regarding a Standard Mail (A) parcel surcharge.

(a) Please confirm that Commissioner LeBlanc's opinion also proposed a 5-cent surcharge for Regular and ECR parcels.

(b) Please confirm that Commission LeBlanc also stated that "the Commission need not know that each and every parcel is being cross-subsidized in order to justify a surcharge."

Response:

(a) Confirmed

(b) Confirmed; you have quoted correctly from Commissioner Le Blanc's dissenting opinion, which speaks for itself.

USPS/NDMS-T3-5.

Please see your testimony at page 9, footnote 6. Please confirm that the quotation attributed to witness Moeller is actually the characterization of the Commission in its Recommended Decision (PRC Op., MC95-1, at page V-230, ¶5569).

Response:

Confirmed that the term used by witness Moeller at USPS-T-36, p. 12, l. 9. is almost identical to that used by the Commission in its *Op. & Rec. Dec.*, Docket No. MC95-1, page V-230, ¶ 5569.

USPS/NDMS-T3-6.

Please see your testimony at page 10, lines 10-12, where you discuss rate increases of up to 7 percent for Regular nonletters.

(a) Please identify the specific rate which is proposed to increase by this amount.

(b) Please confirm that the proposed increase for Regular automation 3/5-digit flats (e.g. nonletters) is 9.5 percent.

Response:

(a) The testimony looked to the Postal Service's proposed increase to piece-rated Standard A Regular nonautomation 3/5 digit DSCF-entry nonletter rates, which would actually be an increase of 7.25 percent, to be precise. The true size of the rate increases faced by some Standard A Regular nonletter mailers (excepting the residual shape surcharge) under the Postal Service's proposal are even greater than stated in my testimony.

(b) Confirmed.

USPS/NDMS-T3-7.

Please see your testimony at page 11, footnote 9.

(a) Please confirm that in the response to PSA/USPS-T36-8 cited in the footnote, witness Moeller provides a projection of Test Year volume subject to the residual shape surcharge. If you cannot confirm, please explain.

(b) Please confirm that in response to PSA/USPS-T26-1, witness Moeller provides a citation to the Test Year volume subject to the residual shape surcharge in the Regular subclass (which was the subclass requested in the interrogatory).

(c) Please clarify how the two responses cited in the footnote are "somewhat at variance"?

Response:

(a) Confirmed.

(b) Confirmed.

(c) A review of witness Moeller's response to PSA/USPS-T26-1 indicates that the Postal Service does not have separate Test Year cost or per-piece revenue data for residual shaped pieces, but it does report volume estimates. Accordingly, the footnote should end after the first sentence, with the remainder of the footnote withdrawn.

USPS/NDMS-T3-8.

Please see your testimony at page 11, line 23, through page 12, line 2.

(a) Assuming a 10 cent residual shape surcharge, do you have a projection of the number of pieces which will be subject to the surcharge in the test year? If so, please provide the projection.

(b) Do you have an own-price elasticity estimate for pieces subject to the residual shape surcharge? If so, please provide the estimate.

(c) Please confirm that price changes are not the only factor affecting volumes from year to year. If you cannot confirm, please explain.

Response:

(a) See my testimony at p. 13, lines 3-6. I do not have any Test Year projection for residual shaped pieces other than that provided by the Postal Service.

(b) I do not have any estimate of own-price elasticity for residual shaped pieces other than that provided by the Postal Service.

(c) I believe that the statement in this part of your question is generally true for every class, subclass and rate category of mail.

Response of Dr. John Haldi to USPS/NDMS-T3-9
Page 1 of 1

USPS/NDMS-T3-9.

Please see your testimony at page 13.

(a) Would the alternative packaging which would allegedly occur increase the cost to the mailer?

(b) If the answer to part (a) is no, please explain why mailers aren't packaging their mailpieces as flats today.

Response:

(a) Yes, all parcel mailers would necessarily incur a one-time non-recurring cost to change over to a package that has flat-shaped dimensions. Whether the recurring cost of new packaging (with flat-shaped dimensions) would exceed the cost of existing packaging would depend upon each mailer's circumstances (*e.g.*, cost of current packaging, volume, the particular design selected for any new packaging, etc.).

(b) Not applicable

USPS/NDMS-T3-10.

Please see your testimony at page 14.

(a) Please confirm that you are predicting that virtually all parcel mailers who can repackage their mailpieces will indeed repackage the pieces as a flat.

(b) What percentage of current non-flat nonletters in Standard Mail (A) can be repackaged?

(c) Provide any quantitative information supporting your contention that "virtually all" mailers who can repackage will indeed do so.

Response:

(a) My testimony at p. 14 states that "virtually all parcel mailers whose product gives them a repackaging option will in fact seek to repackage their products into flat-shaped mailpieces if confronted with a significant surcharge for parcels." (Emphasis added.) It was not my intention to say that those parcel mailers who have an option will in fact repackage, because I have neither surveyed nor discussed the matter with any parcel mailers other than the sponsors of my testimony. The word "seek" was intended to mean that imposition of a significant surcharge will cause virtually all parcel mailers to reexamine all of their options to avoid the surcharge, including repackaging in those circumstances where that is an option.

(b) See my response to USPS/NDMS-T3-1a.

(c) See my response to preceding part a.

USPS/NDMS-T3-11.

Please see your testimony at page 14, lines 1-3, where you state that, other than economy, parcel-shaped pieces do not provide mailers with any added value over a flat-shaped mailpiece.

(a) Please quantify the economy offered to mailers by parcel-shaped pieces versus flat-shaped pieces.

(b) Can you say that there is no added value to the recipient of a parcel-shaped piece versus a flat-shaped piece, all else equal?

Response:

(a) Since the rate for flats and parcels is currently identical, the economy relates to the cost of packaging. For example, photographic prints returned by mail are inserted into a gussetted envelope. An envelope with some kind of an internal divider to keep the contents under 3/4" in thickness might cost more than the envelope currently used by photo finishers. Similarly, a box of checkbooks is inserted into a simple paperboard outer box. A redesigned, flat-shaped outer box might cost more.

(b) For items that can be packaged as a parcel or a flat (*e.g.*, photographs, books of checks, or greeting cards), it is the outer packaging that determines the dimensions, which in turn determines whether the mailpiece can qualify as a flat. In all instances of which I am aware, after being opened the outer packaging is discarded. Assuming that the outer packaging has been designed to protect the contents so that they arrive in the same condition as occurs with the existing parcel-shaped package, I am not aware of any added value to the recipient of a parcel-shaped piece versus a flat-shaped piece.

USPS/NDMS-T3-12.

Please see your testimony at page 14, line 14, regarding unintended consequences.

(a) If widespread repackaging occurred, and indeed the repackaged pieces were significantly more costly than other flats, might one of the consequences be a change in the definition of a flat?

(b) Would the possibility of a change in the definition of a flat temper a mailer's enthusiasm to pursue a repackaging effort to produce, as you describe them, "perversely created cumbersome flats?"

Response:

(a) Inasmuch as the Postal Service determines the definition of a flat, I would suppose that "anything is possible" along the line which your question suggests. I would note, however, that although some flats assertedly cost much less to process than other flats (*e.g.*, polywrapped tabloids that are, or have been, non-machinable), the Postal Service has not attempted to change the definition of a flat, or impose a surcharge on such pieces. A review of available old DMMs reveals that there has been no change in the definition of a flat for at least 11 years (back through DMM 24, issued in 1987).

(b) Mailers typically deal with rules as they are, not how they might be.

USPS/NDMS-T3-13.

Please see your testimony at page 15, lines 6-7.

(a) Might one of the new problems presented to a carrier as a result of the repackaging be the inability to fit the piece into the mailbox, requiring the recipient to retrieve the piece at the post office?

(b) Would such an outcome be desirable from the perspectives of (i) the recipient and (ii) the mailer?

(c) Would the mailer consider this effect on the recipient when deciding whether to engage in repackaging "mischief," as you describe it at page 19 of your testimony?

Response:

(a) This definitely is one distinct possibility that could arise from such repackaging, most especially for rigid boxes that are within the dimensions of a flat as specified in the DMM.

(b) For the recipient, it would probably be less convenient than having the piece delivered in the mailbox. The attitude of mailers is more difficult to project. Some may not consider it at all, while others might consider it undesirable. It would also be less desirable from the perspective of the Postal Service.

(c) As discussed in my response to part b, some mailers might consider this effect, while others might not.

USPS/NDMS-T3-14.

Please see your testimony at page 15, lines 7-9, where you state that the proposed surcharge neither recognizes nor gives any incentive for machinability, citing witness Moeller's response to NDMS/USPS-T36-4.

(a) Please reconcile your statement that "machinability is not recognized" with witness Moeller's statement in the cited response that "machinability is factored into the calculation of the cost differences."

(b) Is it your testimony that machinability of parcels is not encouraged at all by rates or preparation requirements?

Response:

(a) I do not see anything to "reconcile." Witness Moeller's statement pertains to the calculation of cost differences, whereas the statement in my testimony pertains to incentives provided to mailers by the "rate design" of the proposed surcharge. Witness Moeller's response to the above-referenced interrogatory also states:

- "Pieces not meeting the definition of a letter or flat...are subject to the residual shape surcharge. Machinability, per se, is not a determinant." (Emphasis added.)
- "The surcharge itself is not designed to encourage machinability."

(b) This is a compound question. With respect to rates, yes, that is my testimony. To elaborate, one reason that the rate structure provides no incentives to encourage machinability may be the fact that the Postal Service has done so little to mechanize the processing of small parcels. For further discussion on this point, see my response to USPS/NDMS-T3-17.

With respect to preparation requirements, the answer is no. For further discussion, see my response to USPS/NDMS-T3-1, USPS/NDMS-T3-21, and USPS/NDMS-T3-22.

USPS/NDMS-T3-15.

Please see your testimony at page 20, line 12, where you quote parts of an interrogatory response of witness Moeller, and the accompanying footnote 18, which states that the emphasis in your testimony on the words "not relevant" was in the original of the quoted passage. Is it your testimony that the response by witness Moeller contained the emphasis? If this is not your testimony, please provide a revised page 20.

Response:

This correction will be noted in an errata.

USPS/NDMS-T3-16.

Please see your testimony at page 20, line 11, through page 21, line 4.

(a) Please confirm that a rate difference between letters and nonletters was implemented for third-class mail in 1991.

(b) Is it your understanding that the rate differential was instituted so that nonletters would cover their costs?

(c) Were carrier route nonletters not covering their costs prior to the institution of a letter/nonletter rate differential?

(d) Do you advocate elimination of the rate distinction between letters and nonletters in ECR?

(e) If the rate difference were eliminated in ECR, would nonletters cover their costs?

Response:

(a) Confirmed

(b) No.

(c) Carrier route nonletters were covering their costs, to the best of my knowledge.

(d) No.

(e) Yes.

Response of Dr. John Haldi to USPS/NDMS-T3-17
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USPS/NDMS-T3-17.

Please see your testimony at page 22, lines 6-9. You state that it is a reasonable proposition that parcels, on average, cost more to handle than flats.

(a) Please confirm that the first factor you cite to explain why the average parcel costs more to handle than the average flat is the heavier weight of parcels on average.

(b) What other factors can you offer to explain why parcels cost more than flats?

(c) Is it your testimony that weight is the only reason parcels are more costly than flats, and that shape plays no role?

Response:

(a) Confirmed.

(b) The Postal Service has invested far more to mechanize the handling of flats than it has to mechanize the handling of parcels. For example, widespread deployment of the second-generation flat-sorter (the FSM 1000) is well underway, and barcode readers are reported to have been ordered for all FSM 1000s. Ordering and deployment of a third-generation flat sorter is said to be in the advanced planning stage. Parcels, by contrast, are still sorted on the SPBS, and the Postal Service has equipped a very few of these with bar code readers on an experimental basis only. Thus, at the present time it would be an exercise in futility for parcel mailers to put barcodes in the address box.

Further, when flats are sorted and put into flat trays, facing of the address is preserved. Development of a high speed flat feeder (HSFF) which requires facing, is said to be in an advanced stage, nearing deployment. With respect to small parcels, however, to the best of my knowledge the Postal Service has not developed any form of containerization that preserves facing for any subset of parcels. Thus, even those small parcels that are fully machinable on the SPBS must be faced individually (which often requires turning the parcel over each time they are sorted on the SPBS). Mechanization of parcel handling is thus seen to be somewhat primitive in comparison to mechanization of flat processing.

Finally, some parcels, such as rolls and tubes, may be totally unamenable to processing on an SPBS, and have to be processed manually at each stage, from acceptance to delivery.

(c) No. See response to preceding part b.

Response of Dr. John Haldi to USPS/NDMS-T3-18
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USPS/NDMS-T3-18.

Please see your testimony at page 27, line 8. Provide the citation to the quote "it is no secret" attributed to witness Moeller.

Response:

Tr. 7/3162, ll. 7-14:

As a matter of fact, and this isn't a secret, really, I think when parcel classification was filed, the DMA issued an announcement on their web page that said some parcel mailers may, however, be able to avoid the surcharge by mailing their smaller parcels as flats, so it seemed like it was obvious there that these pieces that are in this grey area can be prepared as flats and avoid the surcharge.

Addition of the quotation marks was inadvertent, and this correction will be noted in an errata.

USPS/NDMS-T3-19.

Please see your testimony at page 27, footnote 29.

(a) Please explain how witness Moeller's response to DMA/USPS-T36-3 is related to the sentence to which this footnote refers.

(b) Please explain how witness Moeller's response to DMA/USPS-T36-9 is related to the sentence to which this footnote refers.

(c) Please explain how witness Moeller's response to NAA/USPS-T36-5 is related to the sentence to which this footnote refers.

(d) Please define "characterized" in line 11 of page 27.

Response:

(a) As noted in the sentence of my testimony which immediately precedes the sentence to which the footnote is appended, under oral cross examination witness Moeller states (Tr. 7/3162, ll. 7-14) that it isn't a secret, and is "obvious" that there exists a "grey area" where flat and residual shapes overlap. (See also my response to USPS/NDMS-T3-18.) DMA's interrogatory asked witness Moeller to assume that a residual-shaped piece "has cost-causing characteristics similar to a flat" and is subject to the proposed surcharge. Witness Moeller states "a piece with cost-causing characteristics similar to a flat likely meet the definition of a flat, so I am not sure the assumption here is particularly realistic." Witness Moeller's answer implies that there are no residual shape pieces with cost-causing characteristics of a flat; *i.e.*, flats are flats, parcels are parcels, and each has its own distinct cost-causing characteristics, which he presumes do not overlap.

Response of Dr. John Haldi to USPS/NDMS-T3-19
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(b) DMA's interrogatory cited witness Moeller's response to NAA/USPS-T36-5(d), and asked him whether his answer implies that the Postal Service has performed studies which show that shape is the factor that differentiates the costs of flats from those of nonflats. Witness Moeller states that his answer to NAA "implies that a piece which meets the definition of a flat, and is not prepared as a parcel, is going to be processed as a flat." Again witness Moeller's answer implies that flats have their own distinct cost-causing characteristics and associated unit costs, which he presumes have little or no overlap with the unit costs of residual shaped pieces. His answer to DMA/USPS-T36-9 cites the cost differences between flats and nonletters described in the testimony of witness Crum (USPS-T-28). However, he fails to note that witness Crum's study contains no information concerning the standard deviation (or any other measure of dispersion about the mean) of the unit costs developed there.

(c) NAA's interrogatory asked whether it would be possible to define "parcel" in such a manner as to exempt parcels with flat-like cost characteristics from the surcharge. Witness Moeller answered that a piece with "flat-like" costs will likely meet the definition of a flat, in which case it would be exempt from the surcharge, as long as it is prepared in accordance with flat preparation requirements. Moeller's answer thus implies that no residual shape pieces share cost-causing characteristics with flats, while his answer under cross-examination

(Tr. 7/3162, 11. 7-14) states that it is not a secret, and is "obvious," that there is a "grey area" where flat and residual shapes overlap.

(d) The term "characterized" is defined in this context as "being regarded for purpose of being recorded [in RPW statistics and IOCS cost data]."

USPS/NDMS-T3-20.

Please see your testimony at page 29 where you say there may be "chaos" if all pieces subject to the surcharge are not identifiable by IOCS as pieces which are subject to the surcharge.

(a) Please explain what you mean by "chaos" in this context.

(b) Would a requirement that pieces be marked to indicate that they paid the surcharge prevent this "chaos"?

Response:

(a) In the context of deriving statistical samples for the purposes of estimating the costs of pieces subject to the surcharge, I take "chaos" to mean data collection procedures subject to such massive confusion as to have any impartial professional observer characterize them as unreliable or unacceptable.

(b) Yes, provided (i) a one-to-one correspondence exists between the pieces so marked and the pieces actually subject to the surcharge, and (ii) the markings are readily identifiable by IOCS tally clerks.

USPS/NDMS-T3-21.

Please see your testimony at page 29, lines 6 through 9.

(a) Please confirm that, under the current rates and classifications, there are some pieces which are eligible for more than one rate.

(b) Please confirm that if a piece is prepared as a flat, its costs will be different from its costs if it were prepared as a parcel. If you cannot confirm, please explain why the costs would not be dependent on how the piece was prepared.

Response:

(a) Confirmed. For example, anyone with sufficient funds and insufficient sense could send a postcard by Express Mail. Priority Mail contains a substantial number of pieces that weigh less than 12 ounces, and therefore would qualify for First-Class rates.

(b) There is a presumption that the costs ought to be different, because of the 3-digit presort requirement for flats, which is designed to enable the Postal Service to avoid a separation for pieces prepared as a parcel. However, I do not possess any data to confirm that the costs are in fact different.

USPS/NDMS-T3-22.

Please see your testimony at page 33, line 15.

(a) Please confirm that a machinable parcel presorted to BMC receives the 3/5 digit nonletter presort discount. If you cannot confirm, what presort discount are these pieces eligible for?

(b) Please confirm that if these machinable parcels were instead flats, they would need to be presorted to 3-digit, at a minimum, to receive the 3/5-digit nonletter presort discount. If you cannot confirm, please explain.

(c) Please confirm that 3-digit is a finer presortation than BMC. If you cannot confirm, explain.

(d) Please confirm that it is possible that the parcels presorted to BMC would not have the density required to presort to 3-digit, and therefore, would not qualify for the 3/5-digit presort discount if they were prepared as flats. If you cannot confirm, please explain how, in every instance, a machinable parcel mailing would qualify for the 3/5-digit presort discount if it were instead prepared as a flat mailing.

(e) Assume that a machinable parcel mailing qualifies for the 3/5-digit presort discount, and would not qualify if that same mailing were prepared as non-machinable flats. Would you characterize the presorted parcels as being "short-changed" when it comes to presort discounts?

Response:

(a) Confirmed.

(b) Confirmed.

(c) Confirmed.

(d) Confirmed.

(e) In the situation and circumstances posed by this question, the preparation requirements are used as the basis to charge a non-machinable parcel more than a machinable parcel in similar presort condition, without denominating the difference in rates as a "surcharge" for being non-machinable. Under the presumption that non-machinable parcels do in fact cost somewhat more to handle than machinable parcels, I would not characterize the presorted non-machinable parcels as being short-changed by virtue of using the preparation requirements as a proxy for a cost-related surcharge. Whether it is good policy to allow rates to be set through the DMM in this manner is another question.

USPS/NDMS-T3-23.

Please see your testimony at page 40, line 13, where you refer to a 1.8 cent "margin."

(a) What percent cost coverage is implied for these pieces, assuming they are in the Regular subclass, with a 1.8 cent "margin?"

(b) Does your calculation of the "margin" reflect any rate reduction the piece would receive by virtue of the proposed lowering of the pound rate? If not, how would the "margin" be affected? What would the resulting "margin" be?

Response:

(a) For reasons explained below, your question strikes me as ambiguous, but I will try to answer it as I understand it. The basic cost-revenue data in column 1 below are from my Table 2, page 11, and are for the entire Regular subclass, nonprofit and commercial rate combined.

	Regular Subclass Unadjusted	Regular Subclass w/ 10-cent Surcharge	Regular Subclass w/ 8.3-cent Surcharge
Revenue	0.455	0.555	0.538
Cost	0.520	0.520	0.520
Difference	(0.065)	0.035	0.018
Coverage		107%	103%

The second column has a 10-cent surcharge which, when applied only to mail in the Regular subclass, results in a 3.5 cent margin. The third column has an 8.3 cent surcharge which, when applied only to mail in the Regular subclass, results in a 1.8 cent margin.

(b) The average margin of 1.8 cents discussed in my testimony at page 40 is based on the data provided by witness Crum and shown in my Table 2 at p. 11. Those data are based on billing determinants and do not reflect the proposed lowering of the pound rate (from 67.7 cents to 65.0 cents for the Regular subclass), nor do they reflect the proposed increase in the piece rate for pieces that qualify for the 3/5 digit rate (from 8.5 to 10.6 cents per piece for the Regular subclass). For the average commercial rate Regular subclass parcel which weighs 8.9 ounces, without any surcharge, the current rate is 46.2 cents and the proposed rate is 46.8 cents. Based on this example, which uses the mean weight for 95 percent of all commercial pieces, I doubt that use of proposed rates would change the picture very much.

USPS/NDMS-T3-24.

Please confirm that you have done no analysis to calculate the own-price elasticity for Standard Mail (A) parcels. If you have, please provide your analysis.

Response:

Confirmed; see my response to USPS/NDMS-T3-8b.

USPS/NDMS-T3-25.

Please refer to your comments on page 13 regarding "highly competitive industries." Also, please refer to the Commission's Opinion and Recommended Decision in Docket No. MC95-1, dated January 26, 1996. The Opinion says that "the parcel pricing problem needs action through a near-term rate filing." PRC Op., MC95-1, at V-230. In his dissent from the Commission's declining to recommend a solution in that case, Commissioner LeBlanc stated that "[w[hat is necessary for the Commission is...to alert the third-class parcel mailers that in the future there may be adjustments in their rates. Thus, they would be wise to adjust their mailing practices to protect themselves against these increased costs". Dissenting Opinion of Vice Chairman W.H. "Trey" LeBlanc at 2. Is it your testimony that the business decision makers in these "highly competitive industries" have taken no steps thus far despite such clear statements as to the likely future changes affecting their businesses? Please state your rationale for describing a foreshadowed 10-cent surcharge as "staggering."

Response:

Without any doubt, the clear statement contained in the dissenting opinion of Vice-Chairman W.H. "Trey" LeBlanc, which you quote, contained considerate, well-intentioned advice. With all due respect, however, Commissioner LeBlanc has no responsibility for formulating Postal Service proposals for parcels nor, has he ever represented that he could foretell the future. At the time Commissioner LeBlanc wrote his dissenting opinion, he had no foreknowledge of how the Postal Service would define a parcel, or whether the Postal Service would not apply the surcharge to parcels that are machinable, or bar-coded, or more finely presorted, or drop shipped. Thus, while advising mailers "to adjust their mailing practices to protect themselves," the direction in which they perhaps should have adjusted their mailing practices was, to say the least, somewhat ambiguous. As it turns out, under the Postal Service proposal which has finally emerged in this docket, about the only change in mailing practice that will avoid the surcharge will be to convert parcel-shaped pieces to flat-shaped pieces wherever that is a feasible option. The surcharge will apply to all pieces that do not so convert. The one possible exception pertains to mailers of flat-shaped pieces that are currently prepared as parcels. Those mailers may be able to avoid the surcharge either (i) by paying the somewhat higher unpresorted flat rate, or (ii) by holding on to their flat-shaped mail until they amass sufficient volume to qualify for the 3-digit discount.

Response of Dr. John Haldi to USPS/NDMS-T3-26
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USPS/NDMS-T3-26.

Please refer to page 14 of your testimony where you state "one can predict with a high degree of confidence that virtually all parcel mailers whose product gives them a repackaging option will in fact seek to repackage their products into flat-shaped mailpieces if confronted with a significant surcharge for parcels... Thus, one immediate and highly predictable result of the Standard A parcel surcharge would be a massive repackaging of mailpieces now classified as parcels."

(a) Is it your testimony that the business decision makers in these "highly competitive industries" have taken no steps thus far despite such clear statements as to the likely future changes affecting their businesses? Please state your rationale for describing a foreshadowed 10-cent surcharge as "staggering."

(b) Is it your testimony that the business decision makers in these "highly competitive industries" have taken no steps thus far despite such clear statements as to the likely future changes affecting their businesses? Please state your rationale for describing a foreshadowed 10-cent surcharge as "staggering."

Response:

(a) See my answer to USPS/NDMS-T3-25. In a highly competitive industry, such as photo finishing, a "staggering" added expense is one that, on the one hand, wipes out a substantial portion of each firm's profit margin, and yet, on the other hand, is not an expense to the vast majority of competitors (who do not use or rely on the Postal Service). The increase in Standard A Regular rates for 3/5 digit DSCF parcels, for pieces under the preakpoint, would be 55.56 percent. This increase is "staggering."

(b) See response to part a.

USPS/NDMS-T3-27.

Please provide any analysis you have done within any industry, or any nationally representative study you have completed, showing the costs of repackaging and retooling production systems versus the costs of a 10 cent surcharge?

Response:

I have not undertaken any analysis or studies of the type described by this interrogatory. See, however, my response to USPS/NDMS-T3-10a, in which I state that I have discussed the matter of repackaging with the mailers who are the sponsors of my testimony. I also received relevant information from professional representatives of other intervenors in this docket.

USPS-NDMS-T3-28.

In light of your comments regarding the proposed 10 cent surcharge, please compare the rate for shipping a 15.9-ounce parcel and the rate for shipping a 16.1-ounce parcel, both including and excluding the 10-cent surcharge in Standard Mail (A)? You may make any assumptions regarding dropship or presort that you find reasonable, but please exclude any content restricted subclasses.

Response:

A 15.9 ounce piece entered in Standard A Regular Subclass, Presort Category, by definition is entered as unzoned bulk mail. Under the proposed rates, Standard B Parcel Post has single-piece (*i.e.*, non-bulk) zoned rates, and bulk rates for entry at DBMC (zoned) and DSCF (unzoned). All Standard B Parcel Post rate tables have a 2-pound minimum, as the Postal Service does not offer hundred-weight pricing to its customers.

The following table compares (i) a 15.9 ounce piece of Standard A mail, SCF entry, at proposed rates with and without a surcharge, with (ii) the proposed 2-pound minimum rate (which would be applicable to a 16.1 ounce parcel) for Parcel Post DSCF entry (cents per piece).

Standard A

Per Piece Rate:	
3/5-Digit	10.6
Less: SCF entry	-8.8
Subtotal	1.8
Plus Per Pound:	
15.9 oz. @ 65.0	64.6
Subtotal	66.4
Plus Surcharge	10.0

Total	76.4
<u>Parcel Post</u>	
Per Piece (implicit)	136.0
Plus Per Pound, at 12.0 per pound, 2 pounds minimum	<u>24.0</u>
Total	160.0

USPS/NDMS-T3-29.

Please refer to page 15 of your testimony. Please confirm that you have done no analysis regarding the incentives, either intended or otherwise, related to the proposed 10-cent surcharge. If you have, please provide the results of any such analysis used to support your claims.

Response:

Confirmed.

USPS/NDMS-T3-30.

Please refer to page 17 of your testimony. Please confirm that you have done no nationally representative study to analyze the size and types of delivery receptacles and how packaging changes could raise or lower costs Postal Service delivery costs. If you have, please provide those results.

Response:

Confirmed that I have not undertaken any such study. Moreover, no such study appeared necessary. It strikes me as common sense that when items do not fit into a mail receptacle, the cost of delivery increases. Anyone familiar with (i) mail receptacles in apartment houses, (ii) the "rural" mailbox that is so common in most suburbs, and (iii) the small box that individuals rent in post offices, knows that the DMM dimensions of a flat exceed the dimensions of these receptacles. Most flat-shaped mail pieces fit into such receptacles only because they can be and are folded. If the flat-shaped piece is rigid, however, it cannot be folded, and if its dimensions exceed the size of the receptacle, it will not fit.

USPS/NDMS-T3-31.

Is it your testimony that Standard A parcel mailers might spend more than 10 cents to reconfigure their packages as flats? If not, up to how much do you believe such mailers would spend?

Response:

No. Mailers can be expected to weigh both current and future savings that would accrue through avoidance of the surcharge against costs incurred to avoid the surcharge. Costs incurred to avoid the surcharge would likely be looked upon as an "investment," with estimates for future savings regarded or calibrated as return on the investment. When the return exceeds the "hurdle rate," investment could be reasonably expected to follow. It should be obvious that a mailer's volume will be a critical input to this exercise.

USPS/NDMS-T3-32.

Please refer to page 18 of your testimony. Do you have any nationally representative evidence to show that mailers will indeed repackage their product and that this repackaging will either raise or lower Postal Service mail processing costs?

Response:

No. Nor, apparently, does the Postal Service.

USPS/NDMS-T3-33.

Please refer to page 21 of your testimony and witness Crum's response to NDMS/USPS-T28-19. Please explain exactly how modeling mail processing costs would alter the results shown in Table 3, Exhibit K of witness Crum's testimony.

Response:

Because witness Crum's objective was to lay the foundation for development of a "simple, conservative" surcharge, and since his study was designed to match the objective (and no more), the surcharge is presented to mailers and the Commission as a take-it-or-leave-it proposition. No indication is given of the cost difference between mechanized and manual handling, nor of costs avoided through finer presortation. Yet, the very high cost of handling parcels raises the important question of whether separate presort discounts should be established for parcels, as I discuss on page 33 of my testimony. In other words, if parcels cost so much more to handle, then (i) what costs are avoided through finer presortation and dropshipment? and (ii) what incentives should be established to encourage mailers to adopt practices that will avoid more costs? Without such information, which witness Crum fails to provide, it is extremely difficult to develop any realistic alternatives to the Postal Service proposal, just as it is difficult to accept that there is a reasonable foundation for the proposal itself.

USPS/NDMS-T3-34.

Please refer to page 22, lines 3 and 4 of your testimony. Is it your understanding that the information related to Cost Segments 7, 8, 10, and 14 in Table 3, Exhibit K in witness Crum's testimony is produced by the In-Office Cost System?

Response:

No. A more precise statement would be: Instead, the Postal Service's entire case *with respect to mail processing cost* rests solely on an IOCS-based cost study. In the context of the preceding paragraphs in that portion of my testimony, that meaning seemed to be implied.

USPS/NDMS-T3-35.

Please refer to page 24 of your testimony. Please identify exactly how describing each cost driver to whatever level of detail you desire would alter either the results of the analysis in witness Crum's testimony or the actual surcharge proposed by witness Moeller?

Response:

See my response to USPS/NDMS-T3-33. Also see the discussion in part VI of my testimony, pp. 31-36. By way of example, as pointed out there in Table 3, the unit delivery cost for Nonprofit ECR parcels is 99 cents, and for commercial rate parcels it is 28 cents. The unit delivery cost for each of these ECR subclasses is somewhat higher than the unit delivery cost for "other" parcels (22 and 13 cents, respectively). At the same time, ECR parcels are significantly lighter in weight than "other" parcels. The first question is: Are these cost differences just the result of some anomalous quirk in the data, or are they real? If they result from anomalous, unreliable data, then shouldn't the data be disregarded? (That would change the results of witness Crum's analysis.) Alternatively, if the cost differences are real, then what drives them? Do ECR parcels use detached labels extensively, and if so, are detached labels the source of sharply higher costs? Should detached labels for parcels be banned or subject to a special surcharge? (That proposition would represent a change in witness Moeller's proposal.) Without knowing what cost really is, and the factors that drive that cost to be what it is, the development of sensible cost-based rates ranges between difficult and impossible.

USPS/NDMS-T3-36.

Please provide the sources for your statements on page 34, lines 15-18 and page 35, lines 1-2.

Response:

The data which underlie the comparisons in my statement come directly from Table 3 at page 32 of my testimony. The pertinent data in that table were devised as follows. USPS-T-28, Exhibit K, Table 3A(2) (revised 10/1/97) identifies the total weight of BNP ECR as 266,000 pounds, while the volume was 1,389,000 pieces. (266/1,389 = 0.192) x 16 = 3.1 ounces. The unit delivery cost of BNP ECR is identified as $0.994.

CS6&7 total:	1,315
CS10 total:	66
Total Delivery	1,381

1,381/1,389 = $0.9942

USPS-T-28, Exhibit K, Table 3B(1) (revised 10/1/97) identifies the total weight of BRR Other as 483,659,000 pounds, while the volume was 869,434,000 pieces. (483,659/869,434 = 0.556) x 16 = 8.9 ounces. The unit delivery cost of BNP ECR is identified as $0.126

CS6&7 total:	84,470
CS10 total:	25,173
Total Delivery	109,643

109,643/869,434 = $0.1261

USPS/NDMS-T3-37.

> Please refer to your comments on page 36, lines 1-4 and the results of the study described in Appendix C of LR-PCR-38 in Docket No. MC97-2. Please identify the category which these "odd-shaped parcels" which you claim cause "unusually large costs" would fall in. If you are unable to place them in a category, please describe them in detail and submit all data you have regarding their presence in the Standard Mail (A) mailstream and their relative impact on total parcel costs.

Response:

Please note that my testimony at page 35, which immediately precedes the comments on the top of page 36, discusses the fact that witness Crum's data show a unit mail processing cost of about 15 cents for a commercial ECR parcel, 29 cents for a commercial-rate Other parcel, and about 37 cents for both nonprofit ECR and Other parcels (as shown in Table 3 of my testimony). The portion of my testimony which you cite was giving witness Crum's cost data full credence, and was speculating about what factors might cause the Postal Service to incur such cost differences. It may be entirely possible that witness Crum's cost data are too thin to have any credibility, and should be totally disregarded. In that event, it is of course a waste of time for me (or anyone else) to speculate about underlying causes of such cost differences. Beyond that, if witness Crum believes that his cost data in fact have sufficient credibility to be adopted by the Commission, it really is up to him to support his findings.

My term "odd shaped parcels" refers to parcels with a circular cross section, to irregular shapes known as "outsides," and to other irregular parcels that must be processed manually at every stage. Such parcels are generally considered to have unit costs that are somewhat higher than average. Whether they are more concentrated in some subclasses than others I do not know.

USPS/NDMS-T3-38.

Please refer to page 37, lines 13-15 of your testimony as well as Tr. 15/8063 and Tr. 19E/9850-9851. In light of the record testimony cited, please provide an explanation for your statement that "length and girth were the only measurements available for any parcel in the study."

Response:

Tr. 15/8063 does not exist. Tr. 17/8063 discusses the number of parcels (82 percent) for which "direct measurement" was recorded. Tr. 19E/9850 states that length, width and height were recorded for 82 percent of the parcels described in Exhibit USPS-28K, Table 3.

USPS/NDMS-T3-39.

Please refer to page 38, lines 6-8 of your testimony.

(a) Please describe which line(s) of the transcript page you cite lead to your conclusions and explain.

(b) Please provide all data or analysis you have completed to show beyond a merely intuitive level that "the methodology of the earlier study was less subject to human error".

Response:

(a) Witness Crum's testimony, Tr. 17/8062-63, states that "I would guess, as far as human fallibility, which is only one of the many factors that we would assess in trying to see which is coming up with the best estimate — and I can't say this for certain, but my personal intuition might be that the human fallibility factor might be higher for the study that we did, but again, there are many factors other than human fallibility...." Taking *human fallibility* as a synonym for *human error,* I take this to be at best a weak guess, perhaps not an awareness, that the earlier study might be less prone to human error.

(b) No such empirical analysis has been undertaken.

USPS/NDMS-T3-40.

Please refer to page 39, lines 2-3 of your testimony. Please provide a citation as to exactly where witness Crum asserts a revenue shortfall.

Response:

See NDMS-T-3, p. 10, ll. 3-8. A comparison of the revenue data from witness Crum's testimony, USPS-T-28 (revised 10/1/97), Exhibit K, Table 1 and 2, with the total attributable cost data in Tables 3A(1), 3A(2), 3B(1) and 3B(2) posit a revenue shortfall.

USPS/NDMS-T3-41.

Please refer to page 41 of your testimony. Do you believe that the Commission should de-average dropship discounts by shape in Standard Mail (A)? Do you believe it would be consistent to fully de-average dropship discounts while passing through only 28.5 percent of the stated cost difference between parcels and flats? Please fully explain any affirmative response.

Response:

Please note that my primary recommendation is not to impose any parcel surcharge at this time, in which case your question becomes moot. To your question in context, if the Commission should nevertheless decide to recommend a surcharge based on costs that incorporate shape-based transportation cost differences, then my answer is yes. I believe it would be consistent to de-average fully dropship discounts by shape when passing through 100 percent (or more) of the stated revenue-cost difference for parcels. I further believe that adoption of the Postal Service's proposal which attempts to identify fully shape-based costs, while ignoring shape-based cost avoidance, would be grossly inconsistent.

USPS/NDMS-T3-42.

Please refer to page 14 of your testimony where you state "one can predict with a high degree of confidence that virtually all parcel mailers whose product gives them a repackaging option will in fact seek to repackage their products into flat-shaped mailpieces if confronted with a significant surcharge for parcels... Thus, one immediate and highly predictable result of the Standard A parcel surcharge would be a massive repackaging of mailpieces now classified as parcels."

(a) Please provide any study or analysis you have produced to support such claims.

(b) Please define your use of the terms "high degree of confidence" and "highly predictable" and state the basis (if any) for these conjectures.

Response:

(a) Please see my answers to NDMS/USPS-T3-10 and 27.

(b) My high degree of confidence in standard microeconomics provides the basis for my high degree of confidence that mailers will react as suggested. At the level of theoretical analysis of prospective business costs and cost savings involved in this discussion, I feel that it is indeed highly predictable that mailers will search for ways to offset the impact of the surcharge. Please note that my prediction pertains only to mailers seeking to do so, not necessarily concluding that it would be cost-effective for them to repackage. This much can be derived by standard microanalysis, and my testimony offers it as a conclusion. Conversations with the sponsors of my testimony, who annually mail millions of parcels and therefore would be affected by the surcharge, allow me to go further and assert that the behavior I refer to in my testimony is already underway, and is going forward in a most determined fashion.

CHAIRMAN GLEIMAN: Does any participant have additional written cross-examination for Witness Haldi?

MR. REITER: Yes, I do, Mr. Chairman.

CHAIRMAN GLEIMAN: Mr. Reiter.

CROSS-EXAMINATION

BY MR. REITER:

Q Dr. Haldi, I'm handing you two copies of your answers to USPS Interrogatories 44, 45, and 46. Would you take a look at those, please?

A Yes.

Q If I asked you those questions orally here today, would your answers be as shown?

A Yes, they would.

Q Thank you.

MR. REITER: Mr. Chairman, I will hand these copies to the reporter and ask that they be accepted into evidence as the additional written cross of Dr. Haldi.

CHAIRMAN GLEIMAN: The additional designated written cross-examination of Witness Haldi having been given to the reporter, I direct it be accepted into evidence and transcribed into the record at this point.

[Additional Designation of Written Cross-Examination of Dr. John Haldi, NDMS-T-3, was received into evidence and transcribed into the record.]

USPS/NDMS-T3-44

Please refer to your response to USPS/NDMS-T3-17 where you state that "Parcels, by contrast, are still sorted on the SPBS".

(a) Please provide the basis for this understanding.

(b) Is it your testimony that all Standard Mail (A) parcels are sorted at plants (P&DC)? If not, please provide an estimate of the percentage.

(c) Are you aware that machines other than an SPBS can sort Standard Mail (A) parcels at plants? If so, please describe them and list the nationally representative percentage you believe receive piece sortation on them by machine.

(d) Is it your testimony that no Standard Mail A parcels receive piece sortation on BMC Parcel Sorting Machines (PSMs)? If your answer is no, please provide the nationally representative percentage you believe do.

(e) Are you aware that PSMs have barcode readers?

Response:

Before answering the specific questions posed by your interrogatory, I would like to make it clear that at all places where my response to USPS/NDMS-T3-17 mentioned "parcels," it should be interpreted as referring to Standard A parcels that weigh less than 16 ounces.

(a) It is my understanding that small parcel bundle sorter (SPBS) machines are installed at all P&DCs, and that at least some BMCs are also equipped with one or more SPBS's. It is also my understanding that the SPBS is the preferred machine for sorting small parcels.

(b) No. Some Standard Mail A parcels may be sorted at BMCs. However, since most Standard Mail A parcels are made up to 3 digits, they can be sent directly from BMCs to P&DCs, without sortation at the BMC. Some Standard Mail A parcels are dropshipped directly to P&DCs in order to bypass the BMCs and expedite delivery. I do not have data that would enable me to estimate the precise volume of Standard Mail A parcels sorted at P&DCs (as opposed to BMCs), but I would expect it to be a substantial majority of all Standard Mail A parcels.

(c), (d), and (e) Specifications for the FSM 1000 indicate that it can sort some mailpieces whose dimensions exceed the maximum dimensions for flat-shaped pieces. It is my understanding, however, that at this time the Postal Service generally does not use the FSM 1000 for sorting anything other than flats. Hence, I estimate that the nationally representative percentage that currently receives piece sortation on the FSM 1000 is negligible.

Parcel sorting machines (PSMs) can also be used to sort parcels that weigh less than 1 pound; *e.g.*, Standard Mail A parcels. PSMs are equipped with a barcode reader that can read interleaf barcodes (but not the postnet code used for letters and flats). When sorting parcels that are not barcoded, PSMs must be operated in a manual mode. Since most PSMs are at BMCs, only Standard A parcels that are sorted at BMCs would be processed on PSMs. Since most

Standard A parcels are not sorted at BMCs (see response to part b), I expect that only a small percentage are sorted on PSMs. The Postal Service has not offered shippers of Standard Mail A parcels any discount or other encouragement to barcode their parcels. Moreover, when a mailer is preparing labels for Standard Mail A packages that can turn out to be either flats or parcels, even if the mailer were inclined to assist the Postal Service by preprinting a barcode, the mailer would have trouble determining which barcode to use. This "confusion," which can be solved only by the Postal Service, helps illustrate the point that I was trying to make in my response to USPS/NDMS-T3-17. Namely, to the extent that Standard Mail A parcels may have a somewhat higher unit cost of handling, it is because the Postal Service has not directed much attention or investment to increase the mechanized sorting of such parcels.

USPS/NDMS-T3-45

Please refer to your response to USPS-NDMS-T3-26(a).

(a) Is it your testimony that price is the key decision making criterion for customers deciding whether or not to have their film developed by mail? If so, do you believe that 10 cents will cause them to pursue other options? Please provide any evidence you might have to support your claims.

(b) Are other factors, such as convenience, timeliness, quality, or reliability, of equal or greater importance than price for customers deciding whether to have their film developed by mail?

(c) Please provide the rates that UPS would charge for delivering developed film packages of the type your clients send. Would you characterize the difference between those rates and the rates you now pay as "staggering" or something different? Please explain.

(d) Please estimate for your clients' businesses the percentage of total costs that the 10-cent surcharge would comprise.

Response:

(a) Photo-finishing is a highly price competitive business, but prices can be and often are reduced in a number of different ways; *e.g.*, a second set of prints is offered "free," or a new roll of film is offered "free" (or at a greatly reduced price only when purchased in conjunction with development), larger prints are offered for the same price as smaller prints, etc. Customers of through-the-mail photofinishers are probably more price-conscious than the average consumer (see response to part b, *infra*). The demand for photofinishing is in the nature of a classic "continuous" demand function, hence I would predict that a 10-cent increase in the price would cause a loss of some customers.

(b) All four of the factors which you list play a role in the consumers' choice of photofinishers. The country has a plethora of places that offer photofinishing services. Most large cities have some establishments that develop film on site and have prints available for pickup within one hour, or same-day service (in before 11:00 a.m., back in the afternoon). Where same-day service is not available, overnight service is fairly common. Consumers who place a high value on timeliness would not give any consideration to a through-the-mail photofinisher because even under the best circumstances a round-trip through the mail requires several days. With respect to convenience, the mail may be considered reasonably convenient, but on an almost daily basis a great many customers pass by an equally convenient photofinishing drop-off location such as a drug store, Wal-Mart, etc. Through-the-mail photofinishers must (and do) compete chiefly on the basis of price, quality and reliability.

(c) I have no idea how much UPS would charge for delivering my clients' developed film, as I am aware that UPS is known to offer volume discounts. Using their published rates (Rate Chart effective 2/1/97), UPS would charge from $3.44 to $4.19 for a 1-pound UPS Ground package delivered to a residence, and from $3.50 to $4.80 for a 2-pound UPS Ground package delivered to a residence, depending on distance. Unless these rates were deeply discounted, the effect on costs of switching to UPS would be staggering.

(d) Assuming you mean postage costs, the 10 cent surcharge alone would increase total postage costs for my photofinisher clients by approximately 10 to 13 percent. In terms of postage costs for Standard A Mail only, the surcharge represents an increase that averages about 25 percent. While the surcharge by itself represents a significant increase, the cumulative effect on NDMS of all of the Postal Service's proposed increases they would be forced to pay — *i.e.*, the First-Class Mail nonstandard surcharge plus the 1-cent increase in the rate for the first ounce of First-Class Mail; the proposed Priority Mail rate increase; along with the Standard Mail A surcharge and rate increases for the Standard Mail A Regular subclass — would amount to "rate shock" vis-a-vis an average proposed increase of only 4.5 percent. The Postal Service's proposed rates, applied to 1997 volumes and mailing costs would increase total mailing costs for my through-the-mail photofinisher clients by 18 to 21 percent.

USPS/NDMS-T3-46

Please see your response to USPS/NDMS-T3-19(c).

(a) Please confirm that there is a "grey area" where flat and residual shape pieces overlap.

(b) Please confirm that this overlap does not necessarily mean that pieces in the "grey area" cost the same whether they are prepared as flats or parcels.

(c) Please explain how the statement "a piece with 'flat-like' costs will likely meet the definition of a flat, in which case it would be exempt from the surcharge, as long as it is prepared in accordance with flat preparation requirements" implies that "no residual shape pieces share cost-causing characteristics with flats."

Response:

(a) Confirmed.

(b) Confirmed.

(c) Because it implies that a piece with 'flat-like' costs would not be defined as a parcel; *i.e.*, parcels do not (and cannot) have flat-like costs because any such piece with flat-like costs would likely be a flat (according to Moeller).

CHAIRMAN GLEIMAN: Anyone else?

[No response.]

CHAIRMAN GLEIMAN: If not, that moves us to oral cross-examination, and the Postal Service is the only party who has requested cross-examination. Does anyone else with to cross-examine this witness?

[No response.]

CHAIRMAN GLEIMAN: If not, Mr. Reiter, when you're ready, you can begin?

MR. REITER: Thank you, Mr. Chairman.

CROSS-EXAMINATION

BY MR. REITER:

Q Good morning, Dr. Haldi.

A Good morning, Mr. Reiter.

Q You said at page 13 of your testimony, and I quote, for many industries including but not limited to through-the-mail film processing, the proposed ten-cent surcharge represents a staggering added expense, unquote.

Do you recall that statement?

A Yes, I do.

Q In our Interrogatory No. 26 we asked you to define "staggering," and your answer said, quote, a staggering added expense is one that on the one hand wipes out a substantial portion of each firm's profit margin, and yet, on the other hand, is not an expense to the vast majority of the competitors.

Do you recall that answer?

A Yes, I do.

Q We were concerned, frankly, about your claim that the Postal Service's proposal would wipe out a substantial portion of these firms' profit margin, so we did a little research.

Because it is publicly traded, we were able to find Seattle Filmworks' 10K statement on the Internet and I have a page of that printed out, which I'll show you and everyone.

It is marked USPS Cross-Examination Exhibit NDMS-T-3, Number 1.

[Cross-Examination Exhibit USPS/NDMS-T-3-XE-1 was marked for identification.]

BY MR. REITER:

Q Dr. Haldi, if you'll look on the second of the two pages that I gave you, that is Seattle Filmworks' consolidated statement of income. Do you see that?

A Yes, I do.

Q And do you see the net income listed for the last fiscal year, which ended December 27th, 1997?

A Yes, I do.

Q And that shows $10,145,000?

A That's correct.

Q In response to our Interrogatory Number 2, if you would take a look at that, you told us that the estimate that you had of the number of standard mailing envelopes mailed by NDMS that are parcel shaped was in excess of five million. Do you see that?

A I see the answer, right.

Q So for four companies on average, and I realize this is rough, each one of them mails approximately 1,250,000 parcel shaped packages. Would that be correct?

A Yes, that's correct.

Q And at 10 cents each for the surcharge, that would mean approximately $125,000 in increased expense for them?

A Not right.

Q And why is that?

A Because the mail has mixed parcels. Everything to go out is mailed as a mixed parcel because they drop ship to destination entry, and if they were to try and take the flat shaped parcels and segregate them into those which are flat shaped and those which are parcel shaped, then they would avoid the surcharge on the flat shaped parcels, but that would cause them to have to ship them separately in the -- as two separate shipments and they would incur higher costs in the -- they would either then incur higher costs from the separate smaller shipments, for example if they had let's say 25 pounds to a destination and 10 pounds were parcel shaped and 15 pounds were flat shaped they would have to ship one 10 and one 15 pound shipment instead of one 25 pound shipment and that would cost more.

So right now in their current shipping everything they ship is subject to a parcel surcharge when they ship it as mixed parcels, so the parcel surcharge would have a much wider and heavier impact than just the number of parcel shaped pieces.

Q I am confused about what you just said, that what they ship now is subject to a parcel surcharge?

A No. It would be under the proposal. There is no parcel surcharge at the present time.

Q That's right. I think you meant to say "would be" or I didn't hear you.

A Yes, I'm sorry -- would be. Correct.

Q Would you look at your response to our Question Number 9, please.

In that response -- do you have that?

A Yes, I do.

Q You acknowledge that there would be a one time cost for a shipper to convert to an alternate type of packaging to avoid the surcharge, is that right?

A Correct.

Q You didn't seem sure though whether there would be a recurring cost for new packaging. Do you believe that there would be?

A Well, first of all, let me say that depending on the conditions of the shipper there may be additional cost to those that I have enumerated here on a one-time basis.

For example, I talked to one of my clients who -- I talked to him about this envelope possibility where they would have separated compartments and they would have to get a new sorting machine.

Their existing sorter could not handle that type of an envelope and -- now he did add that, the person I talked to said we have been wanting a new sorter anyhow and if the surcharge is applicable to every package, the sorter would pay for itself in about 10 months, so with that added proviso there could be additional one-time charges other than just the shifting over the way they insert and so forth.

Beyond that, the continuing charges, nonrecurring charges which you alluded to earlier, if the packaging materials had a higher cost -- for example, in a different interrogatory response I noted that the Photo Finishers, for example, use a simple plain gusseted envelope, which is fairly common and fairly economical to produce, and an envelope, large envelope, with interior compartments might cost more.

To the extent that it did cost more, that would be a continuing recurring expense greater than what they are paying right now.

Q So for the Photo Finishers at least it is likely that the packaging that they would have to use on a recurring basis, if they were to convert to flats, would be more expensive than the type of packaging they are using now. Is that what you found out?

A Could be, yes. I mean you don't know until you get into it, but there is always a possibility that it could be.

Q They seemed to indicate to you that it would be?

A They don't have any price estimates, firm price estimates yet.

Q Did they have any feeling about it?

A No. They are kind of waiting to see what happens but they are looking at their alternatives.

Q Alternatives to what?

A Alternative packaging that would qualify everything as a flat.

Q Presumably if that kind of packaging were cheaper than the kind they are using now they would already do that in an effort to reduce their overall costs, wouldn't they?

A It couldn't be much cheaper than a simple gusseted envelope and as I said there's some problems of switching over and when you have got something that is just a simple envelope probably costing a penny or so apiece, they look at other cost factors that loom larger in the total operation than something that is that cheap.

You know, cheaper might mean -- let's assume they are paying two pennies for their gusseted envelope. That is a high estimate considering the volumes they buy and the other envelope might cost them a penny and a half, a penny and three-quarters. Well, sometimes you don't spend every day chasing down those kinds of savings when you have all kinds of other expenses out there.

It would be the same ballpark probably.

Q I am confused. Are you saying that it is possible that the alternative packaging would be cheaper?

A It's possible it could be cheaper right now but so infinitesimally cheaper that they are not jumping all over it.

Q We'll come back to that, I think -- and I think you indicated before when you were talking about some of the transitional costs that your clients have looked at that as an investment that they might have to make that would be -- they would analyze as to how long the return was.

I think you indicated one of them told you 10 months.

A That is correct.

Q Now if they suspected that there would be a shorter amount of time for them to recoup that investment, that would certainly affect their decision to reconfigure their parcels, wouldn't it?

A That is correct. The shorter the payback period, the higher the implicit rate of return.

Q I brought some things I want to use to demonstrate here. I think it will make it easier to picture what we are saying -- the box of checks that I received in the mail.

I think this is fairly typical of the way checks are delivered. I think it came shrink-wrapped. It has a label on it, but other than that, it is pretty much unchanged.

Does that look like something you are familiar with?

A I have seen boxes similar to that.

Q Now if I have the right impression, and I am getting some of this from Mr. Olson's cross examination of Mr. Crum recently where he talked about what photo finishers might do, just using the rudimentary office supplies I had in my office I put something together which I am really only using to ask you if this is the type of thing that you think might possibly happen.

So presumably there would be some type of flat piece that would have pockets or some way that the checks could be arranged so they were flat -- is that your understanding of what they might do?

A They constitute what I have referred to in my testimony as "stackable items" -- yes, sir.

Q So you would end up with a piece, if I can get it in, something like that?

A You could, yes.

Q And that would qualify as a flat?

A My understanding is that would qualify as a flat.

Q Now in your response to our Question Number 11, in Part B, you said that you weren't aware of any added value of any particular shape of packaging that is valued to the ultimate consumer, is that right?

A Correct.

Q Now if I as a recipient get this piece and I open it up and find all my checks are here, I don't know exactly what I'd do with that. I probably would take them out of the little pockets and then be glad that I kept the box from the last bunch of checks that I had.

Does that seem reasonable?

A It seems a possibility.

Q All right.

A If you kept the box.

Q I might keep the box, I might not have, and I might be kind of upset if I had no place to put these --

isn't that possible also?

A Excuse me?

Q If I didn't keep my old box then I would just have a bunch of loose checks when I opened it up and discarded the flat packaging, wouldn't I?

A If you had the packaging that you created, that would be correct, yes.

Q Or some kind of flat packaging that the check printers would do, presumably a lot better than what I have here.

A They might come out with the box rather than slide them up one book apiece the way you have, but the box would be less than three-quarter inches thick.

Q So there would still be a box in addition to the rest of the packaging or something to keep them flat?

A There would be something to keep the contents from moving around, yes, sir.

Q So instead of just a box with some shrink wrap around it --

A Right.

Q -- there's going to have to be additional packaging?

A Correct.

Q And presumably that costs more -- if we are adding on to what we do now, then it's got to cost more. Wouldn't you agree with that?

A The checks I receive -- I get checks in the mail also.

There's two boxes. There is sort of an inner box and then an outer box made of just paperboard that is the mailing box, and then you throw away the outer box and you keep the inner box to keep your checks in.

I presume they might create the same thing but it would be higher -- capable of carrying a measure of checks but there are all kinds of alternatives. All they could do is make sure it's less than three-quarter inches thick when it is finished. Then it would be a flat.

Q From the consumer's viewpoint there are a lot more choices these days for ordering checks than there used to be. Are you aware of that?

A Yes, sir.

Q People used to just go to the bank to get them. Now I know I get inserts every week in the newspaper, sometimes even in the mail, from several companies that do check printing, is that right?

A That's correct.

Q Have you seen those?

A And it has gotten to be a very competitive business.

Q Yes. They offer all kinds of alternatives, different patterns, address labels that match, things like that, is that right?

A That's right.

Q And it would certainly be possible that a consumer might prefer checks that are sent in a box to ones in some kind of flat packaging?

A Might be.

Q And do you think the consumer would make that choice even if it cost ten cents more?

A Well, if you go out of your way to create a package that is -- makes it very difficult to store the checks, then the answer is yes, that's a possibility.

Q And I think you talked about the likelihood of that kind of thing. You called is mischief, the creation of perversely -- or perversely created cumbersome flats?

A That's right. And if you take the checks that you've got there, pocket-size checkbooks, I believe they're referred to typically, you might be able to create just two stacks in a box that would be twice the height of that box that you have there, or you might create three stacks. It'd be a box about three times the height. The height I guess is about -- from here I'd guess about three, three-and-a-half inches, so you could create different-shaped boxes depending on how many you want to stack in each box.

Q But the objective -- I'm sorry.

A The other comment I was going to make with respect to checks, which is a fairly major item through the mail, some banks these days are not returning checks the way they used to, so you don't need a box to store them in. They send you back a photo print of your checks, and they keep the checks, in which case you never have old checks to store, so the box becomes rather superfluous as a storage item.

Q In this case I'm storing my unused checks in the box.

A Well, you'll deal with a bank -- and banks have gone to that, by the way, as a way of cutting down their postage. I have a bank that does that, and they get -- I think they get about 10 or 12 checks photostated on one page, so that one page takes up less weight in the return envelope than those checks would be if they were all stacked in that envelope. So the incremental-ounce charge for First Class mail has fueled that change in technology with respect to returning checks.

Q Now a lot of checks don't happen to be, but I've gotten them before, have duplicates, carbonless duplicates. A consumer might want to keep the box for storing those, wouldn't --

A Might.

Q Now I want to go back to another comment you made about stacking the little checks I think you were talking about, maybe stacking these two or three high.

A Right.

Q I tried that in this piece and I thought I was getting dangerously close to three-quarter inches, which would make it not a flat. That would be a concern, wouldn't it?

A Oh, that would definitely be a concern. You want to --

Q So that might -- I'm sorry.

A Stay under three-quarter inches.

Q We skipped a step along the discussion before, which was I was assuming that a piece of this nature would fit into my mailbox, and I tried it this morning on my way out, at least in my mailbox it doesn't. We asked you about that in our Question No. 13, and I think you indicated that you didn't think that that would be a big issue for the consumer if they had to go to the post office to pick it up. If --

A Well, as I indicated, obviously a large, rigid box would not fit in the typical mailbox you see in the suburbs, oftentimes referred to as a rural mailbox. I haven't measured one lately, because I live in New York City, but -- you don't see many in New York City -- but I think they are about nine-and-a-half, maybe ten inches high at most, and if you had a rigid box whose dimensions exceeded that, they wouldn't fit inside the mailbox.

Q And if we focus for a minute on the photofinishing business, isn't one of the main advantages of photofinishing through the mail that the photos are delivered to the consumer's home?

A I don't know if -- it's -- I don't know if it's an advantage or not. It's the only way they have to deliver them.

Q Well, consumers have other choices. They can go to the supermarket, the drug store, the photo shop. But that requires travel on the consumer's part. Isn't that correct?

A For some consumers it might. Many consumers go right by a film processing place every day in their normal routine.

Q But they still have to leave home.

A Oh, yeah, they would have to leave --

Q Whereas if you do it through the mail, you presumably don't.

A Right.

Q Now if photo finishers reconfigure their pieces to be rigid flats that don't fit into the mailbox, then that advantage of that type of photo finishing would be lost or at least compromised, wouldn't it?

A Correct.

Q So the through-the-mail photo finishers by reconfiguring their pieces would lose one of the clear advantages they have over their competitors -- supermarkets, drug stores, photo shops?

A They would be more likely to go to a divided envelope, which would flip-flop around an axis, either vertical or horizontal axis. That would fold and fit very neatly into a mailbox. It might be difficult for the carrier to handle.

Q Was that -- I think Mr. Olson had a piece like that when he cross-examined Mr. Crum.

A Correct.

Q And it kind of flopped around in the middle like this.

A I'm familiar with it. I created it.

Q We'll come back to that.

CHAIRMAN GLEIMAN: Mr. Reiter, before you move on any further, are you going to put those checks into evidence here and leave them with us?

MR. REITER: No, I wasn't planning on it, Mr. Chairman.

CHAIRMAN GLEIMAN: Just wanted to try.

MR. REITER: Believe me, there's not enough behind them to make it worth --

BY MR. REITER:

Q Continuing actually with the photo finishing industry, we did a little research on that, too, and I have copies of this as well. This is an order form from Seattle Filmworks which I'll show you.

And if you look where it says prints up in the upper left-hand section, deluxe four-by-six, two sets, the price there is 16.25. Do you see that?

A Which set is this?

Q Up where it says prints, deluxe four-by-six. It's the fifth item listed there.

A Yes.

Q And for 36 exposures it says 16.25; is that right?

A Correct.

Q And then down in the lower right-hand corner if you request standard delivery you pay an additional dollar forty-five for that, for shipping.

A Right, I see that. Yes.

Q And the total would be 17.70 then.

A Right.

Q If you'll accept my math.

We also went to CVS to see the same price, and while I don't have a piece of paper from them, what they told me was a dollar -- I'm sorry, 11.99, and I guess you pay five-and-three-quarters percent D.C. tax there, and that comes to 12.68.

A Who's this?

Q This was at CVS.

A Oh, okay.

Q For the same type of 36-exposure, double four-by-six prints.

I conclude from that that that's a difference of five dollars and two cents. By the way, that's a 40-percent difference. Does this -- these kind of prices -- are you familiar at all with the prices that your clients charge or your competitors?

A I don't track their individual prices for their different -- all the different configurations. I would note that Seattle gives you the roll of film free. That's included. I don't think --

Q Actually --

A CVS gives you free film, do they?

Q This was for double prints or single prints and a roll of film, so I think they --

A At CVS?

Q Either one. Yes.

A Okay.

Q In any event, my point really is whether you're aware that price differentials of this nature are not unusual in the industry.

A I know that Seattle charges considerably more than District or Nashua.

Q So for someone to choose to use Seattle rather than go to CVS, there has to be something involved other than price, I would assume.

A There probably is; yes.

Q Do you know what that might be?

A Well, in the case of Seattle, they give you a special film, but there's very few people in this country can develop that film. It's a special type of film. I'm not sure what it is. And if you take a Seattle Filmworks roll of film into a CVS or something, they really can't do an adequate job of developing it and giving you prints back. So you become a quasi-captive of Seattle.

Q But either one of them can develop ordinary film; isn't that right?

A Seattle could. I don't think they get very much ordinary film. They get it mostly from people to whom they send their own film to.

Q But with the price differential in the range of five dollars, then presumably people using Seattle are doing it for reasons such as service, I think that's what you were talking about, convenience as well.

A Yes. I haven't talked as much to Seattle because they're on the west coast, as their name implies, but I do know that discussions with the other photo finishers who are here on the east coast whom I see more often, that a large part of their clientele is actually in rural areas, and in rural areas as opposed to urban areas, small towns, rural areas, it's not as convenient typically.

Those people don't go by a film processor every day in a shopping mall or something like that. If anything, they have to go into town to find a local drug store or someplace, and that drug store oftentimes has a pickup that's served by a more distant, bigger town, and it's at least overnight if not two days or three days, so the mail becomes somewhat more convenient for people in those geographic circumstances.

Q So given that if Seattle and the other companies needed to raise their prices by 10 cents or whatever they needed to recoup the surcharge, it probably wouldn't affect their business that much if the people who use them have many other considerations for using them, such as those you mentioned.

Wouldn't you agree with that?

A Seattle would be affected less, partly because they charge higher prices and a 10 cent increase in their price would be a lower percentage increase than it would be for District or Nashua.

I don't have with me any price charts like this for them but they are readily available. I don't know if you checked those or not.

Q Okay. Thank you. Coming back for a minute to this floppy type of piece that you mentioned before where the flat is essentially folded in the middle, I guess you're assuming that the Postal Service would measure it this way in determining that it is a flat, isn't that right?

A That's right.

Q What if the Postal Service measured it that way? It might end up not being a flat, isn't that right?

A If you folded it over, it might not be a flat. That's correct, but --

Q As I recall from the piece that Mr. Olson had when he cross examined Mr. Crum it seemed to me that that thing tended to flop over, isn't that right?

A Very much so.

Q And if the Postal Service were to -- let's back up.

If your clients reconfigured their pieces in that way, and the Postal Service decided, hey, these are flats -- I'm sorry -- hey, these are parcels, that would sort of negate the investment horizon that you were talking about earlier for conversion, wouldn't it?

MR. OLSON: Mr. Chairman, could I ask if the question presupposes a change in the DMM definition of a parcel and a flat?

CHAIRMAN GLEIMAN: In order that you understand the question that is being asked of your witness, I think that it's not unreasonable.

MR. REITER: Not at all, and we can assume it either way.

Let's assume that the Postal Service doesn't change it and measures the piece like this and says, hey, that's too thick or let's assume that we change it to make that clear that that is how we are measuring it.

We can assume either.

CHAIRMAN GLEIMAN: Let me ask a question along the same lines because I was a little confused too.

If you have one of those floppy envelopes, and the address label is fitted squarely in the middle of the front side of the envelope, why would the Postal Service fold it over to process it? Or would they just fold it over for purposes of charging more money?

MR. REITER: No, my assumption from the piece that Mr. Olson had was that the thing kind of folds itself and maybe we would tell them, hey, put the address label so that it can be read.

I am assuming that is what is going to happen to those pieces when they are processed. That's -- I don't want to argue about that. That is my assumption that I am asking Dr. Haldi to make.

CHAIRMAN GLEIMAN: Well, I am kind of curious and the DMM is relevant because there are requirements for flexibility and the like as well as thickness, so that certain types of envelopes can fit through sorting equipment os it becomes relevant but I am not here to cross examine you and you are not here to try and enlighten me.

MR. REITER: No, but I want to make the question clear and I think that is why you are asking. I appreciate that.

BY MR. REITER:

Q Let's just assume that the Postal Service through whatever means has defined this as a parcel. Whether -- I don't think it matters if the Postal Service can change the DMM, so let's assume that we do that in case there's any lack of clarity -- so I will come back to me question, Dr. Haldi.

Assuming a piece like that is considered a parcel through a DMM change and that would certainly extremely shorten the horizon that you were talking about, about an investment decision and reconfiguring to flat shape, wouldn't it?

A Well, you asked an interrogatory to that effect. I am just curious to know if you are referring to that interrogatory or if this is a different question?.

Q Which one are you looking at?

A I haven't found it yet.

Q Oh, well, I will try to find it also.

A I believe it's number 12, your Interrogatory Number 12.

Q All right. We will take a look at that.

Well, I think there you are discussing the possibility of a change and I guess my question now is asking you to assume that the change is made and get your opinion on how that would affect the decisions that we were talking about before in terms of reconfiguration.

A Well, if you make the change before they make any changes, so as to sort of shore up your recommendation to make sure they can't do something like that, then I don't suppose they would do it because there would be a cost with no reward at that point.

Q Let's -- that's fine. Let's say that given that a lot of this is in the realm of speculation, certainly in terms of exactly how these would be repackaged, as you indicated, what if the scenario was that your client started doing this kind of repackaging and the Postal Service maybe concluded there were some operational problems or whatever and then proceeded to make the change we talked about.

A I can't quite hear you. Would you speak into the mike?

Q I'm sorry. Let's assume that some of your clients made the kind of change we are talking about with the floppy piece and the Postal Service decided that it was having operational problems with that, and then proceeded to make the kind of DMM change we were talking about.

Under those circumstances, how would that affect your client's investment decision?

A Well, if they have already made the investment, they would have to look back and decide they'd been frustrated by the Postal Service again.

Q And if that was something that they saw ahead of time as a possibility, how do you think that would affect their decision either to make that investment or to reconfigure their pieces in that fashion?

A I'll stick by the answer I gave to Part B of your Interrogatory Number 12. I don't think that they would weigh that possibility very heavily.

Q So they would ignore that and just go ahead?

A Probably.

Q Would you look at your response to our Question 14, please, particularly Part B and particularly the first sentence on page 2 of your response there.

Are you saying that preparation requirements created an incentive for machinability?

A What do I say in my other responses?

You have the -- I guess I was thinking about the response to Number 22 where you distinguish between machineable and non-machineable. Those are flats.

With respect to parcels, I am trying to think how the preparation requirements do encourage machinability and I am hard-pressed to think of any just parcels as such how the preparation requirements encourage machinability per se.

Q Well, isn't it true that if a parcel is machineable, it can be prepared to a BMC and get the 3/5 digit rate?

A I guess that's what I was thinking of at the time I wrote this, yes.

Q Okay, whereas if it is not it has to be presorted to three digit --

A Right.

Q -- so there would be that incentive?

THE REPORTER: Is that a question?

THE WITNESS: Oh, is that a question?

BY MR. REITER:

Q Yes. Was that your conclusion?

A Yes.

Q Thank you. Would you look at your response to our Question 44, where you answered Parts (c), (d), and (e) together, the second page of that? It is actually page 3 of

3 of the whole response.

Actually I am looking at the sentence that starts at the very bottom of page 2 and continues on page 3: "Since most Standard A parcels are not sorted at BMCs" -- could you tell me the basis for your assumption there?

A My assumption about which?

Q That most Standard A parcels are not sorted to BMCs -- at BMCs, I'm sorry.

A Well, my understanding is that the BMCs prefer, if they are presorted to three digits, they prefer to kick them along to the P+DCs ~~PMDCs~~, and that they only take them inside to sort them if they can't move them along to the P+DCs ~~PMDCs~~.

Q I want to go back to your statement about what a staggering expense it would be for your clients, and your definition that I read earlier was that it wiped out a substantial portion of each firm's profit margin. Do you have a particular percentage of profit margin in mind?

A I would say something that affects ~~effects~~ profits by 10 to 20 percent would be fairly staggering. If they are not in a position -- particularly, when they are not in a position to pass it on.

If -- you know, if all photo finishers, for example, were through the mail, so that all photo finishers were going to be faced with the same price increase, then they would all be in the position of having to pass on the cost and it probably would not be nearly as influential as an expense, which is strictly limited to some, a group of firms that have only 6 percent of the total market, and where the 94 percent doesn't use the mail at all.

Q But as we discussed before, to the extent that the through-the-mail photo finishers are -- to the extent that their customers are deciding to use them for reasons other than price, then that becomes somewhat less of an issue, doesn't it?

A Oh, I am not pretending that the demand curve is perfectly elastic. I think you have a fairly elastic demand curve and, given the large number of customers, it almost fits the classic mode of what the economists call a continuous demand curve when they draw a demand curve on a blackboard or a chalkboard or something like that. And whenever you have sort of a continuous demand curve, and you move the price up a little bit, you lose some customers. You retain a large base, but you lose some, depending on the elasticity, the number that you lose.

But if you raise your price independent of 96 percent of -- 94 percent of your competitors, and that's what the demand curve really means, relative price, you expect to lose some customers. And you would not expect to lose them all either because it is not a perfect -- you are right, there are other factors and it is not a perfectly competitive situation.

MR. REITER: Thank you. That's all I have, Mr. Chairman.

CHAIRMAN GLEIMAN: Is there any follow-up? Questions from the bench?

[No response.]

CHAIRMAN GLEIMAN: Would you like some time with your witness for redirect?

MR. OLSON: Please, Mr. Chairman, just two minutes.

CHAIRMAN GLEIMAN: Okay. Thank you.

[Recess.]

CHAIRMAN GLEIMAN: Mr. Olson.

MR. OLSON: Mr. Chairman, we have no redirect.

CHAIRMAN GLEIMAN: If that is the case, I get to thank Dr. Haldi yet again for his appearance and his contributions to our record.

If there is nothing further, you are excused. And I guess we won't see you again until the last day of hearings?

THE WITNESS: Wrong, Mr. Chairman.

CHAIRMAN GLEIMAN: Oh, my goodness gracious.

THE WITNESS: Let's try Monday.

CHAIRMAN GLEIMAN: Well, --

THE WITNESS: Have a good weekend.

CHAIRMAN GLEIMAN: We look forward to seeing you on Monday, and you have good weekend, too.

COMMISSIONER LeBLANC: Have a nice trip home.

COMMISSIONER HALEY: Go back to New York City.

THE WITNESS: Right.

[Witness excused.]

CHAIRMAN GLEIMAN: We'll give everybody a moment to get settled at the counsels' and witness' tables and the like.

Ms. Dreifuss, are you ready to introduce your witness so that I can swear him in?

MS. DREIFUSS: Yes, Chairman Gleiman. OCA calls James Callow to the stand.

Whereupon,

JAMES F. CALLOW,

a witness, was called for examination by counsel for the Office of the Consumer Advocate and, having been first duly sworn, was examined and testified as follows:

CHAIRMAN GLEIMAN: Please be seated.

DIRECT EXAMINATION

BY MS. DREIFUSS:

Q Would you state your full name, please?

A James F. Callow.

Q Do you have before you two copies of a document marked OCA-T-500?

A Yes, I do.

Q Is that your testimony in this proceeding?

A Yes, it is. I have one change to make. On page 12 line 8, the word "cost" should be changed to "costs" and those are marked in the two copies I have here for the record.

Q All right. Were there any other changes to OCA-T-500 since the time it was initially filed on December 30th?

A Yes, I should mention that on page 60, which was revised on the 18th of February, line 15 originally said 43 percent, it should say 33 percent, and those changes are made in -- also made in the copies for the record.

MR. RUBIN: Could you repeat the first change you made?

THE WITNESS: Yes. In the testimony, on page 12, line 8, the word "cost" should be changed to "costs".

MR. RUBIN: Thank you.

BY MS. DREIFUSS:

Q If you were to testify orally, would this be your testimony?

A Yes.

MS. DREIFUSS: Mr. Chairman, I move that OCA-T-500 be admitted into evidence.

CHAIRMAN GLEIMAN: Are there any objections?

[No response.]

CHAIRMAN GLEIMAN: Hearing none, Mr. Callow's testimony and exhibits are received into evidence, and I direct that they be transcribed into the record at this point.

[Direct Testimony and Exhibits of James F. Callow, OCA-T-500, was received into evidence and transcribed into the record.]

OCA-T-500

Docket No. R97-1

DIRECT TESTIMONY

OF

JAMES F. CALLOW

ON BEHALF OF

THE OFFICE OF THE CONSUMER ADVOCATE

DECEMBER 30, 1997

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DIRECT TESTIMONY OF
JAMES F. CALLOW

STATEMENT OF QUALIFICATIONS

My name is James F. Callow. I am a Postal Rate and Classification Specialist. I have been employed by the Postal Rate Commission since June 1993, and since February 1995 in the Office of the Consumer Advocate (OCA).

I previously testified before this Commission in Docket Nos. MC96-3 and MC95-1. My testimony in Docket No. MC96-3 opposed the Postal Service's non-resident surcharge on post office boxholders, and proposed alternative box fees designed to equalize inter-group cost coverages and reduce the disparity in cost coverages by box size. In Docket No. MC95-1, my testimony summarized the comments of persons expressing views to the Commission and the Office of the Consumer Advocate on postal rates and services.

As Special Assistant to former Commissioner Quick, I participated in Docket Nos. MC93-1, MC93-2 and R94-1. In the latter docket, I was assigned responsibility for substantive subject areas considered by the Commission in its Opinion and Recommended Decision. Specifically, I analyzed quantitative testimony of the Postal Service with respect to the estimation of workers' compensation costs and evaluated rate design proposals of the Postal Service and other parties related to special postal services.

Prior to joining the Commission, I held positions on the legislative staff of a US Senator and a Member of Congress from Michigan, and served as an aide to the Governor of the State of Michigan in Washington.

I am an accountant by training. In 1985, I earned an MS degree in accounting from Georgetown University. My course work included cost accounting and auditing. In 1977, I obtained my BA degree from the University of Michigan-Dearborn with a double major in political science and history and a minor in economics.

I. PURPOSE AND SCOPE OF TESTIMONY

This testimony addresses the post office box fee proposals of the Postal Service.[1] I propose a classification change that would restructure current Fee Groups C and D into six new fee groups based upon the Cost Ascertainment Group (CAG) of post offices. Three new fee groups, C-I, C-II and C-III, would be formed from CAG A-D, E-G and H-L offices, respectively, in Fee Group C. Three new fee groups, D-I, D-II and D-III, would also be formed from the same CAG level offices in Fee Group D. The new fee groups and proposed fees represent a proposed transition to a further restructuring that would ultimately merge these parallel fee groups into three fee groups.

The fees I propose are based on a new cost allocation methodology. The Postal Service's current allocation methodology results in higher volume-variable unit box costs in smaller offices and lower unit costs in larger offices than if costs were allocated according to office location and size, as measured by CAG. Consequently, I propose a new cost allocation methodology that distributes a portion of volume-variable post office box costs by CAG. My proposed post office

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[1] My testimony consists of this document, OCA-T-500, and workpapers which contain spreadsheets showing the development of my post office box fee proposal, filed as library reference OCA-LR-10. In addition, I sponsor the library reference OCA-LR-2.

box fees are virtually the same as or lower than those proposed by the Postal Service in the new fee groups consisting of CAG E-G and H-L offices, where allocated costs are lower under the new methodology, while box fees are higher in fee groups consisting of CAG A-D offices, where allocated costs are higher.

II. CURRENT POST OFFICE BOX FEES AND FEE GROUPS DO NOT ADEQUATELY REFLECT THE HIGHER COSTS OF PROVIDING BOX SERVICE IN LARGER CAG POST OFFICES, NOR THE LOWER COSTS OF SERVICE IN SMALLER OFFICES

The Postal Service proposes to increase fees for all post office boxes in Fee Groups A-D.[2] The testimony of witness Needham (USPS-T-39) describes post office box service and presents justifications for the Postal Service's proposed fee increases.

The current post office box fee groups, designated A-E, were established in Docket No. MC96-3 at the behest of the Postal Service.[3] The testimony of witness Lion (USPS-T-24) describes the current fee groups and develops estimates of the number of boxes in use for each group. According to witness Lion, the five post office box fee groups "are now defined principally in terms of the fees paid." USPS-T-24 at 2. Fee groups generally "depend upon specified ZIP Codes, customer characteristics, and type of carrier delivery service." Tr. 3/1064 (OCA/USPS-T24-2).

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[2] USPS-T-39, Table 11, at 59. Fee Group E boxholders, those ineligible for any type of carrier delivery service, "pay" a fee of $0, and no fee increase is proposed by the Postal Service for these boxholders.

[3] *See* PRC Op. MC96-3 at 47-48.

The testimony of witness Lion also presents the Postal Service's methodology for allocating volume-variable post office box costs to develop test year before rates (TYBR) unit box costs. Witness Lion describes the allocation methodology generally: "Volume-variable costs are allocated to post office boxes in three categories: space provision, space support, and all other using the same methodology as in Docket No. MC96-3." USPS-T-24 at 3.

The current post office box fee groups, and the Postal Service's allocation methodology, result in higher volume-variable unit costs for boxes in smaller post offices, and lower unit box costs in larger offices, than if costs were allocated to boxes with greater consideration to office location and size. Consequently, fees based upon the Postal Service's unit box costs are higher for boxholders in smaller post offices than would otherwise be necessary if current fee groups were restructured and volume-variable costs were de-averaged based upon CAG.

A. Postal Service Costs Are Higher In Larger CAG Post Offices Than In Smaller Offices

The Postal Service classifies post offices by Cost Ascertainment Group (CAG).[4] Post offices are classified from A-L (excluding the letter "I") based upon the

[4] Glossary of Postal Terms, Publication 32, April 1988, at 16.

amount of revenue generated, as measured by "revenue units."[5] CAG A post offices, defined as offices with 356,250 or more revenue units, generate the greatest revenues, while CAG L offices, with 35 or fewer revenue units, generate the least.[6]

For Fiscal Year 1996, the most recent year available, a revenue unit equals $306.65.[7] Consequently, a CAG A post office would generate revenues of at least $109,244,063 ($306.65*356,250 revenue units), and a CAG L office would generate revenues less than or equal to $10,733 ($306.65*35 revenue units).

1. Average postal rental costs are higher in larger post offices, as measured by CAG

Witness Lion acknowledges that average postal rental costs are higher in CAG A, B and C post offices than average postal rental costs in CAG K and L post offices. Tr. 3/1173 (OCA/USPS-T24-85). Postal Service data support this conclusion. In Docket No. R90-1, Postal Service data revealed:[8]

> there is a *significant relationship* between the CAG designation of a facility and its associated square-foot rent (e.g. CAG A offices have higher rents than CAG L offices). [emphasis added]

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[5] A revenue unit is "[T]he average amount of revenue per fiscal year from postal rates and fees for 1,000 pieces of originating mail and special service transactions." Id. at 54.

[6] *See* U.S. Postal Service Handbook F-4, June 1992, at 22, for the range of revenue units defining each CAG.

[7] Postal Bulletin 21940, February 27, 1997, at 51.

[8] Docket No. R90-1, USPS Library Reference F-183, at 2, n. 2.

The Postal Service's Library Reference F-183, from that same docket, further concluded that "CAG A and B offices tend to be located in higher-rent urban areas, while CAG K and L offices tend to be located in lower-rent rural areas." Id. at 15. More recently, in Docket No. MC96-3, when average rental costs were again examined for post offices classified by CAG, the data revealed an almost uniform decline in the average rental cost as the size of post office declines.[9]

2. Other postal costs are higher in larger CAG post offices

Aside from average postal rental costs, other costs vary by CAG, and are higher in larger CAG offices. Two conditions produce this result. First, certain labor costs are not incurred in smaller post offices. While the salaries and benefits of mailhandlers are uniform nationwide, there are more mailhandlers in higher CAG offices, and proportionately more costs, than in lower offices.[10] In fact, there are virtually no mailhandlers, and consequently almost no mailhandler costs, to be found in CAG F-L offices. Ibid. Similarly, there are virtually no supervisors in offices CAG H or below. Ibid. Hence, virtually no supervisor costs are incurred in such offices.

[9] Docket No. MC96-3, Tr. 8/2916. Response of United States Postal Service to Interrogatory of the Office of the Consumer Advocate, OCA/USPS-88.

[10] Tr. 13/7040-46. OCA/USPS-T5-11-13, Attachment 1, at 1, revised September 25, 1997. The cited material isn't limited to information on mailhandlers, but includes information on postmasters and supervisors, too.

Second, certain other costs, while present in all post offices, are incurred in proportionally greater amounts in higher versus lower CAG offices. For example, postmaster salaries and benefits are dependent, in part, on CAG and therefore vary by CAG. Tr. 13/7069 (OCA/USPS-T24-66b). In Fiscal Year 1996, the average salary for postmasters in CAGs K-L was $39,309, while the average salary for CAG A-G postmasters was $55,220 -- 40 percent greater than the average salary of CAG K-L postmasters. Tr. 13/7061 (OCA/USPS-T5-37).

B. The Postal Service's Methodology For Allocating Certain Post Office Box Volume-Variable Costs Does Not Recognize Higher Costs In Larger Post Offices And Lower Costs In Smaller Offices

In developing unit box costs, the Postal Service allocates volume-variable Space Provision costs to post office boxes utilizing an average postal rental cost for fee groups, and assigns an average of All Other costs to all boxes. In the case of Space Provision costs, the use of an average rental cost to distribute such costs does not recognize the wide variation in rental cost by CAG within Fee Groups C and D. In the case of All Other costs, assigning an average cost to all boxes does not recognize the fact that some costs are proportionately greater in larger CAG post offices, or not incurred at all in smaller CAG offices.

1. Allocating volume-variable Space Provision costs to post office boxes using average postal rental costs for fee groups masks widely different rental costs by CAG in Fee Groups C and D

Volume-variable Space Provision costs are allocated to boxes, in part, upon the average postal rental cost for each fee group. First, the average rental cost for each delivery group is computed as an average of the rental cost per square foot for each facility in each delivery group. Tr. 3/1067 (OCA/USPS-T24-5). Second, the average rent for each fee group is calculated as the weighted average of boxes installed by delivery group, using the percentages in Table 5 of USPS-T-24.[11] Space Provision costs are then allocated in direct proportion to a measure of box capacity and rental cost per square foot for each fee group. USPS-T-24 at 20.

In the case of Fee Groups A and B, rental costs are computed from the average of facilities' rental costs per square foot in designated high-cost ZIP Codes. Fee Group A consists of ZIP Codes in Manhattan, New York, and Fee Group B consists of ZIP Codes in eight large cities and some surrounding suburbs.[12] By contrast, the city-other and non-city delivery groups, which form the basis of Fee Groups C and D, respectively, do not represent rent-homogeneous groupings.

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[11] *See* USPS LR-188, at 15, 15A and 15B, revised August 11, 1997.

[12] *See* Section D910.5.3., DMM 52, July 1, 1997.

Table 1 shows the average postal rental cost by CAG for city-other and non-city delivery offices. For both delivery groups, there is a wide disparity in average rental costs by CAG. In the city-other delivery group, the average rental cost for CAG A offices ($8.98) is more than double that of CAG L offices ($4.37). In the non-city group, the average rental cost for CAG C offices is 32 percent ($7.46/$5.65-1) greater than for CAG L offices, while the average for CAG E offices is more than 49 percent ($8.43/$5.65-1) greater when compared to CAG L offices.

Table 1. Average Rental Cost by CAG for City-Other and Non-City Delivery Offices

CAG	City-Other Offices	Average Rental Cost ($/sq.ft.)	Non-City Offices	Average Rental Cost ($/sq.ft.)
A	1,005	$8.98	0	NA
B	576	$9.02	3	$5.93
C	988	$9.41	12	$7.46
D	448	$8.57	16	$7.31
E	691	$7.80	87	$8.43
F	659	$7.11	268	$7.90
G	911	$6.01	1,166	$7.07
H	470	$5.21	2,431	$6.26
J	142	$4.77	3,517	$5.82
K	144	$4.44	5,971	$5.70
L	16	$4.37	699	$5.65
TOTAL	6,050	$7.73	14,170	$6.00

By contrast, average rental costs by CAG show greater similarity across delivery groups. Average rental costs vary in a range from 8 percent ($8.43/$7.80-1) for CAG E offices to 29 percent ($5.65/$4.37-1) for CAG L offices. The percentage difference in average rental cost for each delivery group is also 29 percent ($7.73/$6.00-1).

2. Allocating an average of All Other volume-variable costs to post office boxes generates unit box costs that are too low for larger post offices and too high for smaller offices in all fee groups

All Other volume-variable costs consist primarily of labor costs. USPS-T-24 at 19. Under the Postal Service's methodology, these costs are allocated proportionately to the number of boxes since, it is reasoned, "labor costs do not depend upon box size or location." Id. at 20. This proportional allocation, without regard to office location or size, results in $6.69 ($104,580,000/15,620,769 boxes) being distributed by the Postal Service to all boxes in the TYBR. Id. at 24.

The Postal Service's proportional allocation of All Other costs to boxes ignores the fact that certain costs *do* vary by CAG. As discussed previously, postmasters costs vary by CAG, and it is not reasonable to expect mailhandler and supervisor costs in offices in which they are not located. *See supra*, II. A. 2. Nevertheless, the Postal Service's approach allocates mailhandler and supervisors costs even to those offices that have no mailhandlers or supervisors working in them. The effect of allocating an average cost to all post office boxes unfairly increases unit box costs in smaller CAG offices and reduces such costs relative to larger CAG offices.

C. Post Office Box Fees Based Upon Current Fee Groups And The Postal Service's Cost Allocation Methodology Results In Unjustifiably Higher Fees In Smaller Post Offices And Fees That Are Too Low In Larger Offices

The Postal Service's methodology of averaging higher cost, high CAG post offices with lower cost, low CAG offices has the effect of inappropriately raising volume-variable unit box costs in smaller offices and concomitantly lowering volume-variable unit box costs for larger offices. For Fee Groups C and D, the use of average postal rental costs for allocating Space Provision costs to boxes masks differences in average rental costs by CAG. That is, higher CAG offices have higher average rental costs than lower CAG offices. Similarly, the Postal Service's methodology of allocating an average of All Other costs to all post office boxes unjustly increases unit box costs in smaller CAG offices and reduces such costs for larger CAG offices.

Post office box fees based on these average costs would necessarily mean that box fees are too high in smaller CAG post offices, while box fees are too low in larger CAG offices.

III. CURRENT POST OFFICE BOX FEE GROUPS SHOULD BE RESTRUCTURED TO BETTER REFLECT DIFFERING COSTS OF LARGER AND SMALLER POST OFFICES

A. Fee Groups C And D Should Be Restructured Based Upon The CAG Of The Post Offices

I propose to restructure post office box fee groups by creating six new fee groups. Three new fee groups would be formed from the current Fee Group C and three from current Fee Group D, based upon CAG. CAG A-D post offices in Fee Groups C and D would become new Fee Groups C-I and D-I, respectively. CAG E-G post offices in each fee group would become new Fee Groups C-II and D-II, respectively. The remaining CAG H-L post offices in each fee group would become new Fee Groups C-III and D-III, respectively. This parallel grouping of CAGs from the current fee groups would serve as a prerequisite to merging the six new fee groups, and thereby eliminating a separate fee structure for Fee Groups C and D, in a future proceeding.

1. Fee Groups C and D are similar in fundamental ways

There is a general recognition that Fee Groups C and D are fundamentally similar. In Docket No. MC96-3, the difficulty of pricing post office boxes with a single rate structure where costs are essentially the same was stated succinctly:

> When areas are categorized and prices are set to reflect average cost differences some of the resulting prices may seem irrational, as when a suburban area and a rural area are in close proximity and have essentially the same costs, but have different rates.[13]

In this docket, the Postal Service's fee proposal for Fee Groups C and D is premised, in part, on a recognition that there are "similarities in Groups C and D with respect to costs and service . . . ." USPS-T-39 at 65. According to witness Needham, Fee Groups C and D are similar in that both consist of offices providing carrier delivery service, either city or rural. Tr. 3/688-89. Moreover, "there really is no difference in the type of box service and very minimal differences in the type of costs for these . . . two fee groups." Tr. 3/691. These "minimal differences" in costs are evident in the testimony of witness Lion, which shows that Postal Service unit costs for providing box service in Fee Group D are approximately 10 percent less than in Fee Group C.[14] Table 1 shows similarities in cost from another perspective. Average rental costs by CAG show greater similarity between the city-other and non-city delivery groups, which form the basis of Fee Groups C and D, than within these delivery groups. *See supra*, II. B. 1.

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[13] Docket No. MC96-3, Tr. 7/2296-97, Direct Testimony of OCA Witness Roger Sherman, OCA-T-100.

[14] USPS-T-24, Table 13, at 27, revised October 1, 1997.

These similarities in cost suggest that merging Fee Groups C and D, and establishing three fee groups based upon CAGs A-D, E-G and H-L, would produce more rent-homogeneous fee groups than the current fee groups.[15] However, I did not take this step at this time because of my concern about substantial fee increases for affected boxholders. *See infra*, V. A.

2. Restructuring Fee Groups C and D based upon CAGs A-D, E-G and H-L produces more rent-homogeneous fee groups

In the alternative, Fee Groups C and D were separately restructured by CAG, creating more rent-homogeneous fee groups. Table 2 shows the average rental cost for offices in the city-other and non-city delivery groups displayed by CAGs A-D, E-G and H-L. The first two columns under the headings "City-Other" and "Non-City" offices replicate the same office and average rental cost data by CAG from Table 1. The last column under each heading shows the "Weighted Average Rental Cost ($/Sq.Ft.)" when offices are grouped by CAGs A-D, E-G and H-L.

Average rental costs for each grouping by CAG are more rent-homogeneous than the average for the delivery group as a whole. For city-other offices, the

[15] *See* OCA-LR-2 at 15, which shows the average rental costs when the city-other and non-city delivery offices are combined by CAG.

Table 2. Weighted Average Rental Cost for City-Other and Non-City Delivery Offices by CAG						
	City-Other Offices			Non-City Offices		
CAG	Offices	Average Rental Cost ($/Sq.Ft.)	Weighted Average Rental Cost ($/Sq.Ft.)	Offices	Average Rental Cost ($/Sq.Ft.)	Weighted Average Rental Cost ($/Sq.Ft.)
A	1,005	$8.98	$2.99	0	NA	NA
B	576	$9.02	$1.72	3	$5.93	$0.57
C	988	$9.41	$3.08	12	$7.46	$2.89
D	448	$8.57	$1.27	16	$7.31	$3.77
	3,017		$9.07	31		$7.24
E	691	$7.80	$2.39	87	$8.43	$0.48
F	659	$7.11	$2.07	268	$7.90	$1.39
G	911	$6.01	$2.42	1,166	$7.07	$5.42
	2,261		$6.88	1,521		$7.30
H	470	$5.21	$3.17	2,431	$6.26	$1.21
J	142	$4.77	$0.88	3,517	$5.82	$1.62
K	144	$4.44	$0.83	5,971	$5.70	$2.70
L	16	$4.37	$0.09	699	$5.65	$0.31
	772		$4.96	12,618		$5.84

weighted average rental cost for the largest offices, CAGs A-D, is $9.07, and $4.96 for the smallest offices, CAGs H-L. This compares to an average rental cost for all city-other offices of $7.73. *See* Table 1.

In restructuring Fee Groups C and D, the grouping of offices according to CAG A-D to form new Fee Groups C-I and D-I was suggested to me by the same grouping of CAG offices in the "City-B" delivery group. *See* OCA-LR-2 at 11. I determined the other two groupings of offices by CAG, which form new Fee Groups

C-II and D-II, and C-III and D-III, by dividing the remaining "Average Rental Costs ($/Sq.Ft.)" by two dollar increments.

B. The Development Of Base Year And Post-MC96-3 Estimates Of The Number Of Boxes In Use Is Similar To The Approach Followed By The Postal Service

1. Development of the Base Year estimates of the number of boxes in use involves introduction of CAG groupings

Table 3 shows the estimated number of boxes installed by the type of carrier delivery service offered. Table 3 is analogous to, and uses the same definition of carrier delivery group as, Table 1 of USPS-T-24.[16]

Table 3. Estimated Number of Boxes Installed						
	Carrier Delivery Group					
Box Size	City-A	City-B	City-Other	Non-city	Non-Delivery	Total
1	35,535	58,079	4,201,907	3,577,136	918,567	8,791,224
2	1,987	16,525	2,028,034	1,548,797	323,245	3,918,588
3	1,162	5,899	718,205	411,307	80,017	1,216,590
4	118	1,154	170,547	35,300	5,590	212,709
5	51	747	40,696	6,680	3,680	51,854
TOTAL	38,853	82,404	7,159,389	5,579,220	1,331,099	14,190,965

[16] The totals by box size and for each carrier delivery group are similar to the figures in Table 1 of witness Lion's testimony. I used data contained in Postal Service Library Reference H-278, which was provided in response to OCA/USPS-T24-86, Tr. 3/1174. The data in LR-H-278 reflects the September 1997 Delivery Statistics File (DSF), the most recent data available. Consequently, the data by box size and delivery group are different from those contained in the testimony of witness Lion, who utilized the June 1997 DSF. *See* USPS LR-H-278 at 2.

Table 4 shows the estimated number of boxes in use by carrier delivery group, and is analogous to witness Lion's Table 2.

Table 4. Estimated Number of Boxes in Use						
Carrier Delivery Group						
Box Size	City-A	City-B	City-other	Non-city	Non-Delivery	Total
1	26,350	49,829	3,498,063	2,928,396	742,423	7,245,061
2	1,644	11,966	1,483,084	1,217,569	244,690	2,958,953
3	922	4,309	491,133	318,872	58,774	874,010
4	96	674	104,946	25,503	3,907	135,126
5	28	678	21,979	2,829	414	25,928
TOTAL	29,040	67,456	5,599,205	4,493,169	1,050,208	11,239,078

Table 5 presents the "expansion factors" by carrier delivery group that are used to estimate the number of boxes in use, pre-MC96-3. Unlike Table 3 in witness Lion's testimony, however, Table 5 also shows the expansion factors for each grouping by CAG in the city-other, non-city and nondelivery carrier delivery groups.

The expansion factors, based on the number of boxes installed from two data sources, the Delivery Statistics File (DSF) and the Post Office Box Survey (POB Survey), are calculated as the ratio of column [a] to column [b].[17] These factors are then used to "expand" the number of boxes in use obtained from the POB Survey in Table 4 to estimate the number of boxes in use prior to Docket No. MC96-3.

[17] *See* USPS-T-24 at 6-7.

Table 5. Expansion Factors by CAG by Delivery Group				
Carrier Delivery Group	CAG	Boxes Installed (Sept 97 DSF)	Boxes Installed (POB Survey)	Expansion Factor
		[a]	[b]	[c]
City-A	A	104,384	38,853	2.68664
City-B	A-D	202,719	82,404	2.46006
City-other	A-D	6,608,169	3,989,487	1.65640
	E-G	3,828,343	2,890,257	1.32457
	H-L	333,537	279,645	1.19272
	Total	10,770,049	7,159,389	1.50433
Non-city	A-D	70,428	44,937	1.56726
	E-G	2,202,548	1,544,979	1.42562
	H-L	4,797,066	3,989,304	1.20248
	Total	7,070,042	5,579,220	1.26721
Nondelivery	A-D	15,983	6,633	2.40962
	E-G	336,871	231,101	1.45768
	H-L	1,357,016	1,093,365	1.24114
	Total	1,709,870	1,331,099	1.28456
GRAND TOTAL		19,857,064	14,190,965	1.39928

Table 6 displays the results of applying the expansion factors to the estimated number of boxes in use from Table 4. Totals are presented for each CAG grouping within the city-other, non-city and non-delivery carrier delivery groups, and the total for each carrier delivery group. This table is analogous to Table 4 in USPS-T-24, with the addition of CAG groups.

Table 6. Estimated Boxes in Use by CAG by Delivery Group, Pre MC96-3				
	City-A	City-B		
Box Size	CAG A-D	CAG A-D		
1	70,793	122,582		
2	4,417	29,437		
3	2,477	10,600		
4	258	1,658		
5	75	1,668		
Total	78,020	165,946		
City-other				
Box Size	CAG A-D	CAG E-G	CAG H-L	Total
1	3,174,930	1,927,797	150,137	5,252,863
2	1,450,575	752,140	47,117	2,249,833
3	491,012	240,967	15,241	747,219
4	115,388	44,961	1,598	161,947
5	27,912	6,207	527	34,646
Total	5,259,817	2,972,072	214,620	8,446,508
Non-city				
Box Size	CAG A-D	CAG E-G	CAG H-L	Total
1	33,345	1,166,835	2,511,555	3,711,735
2	20,434	550,702	983,920	1,555,055
3	7,029	147,968	253,237	408,233
4	1,066	16,674	15,785	33,525
5	155	1,860	1,714	3,729
Total	62,029	1,884,038	3,766,211	5,712,278
Nondelivery				
Box Size	CAG A-D	CAG E-G	CAG H-L	Total
1	6,361	200,871	747,141	954,373
2	4,595	62,785	247,869	315,249
3	1,523	16,268	58,311	76,102
4	164	2,294	2,811	5,269
5	53	197	319	569
Total	12,696	282,415	1,056,451	1,351,562
GRAND TOTAL				15,754,314

Table 7 presents the assumptions for allocating post office boxes to fee groups resulting from Docket No. MC96-3. As in Table 5 of witness Lion's testimony, these assumptions are used to estimate the number of customers in classified post offices and contract stations who are ineligible for carrier delivery service, and thus entitled to a post office box at no fee. Table 7 also extends the subgroup naming convention (e.g., "C" and "E-0;" "D-1" and "E-1;" "D-2" and "E-2;" etc.) used by witness Lion to indicate eligible and ineligible customers.

In the non-city delivery group, Table 7 shows the percent of eligible and ineligible customers in classified offices and contract stations by CAG groupings. For example, "D-1" represents the subgroup of customers eligible for delivery from CAG A-D classified offices in the non-city delivery group, while "D-2" represents the subgroup of eligible customers from CAG A-D contract stations.

Table 7. Assumptions for Allocation to Fee Groups

Delivery Group	CAG	Percent Classified/ Contract	Eligible Customers		Ineligible Customers	
			Subgroup	Pct.	Subgroup	Pct.
		[a]		[b]		[c]
City-other Offices			C	99%	E-0	1%
Non-city Offices						
Classified	CAG A-D	100.00%	D-1	98.00%	E-1	2.00%
Contract	CAG A-D	0.00%	D-2	0.00%	E-2	0.00%
Classified	CAG E-G	87.94%	D-3	86.18%	E-3	1.76%
Contract	CAG E-G	12.06%	D-4	1.21%	E-4	10.85%
Classified	CAG H-L	97.66%	D-5	95.71%	E-5	1.95%
Contract	CAG H-L	2.34%	D-6	0.23%	E-6	2.10%
Nondelivery Offices			D-7	70%	E-7	30%

Because offices are grouped by CAG, separate estimates of the percentage of eligible and ineligible customers from classified offices and contract stations are necessary. These percentages, shown in column [a] of Table 7, are developed in Table 7A.

Table 7A. Development of Assumptions on Percent of Boxes at Classified Offices and Contract Stations by CAG

CAG	Number of Boxes In Use at Non-city Delivery Offices	Boxes in Contract Stations by CAG	Adjustment to Number of Boxes at Contract Stations	Percent of Boxes at Classified Offices	Percent of Boxes at Contract Stations
	[a]	[b]	[c]	[d]	[e]
A	0	0	0		
B	8,098	0	0		
C	24,821	0	0		
D	29,110	0	0		
Total	62,029	0	0	100.00%	0.00%
E	204,416	5,078	109,733		
F	468,080	1,305	28,200		
G	1,211,542	4,130	89,247		
Total	1,884,038	10,513	227,180	87.94%	12.06%
H	1,483,834	1,469	31,744		
J	1,287,203	1,393	30,102		
K	963,414	1,148	24,808		
L	31,760	60	1,297		
Total	3,766,211	4,070	87,950	97.66%	2.34%
GRAND TOTAL	5,712,278	14,583	315,131	94.48%	5.52%

Tables 8A-C show the estimated number of boxes in use, pre-MC96-3. The tables result from applying the percentages for eligible and ineligible delivery service boxholders to the estimated boxes in use found in Table 6. Table 8A summarizes the number of boxes in use for Fee Groups A, B and C. Fee Group C is the sum of three subgroups by CAG. Table 8B provides the same information for Fee Group D, which is the sum of nine subgroups. Table 8C shows the same information for Fee Group E.

Table 8A. Estimated Boxes in Use, Pre-MC96-3						
	Fee Groups					
Box Size	A	B	C [A-D]	C[E-G]	C[H-L]	Total C
1	70,793	122,582	3,143,180	1,908,519	148,635	5,200,334
2	4,417	29,437	1,436,070	744,619	46,646	2,227,334
3	2,477	10,600	486,102	238,557	15,088	739,747
4	258	1,658	114,234	44,512	1,582	160,328
5	75	1,668	27,633	6,145	522	34,300
Total	78,020	165,946	5,207,218	2,942,351	212,473	8,362,043

Table 8B. Estimated Boxes in Use, Pre-MC96-3										
	Fee Groups									
Box Size	D-1	D-2	D-3	D-4	D-5	D-6	D-7[A-D]	D-7[E-G]	D-7[H-L]	Total D
1	32,678	0	1,005,613	14,070	2,403,846	5,865	4,453	140,610	522,999	4,130,134
2	20,025	0	474,611	6,640	941,724	2,298	3,217	43,950	173,508	1,665,973
3	6,889	0	127,523	1,784	242,377	591	1,066	11,387	40,818	432,435
4	1,044	0	14,370	201	15,108	37	115	1,606	1,968	34,449
5	152	0	1,603	22	1,640	4	37	138	223	3,820
Total	60,788	0	1,623,721	22,718	3,604,695	8,795	8,887	197,691	739,516	6,266,811

Table 8C. Estimated Boxes in Use, Pre-MC96-3									
	Fee Groups								
Box Size	E-0	E-1	E-2	E-3	E-4	E-5	E-6	E-7	Total E
1	52,529	667	0	20,523	126,629	49,058	52,786	286,312	588,503
2	22,498	409	0	9,686	59,764	19,219	20,679	94,575	226,830
3	7,472	141	0	2,603	16,058	4,946	5,322	22,831	59,373
4	1,619	21	0	293	1,810	308	332	1,581	5,964
5	346	3	0	33	202	33	36	171	824
Total	84,465	1,241	0	33,137	204,462	73,565	79,155	405,469	881,494

2. The post-MC96-3 estimated number of boxes in use shows CAG groupings

Tables 9A-E show the estimated number of boxes in use resulting from fee changes in Docket No. MC96-3. The post-MC96-3 estimate is derived by applying the Commission's elasticities for each box size in each fee group.[18] Table 9A shows the results for Fee Groups A and B. Table 9B presents the estimate for Fee Group C, with the results displayed separately for each grouping by CAG. Table 9C shows the estimates for Fee Group D, maintaining separate estimates for the effects of price increases for each grouping by CAG. Table 9D presents the results for Fee Group E. Table 9E summarizes the estimates by fee group in terms of paid and free boxes, and for caller service and reserve call numbers.

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[18] *See* PRC Op. MC96-3, Appendix D, Schedule 3, at 17. *See also* Docket No. R97-1, USPS-T-24, Tables 7A-D, at 12-15.

Table 9A. Estimated Boxes in Use by Fee Group, Post-MC96-3							
Fee Groups A & B							
Fee Group	Box Size	Pre 96-3 Fees	Post 96-3 Fees	Pct. Change	Pre 96-3 Boxes	Elasti-city	Post 96-3 Boxes
A	1	$48	$48	0%	70,793	-0.522	70,793
	2	$74	$74	0%	4,417	-0.601	4,417
	3	$128	$128	0%	2,477	-0.517	2,477
	4	$210	$242	15%	258	-0.517	238
	5	$348	$418	20%	75	-0.517	67
Total A					78,020		77,992
B	1	$44	$44	0%	122,582	-0.478	122,582
	2	$66	$66	0%	29,437	-0.603	29,437
	3	$112	$112	0%	10,600	-0.517	10,600
	4	$190	$218	15%	1,658	-0.517	1,532
	5	$310	$372	20%	1,668	-0.517	1,496
Total B					165,946		165,647

Table 9B. Estimated Boxes in Use by Fee Group, Post-MC96-3								
Fee Group C								
Fee Group	CAG	Box Size	Pre 96-3 Fees	Post 96-3 Fees	Pct. Change	Pre 96-3 Boxes	Elasti-city	Post 96-3 Boxes
C	A-D	1	$40	$40	0%	3,143,180	-0.522	3,143,180
		2	$58	$58	0%	1,436,070	-0.605	1,436,070
		3	$104	$104	0%	486,102	-0.517	486,102
		4	$172	$172	0%	114,234	-0.517	114,234
		5	$288	$288	0%	27,633	-0.517	27,633
Subtotal C[A-D]						5,207,218		5,207,218
C	E-G	1	$40	$40	0%	1,908,519	-0.522	1,908,519
		2	$58	$58	0%	744,619	-0.605	744,619
		3	$104	$104	0%	238,557	-0.517	238,557
		4	$172	$172	0%	44,512	-0.517	44,512
		5	$288	$288	0%	6,145	-0.517	6,145
Subtotal C[E-G]						2,942,351		2,942,351
C	H-L	1	$40	$40	0%	148,635	-0.522	148,635
		2	$58	$58	0%	46,646	-0.605	46,646
		3	$104	$104	0%	15,088	-0.517	15,088
		4	$172	$172	0%	1,582	-0.517	1,582
		5	$288	$288	0%	522	-0.517	522
Subtotal C[H-L]						212,473		212,473
Total C						8,362,043		8,362,043

Table 9C. Estimated Boxes in Use by Fee Group, Post-MC96-3								
Fee Group D								
Fee Group	CAG	Box Size	Pre 96-3 Fees	Post 96-3 Fees	Pct. Change	Pre 96-3 Boxes	Elasti-city	Post 96-3 Boxes
D-1 Classified eligible	A-D	1	$8	$12	50%	32,678	-0.085	31,290
		2	$13	$20	54%	20,025	-0.136	18,561
		3	$24	$36	50%	6,889	-0.152	6,364
		4	$35	$53	51%	1,044	-0.152	963
		5	$55	$83	51%	152	-0.152	140
Subtotal						60,788		57,318
D-2 Contract eligible	A-D	1	$2	$12	500%	0	-0.054	0
		2	$2	$20	900%	0	-0.069	0
		3	$2	$36	1700%	0	-0.036	0
		4	$2	$53	2550%	0	-0.024	0
		5	$2	$83	4050%	0	-0.015	0
Subtotal						0		0
D-3 Classified eligible	E-G	1	$8	$12	50%	1,005,613	-0.085	962,900
		2	$13	$20	54%	474,611	-0.136	439,897
		3	$24	$36	50%	127,523	-0.152	117,818
		4	$35	$53	51%	14,370	-0.152	13,245
		5	$55	$83	51%	1,603	-0.152	1,479
Subtotal						1,623,721		1,535,340
D-4 Contract eligible	E-G	1	$2	$12	500%	14,070	-0.054	10,301
		2	$2	$20	900%	6,640	-0.069	2,507
		3	$2	$36	1700%	1,784	-0.036	690
		4	$2	$53	2550%	201	-0.024	76
		5	$2	$83	4050%	22	-0.015	8
Subtotal						22,718		13,582
D-5 Classified eligible	H-L	1	$8	$12	50%	2,403,846	-0.085	2,301,744
		2	$13	$20	54%	941,724	-0.136	872,844
		3	$24	$36	50%	242,377	-0.152	223,931
		4	$35	$53	51%	15,108	-0.152	13,925
		5	$55	$83	51%	1,640	-0.152	1,513
Subtotal						3,604,695		3,413,957
D-6 Contract eligible	H-L	1	$2	$12	500%	5,865	-0.054	4,294
		2	$2	$20	900%	2,298	-0.069	867
		3	$2	$36	1700%	591	-0.036	229
		4	$2	$53	2550%	37	-0.024	14
		5	$2	$83	4050%	4	-0.015	2
Subtotal						8,795		5,405

Table 9C. Estimated Boxes in Use by Fee Group, Post MC96-3 (continued)								
Fee Group D								
D-7 Nondelivery eligible	A-D	1	$8	$12	50%	4,453	-0.054	4,334
		2	$13	$20	54%	3,217	-0.069	3,097
		3	$24	$36	50%	1,066	-0.036	1,047
		4	$35	$53	51%	115	-0.024	113
		5	$55	$83	51%	37	-0.015	37
Subtotal						8,887		8,627
D-7 Nondelivery eligible	E-G	1	$8	$12	50%	140,610	-0.054	136,843
		2	$13	$20	54%	43,950	-0.069	42,313
		3	$24	$36	50%	11,387	-0.036	11,182
		4	$35	$53	51%	1,606	-0.024	1,586
		5	$55	$83	51%	138	-0.015	137
Subtotal						197,691		192,061
D-7 Nondelivery eligible	H-L	1	$8	$12	50%	522,999	-0.054	508,990
		2	$13	$20	54%	173,508	-0.069	167,046
		3	$24	$36	50%	40,818	-0.036	40,081
		4	$35	$53	51%	1,968	-0.024	1,943
		5	$55	$83	51%	223	-0.015	222
Subtotal						739,516		718,282
D Total eligible		1				4,130,134		3,960,696
		2				1,665,973		1,547,132
		3				432,435		401,341
		4				34,449		31,865
		5				3,820		3,537
Total D						6,266,811		5,944,572

Table 9D. Estimated Boxes in Use by Fee Group, Post-MC96-3							
Fee Group E							
Fee Group	Box Size	Pre 96-3 Fees	Post 96-3 Fees	Pct. Change	Pre 96-3 Boxes	Elasticity	Post 96-3 Boxes
E-0 City-other ineligible	1	$8	$0		52,529		52,529
	2	$13	$0		22,498		22,498
	3	$24	$0		7,472		7,472
	4	$35	$0		1,619		1,619
	5	$55	$0		346		346
Subtotal					84,465		84,465
E-1 Non-city Classified ineligible	1	$8	$0		667		667
	2	$13	$0		409		409
	3	$24	$0		141		141
	4	$35	$0		21		21
	5	$55	$0		3		3
Subtotal					1,241		1,241
E-2 Noncity Contract ineligible	1	$2	$0		0		0
	2	$2	$0		0		0
	3	$2	$0		0		0
	4	$2	$0		0		0
	5	$2	$0		0		0
Subtotal					0		0
E-3 Noncity Classified ineligible	1	$8	$0		20,523		20,523
	2	$13	$0		9,686		9,686
	3	$24	$0		2,603		2,603
	4	$35	$0		293		293
	5	$55	$0		33		33
Subtotal					33,137		33,137
E-4 Noncity Contract ineligible	1	$2	$0		126,629		126,629
	2	$2	$0		59,764		59,764
	3	$2	$0		16,058		16,058
	4	$2	$0		1,810		1,810
	5	$2	$0		202		202
Subtotal					204,462		204,462
E-5 Noncity Classified ineligible	1	$8	$0		49,058		49,058
	2	$13	$0		19,219		19,219
	3	$24	$0		4,946		4,946
	4	$35	$0		308		308
	5	$55	$0		33		33
Subtotal					73,565		73,565

Table 9D. Estimated Boxes in Use by Fee Group, Post MC96-3 (continued)							
Fee Group E							
E-6 Noncity Contract ineligible	1	$2	$0		52,786		52,786
	2	$2	$0		20,679		20,679
	3	$2	$0		5,322		5,322
	4	$2	$0		332		332
	5	$2	$0		36		36
Subtotal					79,155		79,155
E-7 Nondelivery ineligible	1	$8	$0		286,312		286,312
	2	$13	$0		94,575		94,575
	3	$24	$0		22,831		22,831
	4	$35	$0		1,581		1,581
	5	$55	$0		171		171
Subtotal					405,469		405,469
E Total ineligible	1		$0		588,503		588,503
	2		$0		226,830		226,830
	3		$0		59,373		59,373
	4		$0		5,964		5,964
	5		$0		824		824
Total E					881,494		881,494

Table 9E. Estimated Boxes in Use by Fee Group, Post-MC96-3							
All Fee Groups plus Caller Service and Reserve Numbers							
Fee Group	**Box Size**	**Pre 96-3 Fees**	**Post 96-3 Fees**	**Pct. Change**	**Pre 96-3 Boxes**	**Elasti-city**	**Post 96-3 Boxes**
Paid Boxes (A+B+C+D)					14,872,820		14,550,254
Free Boxes (E)					881,494		881,494
TOTAL BOXES					15,754,314		15,431,749
Caller Service		$349	$451	29%	100,770	-0.398	89,055
Reserve Numbers		$30	$30	0%	178,717		178,717
GRAND TOTAL					16,033,801		15,699,521

C. The Test Year Before Rates And After Rates Estimates Of The Number of Boxes In Use And Revenues Reflect The New Fee Groups

Table 10 reconfigures the post-MC96-3 fee groups into the proposed new fee groups. The test year before rates (TYBR) number of boxes in use is also computed by applying the Postal Service's 1.9 percent growth factor. *See* USPS-T-24 at 16.

Table 10. Estimated Boxes in Use, Proposed New Fee Groups, TYBY			
New Fee Groups			
Growth Factor = 0.019			
New Fee Groups	Box Size	Post 96-3 Boxes	TYBR Boxes
A	1	70,793	72,138
	2	4,417	4,501
	3	2,477	2,524
	4	238	242
	5	67	69
Total A		77,992	79,474
B	1	122,582	124,912
	2	29,437	29,996
	3	10,600	10,802
	4	1,532	1,561
	5	1,496	1,524
Total B		165,647	168,795
C-I	1	3,143,180	3,202,901
	2	1,436,070	1,463,355
	3	486,102	495,338
	4	114,234	116,404
	5	27,633	28,158
Total C-I		5,207,218	5,306,156
C-II	1	1,908,519	1,944,781
	2	744,619	758,767
	3	238,557	243,090
	4	44,512	45,357
	5	6,145	6,262
Total C-II		2,942,351	2,998,256

Table 10. Estimated Boxes in Use, Proposed New Fee Groups, TYBR (continued)			
New Fee Groups			
C-III	1	148,635	151,459
	2	46,646	47,532
	3	15,088	15,375
	4	1,582	1,612
	5	522	532
Total C-III		212,473	216,510
D-I	1	35,624	36,301
	2	21,657	22,069
	3	7,411	7,552
	4	1,076	1,096
	5	177	180
Total D-I		65,945	67,198
D-II	1	1,110,045	1,131,135
	2	484,717	493,926
	3	129,690	132,154
	4	14,907	15,190
	5	1,624	1,655
Total D-II		1,740,982	1,774,061
D-III	1	2,815,028	2,868,513
	2	1,040,758	1,060,532
	3	264,241	269,261
	4	15,882	16,184
	5	1,736	1,769
Total D-III		4,137,645	4,216,260
E	1	588,503	599,685
	2	226,830	231,140
	3	59,373	60,501
	4	5,964	6,078
	5	824	840
Total E		881,494	898,243
GRAND TOTAL		15,431,749	15,724,952

Fee Groups A and B are the same as the post-MC96-3 fee groups. Fee Groups C and D are reconfigured into the proposed new Fee Groups C-I, C-II and C-III and D-I, D-I, and D-III. C-I and D-I consist of CAG A-D post offices, representing the largest post offices in the current Fee Groups C and D, respectively. New Fee Groups C-II and D-II consist of medium-sized post offices, CAG E-G, while C-III and D-III consist of the smallest post offices, CAG H-L.

Tables 11A and B show the development of the estimated boxes in use and revenues in the TYAR. Table 11A shows the proposed fees, and presents the TYAR boxes in use, revenues, and the change in revenues from the test year before rates to the test year after rates for the new fee groups. Table 11B summarizes the estimated boxes in use and revenues in the TYAR by paid and free boxes, and for caller service and reserve call numbers. Revenues are estimated to increase $73 million to a total of $690 million.

Table 11A. Estimated Boxes in Use by New Fee Groups, TYAR										
New Fee Groups										
New Fee Groups	Box Size	Current Fees	Proposed Box Fees	Pct. Chg.	OCA TYBR Boxes	Elasticity	OCA TYAR Boxes	OCA TYBR Revenues	OCA TYAR Revenues	Change in Revenues
		[a]	[b]	[c]	[d]	[e]	[f]	[g]	[h]	[i]
A	1	$48	$75	56%	72,138	-0.522	50,960	$3,462,625	$3,822,014	$359,389
	2	$74	$110	49%	4,501	-0.601	3,186	$333,056	$350,447	$17,390
	3	$128	$190	48%	2,524	-0.517	1,892	$323,090	$359,568	$36,478
	4	$242	$330	36%	242	-0.517	197	$58,595	$64,891	$6,296
	5	$418	$550	32%	69	-0.517	57	$28,713	$31,617	$2,903
Total A					79,474		56,293	$4,206,080	$4,628,536	$422,456
B	1	$44	$65	48%	124,912	-0.478	96,390	$5,496,107	$6,265,339	$769,232
	2	$66	$95	44%	29,996	-0.603	22,055	$1,979,763	$2,095,190	$115,427
	3	$112	$160	43%	10,802	-0.517	8,410	$1,209,804	$1,345,605	$135,802
	4	$218	$290	33%	1,561	-0.517	1,295	$340,285	$375,429	$35,144
	5	$372	$485	30%	1,524	-0.517	1,285	$566,923	$623,133	$56,210
Total B					168,795		129,434	$9,592,883	$10,704,697	$1,111,815
C-I	1	$40	$56	40%	3,202,901	-0.522	2,534,252	$128,116,026	$141,918,088	$13,802,061
	2	$58	$81	40%	1,463,355	-0.605	1,112,183	$84,874,580	$90,086,804	$5,212,224
	3	$104	$146	40%	495,338	-0.517	391,986	$51,515,132	$57,229,916	$5,714,784
	4	$172	$240	40%	116,404	-0.517	92,628	$20,021,558	$22,230,648	$2,209,090
	5	$288	$402	40%	28,158	-0.517	22,399	$8,109,453	$9,004,508	$895,054
Total C-I					5,306,156		4,153,447	$292,636,749	$320,469,963	$27,833,214
C-II	1	$40	$46	15%	1,944,781	-0.522	1,792,531	$77,791,222	$82,456,416	$4,665,194
	2	$58	$67	16%	758,767	-0.605	687,515	$44,008,463	$46,063,521	$2,055,058
	3	$104	$120	15%	243,090	-0.517	223,768	$25,281,331	$26,852,110	$1,570,780
	4	$172	$198	15%	45,357	-0.517	41,815	$7,801,448	$8,279,348	$477,900
	5	$288	$331	15%	6,262	-0.517	5,779	$1,803,345	$1,912,715	$109,370
Total C-II					2,998,256		2,751,407	$156,685,809	$165,564,111	$8,878,302
C-III	1	$40	$40	0%	151,459	-0.522	151,459	$6,058,375	$6,058,375	$0
	2	$58	$58	0%	47,532	-0.605	47,532	$2,756,864	$2,756,864	$0
	3	$104	$104	0%	15,375	-0.517	15,375	$1,598,978	$1,598,978	$0
	4	$172	$172	0%	1,612	-0.517	1,612	$277,319	$277,319	$0
	5	$288	$288	0%	532	-0.517	532	$153,165	$153,165	$0
Total C-III					216,510		216,510	$10,844,702	$10,844,702	$0
D-I	1	$12	$24	100%	36,301	-0.054	34,356	$435,608	$824,544	$388,936
	2	$20	$40	100%	22,069	-0.069	20,542	$441,377	$821,698	$380,320
	3	$36	$72	100%	7,552	-0.036	7,279	$271,869	$524,117	$252,247
	4	$53	$106	100%	1,096	-0.024	1,070	$58,107	$113,378	$55,270
	5	$83	$166	100%	180	-0.015	178	$14,978	$29,495	$14,517
Total D-I					67,198		63,425	$1,221,940	$2,313,232	$1,091,292
D-II	1	$12	$18	50%	1,131,135	-0.054	1,100,837	$13,573,626	$19,815,069	$6,241,444
	2	$20	$30	50%	493,926	-0.069	476,845	$9,878,524	$14,305,338	$4,426,814
	3	$36	$54	50%	132,154	-0.036	129,769	$4,757,533	$7,007,536	$2,250,003
	4	$53	$80	51%	15,190	-0.024	15,001	$805,088	$1,200,115	$395,027
	5	$83	$125	51%	1,655	-0.015	1,642	$137,377	$205,283	$67,907
Total D-II					1,774,061		1,724,095	$29,152,148	$42,533,342	$13,381,194
D-III	1	$12	$15	25%	2,868,513	-0.054	2,830,096	$34,422,158	$42,451,433	$8,029,276
	2	$20	$25	25%	1,060,532	-0.069	1,042,194	$21,210,646	$26,054,849	$4,844,202
	3	$36	$45	25%	269,261	-0.036	266,832	$9,693,407	$12,007,445	$2,314,038
	4	$53	$66	25%	16,184	-0.024	16,087	$857,763	$1,061,762	$203,999
	5	$83	$104	25%	1,769	-0.015	1,762	$146,827	$183,260	$36,433
Total D-III					4,216,260		4,156,971	$66,330,801	$81,758,749	$15,427,948
E	1	$0	$0		599,685		599,685	$0	$0	$0
	2	$0	$0		231,140		231,140	$0	$0	$0
	3	$0	$0		60,501		60,501	$0	$0	$0
	4	$0	$0		6,078		6,078	$0	$0	$0
	5	$0	$0		840		840	$0	$0	$0
Total E					898,243		898,243	$0	$0	$0

Table 11B. Estimated Boxes in Use by Fee Groups, TYAR All Fee Groups plus Caller Service and Reserve Numbers										
New Fee Groups	Box Size	Current Fees	Proposed Fees	Pct. Chg.	OCA TYBR Boxes	Elasti-city	OCA TYAR Boxes	OCA TYBR Revenues	OCA TYAR Revenues	Change in Revenues
Paid Boxes					14,826,709		13,251,582	$570,671,113	$638,817,332	$68,146,219
Free Boxes (E)					898,243		898,243	$0	$0	$0
TOTAL BOXES					15,724,952		14,149,825	$570,671,113	$638,817,332	$68,146,219
Caller Service		$451	$550	22%	90,747	-0.431	82,161	$40,926,917	$45,188,468	$4,261,551
Reserve Numbers		$30	$40	33%	182,113	-0.517	150,749	$5,463,379	$6,029,976	$566,597
GRAND TOTAL					15,997,812		14,382,735	$617,061,409	$690,035,776	$72,974,367

IV. POST OFFICE BOX VOLUME-VARIABLE COSTS SHOULD BE ALLOCATED SO THAT HIGHER COSTS ASSOCIATED WITH LARGER POST OFFICES ARE DISTRIBUTED TO BOXES IN THOSE OFFICES

A. Space Provision Costs Should Be Allocated Based Upon Average Rental Costs For The New Fee Groups To Better Reflect Costs In Larger And Smaller Post Offices

In developing unit box costs, I allocate Space Provision costs in direct proportion to both a measure of box size (capacity) and the particular average rental cost per square foot for each respective fee group. This is the same general approach followed by witness Lion. *See* USPS-T-24 at 20. However, my allocation is formed by the *product of the average postal rental cost for each fee group and the equivalent capacity* by box size.

Table 12 shows the allocation of Space Provision costs to derive the total cost by box size and the unit box costs in the TYBR. The distribution key is shown in column [e], "Rent x Equivalent Capacity."

Table 12. Allocation of Space Provision Costs by New Fee Groups, TYBR								
New Fee Groups								
New Fee Groups	Box Size	TYBR Boxes	Capacity Factor	Equivalent Capacity	Average Rent ($/sq. ft.)	Rent x Equivalent Capacity	Total Costs ($000)	Cost Per Box
		[a]	[b]	[c]	[d]	[e]	[f]	[g]
A	1	72,138	1	72,138	$23.49	1,694,558	$2,269	$31.45
	2	4,501	1.5	6,751	$23.49	158,588	$212	$47.17
	3	2,524	3	7,572	$23.49	177,880	$238	$94.35
	4	242	6	1,453	$23.49	34,126	$46	$188.69
	5	69	12	824	$23.49	19,363	$26	$377.39
Total A		79,474	1.12	88,739	$23.49	2,084,516	$2,791	$35.12
B	1	124,912	1	124,912	$16.74	2,091,401	$2,800	$22.42
	2	29,996	1.5	44,995	$16.74	753,348	$1,009	$33.62
	3	10,802	3	32,405	$16.74	542,566	$726	$67.25
	4	1,561	6	9,366	$16.74	156,810	$210	$134.49
	5	1,524	12	18,288	$16.74	306,195	$410	$268.99
Total B		168,795	1.36	229,965	$16.74	3,850,319	$5,155	$30.54
C-I	1	3,202,901	1	3,202,901	$9.07	29,044,275	$38,884	$12.14
	2	1,463,355	1.5	2,195,032	$9.07	19,904,807	$26,649	$18.21
	3	495,338	3	1,486,013	$9.07	13,475,342	$18,041	$36.42
	4	116,404	6	698,426	$9.07	6,333,412	$8,479	$72.84
	5	28,158	12	337,894	$9.07	3,064,061	$4,102	$145.68
Total C-I		5,306,156	1.49	7,920,267	$9.07	71,821,898	$96,155	$18.12
C-II	1	1,944,781	1	1,944,781	$6.88	13,379,446	$17,912	$9.21
	2	758,767	1.5	1,138,150	$6.88	7,830,094	$10,483	$13.82
	3	243,090	3	729,269	$6.88	5,017,130	$6,717	$27.63
	4	45,357	6	272,144	$6.88	1,872,257	$2,507	$55.26
	5	6,262	12	75,139	$6.88	516,934	$692	$110.53
Total C-II		2,998,256	1.39	4,159,483	$6.88	28,615,862	$38,311	$12.78
C-III	1	151,459	1	151,459	$4.96	751,983	$1,007	$6.65
	2	47,532	1.5	71,298	$4.96	353,990	$474	$9.97
	3	15,375	3	46,124	$4.96	229,004	$307	$19.94
	4	1,612	6	9,674	$4.96	48,030	$64	$39.88
	5	532	12	6,382	$4.96	31,686	$42	$79.76
Total C-III		216,510	1.32	284,938	$4.96	1,414,692	$1,894	$8.75
D-I	1	36,301	1	36,301	$7.23	262,432	$351	$9.68
	2	22,069	1.5	33,103	$7.23	239,317	$320	$14.52
	3	7,552	3	22,656	$7.23	163,788	$219	$29.04
	4	1,096	6	6,578	$7.23	47,557	$64	$58.07
	5	180	12	2,165	$7.23	15,655	$21	$116.14
Total D-I		67,198	1.50	100,803	$7.23	728,749	$976	$14.52
D-II	1	1,131,135	1	1,131,135	$7.29	8,241,234	$11,033	$9.75
	2	493,926	1.5	740,889	$7.29	5,397,976	$7,227	$14.63
	3	132,154	3	396,461	$7.29	2,888,539	$3,867	$29.26
	4	15,190	6	91,142	$7.29	664,044	$889	$58.53
	5	1,655	12	19,862	$7.29	144,708	$194	$117.05
Total D-II		1,774,061	1.34	2,379,490	$7.29	17,336,501	$23,210	$13.08

Table 12. Allocation of Space Provision Costs by New Fee Groups, TYBR (continued)								
New Fee Groups								
D-III	1	2,868,513	1	2,868,513	$6.07	17,410,496	$23,309	$8.13
	2	1,060,532	1.5	1,590,798	$6.07	9,655,382	$12,927	$12.19
	3	269,261	3	807,784	$6.07	4,902,860	$6,564	$24.38
	4	16,184	6	97,105	$6.07	589,382	$789	$48.76
	5	1,769	12	21,228	$6.07	128,844	$172	$97.51
Total D-III		4,216,260	1.28	5,385,429	$6.07	32,686,964	$43,761	$10.38
E	1	599,685	1	599,685	$6.98	4,185,123	$5,603	$9.34
	2	231,140	1.5	346,709	$6.98	2,419,640	$3,239	$14.01
	3	60,501	3	181,502	$6.98	1,266,678	$1,696	$28.03
	4	6,078	6	36,467	$6.98	254,498	$341	$56.06
	5	840	12	10,080	$6.98	70,344	$94	$112.12
Total E		898,243	1.31	1,174,442	$6.98	8,196,283	$10,973	$12.22
GRAND TOTAL		15,724,952		21,723,555		166,735,784	$223,226	$14.20

The development of the "Average Rent ($/sq.ft.)" in Table 12 is shown in Tables 12A-B. Table 12A presents, based upon the estimated number of boxes installed, the conversion of the average postal rental costs by delivery group into the weighted average rental costs for the new fee group. Table 12B develops the number of boxes installed for each new fee group, using the percentages shown in Table 7. The average rents for the new fee group are simply the weighted average of boxes installed by delivery group, which are shown on the last row of Table 12A.

Table 12A. Weighted Average Rental Cost for New Fee Groups												
Boxes Installed by Delivery Groups and New Fee Groups												
CARRIER DELIVERY GROUPS		NEW FEE GROUPS									TOTAL	AVERAGE RENT
		A	B	C-I	C-II	C-III	D-I	D-II	D-III	E		
											[a]	[b]
CITY-A		104,384									104,384	$23.49
CITY-B			202,719								202,719	$16.74
CITY-OTHER											10,770,049	
	CAG A-D			6,542,087							6,542,087	$9.07
	CAG E-G				3,790,060						3,790,060	$6.88
	CAG H-L					330,202					330,202	$4.96
	E-0									107,700	107,700	$7.19
NON-CITY											7,070,042	
Classified	CAG A-D						69,019			1,409	70,428	$7.24
Contract	CAG A-D						0			0	0	$7.24
Classified	CAG E-G							1,898,222		38,739	1,936,961	$7.30
Contract	CAG E-G							26,559		239,028	265,587	$7.30
Classified	CAG H-L								4,591,342	93,701	4,685,042	$5.84
Contract	CAG H-L								11,202	100,821	112,024	$5.84
NONDELIVERY											1,709,870	
	CAG A-D						11,188				11,188	$7.19
	CAG E-G							235,810			235,810	$7.19
	CAG H-L								949,911		949,911	$7.19
	E-7									512,961	512,961	$7.19
TOTAL		104,384	202,719	6,542,087	3,790,060	330,202	80,208	2,160,591	5,552,455	1,094,359	19,857,064	
AVERAGE RENT PER SQ.FT., NEW FEE GROUP		$23.49	$16.74	$9.07	$6.88	$4.96	$7.23	$7.29	$6.07	$6.98		

Table 12B. Estimated Boxes Installed by CAG by Fee Group

	Fee Groups					
	A	B	C [A-D]	C[E-G]	C[H-L]	Total C
Boxes Installed	104,384	202,719	6,542,087	3,790,060	330,202	10,662,349

	Fee Groups									
	D-1	D-2	D-3	D-4	D-5	D-6	D-7[A-D]	D-7[E-G]	D-7[H-L]	Total D
Boxes Installed	69,019	0	1,898,222	26,559	4,591,342	11,202	11,188	235,810	949,911	7,793,253

	Fee Groups								
	E-0	E-1	E-2	E-3	E-4	E-5	E-6	E-7	Total E
Boxes Installed	107,700	1,409	0	38,739	239,028	93,701	100,821	512,961	1,094,359

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B. A Portion Of All Other Costs Should Be Allocated To The New Fee Groups Based Upon Groupings By CAG To Better Reflect Costs In Larger And Smaller Post Offices

I allocate a portion of All Other costs to boxes by CAG. Table 13 summarizes the allocation of All Other costs and the development of TYBR unit box costs.

Table 13. Summary of Allocation of All Other Costs by New Fee Groups, TYBR								
New Fee Groups								
New Fee Groups	Box Size	TYBR Boxes	Post-masters Costs (000)	Supervisor Costs (000)	Mailhandler Costs (000)	Non-CAG Costs (000)	Total (000)	Cost per Box
		[a]	[b]	[c]	[d]	[e]	[f]	[g]
A	1	72,138	$0	$52	$154	$375	$582	$8.07
	2	4,501	$0	$3	$10	$23	$36	$8.07
	3	2,524	$0	$2	$5	$13	$20	$8.07
	4	242	$0	$0	$1	$1	$2	$8.07
	5	69	$0	$0	$0	$0	$1	$8.07
Total A		79,474	$0	$58	$170	$414	$642	$8.07
B	1	124,912	$2	$91	$268	$650	$1,010	$8.08
	2	29,996	$0	$22	$64	$156	$243	$8.08
	3	10,802	$0	$8	$23	$56	$87	$8.08
	4	1,561	$0	$1	$3	$8	$13	$8.08
	5	1,524	$0	$1	$3	$8	$12	$8.08
Total B		168,795	$3	$122	$361	$878	$1,365	$8.08
C-I	1	3,202,901	$105	$2,321	$6,859	$16,667	$25,951	$8.10
	2	1,463,355	$48	$1,060	$3,134	$7,615	$11,857	$8.10
	3	495,338	$16	$359	$1,061	$2,578	$4,013	$8.10
	4	116,404	$4	$84	$249	$606	$943	$8.10
	5	28,158	$1	$20	$60	$147	$228	$8.10
Total C-I		5,306,156	$173	$3,845	$11,363	$27,611	$42,993	$8.10
C-II	1	1,944,781	$336	$1,409	$0	$10,120	$11,865	$6.10
	2	758,767	$131	$550	$0	$3,948	$4,629	$6.10
	3	243,090	$42	$176	$0	$1,265	$1,483	$6.10
	4	45,357	$8	$33	$0	$236	$277	$6.10
	5	6,262	$1	$5	$0	$33	$38	$6.10
Total C-II		2,998,256	$518	$2,172	$0	$15,602	$18,292	$6.10
C-III	1	151,459	$80	$0	$0	$788	$868	$5.73
	2	47,532	$25	$0	$0	$247	$272	$5.73
	3	15,375	$8	$0	$0	$80	$88	$5.73
	4	1,612	$1	$0	$0	$8	$9	$5.73
	5	532	$0	$0	$0	$3	$3	$5.73
Total C-III		216,510	$114	$0	$0	$1,127	$1,241	$5.73

Table 13. Summary of Allocation of All Other Costs by New Fee Groups, TYBR (continued)								
New Fee Groups								
D-I	1	36,301	$2	$26	$78	$189	$294	$8.11
	2	22,069	$1	$16	$47	$115	$179	$8.11
	3	7,552	$0	$5	$16	$39	$61	$8.11
	4	1,096	$0	$1	$2	$6	$9	$8.11
	5	180	$0	$0	$0	$1	$1	$8.11
Total D-I		67,198	$3	$49	$144	$350	$545	$8.11
D-II	1	1,131,135	$133	$820	$0	$5,886	$6,839	$6.05
	2	493,926	$58	$358	$0	$2,570	$2,986	$6.05
	3	132,154	$16	$96	$0	$688	$799	$6.05
	4	15,190	$2	$11	$0	$79	$92	$6.05
	5	1,655	$0	$1	$0	$9	$10	$6.05
Total D-II		1,774,061	$208	$1,285	$0	$9,232	$10,725	$6.05
D-III	1	2,868,513	$1,108	$0	$0	$14,927	$16,034	$5.59
	2	1,060,532	$410	$0	$0	$5,519	$5,928	$5.59
	3	269,261	$104	$0	$0	$1,401	$1,505	$5.59
	4	16,184	$6	$0	$0	$84	$90	$5.59
	5	1,769	$1	$0	$0	$9	$10	$5.59
Total D-III		4,216,260	$1,628	$0	$0	$21,940	$23,568	$5.59
E	1	599,685	$358	$0	$0	$3,121	$3,478	$5.80
	2	231,140	$138	$0	$0	$1,203	$1,341	$5.80
	3	60,501	$36	$0	$0	$315	$351	$5.80
	4	6,078	$4	$0	$0	$32	$35	$5.80
	5	840	$1	$0	$0	$4	$5	$5.80
Total E		898,243	$536	$0	$0	$4,674	$5,210	$5.80
GRAND TOTAL		15,724,952	$3,183	$7,531	$12,039	$81,827	$104,580	$6.65

There are two types of costs to be allocated. One type of cost is allocated by CAG. The second type of cost, which cannot be allocated by CAG, is allocated proportionately to the number of boxes in the same manner as performed by witness Lion. *See* USPS-T-24 at 24.

Postmaster costs are allocated according to the distribution of postmasters by CAG. Table 13A presents the allocation of postmaster costs.

Table 13A. Distribution of Postmaster Costs to Boxes				
New Fee Groups	Box Size	TYBR Boxes	Percent of Fee Group	Postmaster Costs (000)
		[a]	[b]	[c]
A	1	72,138	90.77%	$0
	2	4,501	5.66%	$0
	3	2,524	3.18%	$0
	4	242	0.30%	$0
	5	69	0.09%	$0
Total A		79,474	100.00%	$0
B	1	124,912	74.00%	$2
	2	29,996	17.77%	$0
	3	10,802	6.40%	$0
	4	1,561	0.92%	$0
	5	1,524	0.90%	$0
Total B		168,795	100.00%	$3
C-I	1	3,202,901	60.36%	$105
	2	1,463,355	27.58%	$48
	3	495,338	9.34%	$16
	4	116,404	2.19%	$4
	5	28,158	0.53%	$1
Total C-I		5,306,156	100.00%	$173
C-II	1	1,944,781	64.86%	$336
	2	758,767	25.31%	$131
	3	243,090	8.11%	$42
	4	45,357	1.51%	$8
	5	6,262	0.21%	$1
Total C-II		2,998,256	100.00%	$518
C-III	1	151,459	69.95%	$80
	2	47,532	21.95%	$25
	3	15,375	7.10%	$8
	4	1,612	0.74%	$1
	5	532	0.25%	$0
Total C-III		216,510	100.00%	$114
D-I	1	36,301	54.02%	$2
	2	22,069	32.84%	$1
	3	7,552	11.24%	$0
	4	1,096	1.63%	$0
	5	180	0.27%	$0
Total D-I		67,198	100.00%	$3

Table 13A. Distribution of Postmaster Costs to Boxes (continued)				
New Fee Groups				
D-II	1	1,131,135	63.76%	$133
	2	493,926	27.84%	$58
	3	132,154	7.45%	$16
	4	15,190	0.86%	$2
	5	1,655	0.09%	$0
Total D-II		1,774,061	100.00%	$208
D-III	1	2,868,513	68.03%	$1,108
	2	1,060,532	25.15%	$410
	3	269,261	6.39%	$104
	4	16,184	0.38%	$6
	5	1,769	0.04%	$1
Total D-III		4,216,260	100.00%	$1,628
E	1	599,685	66.76%	$358
	2	231,140	25.73%	$138
	3	60,501	6.74%	$36
	4	6,078	0.68%	$4
	5	840	0.09%	$1
Total E		898,243	100.00%	$536
GRAND TOTAL		15,724,952		$3,183

Table 13B begins the process of allocating postmaster costs by CAG. Column [a] displays the number of offices by CAG in each fee group, and column [b] computes the percent of offices by CAG in each fee group to the total number of offices by CAG. For example, the data show 29 CAG A offices in Fee Group A, which represents 2.55 percent (29/1,138) of the total number of offices in CAG A. The percentages computed in column [b] are used to distribute the number of employees in each CAG to the CAG levels in each fee group. Continuing the example for postmasters, I estimate that there are two CAG A postmasters in Fee

Group A, as shown in column [c]. This represents 0.01 percent (2/26,403) of all postmasters. The resulting percentages, displayed in column [d], of postmasters at each CAG level are then used to distribute total postmaster costs of $3,183,000 to each CAG level in the fee groups. The amounts so distributed are totaled by fee group and transferred to Table 13A, where the totals are allocated proportionately by box size in each fee group.

Table 13B. Distribution of Postmasters Costs by CAG, and Index of Supervisors and Mailhandlers by CAG

				Postmasters			Supervisors	Mailhandlers
New Fee Groups	CAG	Number of Offices	Percent of Total CAG Level	Number by CAG Level	Percent at CAG Level	Total Costs (000)	Index of Employment at CAG Level	Index of Employment at CAG Level
		[a]	[b]	[c]	[d]	[e]	[f]	[g]
A								
	CAG A	29	2.55%	2	0.01%	$0	1	1
	Total	29		2		$0	1	1
B								
	CAG A	56	4.92%	4	0.01%	$0	1	1
	CAG B	42	6.13%	11	0.04%	$1	1	1
	CAG C	9	0.73%	5	0.02%	$1	1	1
	CAG D	2	0.30%	2	0.01%	$0	1	1
	Total	109		21		$3	1	1
C-I								
	CAG A	1,053	92.53%	68	0.26%	$8	1	1
	CAG B	637	92.99%	163	0.62%	$20	1	1
	CAG C	1,213	97.74%	661	2.50%	$80	1	1
	CAG D	638	96.96%	545	2.06%	$66	1	1
	Total	3,541		1,437		$173	1	1
C-II								
	CAG E	1,228	91.23%	1,334	5.05%	$161	1	0
	CAG F	1,264	79.25%	1,456	5.51%	$176	1	0
	CAG G	1,238	50.82%	1,505	5.70%	$181	1	0
	Total	3,730		4,295		$518	1	0
C-III								
	CAG H	520	17.22%	620	2.35%	$75	0	0
	CAG J	130	3.15%	148	0.56%	$18	0	0
	CAG K	136	1.68%	151	0.57%	$18	0	0
	CAG L	23	2.04%	28	0.11%	$3	0	0
	Total	809		946		$114	0	0

Table 13B. Distribution of Postmasters Costs by CAG, and Index of Supervisors and Mailhandlers by CAG (continued)								
New Fee Groups								
D-I								
	CAG A	0	0.00%	0	0.00%	$0	1	1
	CAG B	5	0.73%	1	0.00%	$0	1	1
	CAG C	14	1.13%	8	0.03%	$1	1	1
	CAG D	17	2.58%	15	0.05%	$2	1	1
	Total	36		23		$3	1	1
D-II								
	CAG E	106	7.88%	115	0.44%	$14	1	0
	CAG F	294	18.43%	339	1.28%	$41	1	0
	CAG G	1,049	43.06%	1,276	4.83%	$154	1	0
	Total	1,449		1,729		$208	1	0
D-III								
	CAG H	2,186	72.38%	2,604	9.86%	$314	0	0
	CAG J	3,284	79.59%	3,748	14.20%	$452	0	0
	CAG K	5,759	70.98%	6,375	24.15%	$769	0	0
	CAG L	640	56.89%	777	2.94%	$94	0	0
	Total	11,869		13,505		$1,628	0	0
E								
	CAG A	0	0.00%	0	0.00%	$0	1	1
	CAG B	1	0.15%	0	0.00%	$0	1	1
	CAG C	5	0.40%	3	0.01%	$0	1	1
	CAG D	1	0.15%	1	0.00%	$0	1	1
	CAG E	12	0.89%	13	0.05%	$2	1	1
	CAG F	37	2.32%	43	0.16%	$5	1	0
	CAG G	149	6.12%	181	0.69%	$22	1	0
	CAG H	314	10.40%	374	1.42%	$45	0	0
	CAG J	712	17.26%	813	3.08%	$98	0	0
	CAG K	2,219	27.35%	2,456	9.30%	$296	0	0
	CAG L	462	41.07%	561	2.12%	$68	0	0
	Total	3,912		4,445		$536	0	0
GRAND TOTAL		25,484		26,403		$3,183		

The allocation of supervisor and mailhandler costs by CAG is based on a different method. Table 13C shows the allocation of supervisor and mailhandler costs. In order to allocate such costs, however, I used an index to represent the employment, or the absence thereof, of supervisors and mailhandlers at certain CAG levels. This "Index of Employment," consisting of a "1" to indicate employment, and a "0" to indicate no employment, is shown in Table 13B, columns [f] and [g]. Where a 1 is assigned to all CAG levels in a fee group, a 1 is also assigned to the fee group. Similarly, where a 0 is assigned to all CAG levels in a fee group, a 0 is also assigned to that fee group. The index number for each fee group is multiplied by the TYBR number of boxes in each fee group to determine the number of "supervisor" boxes and "mailhandler" boxes, as shown in columns [b] and [d] of Table 13C. The percent of total "supervisor" boxes in column [c] is used to allocate volume-variable supervisor costs of $7,531,000. With respect to mailhandlers, I determined volume-variable mailhandler costs to be $12,039,000, or 16.83 percent, of Cost Segment 3 volume-variable post office box costs of $71,527,000.[19] Volume-

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[19] *See* USPS LR-H-9 at 19-20. Total costs for Cost Segment 3 are $16.456 billion, of which 16.83 percent ($2.770/$16.456) are mailhandler costs.

variable mailhandler costs are then allocated based upon the percent of total "mailhandler" boxes shown in column [e].

Table 13C. Distribution of Supervisor and Mailhandler Costs to Boxes								
New Fee Groups	Box Size	TYBR Boxes	"Supervisor" Boxes	Percent	"Mailhandler" Boxes	Percent	Supervisor Costs (000)	Mailhandler Costs (000)
		[a]	[b]	[c]	[d]	[e]	[f]	[g]
A	1	72,138	72,138	0.69%	72,138	1.28%	$52	$154
	2	4,501	4,501	0.04%	4,501	0.08%	$3	$10
	3	2,524	2,524	0.02%	2,524	0.04%	$2	$5
	4	242	242	0.00%	242	0.00%	$0	$1
	5	69	69	0.00%	69	0.00%	$0	$0
Total A		79,474	79,474	0.76%	79,474	1.41%	$58	$170
B	1	124,912	124,912	1.20%	124,912	2.22%	$91	$268
	2	29,996	29,996	0.29%	29,996	0.53%	$22	$64
	3	10,802	10,802	0.10%	10,802	0.19%	$8	$23
	4	1,561	1,561	0.02%	1,561	0.03%	$1	$3
	5	1,524	1,524	0.01%	1,524	0.03%	$1	$3
Total B		168,795	168,795	1.62%	168,795	3.00%	$122	$361
C-I	1	3,202,901	3,202,901	30.82%	3,202,901	56.97%	$2,321	$6,859
	2	1,463,355	1,463,355	14.08%	1,463,355	26.03%	$1,060	$3,134
	3	495,338	495,338	4.77%	495,338	8.81%	$359	$1,061
	4	116,404	116,404	1.12%	116,404	2.07%	$84	$249
	5	28,158	28,158	0.27%	28,158	0.50%	$20	$60
Total C-I		5,306,156	5,306,156	51.05%	5,306,156	94.39%	$3,845	$11,363
C-II	1	1,944,781	1,944,781	18.71%	0	0.00%	$1,409	$0
	2	758,767	758,767	7.30%	0	0.00%	$550	$0
	3	243,090	243,090	2.34%	0	0.00%	$176	$0
	4	45,357	45,357	0.44%	0	0.00%	$33	$0
	5	6,262	6,262	0.06%	0	0.00%	$5	$0
Total C-II		2,998,256	2,998,256	28.85%	0	0.00%	$2,172	$0
C-III	1	151,459	0	0.00%	0	0.00%	$0	$0
	2	47,532	0	0.00%	0	0.00%	$0	$0
	3	15,375	0	0.00%	0	0.00%	$0	$0
	4	1,612	0	0.00%	0	0.00%	$0	$0
	5	532	0	0.00%	0	0.00%	$0	$0
Total C-III		216,510	0	0.00%	0	0.00%	$0	$0
D-I	1	36,301	36,301	0.35%	36,301	0.65%	$26	$78
	2	22,069	22,069	0.21%	22,069	0.39%	$16	$47
	3	7,552	7,552	0.07%	7,552	0.13%	$5	$16
	4	1,096	1,096	0.01%	1,096	0.02%	$1	$2
	5	180	180	0.00%	180	0.00%	$0	$0
Total D-I		67,198	67,198	0.65%	67,198	1.20%	$49	$144

Table 13C. Distribution of Supervisor and Mailhandler Costs to Boxes (continued)								
New Fee Groups								
D-II	1	1,131,135	1,131,135	10.88%	0	0.00%	$820	$0
	2	493,926	493,926	4.75%	0	0.00%	$358	$0
	3	132,154	132,154	1.27%	0	0.00%	$96	$0
	4	15,190	15,190	0.15%	0	0.00%	$11	$0
	5	1,655	1,655	0.02%	0	0.00%	$1	$0
Total D-II		1,774,061	1,774,061	17.07%	0	0.00%	$1,285	$0
D-III	1	2,868,513	0	0.00%	0	0.00%	$0	$0
	2	1,060,532	0	0.00%	0	0.00%	$0	$0
	3	269,261	0	0.00%	0	0.00%	$0	$0
	4	16,184	0	0.00%	0	0.00%	$0	$0
	5	1,769	0	0.00%	0	0.00%	$0	$0
Total D-III		4,216,260	0	0.00%	0	0.00%	$0	$0
E	1	599,685	0	0.00%	0	0.00%	$0	$0
	2	231,140	0	0.00%	0	0.00%	$0	$0
	3	60,501	0	0.00%	0	0.00%	$0	$0
	4	6,078	0	0.00%	0	0.00%	$0	$0
	5	840	0	0.00%	0	0.00%	$0	$0
Total E		898,243	0	0.00%	0	0.00%	$0	$0
GRAND TOTAL		15,724,952	10,393,939	100.00%	5,621,622	100.00%	$7,531	$12,039

The remaining costs, referred to as "non-CAG costs," are allocated proportionally to the total number of boxes, as shown in Table 13D. Non-CAG costs include $59,488,000 of clerk costs from Cost Segment 3. The allocation of non-CAG costs is consistent with the methodology used by witness Lion for All Other costs.

Table 13D. Distribution of Costs by Box Size				
New Fee Groups	Box Size	TYBR Boxes	Percent	Non-CAG Costs (000)
		[a]	[b]	[c]
A	1	72,138	0.46%	$375
	2	4,501	0.03%	$23
	3	2,524	0.02%	$13
	4	242	0.00%	$1
	5	69	0.00%	$0
Total A		79,474	0.51%	$414
B	1	124,912	0.79%	$650
	2	29,996	0.19%	$156
	3	10,802	0.07%	$56
	4	1,561	0.01%	$8
	5	1,524	0.01%	$8
Total B		168,795	1.07%	$878
C-I	1	3,202,901	20.37%	$16,667
	2	1,463,355	9.31%	$7,615
	3	495,338	3.15%	$2,578
	4	116,404	0.74%	$606
	5	28,158	0.18%	$147
Total C-I		5,306,156	33.74%	$27,611
C-II	1	1,944,781	12.37%	$10,120
	2	758,767	4.83%	$3,948
	3	243,090	1.55%	$1,265
	4	45,357	0.29%	$236
	5	6,262	0.04%	$33
Total C-II		2,998,256	19.07%	$15,602
C-III	1	151,459	0.96%	$788
	2	47,532	0.30%	$247
	3	15,375	0.10%	$80
	4	1,612	0.01%	$8
	5	532	0.00%	$3
Total C-III		216,510	1.38%	$1,127
D-I	1	36,301	0.23%	$189
	2	22,069	0.14%	$115
	3	7,552	0.05%	$39
	4	1,096	0.01%	$6
	5	180	0.00%	$1
Total D-I		67,198	0.43%	$350

Table 13D. Distribution of Costs by Box Size (continued)				
New Fee Groups				
D-II	1	1,131,135	7.19%	$5,886
	2	493,926	3.14%	$2,570
	3	132,154	0.84%	$688
	4	15,190	0.10%	$79
	5	1,655	0.01%	$9
Total D-II		1,774,061	11.28%	$9,232
D-III	1	2,868,513	18.24%	$14,927
	2	1,060,532	6.74%	$5,519
	3	269,261	1.71%	$1,401
	4	16,184	0.10%	$84
	5	1,769	0.01%	$9
Total D-III		4,216,260	26.81%	$21,940
E	1	599,685	3.81%	$3,121
	2	231,140	1.47%	$1,203
	3	60,501	0.38%	$315
	4	6,078	0.04%	$32
	5	840	0.01%	$4
Total E		898,243	5.71%	$4,674
GRAND TOTAL		15,724,952	100.00%	$81,827

Table 14 shows the development of the TYAR All Other costs by box size, and the TYAR unit box costs. I assumed a volume variability for All Other costs in the TYAR of 1.002067747. *See* Tr. 13/7338-39.

Table 14. Allocation of All Other Costs to Boxes in New Fee Groups, TYAR							
New Fee Groups							
Elasticity = 1.002067747							
New Fee Groups	Box Size	OCA TYBR Boxes	OCA TYAR Boxes	TYBR Total (000)	TYBR Cost per Box	TYAR Total All Other Costs	TYAR All Other Cost per Box
		[a]	[b]	[c]	[d]	[e]	[f]
A	1	72,138	50,960	$582,342	$8.07	$411,028	$8.07
	2	4,501	3,186	$36,333	$8.07	$25,696	$8.07
	3	2,524	1,892	$20,376	$8.07	$15,267	$8.07
	4	242	197	$1,955	$8.07	$1,587	$8.07
	5	69	57	$555	$8.07	$464	$8.07
Total A		79,474	56,293	$641,561	$8.07	$454,042	$8.07
B	1	124,912	96,390	$1,009,877	$8.08	$778,810	$8.08
	2	29,996	22,055	$242,513	$8.08	$178,173	$8.08
	3	10,802	8,410	$87,330	$8.08	$67,953	$8.08
	4	1,561	1,295	$12,620	$8.08	$10,462	$8.08
	5	1,524	1,285	$12,321	$8.08	$10,383	$8.08
Total B		168,795	129,434	$1,364,661	$8.08	$1,045,781	$8.08
C-I	1	3,202,901	2,534,252	$25,951,183	$8.10	$20,522,318	$8.10
	2	1,463,355	1,112,183	$11,856,686	$8.10	$9,005,466	$8.10
	3	495,338	391,986	$4,013,425	$8.10	$3,174,294	$8.10
	4	116,404	92,628	$943,155	$8.10	$750,108	$8.10
	5	28,158	22,399	$228,146	$8.10	$181,391	$8.10
Total C-I		5,306,156	4,153,447	$42,992,595	$8.10	$33,633,577	$8.10
C-II	1	1,944,781	1,792,531	$11,864,885	$6.10	$10,934,106	$6.10
	2	758,767	687,515	$4,629,149	$6.10	$4,193,554	$6.10
	3	243,090	223,768	$1,483,063	$6.10	$1,364,937	$6.10
	4	45,357	41,815	$276,719	$6.10	$255,063	$6.10
	5	6,262	5,779	$38,201	$6.10	$35,248	$6.10
Total C-II		2,998,256	2,751,407	$18,292,018	$6.10	$16,782,908	$6.10
C-III	1	151,459	151,459	$867,950	$5.73	$867,950	$5.73
	2	47,532	47,532	$272,387	$5.73	$272,387	$5.73
	3	15,375	15,375	$88,106	$5.73	$88,106	$5.73
	4	1,612	1,612	$9,240	$5.73	$9,240	$5.73
	5	532	532	$3,048	$5.73	$3,048	$5.73
Total C-III		216,510	216,510	$1,240,731	$5.73	$1,240,731	$5.73

Table 14. Allocation of All Other Costs to Boxes in New Fee Groups, TYAR (continued)							
New Fee Groups							
D-I	1	36,301	34,356	$294,463	$8.11	$278,656	$8.11
	2	22,069	20,542	$179,018	$8.11	$166,610	$8.11
	3	7,552	7,279	$61,260	$8.11	$59,044	$8.11
	4	1,096	1,070	$8,893	$8.11	$8,676	$8.11
	5	180	178	$1,464	$8.11	$1,441	$8.11
Total D-I		67,198	63,425	$545,098	$8.11	$514,427	$8.11
D-II	1	1,131,135	1,100,837	$6,838,511	$6.05	$6,654,958	$6.05
	2	493,926	476,845	$2,986,132	$6.05	$2,882,648	$6.05
	3	132,154	129,769	$798,962	$6.05	$784,516	$6.05
	4	15,190	15,001	$91,836	$6.05	$90,692	$6.05
	5	1,655	1,642	$10,006	$6.05	$9,928	$6.05
Total D-II		1,774,061	1,724,095	$10,725,448	$6.05	$10,422,742	$6.05
D-III	1	2,868,513	2,830,096	$16,034,333	$5.59	$15,819,143	$5.59
	2	1,060,532	1,042,194	$5,928,133	$5.59	$5,825,414	$5.59
	3	269,261	266,832	$1,505,109	$5.59	$1,491,502	$5.59
	4	16,184	16,087	$90,466	$5.59	$89,923	$5.59
	5	1,769	1,762	$9,888	$5.59	$9,850	$5.59
Total D-III		4,216,260	4,156,971	$23,567,929	$5.59	$23,235,832	$5.59
E	1	599,685	599,685	$3,478,273	$5.80	$3,478,273	$5.80
	2	231,140	231,140	$1,340,649	$5.80	$1,340,649	$5.80
	3	60,501	60,501	$350,914	$5.80	$350,914	$5.80
	4	6,078	6,078	$35,252	$5.80	$35,252	$5.80
	5	840	840	$4,872	$5.80	$4,872	$5.80
Total E		898,243	898,243	$5,209,959	$5.80	$5,209,959	$5.80
GRAND TOTAL		15,724,952	14,149,825	$104,580,000	$6.65	$92,540,001	$6.54

C. Space Support Costs Should Be Allocated Using The Same Methodology Used By The Postal Service

I allocate Space Support costs on the basis of equivalent capacity. This is the same allocation methodology as presented by witness Lion in USPS-T-24, and in Docket No. MC96-3. Table 15 shows the allocation of Space Support costs and the development of TYBR unit costs.

Table 15. Allocation of Space Support Costs to Boxes by New Fee Groups, TYBR							
New Fee Groups							
New Fee Groups	Box Size	TYBR Boxes	Capacity Factor	Equivalent Capacity	Percent of Equivalent Capacity	Total Costs ($000)	Cost Per Box
		[a]	[b]	[c]	[d]	[e]	[f]
A	1	72,138	1	72,138	0.3321%	$930	$12.89
	2	4,501	1.5	6,751	0.0311%	$87	$19.33
	3	2,524	3	7,572	0.0349%	$98	$38.66
	4	242	6	1,453	0.0067%	$19	$77.32
	5	69	12	824	0.0038%	$11	$154.63
Total A		79,474	1.12	88,739	0.41%	$1,143	$14.39
B	1	124,912	1	124,912	0.5750%	$1,610	$12.89
	2	29,996	1.5	44,995	0.2071%	$580	$19.33
	3	10,802	3	32,405	0.1492%	$418	$38.66
	4	1,561	6	9,366	0.0431%	$121	$77.32
	5	1,524	12	18,288	0.0842%	$236	$154.63
Total B		168,795	1.36	229,965	1.06%	$2,963	$17.56
C-I	1	3,202,901	1	3,202,901	14.7439%	$41,272	$12.89
	2	1,463,355	1.5	2,195,032	10.1044%	$28,285	$19.33
	3	495,338	3	1,486,013	6.8406%	$19,149	$38.66
	4	116,404	6	698,426	3.2151%	$9,000	$77.32
	5	28,158	12	337,894	1.5554%	$4,354	$154.63
Total C-I		5,306,156	1.49	7,920,267	36.46%	$102,060	$19.23
C-II	1	1,944,781	1	1,944,781	8.9524%	$25,060	$12.89
	2	758,767	1.5	1,138,150	5.2392%	$14,666	$19.33
	3	243,090	3	729,269	3.3570%	$9,397	$38.66
	4	45,357	6	272,144	1.2528%	$3,507	$77.32
	5	6,262	12	75,139	0.3459%	$968	$154.63
Total C-II		2,998,256	1.39	4,159,483	19.15%	$53,599	$17.88
C-III	1	151,459	1	151,459	0.6972%	$1,952	$12.89
	2	47,532	1.5	71,298	0.3282%	$919	$19.33
	3	15,375	3	46,124	0.2123%	$594	$38.66
	4	1,612	6	9,674	0.0445%	$125	$77.32
	5	532	12	6,382	0.0294%	$82	$154.63
Total C-III		216,510	1.32	284,938	1.31%	$3,672	$16.96

Table 15. Allocation of Space Support Costs to Boxes by New Fee Groups, TYBR (continued)							
New Fee Groups							
D-I	1	36,301	1	36,301	0.1671%	$468	$12.89
	2	22,069	1.5	33,103	0.1524%	$427	$19.33
	3	7,552	3	22,656	0.1043%	$292	$38.66
	4	1,096	6	6,578	0.0303%	$85	$77.32
	5	180	12	2,165	0.0100%	$28	$154.63
Total D-I		67,198		100,803	0.46%	$1,299	$19.33
D-II	1	1,131,135	1	1,131,135	5.2070%	$14,576	$12.89
	2	493,926	1.5	740,889	3.4105%	$9,547	$19.33
	3	132,154	3	396,461	1.8250%	$5,109	$38.66
	4	15,190	6	91,142	0.4196%	$1,174	$77.32
	5	1,655	12	19,862	0.0914%	$256	$154.63
Total D-II		1,774,061		2,379,490	10.95%	$30,662	$17.28
D-III	1	2,868,513	1	2,868,513	13.2046%	$36,963	$12.89
	2	1,060,532	1.5	1,590,798	7.3229%	$20,499	$19.33
	3	269,261	3	807,784	3.7185%	$10,409	$38.66
	4	16,184	6	97,105	0.4470%	$1,251	$77.32
	5	1,769	12	21,228	0.0977%	$274	$154.63
Total D-III		4,216,260		5,385,429	24.79%	$69,396	$16.46
E	1	599,685	1	599,685	2.7605%	$7,727	$12.89
	2	231,140	1.5	346,709	1.5960%	$4,468	$19.33
	3	60,501	3	181,502	0.8355%	$2,339	$38.66
	4	6,078	6	36,467	0.1679%	$470	$77.32
	5	840	12	10,080	0.0464%	$130	$154.63
Total E		898,243	1.31	1,174,442	5.41%	$15,134	$16.85
GRAND TOTAL		15,724,952		21,723,555	100%	$279,928	$17.80

Table 16 summarizes the unit volume-variable box costs for the fee groups in the test year before rates.

Table 16. Total Volume-Variable Costs Per Box by New Fee Groups, TYBR						
New Fee Groups						
New Fee Groups	Box Size	TYBR Boxes	Space Provision	Space Support	All Other	Cost Per Box
		[a]	[b]	[c]	[d]	[e]
A	1	72,138	$31.45	$12.89	$8.07	$52.41
	2	4,501	$47.17	$19.33	$8.07	$74.58
	3	2,524	$94.35	$38.66	$8.07	$141.08
	4	242	$188.69	$77.32	$8.07	$274.08
	5	69	$377.39	$154.63	$8.07	$540.09
Total A		79,474	$35.12	$14.39	$8.07	$57.58
B	1	124,912	$22.42	$12.89	$8.08	$43.39
	2	29,996	$33.62	$19.33	$8.08	$61.04
	3	10,802	$67.25	$38.66	$8.08	$113.99
	4	1,561	$134.49	$77.32	$8.08	$219.89
	5	1,524	$268.99	$154.63	$8.08	$431.70
Total B		168,795	$30.54	$17.56	$8.08	$56.18
C-I	1	3,202,901	$12.14	$12.89	$8.10	$33.13
	2	1,463,355	$18.21	$19.33	$8.10	$45.64
	3	495,338	$36.42	$38.66	$8.10	$83.18
	4	116,404	$72.84	$77.32	$8.10	$158.26
	5	28,158	$145.68	$154.63	$8.10	$308.42
Total C-I		5,306,156	$18.12	$19.23	$8.10	$45.46
C-II	1	1,944,781	$9.21	$12.89	$6.10	$28.20
	2	758,767	$13.82	$19.33	$6.10	$39.25
	3	243,090	$27.63	$38.66	$6.10	$72.39
	4	45,357	$55.26	$77.32	$6.10	$138.68
	5	6,262	$110.53	$154.63	$6.10	$271.26
Total C-II		2,998,256	$12.78	$17.88	$6.10	$36.76
C-III	1	151,459	$6.65	$12.89	$5.73	$25.26
	2	47,532	$9.97	$19.33	$5.73	$35.03
	3	15,375	$19.94	$38.66	$5.73	$64.33
	4	1,612	$39.88	$77.32	$5.73	$122.93
	5	532	$79.76	$154.63	$5.73	$240.13
Total C-III		216,510	$8.75	$16.96	$5.73	$31.44
D-I	1	36,301	$9.68	$12.89	$8.11	$30.68
	2	22,069	$14.52	$19.33	$8.11	$41.96
	3	7,552	$29.04	$38.66	$8.11	$75.81
	4	1,096	$58.07	$77.32	$8.11	$143.50
	5	180	$116.14	$154.63	$8.11	$278.89
Total D-I		67,198	$14.52	$19.33	$8.11	$41.96

Table 16. Total Volume-Variable Costs Per Box by New Fee Groups, TYBR (continued)						
New Fee Groups						
D-II	1	1,131,135	$9.75	$12.89	$6.05	$28.69
	2	493,926	$14.63	$19.33	$6.05	$40.01
	3	132,154	$29.26	$38.66	$6.05	$73.97
	4	15,190	$58.53	$77.32	$6.05	$141.89
	5	1,655	$117.05	$154.63	$6.05	$277.73
Total D-II		1,774,061	$13.08	$17.28	$6.05	$36.41
D-III	1	2,868,513	$8.13	$12.89	$5.59	$26.60
	2	1,060,532	$12.19	$19.33	$5.59	$37.11
	3	269,261	$24.38	$38.66	$5.59	$68.63
	4	16,184	$48.76	$77.32	$5.59	$131.66
	5	1,769	$97.51	$154.63	$5.59	$257.73
Total D-III		4,216,260	$10.38	$16.46	$5.59	$32.43
E	1	599,685	$9.34	$12.89	$5.80	$28.03
	2	231,140	$14.01	$19.33	$5.80	$39.14
	3	60,501	$28.03	$38.66	$5.80	$72.49
	4	6,078	$56.06	$77.32	$5.80	$139.18
	5	840	$112.12	$154.63	$5.80	$272.55
Total E		898,243	$12.22	$16.85	$5.80	$34.86
GRAND TOTAL		15,724,952	$14.20	$17.80	$6.65	$38.65

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Revised 2-18-98

V. PROPOSED POST OFFICE BOX FEES SHOULD REFLECT THE HIGHER COSTS OF PROVIDING BOX SERVICE IN LARGER VERSUS SMALLER POST OFFICES, AND ENSURE A REASONABLE CONTRIBUTION TO INSTITUTIONAL COSTS

Under my proposal, post office box fees would increase for Fee Groups A, B, C-I, C-II, D-I, D-II and D-III. No fee increase is proposed for Fee Group C-III, or the $0 fee for Fee Group E boxholders. Proposed fee increases for boxholders in Fee Group A range from 32 to 56 percent, and from 30 to 46 percent in Fee Group B. Proposed fees for new Fee Groups C-I and C-II would increase by 40 percent and 15 to 16 percent, respectively. For new Fee Group D-I, fees increase by 100 percent. For new Fee Groups D-II and D-III, fees increase 50 to 51 percent and 25 percent, respectively.

I propose fee increases for caller service averaging 22 percent, and I propose a 33 percent increase for reserve call numbers. Table 17 presents the current annual fees, the fees proposed by the Postal Service, and my proposed fees. The percentage change in fees is also presented.

Table 17. Post Office Box Fee Comparison						
New Fee Groups	Box Size	Current Box Fees	USPS Proposed Box Fees	OCA Proposed Box Fees	USPS Percent Change	OCA Percent Change
		[a]	[b]	[c]	[d]	[e]
A	1	$48	$70	$75	46%	56%
	2	$74	$105	$110	42%	49%
	3	$128	$185	$190	45%	48%
	4	$242	$325	$330	34%	36%
	5	$418	$550	$550	32%	32%
Total A						
B	1	$44	$60	$65	36%	48%
	2	$66	$90	$95	36%	44%
	3	$112	$150	$160	34%	43%
	4	$218	$290	$290	33%	33%
	5	$372	$435	$485	17%	30%
Total B						
C-I	1	$40	$45	$56	13%	40%
	2	$58	$65	$81	12%	40%
	3	$104	$115	$146	11%	40%
	4	$172	$195	$240	13%	40%
	5	$288	$325	$402	13%	40%
Total C-I						
C-II	1	$40	$45	$46	13%	15%
	2	$58	$65	$67	12%	16%
	3	$104	$115	$120	11%	15%
	4	$172	$195	$198	13%	15%
	5	$288	$325	$331	13%	15%
Total C-II						
C-III	1	$40	$45	$40	13%	0%
	2	$58	$65	$58	12%	0%
	3	$104	$115	$104	11%	0%
	4	$172	$195	$172	13%	0%
	5	$288	$325	$288	13%	0%
Total C-III						
D-I	1	$12	$18	$24	50%	100%
	2	$20	$30	$40	50%	100%
	3	$36	$55	$72	53%	100%
	4	$53	$80	$106	51%	100%
	5	$83	$125	$166	51%	100%
Total D-I						

Table 17. Post Office Box Fee Comparison (continued)						
D-II	1	$12	$18	$18	50%	50%
	2	$20	$30	$30	50%	50%
	3	$36	$55	$54	53%	50%
	4	$53	$80	$80	51%	51%
	5	$83	$125	$125	51%	51%
Total D-II						
D-III	1	$12	$18	$15	50%	25%
	2	$20	$30	$25	50%	25%
	3	$36	$55	$45	53%	25%
	4	$53	$80	$66	51%	25%
	5	$83	$125	$104	51%	25%
Total D-III						
E	1	$0	$0	$0	0%	0%
	2	$0	$0	$0	0%	0%
	3	$0	$0	$0	0%	0%
	4	$0	$0	$0	0%	0%
	5	$0	$0	$0	0%	0%
Total E						

Collectively, these changes result in a cost coverage of 116 percent and net revenues of $94.3 million. The before rates and after rates revenues, costs and cost coverage for my proposal are shown in Table 18.

Table 18. Summary of Revenues and Costs, Proposed New Fee Groups, TYBR and TYAR											
New Fee Groups											
New Fee Groups	Box Size	OCA TYBR Boxes	Current Fees	Proposed Box Fees	OCA TYAR Boxes	TYBR Revenues	TYAR Revenues	OCA TYBR Total Costs	OCA TYAR Total Costs	OCA TYAR TTL Rev - TTL Costs	OCA TYAR Cost Cover -age
A	1	72,138	$48	$75	50,960	$3,462,625	$3,822,014	$3,780,583	$3,609,269	$212,745	1.06
	2	4,501	$74	$110	3,186	$333,056	$350,447	$335,645	$325,008	$25,438	1.08
	3	2,524	$128	$190	1,892	$323,090	$359,568	$356,100	$350,991	$8,578	1.02
	4	242	$242	$330	197	$58,595	$64,891	$66,363	$65,995	-$1,105	0.98
	5	69	$418	$550	57	$28,713	$31,617	$37,100	$37,010	-$5,393	0.85
Total A		79,474			56,293	$4,206,080	$4,628,536	$4,575,792	$4,388,273	$240,264	1.05
B	1	124,912	$44	$65	96,390	$5,496,107	$6,265,339	$5,419,447	$5,188,379	$1,076,960	1.21
	2	29,996	$66	$95	22,055	$1,979,763	$2,095,190	$1,830,893	$1,766,553	$328,638	1.19
	3	10,802	$112	$160	8,410	$1,209,804	$1,345,605	$1,231,292	$1,211,915	$133,690	1.11
	4	1,561	$218	$290	1,295	$340,285	$375,429	$343,241	$341,084	$34,346	1.10
	5	1,524	$372	$485	1,285	$566,923	$623,133	$657,910	$655,973	-$32,839	0.95
Total B		168,795			129,434	$9,592,883	$10,704,697	$9,482,783	$9,163,904	$1,540,794	1.17
C-I	1	3,202,901	$40	$56	2,534,252	$128,116,026	$141,918,088	$106,108,004	$100,679,139	$41,238,949	1.41
	2	1,463,355	$58	$81	1,112,183	$84,874,580	$90,086,804	$66,790,269	$63,939,049	$26,147,755	1.41
	3	495,338	$104	$146	391,986	$51,515,132	$57,229,916	$41,202,875	$40,363,743	$16,866,173	1.42
	4	116,404	$172	$240	92,628	$20,021,558	$22,230,648	$18,422,200	$18,229,153	$4,001,495	1.22
	5	28,158	$288	$402	22,399	$8,109,453	$9,004,508	$8,684,387	$8,637,632	$366,875	1.04
Total C-I		5,306,156			4,153,447	$292,636,749	$320,469,963	$241,207,734	$231,848,716	$88,621,247	1.38
C-II	1	1,944,781	$40	$46	1,792,531	$77,791,222	$82,456,416	$54,837,586	$53,906,806	$28,549,610	1.53
	2	758,767	$58	$67	687,515	$44,008,463	$46,063,521	$29,778,194	$29,342,599	$16,720,922	1.57
	3	243,090	$104	$120	223,768	$25,281,331	$26,852,110	$17,597,305	$17,479,179	$9,372,931	1.54
	4	45,357	$172	$198	41,815	$7,801,448	$8,279,348	$6,290,119	$6,268,463	$2,010,885	1.32
	5	6,262	$288	$331	5,779	$1,803,345	$1,912,715	$1,698,513	$1,695,560	$217,155	1.13
Total C-II		2,998,256			2,751,407	$156,685,809	$165,564,111	$110,201,717	$108,692,607	$56,871,504	1.52
C-III	1	151,459	$40	$40	151,459	$6,058,375	$6,058,375	$3,826,400	$3,826,400	$2,231,976	1.58
	2	47,532	$58	$58	47,532	$2,756,864	$2,756,864	$1,665,052	$1,665,052	$1,091,813	1.66
	3	15,375	$104	$104	15,375	$1,598,978	$1,598,978	$989,052	$989,052	$609,926	1.62
	4	1,612	$172	$172	1,612	$277,319	$277,319	$198,200	$198,200	$79,119	1.40
	5	532	$288	$288	532	$153,165	$153,165	$127,705	$127,705	$25,461	1.20
Total C-III		216,510			216,510	$10,844,702	$10,844,702	$6,806,408	$6,806,408	$4,038,294	1.59
D-I	1	36,301	$12	$24	34,356	$435,608	$824,544	$1,113,576	$1,097,768	-$273,224	0.75
	2	22,069	$20	$40	20,542	$441,377	$821,698	$925,982	$913,575	-$91,877	0.90
	3	7,552	$36	$72	7,279	$271,869	$524,117	$572,479	$570,264	-$46,147	0.92
	4	1,096	$53	$106	1,070	$58,107	$113,378	$157,328	$157,111	-$43,733	0.72
	5	180	$83	$166	178	$14,978	$29,495	$50,327	$50,304	-$20,809	0.59
Total D-I		67,198			63,425	$1,221,940	$2,313,232	$2,819,693	$2,789,022	-$475,790	0.83

Table 18. Summary of Revenues and Costs, Proposed New Fee Groups, TYBR and TYAR (continued)											
New Fee Groups											
D-II	1	1,131,135	$12	$18	1,100,837	$13,573,626	$19,815,069	$32,447,603	$32,264,050	-$12,448,981	0.61
	2	493,926	$20	$30	476,845	$9,878,524	$14,305,338	$19,759,988	$19,656,504	-$5,351,166	0.73
	3	132,154	$36	$54	129,769	$4,757,533	$7,007,536	$9,774,906	$9,760,461	-$2,752,925	0.72
	4	15,190	$53	$80	15,001	$805,088	$1,200,115	$2,155,308	$2,154,163	-$954,049	0.56
	5	1,655	$83	$125	1,642	$137,377	$205,283	$459,678	$459,600	-$254,317	0.45
Total D-II		1,774,061			1,724,095	$29,152,148	$42,533,342	$64,597,483	$64,294,778	-$21,761,436	0.66
D-III	1	2,868,513	$12	$15	2,830,096	$34,422,158	$42,451,433	$76,306,951	$76,091,761	-$33,640,328	0.56
	2	1,060,532	$20	$25	1,042,194	$21,210,646	$26,054,849	$39,353,669	$39,250,949	-$13,196,101	0.66
	3	269,261	$36	$45	266,832	$9,693,407	$12,007,445	$18,478,102	$18,464,495	-$6,457,050	0.65
	4	16,184	$53	$66	16,087	$857,763	$1,061,762	$2,130,823	$2,130,280	-$1,068,518	0.50
	5	1,769	$83	$104	1,762	$146,827	$183,260	$455,926	$455,888	-$272,627	0.40
Total D-III		4,216,260			4,156,971	$66,330,801	$81,758,749	$136,725,470	$136,393,373	-$54,634,624	0.60
E	1	599,685	$0	$0	599,685	$0	$0	$16,808,809	$16,808,809	-$16,808,809	0.00
	2	231,140	$0	$0	231,140	$0	$0	$9,047,734	$9,047,734	-$9,047,734	0.00
	3	60,501	$0	$0	60,501	$0	$0	$4,385,562	$4,385,562	-$4,385,562	0.00
	4	6,078	$0	$0	6,078	$0	$0	$845,883	$845,883	-$845,883	0.00
	5	840	$0	$0	840	$0	$0	$228,933	$228,933	-$228,933	0.00
Total E		898,243			898,243	$0	$0	$31,316,921	$31,316,921	-$31,316,921	0.00
TOTAL		15,724,952			14,149,825	$570,671,113	$638,817,332	$607,734,000	$595,694,001	$43,123,331	1.07
Caller Service		90,747	$451	$550	82,161	$40,926,917	$45,188,468			$45,188,468	
Reserve Number		182,113	$30	$40	150,749	$5,463,379	$6,029,976			$6,029,976	
GRAND TOTAL		15,997,812			14,382,735	$617,061,409	$690,035,776	$607,734,000	$595,694,001	$94,341,775	1.16

Table 19 compares the revenues, costs and cost coverage for the Postal Service's proposal and my proposal.

Table 19. Comparison of Postal Service and OCA Proposals, TYAR		
Post Office Box and Caller Service	**USPS Proposal**	**OCA Proposal**
Revenues	$683,362,079	$690,035,776
Costs	$589,954,455	$595,694,001
Net Revenues	$93,407,624	$94,341,775
Cost Coverage	116%	116%

A. Proposed Fees And The New Fee Groups Constitute A Transition To De-Averaged Allocated Costs And Further Restructuring Of Fee Groups

The proposed fees for boxes in new Fee Groups C-I, C-II and C-III and D-I, D-II and D-III constitute a transition to a uniform fee by box size for each CAG grouping comprising the new fee groups. As stated previously, combining Fee Groups C and D to create three fee groups out of CAG A-D, E-G and H-L offices was tabled for the present. To propose a uniform fee for each box size for such combined fee groups would cause large percentage increases for boxholders from Fee Group D. For example, if a new fee group, comprised of boxes in CAG A-D offices from Fee Groups C and D, were formed, a uniform fee of $56 for all size 1 boxes would represent a 40 percent ($56/$40-1) increase for size 1 boxholders from Fee Group C. However, a $56 fee for a size 1 box from Fee Group D would represent a 367 percent ($56/$12-1) increase. Because of my concern about "rate shock" for Fee Group D boxholders, I decided to move toward merging Fee Groups C and D in separate stages.

Consequently, I formed three new fee groups from Fee Group C and three from Fee Group D. This permits differential fee increases for boxes by CAG within Fee Groups C and D until such time as Fee Groups C and D are merged and restructured by CAGs A-D, E-G and H-L. In so doing, the proposed fees result in more gradual fee increases for boxholders in CAGs A-D, E-G and H-L from current Fee Group D.

B. The Proposed Post Office Box Fees Satisfy The Pricing Criteria Of The Postal Reorganization Act

The pricing criteria for postal rates and fees are enumerated in Section 3622(b), paragraphs 1 through 9, of the Postal Reorganization Act. In developing the proposed fees for post office boxes, I considered the relevant pricing criteria. The proposed fees reflect my judgment as to the application of those criteria.

Criterion number one refers to "the establishment and maintenance of a fair and equitable schedule." The proposed fees are fair and equitable. Proposed fees for Fee Groups A and B are higher than those proposed by the Postal Service, reflecting the higher allocation of All Other costs to boxes in the larger CAG offices that comprise these fee groups.

For the other fee groups, current post office box fees are misaligned with costs. Under current fees, boxholders who are similarly situated in terms of CAG pay vastly different rates. That is, boxholders with size 1 boxes in CAG A-D offices in Fee Group C pay much higher rates than size 1 boxholders in Fee Group D, i.e., $40 and $12, respectively. Nevertheless, unit box costs in the TYBR for size 1 boxes are much closer together, i.e., $33.13 and $30.68, respectively.

The proposed fees begin to reduce this inequity with higher fees for boxholders in CAG A-D offices from Fee Group D, forming new Fee Group D-I. These boxholders face a 100 percent increase. In comparison, boxholders in CAG A-D offices from Fee Group C face a smaller increase of 40 percent. Similarly, boxholders in CAGs E-G and H-L offices from Fee Group C, which form new Fee Groups C-II and C-III, respectively, face smaller increases than boxholders in CAGs E-G and H-L offices from Fee Group D, which form new Fee Groups D-II and D-III, respectively. Fees for boxholders in new Fee Groups C-II and C-III would increase by 15 to 16 percent and 0 percent, respectively, while fees in new Fee Groups D-II and D-III would increase 50 to 51 percent and 25 percent, respectively. By contrast, the Postal Service's proposed fees increase between 11 and 13 percent for all boxholders in Fee Group C, and between 50 and 53 percent for all boxholders in Fee Group D.

Moreover, the proposed fees permit a more gradual transition to a further restructuring of the classification schedule. Higher box fees for new Fee Groups D-I, D-II and D-III, and comparatively lower fees for new Fee Groups C-I, C-II and C-III would, over time, ease the transition for boxholders into fee groups consisting of CAG A-D, E-G and H-L offices from merged Fee Groups C and D in a future proceeding.

The second criterion directs that consideration be given to "the value of the mail service actually provided." Post office box service is an alternative form of delivery service that is valued by some customers. Box features such as privacy, security and the generally earlier availability of box mail vis-à-vis carrier delivery service are valued features. The value of service to boxholders is explicitly recognized in the elasticities adopted by the Commission in Docket No. MC96-3, and utilized in developing my after rates volumes and revenues.

The third criterion -- recovery of attributable costs -- requires that revenues for each mail class or service be at least equal to the attributable costs for that class or service. My proposed fees for post office boxes alone results in an implicit cost coverage of 107 percent.[20] Including caller service and reserve call numbers results in combined net revenues of $94.3 million, with a cost coverage of 116 percent (without the 1 percent contingency). This cost coverage is identical to the Postal Service's proposed cost coverage for post office boxes, caller service and reserve call numbers, i.e., 116 percent (without the 1 percent contingency).

Criterion number four concerns "the effect of rate increases" on the general public. Considerable attention was given to the effect of proposed fee increases on boxholders. Combining Fee Groups C and D to form three new fee groups by CAG

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[20] Under the Postal Service's proposal, witness Needham claims post office box revenues "make a small contribution with a 106 percent proposed implicit cost coverage." USPS-T-39 at 66.

was tabled at this time because of the significant percentage fee increases that could attend a uniform fee by box size for certain boxholders now in Fee Group D.

In order to limit such percentage fee increases, three new fee groups were created from Fee Group D, with proposed fee increases limited to 100 percent for boxholders in CAG A-D offices in Fee Group D -- boxholders in the larger (CAG A-D) offices that comprise the new Fee Group D-I. In all, fee increases of this magnitude are limited to only 63,425 boxholders. Similarly, proposed fee increases for boxholders in CAG E-G offices in Fee Group D, which comprise new Fee Group D-II, are limited to 51 percent, nearly the same percentage fee increase as proposed by the Postal Service. At the same time, fee increases for all boxholders in the smallest offices (i.e., CAG H-L) in Fee Group D, which comprise new Fee Group D-III, are limited to 25 percent.

Boxholders in new Fee Groups C-III and D-III experience the lowest percentage fee increases, as compared to other boxholders from current Fee Groups C and D, respectively, because of the lower allocated costs to boxes in the smaller offices that comprise new Fee Groups C-III and D-III.

The fifth criterion directs consideration to the role of available alternatives at reasonable cost. For boxholders subject to the proposed box fee increases, the most feasible alternative is free carrier delivery service, if the proposed box fees are considered too high or private sector alternatives prohibitive.

Criterion number seven refers to the "simplicity of [the] structure for the entire schedule and simple, identifiable relationships between the rates or fees charged." For Fee Groups A, B and E, there is no change in the fee structure. However, the proposed fee group structure is more complex than the current fee group structure for Fee Groups C and D. Fee Groups C and D are proposed to be replaced by six new fee groups, C-I, C-II and C-III, and D-I, D-II and D-III, as a transition to a further restructuring of the fee schedule. Consequently, the proposed fee schedule represents a balance between substantial fee increases for certain boxholders and a temporarily more complex fee structure for the Postal Service to administer.

C. The Proposed New Fee Groups Accord With The Classification Criteria Of The Postal Reorganization Act

The classification criteria for changes in mail and special service classifications are found in Section 3623(c), paragraphs 1 through 6, of the Postal Reorganization Act. I have considered the relevant classification criteria in relation to my development of the proposed new fee groups. Establishment of the new fee groups reflect my judgment as to the application of those criteria.

Classification criterion one refers to the "establishment and maintenance of a fair and equitable classification system for all mail." The proposed new fee groups are fair and equitable in that they maintain the basic distinction in the existing fee group structure, i.e., that between boxholders eligible for carrier delivery service and those not eligible for carrier delivery, with boxholders eligible for delivery paying box fees, and those not eligible paying no box fees. Establishing three new fee groups by CAG from Fee Group C that parallel three new fee groups from Fee Group D begins the process of eliminating the dichotomy between Fee Groups C and D, where boxholders pay differing fees depending upon their eligibility for city or "rural" delivery, respectively, and explicitly recognizes the similarities between these groups in terms of box service, the availability of carrier delivery service, and costs.

Classification criterion five concerns "the desirability of special classifications from the point of view of both the user and the Postal Service." From the point of view of boxholders, the new fee groups better reflect the costs of providing box service in post offices of comparable size. From the point of view of the Postal Service, the fact that boxholders in Fee Groups C and D are eligible for delivery services provided by either city or rural carriers would, in the future, no longer lead to significantly different post office box fees.

VI. CONCLUSION

Current post office box fees and the existing fee groups do not adequately recognize the higher costs of providing box service in larger offices nor the lower costs in smaller offices. The existing fee group structure and the Postal Service's methodology for allocating certain post office box costs results in unfairly high costs for boxholders in smaller offices and inappropriately low costs to boxholders in larger offices. As a result, current fees, and the Postal Service's proposed fees, produce fees that are too high in smaller CAG offices and too low in larger CAG offices.

The restructured post office box fee groups and the new cost allocation methodology proposed herein provide a more reasonable cost-basis for setting fees. Restructuring Fee Groups C and D based upon CAG produces more rent-homogeneous fee groups that better reflect cost in larger and smaller offices. Similarly, my new cost allocation methodology, that distributes a portion of volume-variable post office box costs by CAG, better reflects costs in larger and smaller offices.

The proposed post office box fees satisfy the relevant statutory pricing and classification criteria. My proposed box fees, combined with caller service and reserve call number fees, provide virtually the same net revenues as proposed by the Postal Service, and a reasonable contribution to institutional costs. The proposed classification changes establish a more fair and equitable classification for post office boxes by creating a more rational structure of fee groups based upon CAGs.

CHAIRMAN GLEIMAN: Mr. Callow, have you had an opportunity to examine the packet of designated written cross-examination that was made available earlier today?

THE WITNESS: Yes, I have.

CHAIRMAN GLEIMAN: And if these questions were asked of you today, would your answers be the same as those you previously provided in writing?

THE WITNESS: Yes. I have two -- I'm sorry, three corrections to be made. On Interrogatory No. 11, in Part B, the first line, "emphasis" should be changed to "emphasize". In Interrogatory 28, C, in the second line of that response, "was" should be changed to "were". And those -- those would be my changes.

CHAIRMAN GLEIMAN: I thought you mentioned three changes, and I got --

THE WITNESS: I am jumping ahead here. I'm sorry.

MS. DREIFUSS: Right. There was another Interrogatory response that is going to be changed, but I believe it is going to be moved into evidence orally this morning. It hasn't yet been included in that designated packet.

CHAIRMAN GLEIMAN: Have those two changes been incorporated into the package?

MS. DREIFUSS: Yes, sir, they have.

CHAIRMAN GLEIMAN: And with those changes, your answers would be the same as those you previously provided in writing?

THE WITNESS: Yes.

CHAIRMAN GLEIMAN: That being the case, I am going to provide two copies of the corrected designated written cross-examination of Witness Callow to the reporter and direct that it be accepted into evidence and transcribed into the record at this point.

[Designation of Written Cross-Examination of James F. Callow, OCA-T-500, was received into evidence and transcribed into the record.]

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 1997 — Docket No. R97-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF OFFICE OF THE CONSUMER ADVOCATE
WITNESS JAMES F. CALLOW
(OCA-T500)

Party	Interrogatories
Douglas F. Carlson	USPS/OCA-T500-4, 6-10, 14, 16-18, 20-23, 25, 27-28, 32-35
United Parcel Service	USPS/OCA-T500-12
United States Postal Service	USPS/OCA-T500-1-20, 22-36

Respectfully submitted,

Margaret P. Crenshaw

Margaret P. Crenshaw
Secretary

INTERROGATORY RESPONSES OF
OFFICE OF THE CONSUMER ADVOCATE
WITNESS JAMES F. CALLOW (T500)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory:	Designating Parties:
USPS/OCA-T500-1	USPS
USPS/OCA-T500-2	USPS
USPS/OCA-T500-3	USPS
USPS/OCA-T500-4	Carlson, USPS
USPS/OCA-T500-5	USPS
USPS/OCA-T500-6 (as revised 2/18/98)	Carlson, USPS
USPS/OCA-T500-7	Carlson, USPS
USPS/OCA-T500-8	Carlson, USPS
USPS/OCA-T500-9	Carlson, USPS
USPS/OCA-T500-10	Carlson, USPS
USPS/OCA-T500-11	USPS
USPS/OCA-T500-12	UPS, USPS
USPS/OCA-T500-13	USPS
USPS/OCA-T500-14	Carlson, USPS
USPS/OCA-T500-15	USPS
USPS/OCA-T500-16	Carlson, USPS
USPS/OCA-T500-17 (as revised 2/18/98)	Carlson, USPS
USPS/OCA-T500-18	Carlson, USPS
USPS/OCA-T500-19	USPS
USPS/OCA-T500-20	Carlson, USPS
USPS/OCA-T500-21	Carlson
USPS/OCA-T500-22	Carlson, USPS
USPS/OCA-T500-23 (as revised 2/18/98)	Carlson, USPS
USPS/OCA-T500-24	USPS
USPS/OCA-T500-25	Carlson, USPS
USPS/OCA-T500-26	USPS

Interrogatory:	Designating Parties:
USPS/OCA-T500-27	Carlson, USPS
USPS/OCA-T500-28 (as revised 2/19/98)	Carlson, USPS
USPS/OCA-T500-29	USPS
USPS/OCA-T500-30	USPS
USPS/OCA-T500-31	USPS
USPS/OCA-T500-32	Carlson, USPS
USPS/OCA-T500-33	Carlson, USPS
USPS/OCA-T500-34	Carlson, USPS
USPS/OCA-T500-35	Carlson, USPS
USPS/OCA-T500-36	USPS

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES USPS/OCA-T500-1-11

USPS/OCA-T500-1. Did you consider any alternatives to creating groups of offices other than by using CAG designations? If so, please describe each alternative, why it was rejected.

A. No.

USPS/OCA-T500-2. If you could determine costs for each office, would grouping offices directly into cost-homogeneous groups be preferable to using CAGs to group the offices? Please explain your answer.

A. Since I did not have cost data for each office, I do not know whether costs by office would have been preferable to CAG cost data in developing my fee groups. In the absence of such cost data, I do not know *a priori* whether a reasonable basis for grouping offices might have emerged from the data.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES USPS/OCA-T500-1-11

USPS/OCA-T500-3. Please refer to page 8, lines 10 to 11, where you state that "certain labor costs are not incurred in smaller post offices." Are you stating that certain work (regardless of who performs it) is done only in larger offices and not in smaller offices? If so, please explain. If not, is your position that smaller offices perform such work more efficiently? Please explain.

A. No. It would be reasonable to expect that certain work is required to maintain and service post office boxes, wherever located. What I am saying is that certain labor costs so categorized by the Postal Service (e.g., mailhandler and supervisor costs) are not incurred in smaller post offices because there are no mailhandlers or supervisors in such offices. I do not know whether "certain work" is performed more efficiently in smaller offices. It is clear, however, that such work is not being performed by mailhandlers or supervisors.

USPS/OCA-T500-4. Please refer to your Table 2.

(a) Please confirm that for non-city offices the highest average rental cost is for CAG E, and the second highest cost is for CAG F. If you do not confirm, please explain why not.

(b) Please confirm that for non-city offices CAGS C, D, E, F, G, and H have higher average rental costs than CAG B. If you do not confirm, please explain why not.

A. (a) Confirmed.

(b) Confirmed. However, it should be noted that the average rental cost of $5.93 per square foot for CAG B is computed from only three offices. This small number of observations might explain the comparatively low average rental cost for CAG B offices.

USPS/OCA-T500-5. Please refer to library reference OCA-LR-2, page 16.
(a) Please confirm that for city offices, the maximum rental cost for each of CAGS A through G is between $33 and $36. If you do not confirm, please explain why not.
(b) Please confirm that for non-city offices, the maximum rental cost for each of CAGS E through L is between $17 and $18, while the maximum rental cost for each of CAGS B through D is between $9 and $14. If you do not confirm, please explain why not.

A. (a) Confirmed, if you round the maximum rental cost for CAG E offices to the nearest dollar.

(b) Confirmed.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES USPS/OCA-T500-1-11

USPS/OCA-T500-6. Please refer to your testimony at page 14, lines 5 through 14.
(a) When an office's revenue changes so that it moves between CAGS D and E, or between CAGS G and H, would that office be reclassified into a different fee group under your proposal?
(b) If so, would that reclassification be at the same time as the CAG move, or later. If later, how much later?

A. (a) Yes.

(b) The reclassification of an office into a different fee group, where the office is placed in a new CAG level caused by the office's change in revenues, could be addressed in several ways. One possible approach would be to reclassify an office into a different fee group at the time changes in post office box fees are implemented by the Postal Service. Ultimately, however, the determination of when to make such a reclassification should rest with the Postal Service, in a manner that is administratively convenient to the Postal Service.

USPS/OCA-T500-7. Please refer to your testimony at page 17, lines 6 to 8. If in the future some offices in the city-B delivery group were reclassified into CAG E, or some CAG E offices were added to the city-B delivery group, would you adjust Fee Groups C-I and D-I so that they also include CAG E, as well as CAGs A through D? Please explain your answer.

A. The city-B delivery group, and consequently Fee Group B, consists of "specific high-cost ZIP Code areas in eight large cities and their suburbs." USPS-T-39 at 60. These high-cost ZIP Code areas encompass certain CAG A-D offices. In developing my new Fee Groups C-I and D-I, I accepted the Postal Service's (and the Commission's) determination from Docket No. R90-1 that some CAG A-D offices were in high-cost areas. I decided to use this determination as a basis for my new Fee Groups C-I and D-I. If it were determined that CAG E offices were also in high-cost areas, I would not rule out the possibility of including CAG E, as well as CAG A-D offices, in new Fee Groups C-I and D-I.

USPS/OCA-T500-8. Please refer to your testimony at page 17, line, 8, to page 18, line 2. Assume that during 1998 the average rental costs for CAG H increased to at least $5.80 for city-other offices, and $6.43 for non-city offices. Also assume that the average rental costs for the other CAGS remained the same, so that the CAG H averages were within $2 of the average CAG E rental cost. Under these conditions, would you adjust your fee group definitions so that CAGS E through H were grouped together? Please explain your answer.

A. I am unable to answer the question as framed because I did not make my determination to group CAGs E-G and H-L in the manner described. Rather, I started with the intention of merging the same CAG level offices from the city-other and non-city delivery groups, which form the basis of Fee Groups C and D. Although this effort was tabled to a future proceeding, *see* OCA-T-500 at 65-66, the data were used to develop my proposed fee groups.

I decided that three CAG groupings would best achieve the goal of having boxholders in smaller, lower-cost offices pay lower fees associated with the lower costs in those offices. To achieve this goal, I "de-averaged" rental costs by CAG. I reasoned that three CAG groupings would effectively minimize the recovery of costs from boxholders in the smallest CAG offices. I rejected establishing two fee groups because costs would not be de-averaged enough. Four or more fee groups were also unacceptable because they create too complicated a fee schedule.

The first grouping, hypothetical fee group CD-I (CAGs A-D), was based on the CAG level offices constituting the City-B delivery group. The other two groups result from finding an appropriate division of CAG E-L offices. The data presented at page 15 of OCA-LR-2 were the basis of my determination to group CAG E-G offices and H-L offices into the remaining two groups: hypothetical fee groups CD-II and CD-III, respectively.

As a first step, I grouped CAG E-G offices and H-L offices to balance the number of CAGs. The computed average rental costs (the upper table of OCA-LR-2 at 15) revealed that the averages for hypothetical fee groups CD-I, CD-II and CD-III fall roughly into two dollar increments, i.e., the average rental cost of hypothetical fee group CD-I is in the $9 range; the average cost of hypothetical fee group CD-II is in the $7 range; and the average cost of hypothetical fee group CD-III is in the $5 range. I considered this a reasonable and acceptable result. The largest CAG offices were shown to have the highest average rental costs and the smallest CAG offices the lowest. Moreover, the average rental cost for hypothetical fee group CD-III ($5.79) was less than the average for the non-city delivery group as a whole ($6.00), ensuring lower costs for boxholders in the smallest offices. Because of my desire to avoid "rate shock," I retained the separate fee structure for the city-other and non-city delivery groups. However, I maintained the same groupings by CAG (CAGs A-D, E-G, and H-L) and finally proposed the three groupings separately for the city-other and non-city delivery groups.

USPS/OCA-T500-9. Please refer to section V, part A of your testimony. If your proposal and fees are implemented, do you believe that Groups C-I and D-I, C-II and D-II, and C-III and D-III could be merged in the next case involving post office box fees, without imposing "rate shock." If so, please explain how, with reference to how large fee increases would need to be to merge the groups. If not, please estimate how many cases would be needed to complete the merger of the C and D groups.

A. No. In developing my fees, the maximum fee increases were limited to 100 percent. In the context of my proposal to restructure fee groups and de-average costs, I considered fee increases of more than 100 percent to be burdensome. In the next rate proceeding, fee increases of more than 100 percent for boxholders in new Fee Groups D-I, D-II and D-III would be necessary if such fees were to be brought to parity with boxholders in new Fee Groups C-I, C-II and C-III. Consequently, I believe merging new Fee Groups C-I and D-I, C-II and D-II, and C-III and D-III would require two more rate proceedings.

USPS/OCA-T500-10. Please refer to page 66 of your testimony, lines 11 through 15.
(a) Please confirm that Table 16 of your testimony presents total costs per box for Groups A and B that are lower than those presented by the Postal Service in witness Lion's Table 13, as revised October 1, 1997. If you do not confirm, please explain why not.
(b) What is the basis for your proposing higher fees for Groups A and B than the Postal Service has proposed?

A. (a) Confirmed.

(b) Almost all my fees differ from those of the Postal Service, some higher and some lower. My total unit box costs in Fee Groups A and B are only slightly below those of the Postal Service, ranging from 0.49 percent to 4.64 percent less. Nevertheless, I proposed somewhat higher fees for boxholders in Fee Groups A and B because Fee Groups A and B represent high cost areas which are reflected in relatively higher unit box costs, as compared to other fee groups.

USPS/OCA-T500-11. Please refer to page 67 of your testimony, lines 1 to 4.
(a) Please confirm that under your proposal Group C-I faces larger dollar increases in box fees than Group D-I. If you do not confirm, please explain why not.
(b) How would this greater fee increase for Group C-I than for Group D-I ease the transition when merging fee groups C-I and D-I in the future, as you assert on page 67, lines 14 to 18.

A. (a) Confirmed.

(b) I must empha~~sis~~SIZE that the percentage increase in fees for new Fee Group C-I is considerably lower than for new Fee Group D-I. I recommend a 40 percent increase for new Fee Group C-I and a 100 percent increase for new Fee Group D-I. It is the relative percentage change in fees for new Fee Groups C-I and D-I that, over time, permits a more gradual transition for boxholders and leads to the merger of the fee groups. In this proceeding, for example, I am proposing a fee of $56 for box size 1 in Fee Group C-I, a fee that is 133 percent greater ($56/$24-1) than the proposed $24 fee for the same size box in Fee Group D-I. In a subsequent proceeding, I might propose a $48 ($24*2.0%) fee for box size 1 in Fee Group D-I, and a $78 ($56*1.40%) fee for box size 1 in Fee Group C-I, a fee that is 63 percent ($78/$48-1) greater. In this way, the fees for Fee Groups C-I and D-I would tend to converge.

By implication, the question is proposing that new Fee Groups C-I and D-I receive the same dollar increase. By way of illustration, for a box size 1, fees in new Fee Group D-I would be increased by $16 (rather than $12) or, in the alternative, fees in new Fee Group C-I would be increased by $12 (rather than $16).

Both alternatives are problematic. Increasing fees by $16 for a box size 1 in new Fee Group D-I would have constituted a 133 percent (($12+$16)/$12-1) increase. In fact, any fee increase of more than $12 would have been greater than 100 percent. I considered fee increases greater than 100 percent to be burdensome. Increasing fees by only $12 for new Fee Group C-I would have required that additional revenues be obtained through higher fees from other fee groups. My proposed fees balance the need for additional revenues among fee groups and boxes in the context of de-averaging costs and better aligning fees with costs.

USPS/OCA-T500-12. Please confirm that the classification of post offices by CAG is based upon post office revenue, rather than post office costs. If you do not confirm, please explain your answer fully and provide the source of your information.

A. Confirmed. *See* OCA-T-500 at 6-7.

USPS/OCA-T500-13. Please confirm that post office box fees are based (in part) on post office costs, but not on post office revenues. If you do not confirm, please explain your answer fully and provide the source of your information.

A. I am unable to answer this question. It is not clear from the question whether reference is being made to the Postal Service's post office box fee proposal or my proposal. In developing my fee proposal, I would note that my new fee groups are based upon groupings of CAGs, which are dependent upon post office revenues.

USPS/OCA-T500-14. Please refer to page 3, line[s] [11-] 14, of your testimony, where you state that "the Postal Service's current allocation methodology results in higher volume-variable unit box costs in smaller offices and lower unit costs in larger offices than if costs were allocated according to office location and size, as measured by CAG."

(a) Please explain how a CAG designation can be used to "measure" an office's location.

(b) In what way does a CAG designation indicate an office's size?

(c) Please confirm that an office's CAG designation does not provide information on the costs, number of employees, size of facility, or volume of incoming mail processed for that office. If you do not confirm, please explain your answer fully and the source of your information.

A. (a) Strictly speaking, an office's CAG designation does not "measure" location. However, a CAG designation does reveal something about an office's location. According to the Postal Service, "CAG A and B offices tend to be located in higher-rent urban areas, while CAG K and L offices tend to be located in lower rent rural areas." Docket No R90-1, U.S. Postal Service Library Reference F-183 at 15.

(b) Revenues, as measured by revenue units. *See* Glossary of Postal Terms, Publication 32, April 1988, at 16. *See also* U.S. Postal Service Handbook F-4, June 1992, at 22.

(c) Not confirmed. It is my understanding that the CAG level of an office is highly correlated with the items listed. However, I do not have facility-specific information available to me to demonstrate the correlation.

USPS/OCA-T500-15. Please refer to page 8 beginning at line 9, where you state that

> aside from average postal rental costs, other costs vary by CAG, and are higher in larger CAG offices. Two conditions produce this result. First, certain labor costs are not incurred in smaller post offices. While the salaries and benefits of mailhandlers are uniform nationwide, there are more mailhandlers in higher CAG offices, and proportionately more costs, than in lower offices. In fact, there are virtually no mailhandlers, and consequently almost no mailhandler costs, to be found in CAG F-L offices. Similarly, there are virtually no supervisors in offices CAG H or below. Hence, virtually no supervisor costs are incurred in such offices.

(a) Is it your contention that window service costs related to post office box service are lower in small offices than in large ones because small offices have no supervisors or mail handlers?

(b) Are you aware that clerks and postmasters in small offices often perform the same functions in small offices as mailhandlers and supervisors perform in larger offices? Please provide your understanding of how the functions performed by mailhandlers and supervisors in larger offices are performed in small offices.

(c) Are you aware that postmasters in large offices generally do not perform window service activities related to post office box service? Please provide your understanding of how the functions of postmasters differ in large and small offices.

A. (a) In developing my cost allocation methodology for All Other costs, I examined Postal Service data showing the absence of mailhandlers and supervisors in smaller offices. I considered it reasonable to conclude that where there were no mailhandlers or supervisors there would be no such costs associated with post office box service. At that time, I had no other basis for allocating costs. It should be noted that those costs I determined to be clerk costs are allocated in the same manner as witness Lion.

(b) I do not know how the functions performed by mailhandlers and supervisors in larger offices are performed in small offices. However it would not be unreasonable to expect clerks and postmasters in smaller offices to perform similar functions as mailhandlers and supervisors in larger offices.

(c) I do not know how the functions of postmasters differ in large and small offices. However, it would not be unreasonable to expect postmasters to perform different activities in larger versus smaller offices.

USPS/OCA-T500-16. Please refer to page 9, line 3, of your testimony, where you state that:

> postmaster salaries and benefits are dependent, in part, on CAG and therefore vary by CAG. In Fiscal Year 1996, the average salary for postmasters in CAGs K-L was $39,309, while the average salary for CAG A-G postmasters was $55,220 - 40 percent greater than the average salary of CAG K-L postmasters.

(a) Please confirm that the example you have used reflects a difference in the average salaries of postmasters, not a difference in the total cost of Postmasters relating to post office box service. If you do not confirm, please explain your answer fully.

(b) Assume that postmasters in smaller offices spend a greater proportion of their time on post office box functions than postmasters in large offices. Under this scenario would the additional hours spent on post office box functions by postmasters in smaller offices result in a larger portion of their salaries being spent on post office box operations than in larger offices where fewer or no postmaster hours are spent on post office box operations? If you answer is other than yes, please explain your answer fully.

(c) Please refer to pages 9 and 10 of Exhibit USPS-5A (Testimony of Joe Alexandrovich). Please confirm that volume variable costs are allocated to post office box service for postmasters EAS 23 and below, but not for postmasters EAS 24 and above. If you do not confirm, please explain your answer fully

(d) Please confirm that postmasters EAS 23 and below are generally found in smaller post offices, and that postmasters EAS 24 and above are generally found in larger post offices. If you do not confirm please explain your answer fully.

A. (a) Confirmed.

(b) Yes.

(c) Confirmed.

(d) Confirmed.

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USPS/OCA-T500-17. Please refer to page 14, line 8 of your testimony where you state:

> I propose to restructure post office box fee groups by creating six new fee groups. Three new fee groups would be formed from the current Fee Group C and three from current Fee Group D, based upon CAG. CAG A-D post offices in Fee Groups C and D would become new Fee Groups C-I and D-I, respectively.

(a) In determining that CAG A-D city delivery offices are analogous to and properly included in the same group as CAG A-D non-city delivery offices, have you examined the individual characteristics of any CAG A-D non-city delivery offices in this category and compared them to CAG A-D city delivery offices? If so, please present any conclusions you reached based on your examination.

(b) Are you aware that CAG A-D non-city delivery offices may be very small offices in towns having a very large plant load mailer providing enough revenue to qualify the office for a CAG A-D classification?

(c) To what extent would the type of CAG A-D non-city delivery office described in part (b) share cost characteristics with CAG A-D city delivery offices? Please explain.

(d) Should small CAG A-D non-city delivery offices in towns having a very large plant load mailer have the same post office box fees as much larger CAG A-D city delivery offices? Please explain your answer fully.

(e) How does your post office box fee proposal address the issue discussed in part (d)?

A. (a) No

(b) I have no personal knowledge of the situation described, and I doubt that there are very many examples of this situation. Since I did not examine the individual characteristics of any CAG A-D non-city delivery offices, however, I do not know the extent of the situation described.

(c) I did not examine the cost characteristics of any CAG A-D city delivery or non-city delivery offices. Therefore I am unable to answer this question.

(d) Yes, in the absence of data concerning the extent of the situation described. In developing my fee proposals, I relied on the Postal Service's conclusion in Docket No. R90-1 Library Reference F-183 that there is a significant relationship between the CAG designation of a facility and its associated square-foot rent, wherein higher CAG offices have higher rents and lower CAG offices have lower rents. It would not be unexpected to find exceptions to this "significant relationship." However, I did not examine the individual characteristics of any CAG city-other or non-city delivery offices to know the extent of the situation described.

(e) My fee proposal did not address the situation discussed in part (d). If the Commission adopts my proposal and the situation described in part (d) is found to be a significant problem, the Postal Service could consider, in this or a later proceeding, identifying those offices (or areas) by specific ZIP Codes, in the same manner as Fee Groups A and B, with separate fee schedules.

USPS/OCA-T500-18. Please refer to your testimony at page 37. Please confirm that your method for allocating space provision costs is equivalent to the method used by witness Lion. If you do not confirm, please describe the differences between your methodology and witness Lion's.

A. Confirmed. Using witness Lion's methodology for allocating space provision costs, the "constant of proportionality" i.e., c=$223,226,000/Q, in Table 12 of OCA-T-500, would be 1.338800798.

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USPS/OCA-T500-19. Please refer to your testimony at page 48, lines 8 to 10. Witness Lion defines "All Other" costs as "primarily labor costs for window service, and related supervisory and personnel costs." USPS-T-24 at 19, lines 21-22.

(a) Please confirm that your estimate of volume variable mailhandler costs of $12,039,000 assumes that mailhandler costs make up the same proportion of post office box Cost Segment 3 "All Other" post office box service costs as they make up of total Cost Segment 3 costs. If you do not confirm, please explain why not.

(b) Why do you believe that mailhandlers would perform post office box service functions to the same extent they perform all other Cost Segment 3 functions?

(c) On what basis do you believe that mailhandlers perform window service type functions?

A. (a) Confirmed.

(b) - (c) I made a simplifying assumption based upon the information I had available at the time.

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USPS/OCA-T500-20.

(a) Please provide versions of Tables 18 and 19, Summary of Revenues and Costs, Proposed and New Fee Groups, TYBR and TYAR, (pages 63 and 64) - based on the cost methodology presented by witness Lion (USPS-T-24), i.e., without your proposed new allocation of costs.

(b) To what extent does the closer fit of costs you claim for your proposed fee groups depend on the changes you are proposing to witness Lion's cost methodology?

A. (a) See Tables 18 and 19, attached.

(b) My proposed cost allocation methodology distributes only a portion of volume-variable post office box costs by CAG. Only $22,753,000, or 21.8 percent of total All Other costs of $104,580,000 in the TYBR, are distributed by CAG. However, under my methodology, more than one-half of the $22,753,000 is distributed to boxes in the largest, e.g., CAG A-D, offices.

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Table 18. Summary of Revenues and Costs, Proposed New Fee Groups, TYBR and TYAR											
New Fee Groups											
Fee Group	Box Size	OCA TYBR Boxes	Current Box Fees	OCA Proposed Box Fees	OCA TYAR Boxes	TYBR Revenues	TYAR Revenues	OCA TYBR Total Costs	OCA TYAR Total Costs	OCA TYAR TTL Rev - TTL Costs	OCA TYAR Cost Cover -age
A	1	72,138	$48	$75	50,960	$3,462,625	$3,822,014	$3,678,000	$3,536,864	$285,150	1.08
	2	4,501	$74	$110	3,186	$333,056	$350,447	$329,245	$320,482	$29,965	1.09
	3	2,524	$128	$190	1,892	$323,090	$359,568	$352,511	$348,301	$11,267	1.03
	4	242	$242	$330	197	$58,595	$64,891	$66,019	$65,716	-$825	0.99
	5	69	$418	$550	57	$28,713	$31,617	$37,003	$36,928	-$5,311	0.86
Total A		79,474			56,293	$4,206,080	$4,628,536	$4,462,777	$4,308,290	$320,246	1.07
B	1	124,912	$44	$65	96,390	$5,496,107	$6,265,339	$5,240,303	$5,050,225	$1,215,114	1.24
	2	29,996	$66	$95	22,055	$1,979,763	$2,095,190	$1,787,873	$1,734,946	$360,244	1.21
	3	10,802	$112	$160	8,410	$1,209,804	$1,345,605	$1,215,801	$1,199,861	$145,744	1.12
	4	1,561	$218	$290	1,295	$340,285	$375,429	$341,003	$339,228	$36,202	1.11
	5	1,524	$372	$485	1,285	$566,923	$623,133	$655,725	$654,131	-$30,997	0.95
Total B		168,795			129,434	$9,592,883	$10,704,697	$9,240,704	$8,978,391	$1,726,306	1.19
C-I	1	3,202,901	$40	$56	2,534,252	$128,116,026	$141,918,088	$101,457,958	$97,001,861	$44,916,227	1.46
	2	1,463,355	$58	$81	1,112,183	$84,874,580	$90,086,804	$64,665,736	$62,325,410	$27,761,394	1.45
	3	495,338	$104	$146	391,986	$51,515,132	$57,229,916	$40,483,732	$39,794,959	$17,434,956	1.44
	4	116,404	$172	$240	92,628	$20,021,558	$22,230,648	$18,253,201	$18,094,745	$4,135,903	1.23
	5	28,158	$288	$402	22,399	$8,109,453	$9,004,508	$8,643,507	$8,605,130	$399,378	1.05
Total C-I		5,306,156			4,153,447	$292,636,749	$320,469,963	$233,504,133	$225,822,105	$94,647,858	1.42
C-II	1	1,944,781	$40	$46	1,792,531	$77,791,222	$82,456,416	$55,906,612	$54,891,970	$27,564,446	1.50
	2	758,767	$58	$67	687,515	$44,008,463	$46,063,521	$30,195,281	$29,720,439	$16,343,082	1.55
	3	243,090	$104	$120	223,768	$25,281,331	$26,852,110	$17,730,929	$17,602,160	$9,249,950	1.53
	4	45,357	$172	$198	41,815	$7,801,448	$8,279,348	$6,315,052	$6,291,444	$1,987,904	1.32
	5	6,262	$288	$331	5,779	$1,803,345	$1,912,715	$1,701,955	$1,698,736	$213,979	1.13
Total C-II		2,998,256			2,751,407	$156,685,809	$165,564,111	$111,849,829	$110,204,748	$55,359,362	1.50
C-III	1	151,459	$40	$40	151,459	$6,058,375	$6,058,375	$3,965,742	$3,965,742	$2,092,634	1.53
	2	47,532	$58	$58	47,532	$2,756,864	$2,756,864	$1,708,781	$1,708,781	$1,048,083	1.61
	3	15,375	$104	$104	15,375	$1,598,978	$1,598,978	$1,003,196	$1,003,196	$595,782	1.59
	4	1,612	$172	$172	1,612	$277,319	$277,319	$199,683	$199,683	$77,636	1.39
	5	532	$288	$288	532	$153,165	$153,165	$128,194	$128,194	$24,971	1.19
Total C-III		216,510			216,510	$10,844,702	$10,844,702	$7,005,596	$7,005,596	$3,839,106	1.55
D-I	1	36,301	$12	$24	34,356	$435,608	$824,544	$1,060,533	$1,047,573	-$223,029	0.79
	2	22,069	$20	$40	20,542	$441,377	$821,698	$893,735	$883,563	-$61,865	0.93
	3	7,552	$36	$72	7,279	$271,869	$524,117	$561,444	$559,628	-$35,511	0.94
	4	1,096	$53	$106	1,070	$58,107	$113,378	$155,726	$155,548	-$42,170	0.73
	5	180	$83	$166	178	$14,978	$29,495	$50,063	$50,045	-$20,549	0.59
Total D-I		67,198			63,425	$1,221,940	$2,313,232	$2,721,502	$2,696,357	-$383,125	0.86

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Table 18. Summary of Revenues and Costs, Proposed New Fee Groups, TYBR and TYAR (continued)

New Fee Groups

D-II	1	1,131,135	$12	$18	1,100,837	$13,573,626	$19,815,069	$33,131,796	$32,929,878	-$13,114,809	0.60
	2	493,926	$20	$30	476,845	$9,878,524	$14,305,338	$20,058,750	$19,944,913	-$5,639,575	0.72
	3	132,154	$36	$54	129,769	$4,757,533	$7,007,536	$9,854,843	$9,838,951	-$2,831,415	0.71
	4	15,190	$53	$80	15,001	$805,088	$1,200,115	$2,164,496	$2,163,237	-$963,122	0.55
	5	1,655	$83	$125	1,642	$137,377	$205,283	$460,679	$460,593	-$255,310	0.45
Total D-II		1,774,061			1,724,095	$29,152,148	$42,533,342	$65,670,563	$65,337,572	-$22,804,231	0.65
D-III	1	2,868,513	$12	$15	2,830,096	$34,422,158	$42,451,433	$79,349,885	$79,093,857	-$36,642,424	0.54
	2	1,060,532	$20	$25	1,042,194	$21,210,646	$26,054,849	$40,478,687	$40,356,474	-$14,301,626	0.65
	3	269,261	$36	$45	266,832	$9,693,407	$12,007,445	$18,763,736	$18,747,547	-$6,740,102	0.64
	4	16,184	$53	$66	16,087	$857,763	$1,061,762	$2,147,991	$2,147,345	-$1,085,583	0.49
	5	1,769	$83	$104	1,762	$146,827	$183,260	$457,803	$457,757	-$274,497	0.40
Total D-III		4,216,260			4,156,971	$66,330,801	$81,758,749	$141,198,101	$140,802,980	-$59,044,231	0.58
E	1	599,685	$0	$0	599,685	$0	$0	$17,318,786	$17,318,786	-$17,318,786	0.00
	2	231,140	$0	$0	231,140	$0	$0	$9,244,297	$9,244,297	-$9,244,297	0.00
	3	60,501	$0	$0	60,501	$0	$0	$4,437,012	$4,437,012	-$4,437,012	0.00
	4	6,078	$0	$0	6,078	$0	$0	$851,052	$851,052	-$851,052	0.00
	5	840	$0	$0	840	$0	$0	$229,647	$229,647	-$229,647	0.00
Total E		898,243			898,243	$0	$0	$32,080,794	$32,080,794	-$32,080,794	0.00
TOTAL		15,724,952			14,149,825	$570,671,113	$638,817,332	$607,734,000	$597,236,834	$41,580,498	1.07
Caller Service		90,747	$451	$550	82,161	$40,926,917	$45,188,468			$45,188,468	
Reserve Number		182,113	$30	$40	150,749	$5,463,379	$6,029,976			$6,029,976	
GRAND TOTAL		15,997,812			14,382,735	$617,061,409	$690,035,776	$607,734,000	$597,236,834	$92,798,942	1.16

Table 19. Comparison of Postal Service and OCA Proposals, TYAR

Post Office Box and Caller Service	USPS Proposal	OCA Proposal
Revenues	$683,362,079	$690,035,776
Costs	$589,954,455	$597,236,834
Net Revenues	$93,407,624	$92,798,942
Cost Coverage	116%	116%

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES USPS/OCA-T500-12-21

USPS/OCA-T500-21. Refer to library reference OCA-LR-10, page 22. Please confirm that footnote [c] should read "[b] * Table 13E, Col. [b] by CAG." instead of "[b] / Table 13E, Col. [b] by CAG." If you do not confirm, please explain why not.

A. Confirmed. *See* OCA-LR-10, Table 13B, revised 1-23-98.

USPS/OCA-T500-22. Please refer to your testimony at page 6, line 14. Clarify the meaning of "larger CAG offices." Does this refer to larger offices in each CAG category, or higher CAG offices (with CAG A the highest and CAG L the lowest)?

A. The phrase "larger CAG offices" refers to higher CAG offices, i.e., CAG A offices the highest and CAG L offices the lowest.

USPS/OCA-T500-23. Please refer to your testimony at page 7, lines 8 to 9, where you state that:

> Average postal rental costs are higher in larger offices, as measured by CAG.

(a) Please confirm that, according to Table 2 on page 17 of your testimony, the CAG rankings by average rental costs start with CAG E with the highest cost, followed by CAGs F, C, D, G, H, B, J, K, and L, with the lowest cost. If you do not confirm, please explain why not.

(b) Please confirm that your statement on page 7 therefore does not hold true for non-city offices. If you do not confirm, please explain why not.

(c) Is the reason that average rental costs are greater for CAGs E through L non-city offices than for CAGs E through L city-other offices, respectively (according to your Table 2), that the non-city offices are larger on average than the city offices in each of those CAGs? Please explain your answer fully.

A. (a) Partially confirmed. The ranking of offices by CAG level in part (a) applies only to the non-city delivery offices in Table 2. The ranking does not apply to city-other delivery offices.

(b) Not confirmed. The ranking in part (a) simply shows the fact that the average postal rental costs by CAG are not monotonic. When CAG levels are viewed from highest to lowest, some lower CAG offices have higher average rental costs than higher level CAG offices. This condition holds not only when average rental costs by CAG are examined for non-city delivery offices, but also for city-other delivery offices, *see* OCA-LR-2 at 16, and for all offices by CAG. *See* Docket No. MC96-3, Tr. 8/2916.

Nevertheless, even with the variation in average rental costs by CAG, the general proposition stated in the quoted passage still holds: Average postal rental costs are higher in larger CAG offices. Excluding CAG B offices for non-city delivery, only two CAG levels have average rental costs greater than CAG C; six CAG levels have average rental costs below CAG C. Similarly, for CAG D offices, only three CAG levels have average rental costs higher than CAG D, and five have average rental costs below CAG D.

Moreover, I rejected establishing my new fee groups based upon individual CAG levels. Thus, my fee groups are unaffected by the fact that the average rental costs by CAG are not monotonic. Instead, my new fee groups are based upon groupings of CAG levels. The result is that the groupings of the highest CAG levels (e.g., A-D) have, with one exception, higher average rental costs than groupings of lower CAG level offices (e.g., E-G, and H-L). It should be noted that when the average rental cost for the three non-city CAG B offices is excluded, the weighted average rental cost for CAG A-D non-city delivery offices has a higher average rental cost ($7.38) than the other two grouping of offices by CAG.

In developing my new fee groups, I considered that the six fee groups I proposed would be merged into three in a future proceeding. Consequently, the existence of one new fee group (e.g., D-I) with an average rental cost one percent less than average for D-II did not seem problematic.

(c) I do not know.

USPS/OCA-T500-24. Please refer to your testimony at page 8, lines 12 to 13, and page 9, lines 1 to 2 and 18 to 19.

(a) Please explain what you mean by "proportionately" and "proportionally".

(b) Does each of the cited statements apply to costs per box? Please provide any data supporting an affirmative response.

A. (a) - (b) In preparing my testimony, I considered the terms "proportionately" and "proportionally" to be synonymous. Rather than give every boxholder (separately for Fee Groups C and D) an equal amount of such costs, I distributed them more proportionately than did witness Lion because I only allocated such costs to offices that incurred them and refrained from including such costs in the volume-variable cost base of offices in which such costs were not present.

USPS/OCA-T500-25. Please refer to Table 1 on page 11 of your testimony.

(a) Please confirm that the average rental costs for CAG A through D city-other offices are all within 84 cents of each other, while each of these costs (excluding CAG A, for which there is no non-city comparison) are at least $1.26 more than the average rental cost for the comparable CAG B through D non-city office (e.g., CAG B city-other is $3.09 greater than CAG B non-city). If you do not confirm, please explain why not.

(b) Please confirm that the average rental costs for CAG H through L non-city offices are all within 61 cents of each other, while each of these costs are at least $1.05 more than the average rental cost for the comparable CAG H through L city-other office (e.g., CAG H non-city is $1.05 greater than CAG H city-other). If you do not confirm, please explain why not.

A. (a) Confirmed. However, comparing the average rental cost of city-other CAG B offices and non-city CAG B offices is of questionable value. The average rental cost of $5.93 per square foot for CAG B offices in the non-city delivery group is computed from only three offices. This small number of observations might explain the comparatively low average rental cost for CAG B offices in this delivery group, and relative to CAG B offices in the city-other delivery group.

(b) Confirmed. The facts stated in the question reinforce my position that, eventually, new fee groups C-III and D-III should be merged, because, while CAG H-L city-other average rental costs are somewhat lower than CAG H-L non-city average rental costs, the current fees paid by city-other boxholders are far higher than those paid by non-city boxholders.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES USPS/OCA-T500-22-28

USPS/OCA-T500-26. Please refer to Table 3, on page 18 of your testimony.

(a) Please confirm that the difference between the total installed boxes (14,190,165) in Table 3 and the corresponding total (14,290,298) in Table 1 of witness Lion's testimony (USPS-T-24) is due entirely to your omission of boxes from records in Postal Service library reference H-278 for which there is no data on Delivery Group or CAG. If you do not confirm, please explain why not.

(b) Do you know the effect on your analysis of omitting these records? If so, please explain the effect.

A. (a) Confirmed.

(b) I did not consider the difference in the number of boxes installed on my analysis since my proposal is based upon post office boxes in offices grouped by CAG level, which form my new fee groups.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES USPS/OCA-T500-22-28

USPS/OCA-T500-27. Please refer to Table 17, at pages 61-62 of your testimony.

(a) Please confirm that your proposed fees for proposed fee groups C-II and C-III are higher than your proposed fees for proposed fee groups D-I, D-II, and D-III, even though group D-I consists of higher CAGs than either group C-II or C-III, and group D-II consists of higher CAGs than group C-III. If you do not confirm, please explain why not.

(b) Is it reasonable to conclude that your proposed fees for groups C-I, C-II, C-III, D-I, D-II, and D-III are based primarily on delivery group, and only secondarily on CAG? Please explain.

A. (a) Confirmed.

(b) No. I proposed different fees for my new fee groups that, although consisting of the same CAG levels and found in Fee Groups C and D, reflected the higher allocated costs for boxes in my new fee groups having higher CAG offices. The differential fees in the new fee groups consisting of the same CAG levels in Fee Groups C and D also served to avoid rate shock and ease the transition to a uniform fee by box size for each CAG grouping comprising the new fee groups. *See* OCA-T-500 at 65-66.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES USPS/OCA-T500-22-28

USPS/OCA-T500-28. Please refer to your testimony at page 72, lines 12-13, where you state that:

> Restructuring Fee Groups C and D based upon CAG produces more rent-homogeneous fee groups that better reflect cost in larger and smaller offices.

(a) With reference to the upper table on page 15 of OCA-LR-2, please confirm that the coefficients of variation for new groups CD1, CD2, and CD3 are 76.6 percent, 64.3 percent, and 47.7 percent, respectively. If you do not confirm, please explain why not.

(b) With reference to the upper table on page 15 of OCA-LR-2, and considering those rents (RCSF) that are within one standard deviation of the mean rent for each of groups CD1, CD2, and CD3, please confirm that there is substantial overlap of the variable RCSF among these three groups. If you do not confirm, please explain why not.

(c) Based on the coefficients of variation and the overlap of rents for new groups CD1, CD2, and CD3, do you consider each of these new groups to be "rent-homogeneous"? Please explain your reasoning.

(d) With reference to the lower table on page 15 of OCA-LR-2, please confirm that the coefficients of variation[ ] for rental cost per square feet for CAGs A through L range from 45.5 percent (CAG J) to 80.7 percent (CAG A). If you do not confirm, please explain why not.

(e) With reference to the lower table on page 15 of OCA-LR-2, and considering those rents (RCSF) that are within one standard deviation of the mean rent for each CAG, please confirm that there is substantial overlap of the variable RCSF among the CAGs. If you do not confirm, please explain why not.

(f) Based on the coefficients of variation and the overlap of rents that can be derived from the lower table on page 15 of OCA-LR-2 for each CAG, do you consider each of CAGs A through L to be "rent-homogeneous"? Please explain your reasoning.

(g) Please provide a version of the upper table on page 15 of OCA-LR-2 that divides groups CD1, CD2, and CD3 into the fee groups you propose in your testimony - C-I, C-II, C-III, D-I, D-II, and D-III.

A. (a) [Please note this answer is being revised to conform with the response to USPS/OCA-T500-43.] Although I am not a statistician, I am aware that when the standard deviation is divided by the mean for CD1, CD2 and CD3, I obtain the percentages 76.6, 64.3 and 47.7 cited in part (a) of the interrogatory. Please note that I

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES USPS/OCA-T500-22-28

did not rely on such comparisons in developing my groups. It should also be noted that, using the same calculation, the percentages for new groups CD1 and CD2 are smaller than the percentage calculated for delivery group C, and the percentage for CD3 is smaller than the percentage for delivery group D. *See* table below.

USPS GROUP	Mean	Std. Dev.	Std. Dev. / Mean
A	$23.49	17.1993379	73.2%
B	$16.74	10.6920571	63.9%
C	$7.71	6.0529773	78.6%
D	$6.00	2.8884734	48.1%
E	$7.19	3.8095395	53.0%

Source: US Postal Service LR-H-188 at 23 and 24.

(b) While it is apparent that there is overlap among the groups CD1, CD2 and CD3, I am unable to confirm whether it constitutes "substantial" overlap. *Compare* OCA Groups A, B, CD1, CD2 and CD3 with USPS Groups A, B, C and D, below.

OCA GROUP	Mean	Std. Dev.	Mean - Std. Dev.	Mean + Std. Dev.
A	$23.49	17.1993379	6.2911601	40.6898359
B	$16.74	10.6920571	6.0510012	27.4351154
CD1	$9.05	6.9274203	2.1220541	15.9768947
CD2	$7.05	4.5347886	2.5127599	11.5823371
CD3	$5.79	2.7621283	3.0250878	8.5493444
E	$7.19	3.8123217	3.3812584	11.0059018

Source: OCA-LR-2 at 15.

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ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES USPS/OCA-T500-22-28

USPS GROUP	Mean	Std. Dev.	Mean - Std Dev	Mean + Std Dev
A	$23.49	17.1993379	6.2911601	40.6898359
B	$16.74	10.6920571	6.0510012	27.4351154
C	$7.71	6.0529773	1.6521167	13.7580713
D	$6.00	2.8884734	3.1126676	8.8896144
E	$7.19	3.8095395	3.3837174	11.0027964

Source: US Postal Service LR-H-188 at 23 and 24.

(c) Yes. In developing my new groups, C-I, C-II, C-III, D-I, D-II and D-III, I found that the average rental costs for each new group ~~was~~ were more rent-homogeneous than the average for their respective delivery groups as a whole. *See* OCA-T-500 at 16-17.

(d) [Please note this answer is being revised to conform with the response to USPS/OCA-T500-43.] Although I am not a statistician, I am aware that when the standard deviation is divided by the mean for CAGs A through L, I obtain percentages for the CAG levels that range from 45.5 percent (CAG J) to 80.7 percent (CAG A). Please note that I did not rely on such comparisons in developing my groups.

(e) While it is apparent that there is overlap among the CAG levels, I am unable to confirm whether it constitutes "substantial" overlap.

(f) See response to (c) above. In any event, the rent homogeneity of individual CAG levels is irrelevant to my proposal because my new fee groups are based on groupings of several CAG levels.

(g) *See* attached table. *See also* OCA-T-500, Table 2.

Attachment to Response to
USPS/OCA-T500-28(g)
Page 1 of 3

Rental Cost per SF, by NEWGRP, H-216 data 1
08:53 Monday, February 2, 1998

Analysis Variable : RCSF

NEWGRP	N Obs	N	Mean	Std Dev	Minimum	Maximum
A	30	30	23.4904980	17.1993379	0.0019685	64.0482433
B	153	153	16.7430583	10.6920571	0.0051282	43.5236769
CI	3017	3017	9.0681161	6.9529147	0.0076923	35.7997936
CII	2261	2261	6.8796686	5.1052680	0.0076923	34.4827586
CIII	772	772	4.9649169	2.6802886	0.8640000	26.6166667
DI	31	31	7.2352096	3.2521942	1.4803597	13.3088042
DII	1521	1521	7.2971055	3.5066756	1.2860483	17.8618682
DIII	12618	12618	5.8375263	2.7592156	1.2847966	17.8722003
E	4170	4170	7.1935801	3.8123217	1.0666667	23.3690360

```
****************************************************************;
*     Program: NBOXSQF.SAS                                      ;
*                                                               ;
*     This program retabulates the H-216 data file RENT.DATA    ;
*     to produce cost per square foot estimates for the         ;
*     Delivery groups requested by the Postal Service in        ;
*     in OCA/USPST500-28(g)                                     ;
****************************************************************;

filename in1 't:\r97-1\libref\h-216\rent.data';
filename in1 'c:\trash\rent.data';

proc format; *formats for the delivery group codes;
      value $dgrp
      'A'='City-A'
      'B'='City-B'
      'C'='City-Other'
      'D'='Non-city'
      'E'='Nondel.'
      ;
data a;
  infile in1 dlm=' , ' firstobs=2;
  input group $ cag $ rcsf ra sf;
  if cag~='';  **eliminate records with missing cag or group;
  if group~=''; **eliminate records with missing cag or group;
      if group='A' then newgrp='A   ';
      if group='B' then newgrp='B   ';
      if group='C' then do;
            if 'A'<=cag<='D' then newgrp='CI  ';
            else if 'E'<=cag<='G' then newgrp='CII ';
            else if 'H'<=cag<='L' then newgrp='CIII';
            end;

      if group='D' then do;
            if 'A'<=cag<='D' then newgrp='DI  ';
             else if 'E'<=cag<='G' then newgrp='DII ';
             else if 'H'<=cag<='L' then newgrp='DIII';
            end;
```

Attachment to Response to
USPS/OCA-T500-28(g)
Page 3 of 3

```
if group='E' then newgrp='E   ';

*if group='C' or group='D' then do;
*       if 'A'<=cag<='D' then newgrp='CD1';
*       if 'E'<=cag<='G' then newgrp='CD2';
*       if 'H'<=cag<='L' then newgrp='CD3';
*       end;
*save formatted delivery group as DGROUP;
dgroup=put(group, $dgrp.);
```

ANSWER OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORY USPS/OCA-T500-29

USPS/OCA-T500-29. Please refer to your testimony at page 48, lines 8 to 10.

(a) Please confirm that in FY 1996, only 0.329 percent of all weighted tallies for cost segment 3 post office box and caller service costs were mailhandler tallies, while 99.671 percent were clerk tallies. If you do not confirm, please explain why not.

(b) Please confirm that, using these percentages, one would estimate volume-variable mailhandler costs to be $235,000, or 0.329 percent of Cost Segment 3 volume-variable post office box and caller service costs of $71,527,000.

(c) Do you believe that this $235,000 estimate or the $12,039,000 estimate in your testimony is a better estimate for mailhandler costs for post office box and caller service? Please explain your reasoning.

A. (a) - (c) Unable to confirm. I am unfamiliar with, and do not recognize, the percentages cited, nor do I know how they were developed. Please note that no source documents have been cited or provided.

USPS/OCA-T500-30. Please refer to Table 13 of your testimony, at pages 42-43.

(a) Please confirm that "Non-CAG Costs" are allocated among fee groups according to the number of boxes in each group. If you do not confirm, please explain why not.

(b) Please confirm that "Non-CAG costs" constitute about 78 percent of total "All Other" costs ($81,827/$104,580). If you do not confirm, please explain.

(c) Please confirm that "Supervisor Costs" and "Mailhandler Costs" are allocated among fee groups according to the number of boxes in each group, except that the boxes are zeroed for those CAGs that have no (or virtually no) supervisors or mailhandlers, respectively. If you do not confirm, please explain why not.

(d) Please confirm that "Postmaster Costs" are allocated among fee groups according to your estimate of the number of postmasters in each group, and then to box size according to the number of boxes of each size in each group. If you do not confirm, please explain why not.

(e) Please confirm that you allocate CAG-related "All Other" labor costs (postmaster, supervisors, and mailhandlers) for your proposed fee groups as follows:

Fee Group	*Labor Costs Per Box*
A	$2.86
B	$2.87
C-I	$2.89
C-II	$0.89
C-III	$0.53
D-I	$2.90
D-II	$0.84
D-III	$0.39
E	*$0.60*
Total	$1.45

A. (a) Not confirmed. Non-CAG costs "are allocated proportionally to the total number of boxes, as shown in Table 13D." OCA-T-500 at 51. Also, *compare* OCA-T-500, Table 13D, and USPS-T-24, Table 10.

(b) Confirmed. See my response to USPS/OCA-T500-20(b).

(c) Not confirmed. Supervisor and mailhandler costs are allocated based upon the percent of total "supervisor" boxes and "mailhandler" boxes, respectively.

See OCA-T-500, Table 13C, Columns [c] and [e]. *See also* OCA-T-500 at 47-49 for a description of the allocation process.

(d) Confirmed. However, a more complete description of the process of allocating postmasters costs is found in OCA-T-500 at 45-46.

(e) Confirmed.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES USPS/OCA-T500-30-35

USPS/OCA-T500-31. Please refer to your response to interrogatory USPS/OCA-T500-3.

(a) Please confirm that your method for allocating postmaster costs assumes that each postmaster incurs the same dollar amount of post office box "All Other" costs. If you do not confirm, please explain why not.

(b) Do you believe that postmasters at large offices are as likely to perform post office box "All Other" work as postmasters at small offices? If so, please explain the basis for your response.

(c) Please confirm that your allocation of post office box labor costs does not reflect the possibility that post office box "All Other" activities that are performed by mailhandlers and supervisors at larger offices are performed by postmasters and clerks at smaller offices. If you do not confirm, please explain why not.

A. (a) In the absence of average postmasters salaries by CAG, I used the number of postmasters in each CAG level in each fee group to distribute volume-variable postmasters costs. Consequently, in my allocation methodology, each postmaster has an equal weight in the distribution of postmaster costs to fee groups. On that basis, confirmed.

(b) According to witness Lion, "All Other costs are primarily labor costs for window service, and related supervisory and personnel costs." USPS-T-24 at 19. I do not know whether postmaster in larger offices are as likely to perform post office box "All Other" work as postmasters at smaller offices. However, it would not be unreasonable to expect that, in larger offices where mailhandlers and supervisors (in addition to clerks) are employed, postmasters do not perform as much "All Other" work as postmasters in smaller offices.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES USPS/OCA-T500-30-35

(c) Confirmed, with respect to clerks. Not confirmed, with respect to postmasters. My allocation methodology distributes a larger amount of postmaster costs to boxes in smaller offices than larger offices.

USPS/OCA-T500-32. Please refer to your Table 18. Please confirm that you are proposing a 40 percent fee increase for over 62 percent of Group C boxes, and a 25 percent increase for over 69 percent of Group D boxes. If you do not confirm, please explain why not.

A. Partially confirmed. In the TYAR, 58.3 percent (4,153,447/(4,153,447+2,751,407+216,510)) of boxes in Fee Group C have a 40 percent increase, while 69.9 percent (4,156,971/(63,425+1,724,095+4,156,971)) of boxes in Fee Group D have a 25 percent increase.

In developing my proposed fees, new Fee Group C-I boxholders pay higher fees because they have higher unit box costs. By contrast, new Fee Group D-III boxholders have lower unit box costs. Consequently, boxholders in new Fee Group C-I have a higher percentage fee increase than new Fee Group D-III.

USPS/OCA-T500-33. Please refer to your response to interrogatory USPS/OCA-T500-6(a). Please confirm that an office's revenues could change, so that it needs to be reclassified, even though there has been no change in the office's costs. If you do not confirm, please explain why not.

A. Partially confirmed. The question seems to imply that a change in an office's revenues would automatically result in the reclassification of an office to a different fee group, even though there is no change in an office's costs. Please note that such a reclassification would arise at four places: between CAGs D and E and CAGs G and H within Fee Groups C and D. (When the new fee Groups are ultimately merged, the need to reclassify an office would arise at only two places). However, as stated in my response to USPS/OCA-T500-6(b), the reclassification of an office into a different fee group could occur at the time changes in post office box fees are implemented by the Postal Service.

The situation described in the question is possible in the short-term but unlikely over the long-term. Changes in an office's revenues would likely involve changes in cost. Given the Postal Service's determination that there is a significant relationship between the CAG designation of an office and its associated square-foot rent, I would expect that, over time, a higher (or lower) CAG designation would reflect higher (or lower) average rental costs (and possibly other costs as well), even though there is no change in an office's costs at the time of reclassification.

USPS/OCA-T500-34. Please refer to your response to interrogatory USPS/OCA-T500-7, and to library reference LR-OCA-2 at page 17.

(a) Please provide the mean cost for all offices, combining City-Other and Non-city.

(b) Please confirm that OCA-LR-2 shows that there are offices with high rental costs (at least twice the mean cost) in each of the CAGs.

(c) In your response to interrogatory USPS/OCA-T500-7, you state that you decided to use the Postal Service's determination from Docket No. R90-1 that some CAG A-D offices were in high-cost areas as the basis for defining your new fee groups C-I and D-I. Is your goal for groups C-I and D-I to include offices "in high cost areas", offices with high postal costs, or offices with high revenues? Please explain your response.

A. (a) The mean cost for all city-other and non-city offices, combined, is 6.5147106=((6,050/20,220*7.7266699)+(14,170/20,220*5.9972545)). *See* OCA-LR-2 at 17.

(b) Confirmed. However, the comparison is not relevant. I rejected establishing fee groups based upon individual CAG levels, and instead established my new fee groups based upon groupings of CAG levels.

A more relevant comparison, if one is to be made, is between offices with high rental costs and the mean of each delivery group. Comparing the mean and the maximum for delivery groups reveals offices with average rental costs at least twice the mean in each delivery group proposed by the Postal Service and my proposed delivery groups. *Compare* US Postal Service LR-H-188 at 23-24, and my response to USPS/OCA-T500-28(g).

(c) The question presumes that the three choices–offices "in high cost areas," offices with high postal costs, and offices with high revenues–are unrelated. The CAG designation of an office clearly provides information as to whether an office generates "high" versus "low" revenues. The CAG designation also reveals something about location. As stated in my response to USPS/OCA-T500-14(a), the Postal Service has determined that higher CAG offices tend to be located in higher rent urban areas, while lower CAG offices tend to be located in lower rent rural areas. Finally, the CAG designation of an office also informs about postal costs. Again, according to the Postal Service, "there is a significant relationship between the CAG designation of a facility and its associated square-foot rent (e.g. CAG A offices have higher rents than CAG L offices)." Docket No. R90-1, USPS Library Reference F-183, at 2, n. 2.

It is my goal to define new Fee Groups C-I and D-I by grouping offices with high average postal rental costs. I am able to group offices with high average postal rental costs because of the CAG designations of the offices.

USPS/OCA-T500-35. Please refer to your response to interrogatory USPS/OCA-T500-9.

(a) Do you believe that the Groups C and D fees can be merged with two more changes of the same magnitude you propose in this case?

(b) Please confirm that two more 40 percent increases for Group C-I, and 100 percent increases for Group D-1, would leave Group D-1 more than $13 below Group C-1. If you do not confirm, please explain why not.

(c) Please confirm that a similar process for Groups C-II and D-II, and Groups C-III and D-III would leave gaps even larger than $13 between these fee groups after the second proceeding. If you do not confirm, please explain why not.

A. (a) No. However, in my response to UPS/OCA-T500-9, I did not assume two subsequent increases of exactly the same magnitude as proposed in this case. For example, in new Fee Group C-I, fee increases of less than 40 percent in subsequent proceedings could be utilized. Similarly, in new Fee Groups D-II and D-III, fee increases of more than 50 percent and 25 percent, respectively, would likely be necessary. As a result, I believe that, through a combination of increases that are both greater than and less than those proposed in this proceeding, fees for boxholders in new Fee Groups D-I, D-II and D-III could be brought to parity with fees for boxholders in new Fee Groups C-I, C-II and C-III in two more rate proceedings.

(b) Partially confirmed. Two more 40 percent increases for new Fee Group C-I, and two more 100 percent increases for new Fee Group D-I, would leave only box sizes 1, 4 and 5, from new Fee Group D-I more than $13 below the same size boxes in new Fee Group C-I. Two more fee increases of this magnitude would result in box sizes 2 and 3 in new Fee Group D-I exceeding the fees for the same size boxes in new Fee Group C-I.

(c) Confirmed. However, in my response to UPS/OCA-T500-9, I did not assume two subsequent increases of exactly the same magnitude as proposed in this case. See my response to part (a) above.

USPS/OCA-T500-36. Please refer to your response to interrogatory USPS/OCA-T500-2, where you state that since you do not have cost data for each office, you do not know "*a priori* whether a reasonable basis for grouping offices might have emerged from the data." Please explain specifically what cost data would not provide a reasonable basis for grouping offices based on costs for each office, assuming such costs were available. For example, would not one be able to simply order all offices by costs, and then divide the offices into equally-sized groups, such as quartiles?

A. My response to USPS/OCA-T500-2 was not intended to address whether certain cost data for each office would not provide a reasonable basis for grouping offices. The cost data that would *not* be reasonable could be limitless. Rather, I would be willing to consider relevant post office box cost data for each office as a basis for grouping offices, if such costs were available. Nevertheless, since I did not have cost data for each office, I could not make any statement or determination about the use of office cost data.

In my view, the issue is, What would be a reasonable basis for grouping offices? The question suggests an approach. In the absence of cost data for each office, however, it is not possible to judge whether such an approach is reasonable.

CHAIRMAN GLEIMAN: Is there any additional written cross-examination?

MR. RUBIN: Yes, there is.

CHAIRMAN GLEIMAN: Mr. Rubin, if you would approach the witness.

CROSS-EXAMINATION

BY MR. RUBIN:

Q Good morning, Mr. Callow.

A Good morning.

Q I have handed you two copies of your responses to Interrogatories T-500-37 through 45.

A Yes.

Q Have you reviewed those response?

A Yes, I have.

Q And if you were to testify orally here today, would those be your response?

A Yes, with the third change that I mentioned earlier. On No. 43, the word, in Part A, the word "confirmed" should be changed to "confirm".

MR. RUBIN: In that case, I will provide the two copies of Mr. Callow's responses to Interrogatories 37 to 45 to the reporter and I ask that they be entered into evidence.

CHAIRMAN GLEIMAN: I will direct that the additional designed written cross-examination of Witness

Callow be accepted into evidence and transcribed into the record at this point.

[Additional Designation of Written Cross-Examination of James F. Callow, OCA-T-500, was received into evidence and transcribed into the record.]

USPS/OCA-T500-37. Please refer to your response to interrogatory USPS/OCA-T500-13. Please confirm that **the current** post office box service fees are based (in part) on post office costs, but not on post office revenues. If you do not confirm, please explain why not.

A. Confirmed.

USPS/OCA-T500-38. Please refer to your response to interrogatory USPS/OCA-T500-14(a), which quotes the Postal Service concerning CAG A, B, K, and L offices. Does the designation of an office as CAG C though CAG J reveal anything about that office's location. If so, please explain what.

A. Yes. I relied on findings presented in Postal Service's Library Reference F-183 from Docket No. R90-1. According to the Postal Service, "space provision costs tend to vary with facility *location* (square foot rents are higher in urban and suburban locales than in rural areas) . . ." (Emphasis added) Docket No. R90-1, US Postal Service Library Reference F-183 at 2. Moreover, the Postal Service has determined that "there is a significant relationship between the CAG designation of a facility and its associated square-foot rent (e.g. CAG A offices have higher rents than CAG L offices)." Id. This determination is supported by Postal Service data. *See* table below, reproduced from Docket No. MC96-3, Tr. 8/2916, Response of United States Postal Service to Interrogatory of the Office of the Consumer Advocate, OCA/USPS-88(h). *See also* Docket No. R90-1, US Postal Service Library Reference F-183, Table 6, at 16. In both cases, the data reveal that, "as one goes from CAG A offices to CAG L offices, there is, with two exceptions, a uniform decline in average square foot rent." Id. at 15. Finally, the Postal Service concluded that "[t]his is not surprising, given that CAG A and B offices tend to be located in higher-rent urban areas, while CAG K and L offices tend to be located in lower-rent rural areas." Id.

CAG	NUMBER OF FACILITIES	AVERAGE RENTAL COST ($ / square foot)
A	1,185	$9.13
B	691	$9.07
C	1,111	$9.29
D	495	$8.54
E	815	$7.65
F	1,008	$7.13
G	2,284	$6.35
H	3,400	$6.04
J	4,650	$5.75
K	9,055	$5.76
L	1,572	$5.57

Source: Docket No. MC96-3, OCA/USPS-88(h).

USPS/OCA-T500-39. Please refer to your response to USPS/OCA-T500-14(b), where you state that revenues can be used to indicate an office's size.

(a) Is it possible for a small office to generate a relatively large amount of revenue? If your answer is other than yes, please explain why this is not possible.

(b) Is it possible for a large office to generate a relatively small amount of revenue? If your answer is other than yes, please explain why this is not possible.

(c) Please confirm that for small offices that have a relatively high number of revenue units and for large offices that have a relatively low number of revenue units, CAG designation would not be a reliable indicator of office size. If you do not confirm, please explain why?

A. (a)-(b) No. As explained in my response to USPS/OCA-T500-14(b), when I used the term "size" I was referring to revenues, as measured by revenue units. Therefore, questions (a) and (b) are a logical impossibility as I use the term "size."

(c) Unable to confirm. See my response to (a) and (b) above.

USPS/OCA-T500-40. Please refer to your response to interrogatory USPS/OCA-T500-14(c). What is the basis of your understanding that the CAG level of an office is highly correlated with each of the following:

(a) the costs for that office;
(b) the number of employees for that office;
(c) the size of the facility;
(d) the volume of incoming mail processed for that office?

In answering for each of items (a)-(d), please identify any data, including data averaged by CAG, that support your response.

A. (a) For post office boxes, one of the most important costs is rental costs. As explained in my response to USPS/OCA-T500-38, an office with a high CAG designation means an office with a high rental cost, and an office with a low CAG designation means a low rental cost.

(b) There is a high correlation between the estimated average number of employees in an office and the CAG designation of that office, with a higher average number of employees found in higher CAG offices. See table below.

CAG	Number of Offices	Number of Employees	Average per Office
	[a]	[b]	[c]
A	1,138	421,882	371
B	685	66,316	97
C	1,241	120,033	97
D	658	50,400	77
E	1,346	66,653	50
F	1,595	40,665	25
G	2,436	33,994	14
H	3,020	23,996	8
J	4,126	20,384	5
K	8,114	26,267	3
L	1,125	3,212	3

NOTES AND SOURCES:
[a] OCA-LR-2 at 12.
[b] OCA/USPS-81-82, Attachment 1.
[c] [b]/[a]

(c) When I used the term "size," I was referring to revenues, as measured by revenue units. See my response to USPS/OCA-T500-39, above. Consequently, there is a high correlation between an office with a high CAG designation and size (i.e., revenue units).

(d) I have no data.

USPS/OCA-T500-41. Please refer to your response to interrogatory USPS/OCA-T500-15(a), where you state that, at the time that you developed your cost methodology, you had no other basis for allocating post office box window service costs to offices in which there are no mailhandlers and supervisors. Do you now have any other basis for allocating these costs? If so, please present that alternative basis for allocating costs.

A. No. In responding to USPS/OCA-T500-15(a), I excluded from consideration the allocation methodology proposed by witness Lion in USPS-T-24 at 19-23, since I was seeking a methodology that better reflected costs for boxes in higher and lower cost offices. Nevertheless, witness Lion's methodology would be another basis for allocating costs.

USPS/OCA-T500-42. Please refer to your response to USPS/OCA-T500-17(b), where you state that you doubt that there are very many examples of this situation where CAG A-D non-city delivery offices may be very small offices in towns having a very large plant load mailer providing enough revenue to qualify the office for a CAG A-D classification.

(a) Please confirm that there are 31 non-city delivery offices which are classified as CAGs A through D (if necessary, see LR-H-216, file "Rent.Data"). If you do not confirm, please provide the correct number.

(b) Please confirm that 25 of the offices referenced in part (a) have rents of under $10 per square foot. If you are unable to confirm, please provide the correct number.

(c) Please confirm that 30 of the 31 of the offices referenced in part (a) have less than 10,000 square feet of interior space, and that 27 of the 31 have less than 5,000 square feet of interior space. If you are unable to confirm, please provide the correct numbers.

(d) Please explain why post office box customers at these 31 facilities should face the 100 percent fee increase that you propose for fee group D-I.

A. (a) Confirmed. *See also* OCA-LR-2 at 16.

(b) Confirmed. However, all the average rental costs in Table 2 of my testimony are below $10 per square foot.

(c) Confirmed. However, the interior space of an office is not how I defined size. See my response to USPS/OCA-T500-39.

(d) The interior space of an office is not relevant to my proposal. The size of an office that is important is revenues generated, as measured by revenue units. As explained in USPS/OCA-T500-38, the Postal Service has determined that there is a "significant relationship" between an office's CAG designation and its associated square-foot rent.

It should be noted that the 31 offices referred to represent slightly over 1 percent (31/3,048) of CAG A-L city-other and non-city offices, combined, and only 0.2 percent

(31/14,170) of all non-city office. Consequently, I do not consider an exception for these 31 offices to be warranted, given the Postal Service's determination of a significant relationship between CAG and average rental costs.

Nevertheless, if it is determined that special treatment for these 31 offices is warranted, the Postal Service could consider, in this or a later proceeding, identifying those offices (or areas) by specific ZIP Code, in the same manner as Fee Groups A and B, and establishing separate fee schedules.

USPS/OCA-T500-43. Please refer to your response to USPS/OCA-T500-28, part (a).

(a) Please confirm that the coefficient of variation is a standard normalization that measures the dispersion of a set of measurements. If you do not confirm, please explain.

(b) Please confirm that the coefficient of variation is calculated by dividing the standard deviation of such a group by the mean of the group, rather than the "mean...divided by the standard deviation" as stated in your response. If you do not confirm, please explain.

(c) Please confirm that the percentages cited in your response to part (a) of USPS/OCA-T500-28 (i.e., 76.3, 64.3, and 47.7) are the result of the correct calculation method identified in part (b) of this interrogatory. If you do not confirm, please explain and provide the correct data.

A. (a) Unable to confirm. I am not a statistician. However, according to J. E. Freund, *Modern Elementary Statistics* (1973) at 74, the Coefficient of Variation is a measure of relative variation, "which express[es] the magnitude of the variation relative to the size of whatever is being measured."

(b) Confirmed. The Coefficient of Variation "simply expresses the standard deviation of a set of data (or distribution) as a percentage of its mean." Id. at 75.

(c) Confirmed.

USPS/OCA-T500-44. Please refer to your response to USPS/OCA-T500-28, part (c) and your testimony at pages 16-17.

(a) Please provide your definition of the term "rent-homogeneous."

(b) Please confirm that this term refers to the range (or dispersion) of rental costs within a fee group. If you do not confirm, please explain fully.

(c) Please confirm that with respect to post office box fees "rent homogeneity" is a desirable property, with a smaller range of values being more desirable than a larger range. If you do not confirm, please explain fully.

(d) Please confirm that the only statistics cited in the referenced response regarding CAGs are the average rental costs of CAG groups. If you do not confirm, please explain.

(e) Please refer to your statement in the response to OCA/USPS-T500-28, part (c), where you state that the "average rental cost for each new group was more rent-homogeneous than the average for their respective delivery groups as a whole." Please explain how a single number, an average, can be considered "homogeneous" when compared to other averages.

(f) Assuming that the statement is intended to assert that post office box fee groups based on offices' CAGs are more homogeneous than groups based upon the type of carrier delivery, please explain how such an assertion can be based on group averages alone.

A. (a) I am not a statistician, and therefore I have not used the term "rent-homogeneous" in a statistical sense. My use of the term was intended to convey a grouping of similar elements closer together, which I accomplished by "de-averaging" rental costs for CAG offices by delivery group into three smaller groupings, i.e., the fee groups I propose. Consequently, I considered the weighted average rental costs for my grouping of delivery offices to be more rent-homogeneous than the average for the entire delivery group because the weighted average rental cost for my grouping of CAG offices was generally closer to the individual average rental costs for offices in each CAG level than to the average for the delivery group as a whole. *See* OCA-T-500, Tables 1 and 2.

(b) Confirmed. While the term may refer to the "range (or dispersion) of rental costs within a fee group," it is not how I used the term. See my response to part (a) above.

(c) Confirmed. The weighted average rental costs for my groupings of CAG level offices is based on a smaller range of average rental costs than is the average for their respective delivery groups as a whole. See OCA-T-500, Table 2.

(d) Confirmed.

(e) - (f) See my response to part (a) above.

USPS/OCA-T500-45. Please refer to your response to USPS/OCA-T500-28, part (a) and Table 18 of your testimony.

(a) Is it your testimony that a coefficient of variation of 76.6 percent for your Group CD1 (vs. 78.6 percent for Group C) is a significant or meaningful improvement? Please explain fully why or why not.

(b) Is it your testimony that a coefficient of variation of 47.7 percent for your Group CD3 (vs. 48.1 percent for Group D) is a significant or meaningful improvement? Please explain fully why or why not.

A. (a) - (b) No, and I did not rely on such comparisons in developing my fee groups. Rather, my new fee groups represent a meaningful improvement, by restructuring Fee Groups C and D based upon CAG to produce fee groups that better reflect costs in larger and smaller offices.

CHAIRMAN GLEIMAN: Anyone else?

[No response.]

CHAIRMAN GLEIMAN: If not, that moves us to oral cross. The Postal Service is the only party that has indicated oral cross-examination. Does anyone else wish to cross-examine?

[No response.]

CHAIRMAN GLEIMAN: If not, Mr. Rubin, you can begin when you are ready.

MR. RUBIN: Thank you.

BY MR. RUBIN:

Q Mr. Callow, would you turn to your response to Interrogatory T-500-31, Part C?

A I have it.

Q You state there that you allocate a larger amount of Postmaster costs to boxes in smaller offices than larger offices.

A Correct.

Q Would you agree that the reason you allocate more Postmaster costs to smaller offices is that there are proportionally more Postmasters in smaller offices than larger offices?

A No, there are not more Postmasters in smaller offices than larger offices. There are Postmasters in offices. Maybe I misunderstood the question.

Q I guess I was referring to total Postmasters. Is the percentage of all Postmasters more ~~than~~ that are in smaller offices than larger offices?

A There are more smaller offices than there are larger offices, so there would be more Postmasters in smaller offices.

Q Okay. Well, let's say, hypothetically, there is one Postmaster who spends one hour a month on post office box activities, and another one who spends one hour per day on these activities. Would your analysis treat these two Postmasters the same for distributing Postmaster costs?

A No.

Q And how would they be treated differently?

A My methodology allocated more costs to Postmasters in -- to Postmasters who spent more time on boxes, because in my methodology, the smaller offices have more costs.

Q But that --

A In the smaller, the Postmasters -- my methodology assigned a larger amount of Postmaster costs to smaller offices.

Q But if, hypothetically, there were 90 Postmasters in smaller offices and 10 Postmasters in larger offices, wouldn't your methodology assign 90 percent of the Postmaster costs to the smaller offices?

A Could you repeat the question again?

Q If, hypothetically, we had 90 Postmasters in smaller offices, and 10 Postmasters in larger offices, then wouldn't your allocation methodology assign 90 percent of the Postmaster costs to the smaller offices and 10 percent to the larger offices?

A No, because I had -- this gets to Table 13. If you will give me one second. Table 13B, where I had to make two -- basically, a two step process. The first one was where I had information on CAGs by fee group, if you will, but I didn't have information on Postmasters by fee group.

So the column B, if you will, in that table, makes the allocation of -- or ~~drives~~ derives the percentage of offices by CAG, by fee group, and then that percentage is then used to derive the number of Postmasters by CAG, by fee group, and then that -- then in column D, the percentage then becomes the way the costs get allocated and then summed by fee group. So it is the first, the column B that results in assigning more costs to the smaller CAG offices, because there are more of them.

Q But that analysis is based on numbers of Postmasters rather than how much time different Postmasters spend --

A Yes.

Q -- on post office box activities?

A Yes.

Q Okay. Would you refer to your response to Interrogatory T-500-2?

A I have it.

Q You state there that you do not know a priori whether actual costs for each office would provide a reasonable basis for creating cost homogeneous groups, preferable to the CAG approach you employed, is that correct?

A Correct.

Q And would you agree that CAG is a measure of revenue in an office that is used as ~~uses~~ a proxy for actual costs?

A I used revenues as a measure of office size and once -- using that as a measure of office size I developed fee groups and from those fee groups then I assigned costs but, no, the revenues were not a proxy for costs. They were a proxy -- they were a measure of size.

Q Interrogatory Number 2 sets up a hypothetical asking you to assume that actual costs for each office are available, is that correct?

A Yes.

Q so the two possible data sources that could be used to create cost homogeneous groups consist of, on the one hand, hypothetically, actual costs and on the other hand, the CAG based groupings that you used? Is that right?

A I guess I -- what I would like to amplify is that we did have rental cost data by CAG.

We didn't have office cost data. I guess when you said revenues is a proxy for costs, that is not true. What I had was rental cost data by CAG, so that's the costs I had by CAG.'

Q And the rental cost data by CAG is then applied to each office as a measure of its -- of each office's costs?

A No. As I understand it, the data that came from the Postal Service contained rental cost data for offices that then were grouped by CAG and then we're able to create average rental cost by CAG.

That is my understanding of the data.

Q If you had hypothetically actual cost data for each office, would not that be preferable to the average rental cost by CAG that the Postal Service provided you?

A If you are asking me theoretically would office cost data be better than simply having CAG data, yes.

The problem -- I should say the problem I had with the question was yes, you might have this information but it may -- you still have the affirmative task of determining how you would group those offices.

This question came up again or the follow-up was in T-500-36 and it seemed to me that my difficulty was that even if you had this cost data by office you still had to come up with some reasonable way of grouping the offices since you were not going to have a fee group based upon individual offices, and the question suggests, you know, divided into four -- into equally sized groups such as quartiles -- well, you know, why quartiles? Why not quintiles? Why equally sized? Why not bunched if the office cost data suggested that you had a grouping of higher cost offices or a larger grouping of lower cost offices?

I guess that is how I would answer your question.

Q Thank you. Let's move on to your response to Interrogatory 44.

A I have it.

Q I want to understand your response to Part A better by perhaps seeing a quantitative example of what you mean.

I am especially interested in the sentence that starts "Consequently" -- the third sentence.

Okay. Do you want to provide an example with numbers from your Tables 1 and 2 or should I try to lead you through an example based on my understanding of your answer?

A Why don't I take a stab at it?

What I was saying was that the average -- maybe if we look at Table 2, city other offices, CAG A through D, what I was saying is that the offices A through D that the average, the ~~907~~ $9.07, better represented those four offices than did in the case of city offices the ~~773~~ $7.73, which was on page

17.

Q That's fine. That actually was what -- that was the example I was going to work on. Thank you.

A Yes.

Q Okay. Let's look at your response to Interrogatory 32.

A I have it.

Q Would you agree that you propose a 40 percent increase for all the test year before rates boxes in Group C1?

A The 40 percent increase for C1, for the before rate boxes which resulted in a decline in the number of boxes in use, it gives you the after rate boxes to which -- which actually pay the 40 percent fee increase.

Q Okay, and if you use the test year before rates numbers, which are found in your Table 18, page 63 --

A Yes.

Q -- do you agree that the equivalent calculation to what you did for test year after rates subject to check would be -- would end up with 62.3 percent of the test year before rates boxes?

A I'll accept it subject to check. It seemed a little problematic to me because those people didn't pay the rates, the after rates.

The after rate number of boxes paid the rates and it seemed to me a more relevant calculation to make it off the after rates.

Q Okay, I understand. There are two ways of looking at it.

Is part of the reason why you prefer your proposal to the Postal Service is that it lowers the Postal Service's proposed 50 percent fee increase to 25 percent for most Group D boxes -- and I am referring to Group D-3.

A Right. What I tried to do in looking at average rental cost by CAG it was clear that you had over 100 percent difference in rental costs between the lowest CAG office, the CAG L office, and the highest CAG office, and specifically I am referring to the city other offices in this case.

The increase isn't quite so large in the noncity offices.

It seemed a worthwhile goal to create groups that reflected those lower costs and therefore given that they had lower costs should have lower fees and that was my goal in creating -- in giving the D3 Group and the C3 Group lower fees.

Q And by lowering the D3 boxes from 50 percent to 25 percent increase, was it therefore necessary to increase the Group C1 -- the increase to 40 percent?

A I had to obtain revenue from -- I had to obtain additional revenue, sure, because I wanted to come close to the Postal Service's total revenue, so it was a balancing -- it was a balancing act between attempting to reflect the lower costs in D3 and C3, but also under my methodology C1 had higher costs, so those fees reflect the higher cost but also I had to balance the revenue.

Q Do you recall that Witness Needham proposed about a 13-percent increase for all of Group C?

A Yes.

Q So does it follow that your proposed increase for Group C1 is about three times as much as the increase proposed by the Postal Service?

A Yes, and in part that reflects a higher cost of those offices under my methodology.

Q And even for your proposed Group C2, you propose a 15-percent increase.

A Slightly higher; yes.

Q And do you believe it was necessary to hit Group C as hard as you did in order to implement your proposal?

A The C2 offices also had under my methodology some slightly higher costs, so they reflect -- those fees reflect the additional cost.

Q And in the last paragraph in your response to Interrogatory 32 --

A Yes.

Q You say that the C1 boxholders pay higher fees because they have higher unit box costs.

A Yes.

Q What are you comparing these costs to?

A Well, compared to other boxholders in other -- the boxholders in C2 and C3.

Q So and when -- and when you refer to lower unit box costs for Group D3 in your answer, you're saying -- you're comparing them to the other groups you've proposed.

A Yes.

Q Finally you say consequently boxholders in new fee group C1 have a higher percentage fee increase than new fee group D3. How does it follow that the percentage fee increase for Group C1 must be higher than the percentage fee increase for Group D3?

A As I explained, the C1 boxholders had higher costs under my methodology, while the D3 had lower costs, and therefore had a lower cost increase -- I'm sorry, a lower fee increase. However, in the case of D3, those boxholders are still way below cost under my methodology, under the Postal Service methodology. It seemed appropriate that they receive some fee increase given both their lower costs but still being below the implicit cost coverage, not covering their costs per box.

Q Given that Group D3 as you just said is below cost and would continue to be below cost --

A Right.

Q Wouldn't it be reasonable to propose a fee increase that's higher than 25 percent for them?

A Well, as I explained, one of my -- one of my -- my goals ~~was~~ in establishing the fee groups was to, if you will, isolate the boxholders in the smallest offices, because they had lower costs, lower rental costs, and therefore with those lower costs would come a smaller fee increase. But again because they are below cost under my methodology and as I said under the Postal Service methodology, they should have some fee increase.

Q Do you agree that Group C1 already provides a substantial contribution to other costs of the Postal Service?

A Do you mean in terms of revenues?

Q Correct.

A Yes. It's --

Q Revenue -- yes, I guess revenues minus costs in your Table 18.

A Yes.

Q So I guess I'm still wondering why Group C1 should face a larger percentage fee increase than Group D3 given where these two groups are starting in respect to contribution.

A I'm not certain what else to say. The C1 boxholders had higher costs relative to their -- C2 and C3. D3 had relatively lower costs. But I felt they should have some fee increase. I guess I'm not certain what else to say. I may be missing something here.

Q Okay. Let's move on to your response to Interrogatory 35A.

A I have it.

Q In that response you suggest that in a following proceeding Group C1 may get a lesser increase than you're proposing in this proceeding, and Groups D2 and D3 might get larger increases than you are proposing in this proceeding.

A Yes.

Q Why didn't you implement that approach in this proceeding?

A Because as I stated earlier, my goal -- one of my goals was to in fact isolate the lower-cost offices, the smallest offices, and with those lower costs should come lower fees. And that was my purpose in this proceeding.

You know, alternatively, you know, fee increases for C2 and C3 wouldn't necessarily have to go up by the same amount either, and you could bring them closer together over time. It's not an either/or or it's not -- you simply don't have to just continually raise the C2 -- the D3 to bring it to parity. And that seemed to me where this question was going.

Q Well, it sounds to me like you're -- in this proceeding you're focusing on proposing fee increases to track the changes in costs, and in later proceedings you may focus more on what's needed to get to a merger of the groups. Is that reasonable?

A Well, the question asks, you know, how long would it take, how many rate cases or proceedings would it take, and it seemed to me that it could be accomplished in two. I wouldn't say I'm going to ignore costs, but the desire to merge C1 and D1 and C2 and D2 and C3 and D3 given the desire to if you will simplify the fee structure was what I was directing my attention to here.

Q Okay. Please refer to your response to Interrogatory 42.

A I have it.

Q And on the top of the second page you state that you do not believe that an exception for these 31 offices is warranted.

A Yes.

Q Haven't you in effect provided exceptional treatment for these offices by proposing a 100-percent fee increase only for them?

A No. What I -- given the Postal Service's determination that there's a significant relationship between CAG and average rental costs, I did not think it was warranted for these 31 offices to be given an exception, and I don't consider -- didn't consider my treatment special, considered it the same, in that they would be grouped ultimately with the same size offices from city delivery.

That is, CAG A through D offices in noncity delivery would also be grouped with CAG A through D offices in city delivery and therefore would have the same fee. So no, I didn't consider it special treatment. In effect this is a way to bring them together, if you will.

Q And in part B of your response you confirm that for 25 of the 31 offices the rent per square foot is under $10.

A Correct.

Q Wouldn't it be better to apply the highest fee increase to offices with unusually high rents, such as rents above $25 per square foot?

A I mean, that's done in Fee Group A -- well, that's not true, it's -- Fee Group A has average rental costs around $23 a square foot. But these offices, CAG A through D offices, are the highest-rental-cost offices. In the case of city delivery and in the case of noncity delivery they're not as high, but as I said, I didn't think they warranted special treatment, because they are CAG A through D offices, and the Service has determined that there's a significant relationship in terms of CAG and average rental cost.

Q You state in the last paragraph of your response to part B that the Postal Service might consider establishing a separate fee schedule for these offices if special treatment for them is warranted.

A Yes.

Q Well, do you agree that these are the only offices in your Group D1?

A Well, I guess what I'd say is that these -- maybe you can repeat the question again.

Q Well, do you agree that the 31 offices that the Postal Service might establish a separate fee schedule for are also the only offices that you've grouped in your proposed Group D1?

A Correct.

Q So if the Postal Service acted on your suggestion, wouldn't that do away with the need for your proposed Group D1?

A Yes.

Q Okay. Let's consider hypothetically two city delivery CAG B offices, for example. One has no boxes available with a waiting list for new box customers, and the other has one-half of its boxes available. Do you agree that your proposal would result in the same fees for boxes in these two offices?

A Yes.

Q And would you agree there's also nothing in the Postal Service proposal that addresses utilization?

A Correct.

Q Do you think that ignoring utilization of boxes is a good pricing approach?

A It wasn't something I considered. I didn't give it any thought, so I -- it's just not something I gave any thought to at this point.

Q Did you see any reference to utilization rates in Library Reference 183 when you reviewed it?

A None that I recall.

MR. RUBIN: Okay. I have no more questions.

CHAIRMAN GLEIMAN: Is there any followup?

Questions from the bench?

I have a very few questions, Mr. Callow.

Am I correct that your testimony does not address the impact of the so-called quarter-mile rule?

THE WITNESS: Correct.

CHAIRMAN GLEIMAN: Am I also correct that the quarter-mile rule does not have an impact on your proposal?

THE WITNESS: Correct.

CHAIRMAN GLEIMAN: In your opinion would the fee structure for post office boxes be more fair and understandable to the public if the quarter-mile rule were eliminated?

THE WITNESS: Yes.

CHAIRMAN GLEIMAN: And would that be the case for the existing fee schedule and your proposal both?

THE WITNESS: Yes.

CHAIRMAN GLEIMAN: Okay.

Any other questions?

Followup as a consequence of questions from the bench?

There doesn't appear to be any followup.

MR. RUBIN: That's correct.

CHAIRMAN GLEIMAN: That brings us to redirect.

Would you like some time with your witness?

MS. DREIFUSS: I think just two minutes should be enough, Mr. Chairman.

CHAIRMAN GLEIMAN: Please proceed.

[Discussion off the record.]

CHAIRMAN GLEIMAN: Ms. Dreifuss.

MS. DREIFUSS: Chairman Gleiman, the OCA has no redirect.

CHAIRMAN GLEIMAN: If there's no redirect, then, Mr. Callow, I want to thank you. We appreciate your appearance here today and your contributions to our record, and if there's nothing further, you're excused.

THE WITNESS: Thank you.

[Witness excused.]

CHAIRMAN GLEIMAN: We initially had another witness scheduled for today, Joseph Schick on behalf of AMMA. Apparently there was some confusion on the part of Mr. Schick and his counsel regarding the fact that he'd been rescheduled for today. They had earlier requested that he be rescheduled from this past Monday. Be that as it may, the Postal Service counsel and AMMA counsel have worked out an agreement, and we will reschedule Mr. Schick barring some additional changes for next Thursday the 26th.

That concludes today's hearing. We'll reconvene on Monday the 23rd.

I'm sorry. Mr. Hollies.

MR. HOLLIES: I just wanted to add one piece of information. I take it that Mr. Volner's preference would be to have Mr. Schick appear toward the end of the day.

CHAIRMAN GLEIMAN: Well, we'll see. We always try and accommodate folks, and certainly with respect to this witness we've all attempted to accommodate Mr. Volner, so we'll try once more.

MR. HOLLIES: The Commission certainly has been very understanding in this situation. There is a chance that one of the last witnesses scheduled for Thursday the 26th will not be crossed, but I can't confirm that at this point.

CHAIRMAN GLEIMAN: Thank you.

As I was saying, this concludes today's hearing. We'll reconvene on Monday, the 23rd, to receive testimony from Douglas Carlson, who I guess the Postal Service does want to cross. I'd be interested in knowing, because Mr. Carlson is out of town. Have you all decided not to cross-examine him?

MR. RUBIN: Yes, that's correct. We filed a notice that we have no plans, and I notified Mr. Carlson of that, and I thought he was going to call over here and see if he was excused.

CHAIRMAN GLEIMAN: We'll get that one squared away before Monday for sure.

Other than Mr. Carlson, who we may not hear from or see, we'll have American Banker Association et al. Witness Clifton and Nashua, District et al. Witness Haldi yet again, and Parcel Shipper Association Witnesses Jellison, Mullin, and Zwieg, and OCA Witness Collins.

I want to thank you all for your cooperation today, and have a nice weekend.

[Whereupon, at 12:15 p.m., the hearing was recessed, to reconvene at 9:30 a.m., Monday, February 23, 1998.]