

# Official Transcript of Proceedings

*File*

Before the

RECEIVED  
MAR 23 8 19 AM '98

POSTAL RATE COMMISSION  
OFFICE OF THE SECRETARY

## UNITED STATES POSTAL RATE COMMISSION

In the Matter of: POSTAL RATE AND FEE CHANGES

Docket No. R97-1

VOLUME 36

DATE: Friday, March 20, 1998

PLACE: Washington, D.C.

PAGES: 19196 - 19855

**ANN RILEY & ASSOCIATES, LTD.**

1250 I St., N.W., Suite 300

Washington, D.C. 20005

(202) 842-0034

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

BEFORE THE  
POSTAL RATE COMMISSION

- - - - - X  
In the Matter of: :  
POSTAL RATE AND FEE CHANGES : Docket No. R97-1  
- - - - - X

Third Floor Hearing Room  
Postal Rate Commission  
1333 H Street, N.W.  
Washington, D.C. 20268  
  
Volume 36  
Friday, March 20, 1998

The above-entitled matter came on for hearing,  
pursuant to notice, at 9:30 a.m.

BEFORE:  
  
HON. EDWARD J. GLEIMAN, CHAIRMAN  
HON. W. H. "TREY" LeBLANC, III, COMMISSIONER  
HON. GEORGE W. HALEY, COMMISSIONER  
HON. GEORGE A. OMAS, COMMISSIONER

## 1 APPEARANCES:

2 On behalf of the United States Postal Service:

3 SUSAN DUCHEK, ESQUIRE

4 ERIC KOETTING, ESQUIRE

5 RICHARD COOPER, ESQUIRE

6 MICHAEL TIDWELL, ESQUIRE

7 ANNE REYNOLDS, ESQUIRE

8 DAVID RUBIN, ESQUIRE

9 KENNETH N. HOLLIES, ESQUIRE

10 SCOTT L. REITER, ESQUIRE

11 ANTHONY ALVERNO, ESQUIRE

12 United States Postal Service

13 475 L'Enfant Plaza West, SW

14 Washington, D.C. 20260

15

16 On behalf of American Business Press:

17 DAVID STRAUS, ESQUIRE

18 Thompson Coburn

19 700 14th Street, NW, Suite 900

20 Washington, D.C. 20005

21 (202) 508-1013

22 fax (202) 508-1010

23

24

25

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

1 APPEARANCES: [continued]

2 On behalf of the Association of Alternate Postal Systems:

3 BONNIE S. BLAIR, ESQUIRE

4 Thompson Coburn

5 700 14th Street, NW, Suite 900

6 Washington, D.C. 20005

7 (202) 508-1003

8 fax (202) 508-1010

9

10 On behalf of Nashua Photo, Inc.; District Photo, Inc.;

11 Mystic Color Lab; Seattle FilmWorks, Inc.; ValPak Direct

12 Marketing Systems, Inc.; ValPak Dealers' Association; Carol

13 Wright Promotions:

14 WILLIAM J. OLSON, ESQUIRE

15 ALAN WOLL, ESQUIRE

16 JOHN S. MILES, ESQUIRE

17 JOHN F. CALLENDER, JR., ESQUIRE

18 William J. Olson, P.C.

19 8180 Greensboro Drive, Suite 1070

20 McLean, VA 22102-3823

21 (703) 356-5070

22 fax (703) 356-5085

23

24

25

---

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

1 APPEARANCES: [continued]

2 On behalf of Readers Digest Association, Parcel Shippers  
3 Association:

4 TIMOTHY J. MAY, ESQUIRE

5 Patton Boggs, LLP

6 2550 M Street, NW

7 Washington, D.C. 20037

8 (202) 457-6050

9

10 On behalf of Advertising Mail Marketing Association:

11 IAN D. VOLNER, ESQUIRE

12 Venable, Baetjer, Howard & Civiletti

13 1201 New York Avenue, NW

14 Washington, D.C. 20005

15 (202) 962-4814

16 fax (202) 962-8300

17

18 On behalf of the Dow Jones & Company, Inc.:

19 SAM BEHREND, ESQUIRE

20 MICHAEL F. McBRIDE, ESQUIRE

21 LeBoeuf, Lamb, Greene & Macrae

22 1875 Connecticut Avenue, NW

23 Washington, D.C. 20009

24 (202) 986-8018

25 fax (202) 986-8102

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

1 APPEARANCES: [continued]

2 On behalf of the Major Mailers Association:

3 RICHARD LITTELL, ESQUIRE

4 1220 19th Street, NW, Suite 400

5 Washington, D.C. 20036

6 (202) 466-8260

7

8 On behalf of the Office of Consumer Advocate:

9 SHELLEY S. DREIFUSS, ESQUIRE

10 KENNETH E. RICHARDSON, ESQUIRE

11 Office of the Consumer Advocate

12 Postal Rate Commission

13 1333 H Street, NW, Suite 300

14 Washington, D.C. 20268

15

16 On behalf of the United Parcel Service:

17 JOHN E. MCKEEVER, ESQUIRE

18 Piper & Marbury

19 3400 Two Logan Square

20 18th and Arch Streets

21 Philadelphia, PA 19103

22 (215) 656-3310

23 fax (215) 656-3301

24

25

---

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

1 APPEARANCES: [continued]

2 On behalf of Hallmark Cards, Incorporated:

3 DAVID F. STOVER, ESQUIRE

4 2070 S. Columbus Street, Suite 1B

5 Arlington, VA 22206

6 (703) 998-2568

7 fax (703) 998-2987

8

9 On behalf of ADVO, Inc.:

10 JOHN M. BURZIO, ESQUIRE

11 THOMAS W. McLAUGHLIN, ESQUIRE

12 Burzio & McLaughlin

13 1054 31st Street, NW, Suite 540

14 Washington, D.C. 20007

15 (202) 965-4555

16 fax (202) 965-4432

17

18 On behalf of Time Warner, Inc.:

19 JOHN M. BURZIO, ESQUIRE

20 TIMOTHY L. KEEGAN, ESQUIRE

21 1054 31st Street, NW, Suite 540

22 Washington, D.C. 20007

23 (202) 965-4555

24 fax (202) 965-4432

25

---

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

1 APPEARANCES: [continued]

2 On behalf of the Direct Marketers Association:

3 DANA T. ACKERLY, II, ESQUIRE

4 MICHAEL D. BERGMAN, ESQUIRE

5 Covington & Burling

6 1201 Pennsylvania Avenue, NW

7 Washington, D.C. 20016

8 (202) 662-5296

9 fax (202) 778-5296

10

11 On behalf of the Newspaper Association of America:

12 WILLIAM B. BAKER, ESQUIRE

13 ALAN R. JENKINS, ESQUIRE

14 MICHAEL YOURSHAW, ESQUIRE

15 Wiley, Rein & Fielding

16 1776 K Street, NW

17 Washington, D.C. 20006

18 (202) 429-7255

19 fax (202) 429-7049

20

21 ROBERT J. BRINKMANN

22 Newspaper Association of America

23 529 14th Street, NW, Suite 440

24 Washington, D.C. 20045-1402

25

---

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034



1 APPEARANCES: [continued]

2 On behalf of the McGraw-Hill Companies, Inc.:

3 TIMOTHY W. BERGIN, ESQUIRE

4 Squire, Sanders & Dempsey

5 1201 Pennsylvania Avenue, NW, Suite 500

6 P.O. Box 407

7 Washington, D.C. 20044

8 (202) 626-6608

9 fax (202) 626-6780

10

11 On behalf of the Mail Order Association of America:

12 DAVID C. TODD, ESQUIRE

13 Patton Boggs, LLP

14 2550 M Street, NW

15 Washington, D.C. 20037

16 (202) 457-6410

17 fax (202) 457-6513

18

19 On behalf of David B. Popkin:

20 DAVID B. POPKIN

21 P.O. Box 528

22 Englewood, NJ 07631-0528

23 (201) 569-2212

24 fax (201) 569-2864

25

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

1 APPEARANCES: [continued]

2 On behalf of the Magazine Publishers of America:

3 JAMES R. CREGAN, ESQUIRE

4 Magazine Publishers of America

5 1211 Connecticut Avenue, NW, Suite 610

6 Washington, D.C. 20036

7 (202) 296-7277

8 fax (202) 296-0343

9

10 On behalf of the Alliance of Nonprofit Mailers:

11 JOEL T. THOMAS, ESQUIRE

12 11326 Dockside Circle

13 Reston, VA 20191

14 (703) 476-4646

15 fax (703) 620-2338

16

17 On behalf of the National Newspaper Association:

18 TONDA F. RUSH, ESQUIRE

19 King & Ballon

20 P.O. Box 50301

21 Arlington, VA 22205

22 (703) 534-5750

23 fax (703) 534-5751

24

25

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

1 APPEARANCES: [continued]

2 On behalf of the National Newspaper Association:

3 [continued]

4 SENNY BOONE

5 National Newspaper Association

6 1525 Wilson Boulevard, Suite 550

7 Arlington, VA 22209

8 (703) 907-7900

9

10 On behalf of the National Federation of Nonprofits:

11 CAROLYN EMIGH, ESQUIRE

12 Nonprofit Service Group

13 815 15th Street, NW, Suite 822

14 Washington, D.C. 20005

15 (202) 628-4380

16

17 On behalf of the Florida Gift Fruit Shippers Association:

18 M.W. WELLS, JR., ESQUIRE

19 Maxwell W. Wells, Jr., P.A.

20 105 E. Robinson Street, Suite 201

21 Orlando, FL 32801

22 (407) 422-8250

23 fax (407) 422-8262

24

25

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

1 APPEARANCES: [continued]

2 On behalf of the Recording Industry Association of America,  
3 and Advertising Mail Marketing Association:

4 N. FRANK WIGGINS, ESQUIRE  
5 Venable, Baetjer, Howard & Civiletti, L.L.P.  
6 1201 New York Avenue, NW  
7 Washington, D.C.  
8 (202) 962-4957

9

10 On behalf of Edison Electric Institute:

11 R. BRIAN CORCORAN, ESQUIRE  
12 Oliver & Oliver, P.C.  
13 1090 Vermont Avenue, NW, Suite 800  
14 Washington, D.C. 20005  
15 (202) 371-5656  
16 fax (202) 289-8113

17

18 On behalf of American Business Press:

19 STEPHEN FELDMAN, ESQUIRE  
20 Ramsey, Cook, Looper & Kurlander  
21 c/o Thompson Coburn  
22 700 14th Street, NW, Suite 900  
23 Washington, D.C. 20005  
24 (202) 508-1022  
25 fax (202) 508-1010

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

1 APPEARANCES: [continued]

2 On behalf of Douglas F. Carlson:

3 DOUGLAS F. CARLSON

4 P.O. Box 12574

5 Berkeley, CA 94712-3574

6 (510) 597-9995

7

8 On behalf of the Alliance of Non Profit Mailers:

9 DAVID M. LEVY, ESQUIRE

10 Sidley & Austin

11 1722 I Street, NW

12 Washington, D.C. 20006-3704

13 (202) 736-8214

14

15 On behalf of the National Association of Presort Mailers:

16 HENRY HART, ESQUIRE

17 Hazel & Thomas

18 P.O. Box 820

19 Alexandria, VA 22313

20 (703) 838-5153

21 fax (703) 836-8062

22

23

24

25

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

1 APPEARANCES: [continued]

2 On behalf of Brooklyn Union Gas Company:

3 MICHAEL HALL, ESQUIRE

4 Cullen & Dykman

5 1225 19th Street, NW

6 Washington, D.C. 20036

7 (202) 223-8890

8

9 On behalf of Niagara Telephone Company:

10 TIMOTHY E. WELCH, ESQUIRE

11 Hill & Welch

12 1330 New Hampshire Avenue, NW, Suite 113

13 Washington, D.C. 20036

14 (202) 775-0070

15 fax (202) 775-9026

16

17 On behalf of the Coalition of Religious Press Associations:

18 JOHN STAPERT

19 Associated Church Press

20 18653 N. 41st Place

21 Phoenix, AZ 85024-3759

22 (602) 569-6371

23 fax (602) 569-6180

24

25

1 APPEARANCES: [continued]

2 On behalf of the Greeting Card Association:

3 ALAN R. SWENDIMAN, ESQUIRE

4 Jackson & Campbell, P.C.

5 1120 20th Street, NW, Suite 300 South

6 Washington, D.C. 20036-3437

7 (202) 457-1645

8 fax (202) 457-1617

9

10 On behalf of LabOne, Inc., Osborn Laboratories, Inc., and

11 Clinical Reference Laboratory, Inc.:

12 JOSEPH C. BENAGE, ESQUIRE

13 Hillix, Brewer, Hoffhaus, Whittaker & Wright

14 2420 Pershing Road

15 Kansas City, MO 64108-2574

16 (816) 221-0355

17 fax (816) 421-2896

18

19

20

21

22

23

24

25

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

	C O N T E N T S				
	WITNESS	DIRECT	CROSS	REDIRECT	RECROSS
1					
2					
3	RITA D. COHEN				
4	BY MR. CREGAN	19212			
5	BY MR. McKEEVER		19235		
6	BY MR. KOETTING		19250/19272		
7	HALSTEIN STRALBERG				
8	BY MR. BURZIO	19276			
9	BY MR. KOETTING		19295		
10	BY MR. BURZIO			19308	
11	CARL G. DEGEN				
12	BY MR. KOETTING	19310			
13	BY MR. WIGGINS		19367		
14	BY MR. STRAUS		19373		
15	BY MR. KEEGAN		19455		
16	BY MR. KOETTING			19467	
17	BY MR. KEEGAN				19469
18	STEPHEN E. SELICK				
19	BY MR. McKEEVER	19472			
20	BY MR. GOLD		19491		
21	ROGER C. PRESCOTT				
22	BY MR. TODD	19503			
23	BY MR. OLSON		19547		
24	BY MR. TODD			19580	
25	BY MR. OLSON				19581



	C O N T E N T S [continued]				
	WITNESS	DIRECT	CROSS	REDIRECT	RECROSS
1	LESLIE M. SCHENK				
2	BY MR. REYNOLDS	19583			
3	BY MR. LEVY		19649		
4	GARY M. ANDREW				
5	BY MR. TODD	19661			
6	BY MR. CORCORAN		19730		
7	BY MR. LITTELL		19772		
8	BY MR. BAKER		19778		
9	BY MR. COOPER		19806		
10	BY MR. BAKER		19808		
11	JOHN L. CLARK				
12	BY MR. OLSON	19810			
13	BY MR. McKEEVER		19823		
14	BY MR. OLSON			19849	
15	BY MR. McKEEVER				19852
16	BY MR. OLSON			19854	
17	BY MR. McKEEVER				19854
18					
19	DOCUMENTS TRANSCRIBED INTO THE RECORD:				PAGE
20	Rebuttal Testimony and Exhibits of Rita				
21	D. Cohen, MPA-RT-1				19215
22	Cross-Examination Exhibit No. USPS/MPA-RT-XE-1				19260
23					
24					
25					

1	DOCUMENTS TRANSCRIBED INTO THE RECORD: [continued]	PAGE
2	Rebuttal Testimony and Exhibits of Halstein	
3	Stralberg, TW-RT-1	19278
4	Rebuttal Testimony and Exhibits of Carl G.	
5	Degen, USPS-RT-6	19312
6	Cross-Examination Exhibit No. ABP-XE-1	19422
7	Cross-Examination Exhibit No. ABP-XE-2	19427
8	Cross-Examination Exhibit No. ABP-XE-3	19437
9	Cross-Examination Exhibit ABP-XE-4	19451
10	Rebuttal Testimony and Exhibits of	
11	Stephen E. Sellick, UPS-RT-1	19474
12	Revised Response of UPS Witness Sellick to	
13	POIR-16	19487
14	Rebuttal Testimony and Exhibits of Roger	
15	C. Prescott, MOAA-RT-1	19505
16	Rebuttal Testimony and Exhibits of Leslie	
17	M. Schenk, USPS-RT-22	19587
18	Rebuttal Testimony and Exhibits of Gary M.	
19	Andrew, MOAA, et al.-RT-1	19663
20	Cross-Examination Exhibit No. ABA/EEI/NAPM-XE-1	19769
21	Cross-Examination Exhibit No. ABA/EEI/NAPM-XE-2	19770
22	Cross-Examination Exhibit No. ABA/EEI/NAPM-XE-3	19771
23	Cross-Examination Exhibit No.	
24	NAA/MOAA et al.-RT-1-XE-1	19797
25		

1	DOCUMENTS TRANSCRIBED INTO THE RECORD: [continued]	PAGE
2	Cross-Examination Exhibit No.	
3	NAA/MOAA et al.-RT-1-XE-2	19798
4	Rebuttal Testimony and Exhibits of John L.	
5	Clark, CTC-RT-1	19813
6	Excerpt from the United States Postal	
7	Service Household Diary Study, Fiscal	
8	Year 1996, Executive Summary	19845

9

10

## E X H I B I T S

11	EXHIBITS AND/OR TESTIMONY	IDENTIFIED	RECEIVED
12	Rebuttal Testimony and Exhibits of		
13	Rita D. Cohen, MPA-RT-1	19214	19214
14	Cross-Examination Exhibit No.		
15	USPS/MPA-RT-XE-1	19258	19258
16	Rebuttal Testimony and Exhibits of		
17	Halstein Stralberg, TW-RT-1	19277	19277
18	Rebuttal Testimony and Exhibits of		
19	Carl G. Degen, USPS-RT-6	19311	19311
20	Cross-Examination Exhibit No. ABP-XE-1	19420	19421
21	Cross-Examination Exhibit No. ABP-XE-2	19426	19426
22	Cross-Examination Exhibit No. ABP-XE-3	19436	19436
23	Cross-Examination Exhibit ABP-XE-4	19450	19450
24	Rebuttal Testimony and Exhibits of		
25	Stephen E. Sellick, UPS-RT-1	19472	19472

E X H I B I T S [continued]			
1	EXHIBITS AND/OR TESTIMONY	IDENTIFIED	RECEIVED
2	Revised Response of UPS Witness		
3	Sellick to POIR-16	19486	19486
4	Rebuttal Testimony and Exhibits of		
5	Roger C. Prescott, MOAA-RT-1	19504	19504
6	Rebuttal Testimony and Exhibits of		
7	Leslie M. Schenk, USPS-RT-22	19585	19585
8	Rebuttal Testimony and Exhibits of		
9	Gary M. Andrew, MOAA, et al.-RT-1	19662	19662
10	Cross-Examination Exhibit No.		
11	ABA/EEI/NAPM-XE-1	19739	
12	Cross-Examination Exhibit No:		
13	ABA/EEI/NAPM-XE-2	19742	
14	Cross-Examination Exhibit No.		
15	ABA/EEI/NAPM-XE-3	19750	
16	Cross-Examination Exhibit No.		
17	NAA/MOAA et al.-RT-1-XE-1	19785	19795
18	Cross-Examination Exhibit No.		
19	NAA/MOAA et al.-RT-1-XE-2	19788	19795
20	Rebuttal Testimony and Exhibits of		
21	John L. Clark, CTC-RT-1	19811	19811
22			
23			
24			
25			

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

E X H I B I T S [continued]

EXHIBITS AND/OR TESTIMONY	IDENTIFIED	RECEIVED
Excerpt from the United States		
Postal Service Household Diary		
Study, Fiscal Year 1996,		
Executive Summary	19844	19844

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

[9:30 a.m.]

CHAIRMAN GLEIMAN: Good morning.

Today should be our final day of hearings on this case, unless, of course, we go beyond midnight, in which case tomorrow will be our final day of hearings. Unfortunately, I'm afraid it may come to that, but hopefully not.

We're scheduled to receive testimony in rebuttal to the direct cases of participants other than the Postal Service from Magazine Publishers of America Witness Cohen, Time-Warner Witness Stralberg, United States Postal Service Witnesses Degen and Schenk, United Parcel Service Witness Sellick, Mail Order Association of America Witness Prescott, and Mail Order Association of America, et al., Witness Andrew, and then, finally, CTC Distribution Services Witnesses Clark.

I have several procedural matters to mention before we begin this morning.

There is one outstanding procedural issue still to be resolved.

On March the 17th, the Alliance of Non-Profit Mailers filed a motion to compel production of mail acceptance logs underlying USPS-RT-22 or, in the alternative, to strike portions of that testimony.

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

1           The Postal Service filed a response in opposition  
2 at noon yesterday, and last night, during breaks of the  
3 basketball game, I reviewed that response and also had an  
4 opportunity to leaf through Library Reference H-353, the  
5 survey forms that are at issue, used by Witness Schenk in  
6 preparing her testimony.

7           I'm going to have some questions to ask Ms. Schenk  
8 before I rule on the ANM motion, but I am not going to do  
9 that until all the appropriate counsel are in the room,  
10 perhaps when Ms. Schenk comes to the stand later today.

11           Mr. Koetting, would you inform Postal Service  
12 counsel who is representing Ms. Schenk that I will be asking  
13 her questions concerning the use of actual copies of Form  
14 8075, the so-called disqualification logs referred to in her  
15 testimony that have now become the subject of the ANM motion  
16 to compel production?

17           MR. KOETTING: I'd be happy to do that, Mr.  
18 Chairman.

19           CHAIRMAN GLEIMAN: During Tuesday's hearing, I  
20 addressed the issue of incorporating additional materials  
21 into the evidentiary record and set March 27th as the  
22 deadline for filing such motions.

23           If you have additional materials for inclusion in  
24 the record, please file the appropriate motion, accompanied  
25 by two copies of the designations by close of business

1 Friday, March the 27th.

2 March the 27th is also the date for filing  
3 transcript corrections for this round of hearings.

4 As I mentioned earlier, if a transcript correction  
5 is related to the final round of hearings and is central to  
6 an argument in an initial brief, please identify that  
7 situation in the text or in footnote to the brief.

8 Does any participant have a procedural matter that  
9 they would like to raise at this point in time?

10 [No response.]

11 CHAIRMAN GLEIMAN: If not, then we'll move on to  
12 our first witness.

13 Our first witness today is appearing on behalf of  
14 the Magazine Publishers of America, and Ms. Cohen is already  
15 under oath in this proceeding.

16 Mr. Cregan, if you would introduce your witness  
17 and enter her rebuttal testimony into the record.

18 MR. CREGAN: Thank you, Mr. Chairman.

19 Whereupon,

20 RITA D. COHEN,  
21 a rebuttal witness, was called for examination by counsel  
22 for the Magazine Publishers of America and, having been  
23 previously duly sworn, was further examined and continued to  
24 testify as follows:

25 DIRECT EXAMINATION

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034



1 BY MR. CREGAN:

2 Q Ms. Cohen, I'm handing you two copies of a  
3 document designated MPA-RT-1, Rebuttal Testimony of Rita D.  
4 Cohen on Behalf of Alliance of Non-Profit Mailers, American  
5 Business Press, Coalition of Religious Press Associations,  
6 Doe-Jones and Company, Inc., Magazine Publishers of America,  
7 the McGraw-Hill Companies, Inc., National Newspaper  
8 Association, and Time-Warner, Inc.

9 Are you familiar with this document?

10 A Yes, I am.

11 Q Was it prepared by you or under your supervision?

12 A Yes, it was.

13 Q Do you have any corrections or revisions today?

14 A No, I do not.

15 Q If you were to testify today orally, would your  
16 testimony be the same?

17 A Yes.

18 MR. CREGAN: Mr. Chairman, I will hand two copies  
19 of Ms. Cohen's testimony, designated MPA-RT-1, to the  
20 reporter and ask its admission into evidence.

21 CHAIRMAN GLEIMAN: Are there any objections?

22 [No response.]

23 CHAIRMAN GLEIMAN: Hearing none, Ms. Cohen's  
24 testimony and exhibits are received into evidence, and I  
25 direct that they be transcribed into the record at this

1 point.

2 [Rebuttal Testimony and Exhibits of  
3 Rita D. Cohen, MPA-RT-1, was  
4 received into evidence and  
5 transcribed into the record.]  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

MPA-RT-1

RECEIVED

BEFORE THE MAR 9 3 48 PM '98  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268-0001

POSTAL RATE AND FEE CHANGES, 1997

DOCKET NO. R97-1

REBUTTAL TESTIMONY  
OF  
RITA D. COHEN

ON BEHALF OF  
ALLIANCE OF NONPROFIT MAILERS,  
AMERICAN BUSINESS PRESS,  
COALITION OF RELIGIOUS PRESS ASSOCIATIONS,  
DOW JONES & COMPANY, INC.,  
MAGAZINE PUBLISHERS OF AMERICA,  
THE MCGRAW-HILL COMPANIES, INC.,  
NATIONAL NEWSPAPER ASSOCIATION,

AND  
TIME WARNER INC.

Communications with respect to this document may be sent to:

James R. Cregan  
Counsel  
Magazine Publishers of America  
Suite 610  
1211 Connecticut Avenue, N.W.  
Washington, D.C. 20036  
(202) 296-7277

March 9, 1998

## TABLE OF CONTENTS

I.	AUTOBIOGRAPHICAL SKETCH .....	1
II.	PURPOSE AND SCOPE AND SUMMARY OF CONCLUSIONS .....	1
III.	LARGE NOT-HANDLING AND MIXED-MAIL COSTS PLAY A CRITICAL ROLE IN DETERMINING ATTRIBUTABLE COSTS .....	2
IV.	WHAT THIS RECORD SHOWS AND WHAT SELICK IGNORES ABOUT NOT-HANDLING COSTS .....	3
V.	DEVELOPING OR EVALUATING A PROPOSED COST DISTRIBUTION REQUIRES A DEPTH OF KNOWLEDGE AND EXPERTISE NOT EXHIBITED BY WITNESS SELICK .....	6
VI.	WITNESS SELICK SHOULD HAVE STUDIED THE FUNDAMENTAL ISSUE: CAN WITNESS DEGEN'S METHODOLOGY BE USED WITHOUT BRADLEY'S ANALYTICAL FRAMEWORK? .....	7
VII.	AFTER MISTAKENLY ASSUMING THAT HE COULD USE DEGEN'S METHODOLOGY WITHOUT BRADLEY, SELICK FAILED TO CORRECT DEGEN'S DISTRIBUTIONS TO ACCOUNT FOR COST POOL INTERRELATIONSHIPS. ....	9
VIII.	INCORPORATING COST POOL INTERRELATIONSHIPS INTO WITNESS SELICK'S DISTRIBUTION WOULD LEAD TO VERY DIFFERENT RESULTS .....	12
IX.	INEFFICIENCY AND SLACK TIME REQUIRE CROSS POOL DISTRIBUTIONS IF INEFFICIENT COSTS ARE DISTRIBUTED AT ALL .....	14
X.	WITNESS SELICK FAILED TO CONSIDER THAT DIFFERENCES BETWEEN CAGs AND BASIC FUNCTIONS SUGGEST IT IS APPROPRIATE TO DISTRIBUTE MIXED-MAIL AND NOT-HANDLING COSTS WITHIN CAG AND BASIC FUNCTION .....	15
XI.	CONCLUSION .....	16

1 **I. Autobiographical Sketch.**

2

3 My name is Rita Dershowitz Cohen. I am Vice President for Economic and Legislative  
4 Analysis at the Magazine Publishers of America (MPA). I have been employed by MPA  
5 since 1995 and have represented MPA in postal proceedings since 1987. I have  
6 twenty-five years of experience in postal matters, having worked at both the Postal  
7 Rate Commission and the Postal Service in a variety of positions.

8

9 I filed direct testimony in this proceeding, presenting two alternative distributions of  
10 volume-variable mail processing costs for the Commission's consideration. A full  
11 description of my background and qualifications is contained in that testimony, filed as  
12 MPA-T-2.

13

14 **II. Purpose and Scope and Summary of Conclusions.**

15

16 This testimony rebuts the direct testimony of Stephen E. Sellick on behalf of United  
17 Parcel Service. UPS-T-2. Witness Sellick's proposed distribution of mail processing  
18 costs is not well founded and should not be used by the Commission.

19

- 20
- 21 • Witness Sellick's proposed distribution method (adopted from Postal Service  
22 witness Degen) cannot be used without also using witness Bradley's results.
  - 23 • The real world of postal operations requires distribution of mail processing  
24 costs across MODS pools, not within them as proposed by witness Sellick  
(and Degen).
  - 25 • Costs resulting from inefficiency should be distributed across MODS pools if  
26 they are to be distributed at all.

27

28 In this rebuttal testimony I review the important role of not-handling and mixed-mail  
29 costs in determining attributable costs of the classes and subclasses of mail. I next  
0 review what this record shows about not-handling and mixed-mail costs. I show that

1 witness Sellick did not undertake the necessary substantive analysis to evaluate Postal  
2 Service witness Degen's approach or to suggest alternatives. I review witness Sellick's  
3 treatment of not-handling and mixed-mail costs and show that it is inconsistent with  
4 witness Degen's analytical framework, which depends on witness Bradley's  
5 variabilities. In other words, the Commission cannot do what witness Sellick  
6 recommends because witness Degen's distributions depend on witness Bradley's  
7 attribution. I next describe a number of changes that witness Sellick failed to  
8 implement to correct inaccuracies in the distribution keys he adopts from Degen. I  
9 demonstrate that even if not-handling costs are incurred efficiently, they must be  
10 distributed across groupings of cost pools to be consistent with operational realities  
11 and witness Bradley's results. I show that if not-handling costs are incurred  
12 inefficiently, they must be distributed across all cost pools or treated as institutional and  
13 not distributed at all. Finally, I show that witness Sellick ignored differences in not-  
14 handling and mixed-mail costs across Cost Accounting Groups (CAGs) and basic  
15 functions, differences that demonstrate it is appropriate to distribute mail processing  
16 costs by CAG and basic function.

17  
18 **III. Large Not-Handling and Mixed-Mail Costs Play a Critical Role in Determining**  
19 **Attributable Costs.**

20  
21 Base-year not-handling costs in this case are \$5.4 billion, and mixed-mail costs are an  
22 additional \$1.5 billion. Together, they thus comprise nearly \$7 billion, which is more  
23 than a billion dollars greater than total mail processing direct costs. To help put the  
24 magnitude of these costs in perspective, total not-handling and mixed-mail costs are  
25 well over 10 percent of the entire cost of the Postal Service, and volume-variable not-  
26 handling and mixed-mail costs are about 15 percent of total attributable costs. The  
27 Postal Service spends more money not-handling mail in mail processing operations  
28 than it does on any other cost segment except carrier street time. In fact, if the Postal  
29 Service could "spin off" just the not-handling and mixed-mail processing tasks to the  
30 private sector, the resulting corporation would rank 212 on the Fortune 500 list, several

1 places above Nike, Inc. and only a few places below Sun Microsystems. The resulting  
2 corporation would be 70 percent as large as Federal Express, which had revenues of  
3 \$10.3 billion in 1996, and about one third the size of United Parcel Service, with  
4 revenues of \$22.4 billion. If the "spin off" were a Government agency, its budget would  
5 exceed that of the State Department, at \$5.1 billion, and the Environmental Protection  
6 Agency, at \$6.3 billion.

7  
8 The method of distributing this extremely large pool of costs is obviously important to  
9 all classes of mail, but it is critically important to the total volume-variable costs of small  
10 classes of mail like Priority, Periodicals, and Standard B. Unlike the larger classes,  
11 these small classes are enormously affected by a shift of several hundred million  
12 dollars of attributable costs. For example, UPS Witness Sellick attributes almost \$250  
13 million more in mail processing costs to Periodicals than I do; if his recommended  
14 distributions were accepted together with UPS witness Neels' recommended volume  
15 variability, the resulting attributable cost increase would result in an average rate  
16 increase for the Periodicals Regular Rate subclass of about 15 percent (about four  
17 times the average for all classes), even if coverage were set at 107 percent. In fact,  
18 witness Sellick's distributions combined with UPS witness Henderson's proposed  
19 coverages would result in a 25 percent rate increase for Periodicals. Witness Sellick  
20 also attributes \$370 million more in mail processing costs to Priority than I do, more  
21 than double my attribution. It is obvious why UPS witness Sellick supports witness  
22 Degen's distributions while increasing witness Bradley's variability.<sup>1</sup>

23  
24 **IV. What This Record Shows and What Sellick Ignores About Not-Handling**  
25 **Costs.**

26  
27 In spite of the significance and magnitude of not-handling costs, the record in this case  
28 contains no evidence pertaining to the causality of these costs. There is no evidence

---

<sup>1</sup>UPS-T-2, Table 2; MPA-T-2, Exhibit MPA-2C; UPS-T-3, Exhibit UPS-T-3B.

1 either of their relationship to mail volume or of the reasons for their rapid growth. What  
2 the record does show is that not-handling time is unevenly distributed across  
3 operations and that one component of not-handling – what has previously been called  
4 “overhead” – is growing at an inexplicably rapid rate.<sup>2</sup> (See my direct testimony, MPA-  
5 T-2, and that of witness Stralberg, TW-T-1.) It also shows that not-handling costs as a  
6 percentage of total costs are disproportionately higher at operations where productivity  
7 is not measured (see MPA-T-2, Table 5).

8  
9 The record also shows that not-handling time is unevenly distributed across distribution  
10 operations, sometimes in ways that defy explanation based on the nature of the  
11 operations. For example, in the MODS pool for sorting outside sacks mechanically,  
12 not-handling cost is 61 percent of the total cost, while for sorting parcels mechanically  
13 it is 42 percent. Although both percentages are alarmingly high, it is disturbing that  
14 not-handling is almost 50 percent higher in one mechanical sorting operation than in  
15 another. How can this be?

16  
17 In manual operations, the disproportionate amounts of not-handling costs are similarly  
18 surprising and inexplicable. Not-handling time is 31 percent of total costs for manual  
19 letter sorting distribution while more than one-third higher, at 44 percent, for manual  
20 parcels. This puzzling disparity is also present in BMC operations. For the parcel  
21 sorting machine, not-handling is relatively low, at 19 percent (before reallocation of  
22 breaks). For the sack sorting machine, however, the comparable not-handling ratio is  
23 over 50 percent larger, at 30 percent.

24  
25 Not only are the disparities between operations unexplained, but the absolute levels of  
26 not-handling costs are stunning. For example, not-handling costs are 63 percent of  
27 total platform costs at MODS facilities, which means that employees are handling mail

---

<sup>2</sup> Overhead has increased from 17.2 percent of total mail processing cost in 1986 to 23.9 percent in 1996. Because this is the first case where the Postal Service has used this particular grouping of the not-handling category, I cannot quantify how fast it has been increasing.



1 pieces, items, or containers only about 1 of every 3 minutes. During cross-examination,  
2 the Postal Service suggested that not-handling might be a relatively large proportion of  
3 platform costs because of time spent going back to a truck to get the next pallet of mail  
4 to unload. However, the Postal Service, witness Sellick, and I are all at a loss to  
5 explain why employees should spend more time returning to the truck unladen than  
6 they spend unloading full pallets and containers and moving them across the platform.

7  
8 In spite of these facts and the lack of evidence about causality, witness Sellick  
9 enthusiastically supports witness Degen's restriction of not-handling costs to  
10 distribution within narrowly defined cost pools. He applauds Degen's distribution  
11 because "it links the distribution of ... 'overhead' (not-handling mail) costs with the  
12 operational characteristics of mail processing."<sup>3</sup> Like Degen before him, Sellick simply  
13 assumes what is not the case – that it is the same thing to link a set of costs with a mail  
14 processing operation (in the sense that a statistical system records those costs under a  
15 particular operational heading) as it is to link costs with the operational characteristics  
16 of mail processing. Witness Sellick is apparently unaware of the operational linkages  
17 of the costs pools and that these linkages require cross-pool, rather than within-pool,  
18 cost distributions. As I discuss in sections VI and VII below, these linkages affect the  
19 distribution of mail processing costs in two ways: they imply (1) the need to incorporate  
20 differing variabilities into cost distributions and (2) the need to distribute costs over all  
21 the cost drivers for a cost pool. Finally, witness Sellick also seems unaware that  
22 inefficiency, which is one probable explanation for the level and growth of not-handling  
23 costs, is likely to require across-pool, rather than within-pool, distributions of not-  
24 handling costs. I discuss this in Section IX.

---

<sup>3</sup>Tr. 26/ 14163.

1 **V. Developing or Evaluating a Proposed Cost Distribution Requires a Depth of**  
2 **Knowledge and Expertise Not Exhibited by Witness Sellick.**

3  
4 The cross-examination of witness Sellick confirmed that he understands little about  
5 mail processing functions and data systems or the changes in the Postal Service's  
6 operating conditions as mail processing has moved increasingly to an automated  
7 environment. Such understanding is a prerequisite for evaluating how to distribute not-  
8 handling and mixed-mail costs in light of their enormous growth relative to direct costs  
9 over the past ten years as a consequence of automation. Witness Sellick admitted on  
10 oral cross-examination that he does not know what specific functions employees  
11 perform while not-handling mail even to the extent of being able to name a few  
12 examples.<sup>4</sup> Nor was he conversant with the definitions of identical mail or mixed mail  
13 even at the most general level.<sup>5</sup> Witness Sellick was unable to name the types of  
14 containers the Postal Service uses or to say what subclasses they are used for, despite  
15 his written testimony that "different types of containers are used for different types of  
16 mail."<sup>6</sup> Notwithstanding the fact that he relied in his testimony on the Overhead and  
17 Subclass Cost Study prepared by Foster Associates Inc. in 1992, he did not know what  
18 general conclusions the study had reached, or whether the report was consistent with  
19 his testimony.<sup>7</sup> Perhaps even more troubling is that his testimony neglected to mention  
20 one of the study's most important conclusions: "Additional field operating data are  
21 necessary to determine the proper (causative) attribution of the break and subclass  
22 costs in question and those other costs which are presently attributed as mixed mail or  
23 overhead activities."<sup>8</sup> With respect to the MODS system, witness Sellick not only failed  
24 to examine witness Degen's grouping of MODS codes into cost pools, he did not know  
25 what types of mail would be processed at specific types of operations, how individual

---

<sup>4</sup>Tr. 26/14248.

<sup>5</sup>Tr. 26/14253-4.

<sup>6</sup>Tr. 26/14256.

<sup>7</sup>ibid.

<sup>8</sup>Tr. 26/14256-8.

1 operations should be combined into cost pools, or whether witness Degen's  
2 combination of operations into cost pools made sense.<sup>9</sup>

3  
4 Witness Sellick's lack of knowledge is disturbing, although not surprising, given his  
5 limited operational experience. Witness Stralberg and I, on the other hand, have  
6 developed a depth of expertise from studying postal operations and costing systems for  
7 twenty-five years.

8  
9 Given his limited expertise, one might have hoped that witness Sellick would have  
10 undertaken at least some rudimentary analyses to verify that his proposals were well-  
11 grounded. Therefore it is surprising that, while admitting that the distribution  
12 assumptions that underlie his testimony are important, he made no attempt to test the  
13 validity of the assumptions.<sup>10</sup>

14  
15 Further, witness Sellick appears to recognize that correct cost distribution should be  
16 based on the activities a clerk or mailhandler is performing rather than what MODS  
17 code he or she is clocked into.<sup>11</sup> Yet he concludes that the admission by witness  
18 Degen that employees are sometimes not clocked into the operation at which they are  
19 working is not important. He reaches this conclusion without any knowledge of how  
20 often misclocking occurs.<sup>12</sup>

21  
22 **VI. Witness Sellick Should Have Studied the Fundamental Issue: Can Witness**  
23 **Degen's Methodology Be Used Without Witness Bradley's Analytical Framework?**

24  
25 Witness Sellick admits in his testimony that he addresses only the subject covered by  
26 witness Degen: the distribution of mail processing costs. He assumes, however, that  
27 witness Degen's cost pool categorization is meaningful even if witness Bradley's

---

<sup>9</sup>Tr. 26/14262-3.

<sup>10</sup>Tr. 26/14241-2.

<sup>11</sup>Tr. 26/14202.

variability analysis is rejected. It is not clear why he feels no discomfort making this assumption since Sellick admitted during cross-examination that he wasn't sure which witness, Degen or Bradley, originated the cost pool framework.<sup>13</sup>

In fact, as stated by witness Bradley, Degen designated the cost pools.<sup>14</sup> Witness Degen did not, however, identify the cost drivers for the cost pools. The cost drivers were identified by witness Bradley.

Witness Sellick relies on witness Neels' rejection of witness Bradley's analysis and a return to the previously assumed variability levels for mail processing. It would appear, therefore, that witness Sellick is also rejecting witness Bradley's cost drivers, without which, witness Sellick lacks a foundation for his distribution.

There is another fundamental problem with witness Sellick's use of Degen's distribution keys while rejecting witness Bradley's variability results. Sellick does not appear to understand that witness Degen's distributions depend on witness Bradley's attribution framework on a number of levels, going beyond simply using Bradley's overall variability results. Witness Sellick does not take into account that Degen's approach to cost distribution is violated if all cost pools are assumed to have the same variability: differing variabilities between distribution and allied operations are fundamental to witness Degen's approach.

When witness Sellick rejected the overall level of variability found by witness Bradley, he ignored the inherent balance in the analysis between various operations and groups of operations, particularly between allied and distribution operations. This balance is integral to witness Degen's methodology. The average variability for distribution operations in witness Degen's approach is 83 percent, while the average variability for allied operations is only 71 percent. For BMCs, the difference is even more dramatic,

---

<sup>12</sup>Tr. 26/14245-6.

<sup>13</sup>Tr. 26/14261.

1 with distribution operations at 80 percent variability and allied operations at only 53  
2 percent. This means when witness Degen performs his distribution, he distributes 85  
3 cents of allied operations cost for each dollar of distribution operations costs. This  
4 pairing takes into account the support nature of allied operations and the  
5 interrelationships between the sets of operations. This point was described by witness  
6 Bradley: "Allied activities are the 'mortar' that binds the 'bricks' of the direct piece  
7 sorting activities. Because they are all manual activities and because of their role as  
8 facilitating activities, I would expect allied activities to have variabilities which are, on  
9 average, below direct piece sorting activities."<sup>15</sup>

10  
11 This balance is a fundamental underpinning of witness Degen's approach. Despite the  
12 fact that witness Sellick claims to adopt witness Degen's methodology, he ignores the  
13 fact that using equal variabilities for the distribution and allied groupings of operations  
14 distorts witness Degen's implementation of operational interrelationships and places a  
15 disproportionate emphasis on the allied operations in the distribution of mail processing  
16 costs.

17  
18 **VII. After Mistakenly Assuming That He Could Use Degen's Methodology Without**  
19 **Bradley, Sellick Failed to Correct Degen's Distributions To Account for Cost Pool**  
20 **Interrelationships.**

21  
22 As I mentioned earlier, operational characteristics and interrelationships need to be  
23 reflected in mail processing cost distribution both by recognizing differing variabilities  
24 and by distributing costs over all the cost drivers for a cost pool. In adopting witness  
25 Degen's within cost pool distribution, witness Sellick ignored evidence on the multiple  
26 cost drivers found to be significant for both allied and distribution operations.

---

27  
<sup>14</sup>USPS-T-14 at 6.

<sup>15</sup>USPS-T-14 at 61-62.

1 Witness Sellick claims to have reviewed the testimonies of both witnesses Moden and  
2 Bradley.<sup>16</sup> Yet he stated on oral cross examination that he was not aware of any  
3 analyses as to how the costs in one cost pool vary because of what is happening in  
4 another cost pool. He admitted that such relationships are possible but said he "hadn't  
5 seen any analyses in that regard."<sup>17</sup> This admission is surprising given the numerous  
6 statements addressing this topic in the testimonies of witnesses Moden and Bradley.  
7 Both of these witnesses addressed the interrelationships between allied and  
8 distribution operations and among the automated, mechanized, and manual  
9 components of distribution operations.

10  
11 With regard to the allied operations, in addition to his bricks and mortar analogy,  
12 witness Bradley noted: "Allied activities exist to support the direct piece sorting of mail  
13 and it is in this sense that they are 'allied' with direct activities."<sup>18</sup> Discussing the  
14 results of his analysis, witness Bradley stated: "All....piece-handling variables have  
15 explanatory power for the allied activities, revealing the general nature of these support  
16 activities."<sup>19</sup> Describing the platform operation as a gateway operation, Bradley  
17 explained that "breakdowns in that operation would have ripple effects throughout the  
18 rest of the night in terms of not getting the mail where it has to be to accomplish the  
19 sorting."<sup>20</sup>

20  
21 Witness Moden also recognized the support nature of allied operations, stating:  
22 "Adding a sophisticated automated processing stream to existing mechanized and  
23 manual streams also required an increase in workhours for non-distribution activities,  
24 such as moving mail between operations, to handle the complex mail flows that  
25 resulted. Most support activities occur in the Allied Labor Operations - Platform,

---

<sup>16</sup>Tr. 26/14162.

<sup>17</sup>Tr. 26/14248-49.

<sup>18</sup>USPS-T-14 at 18.

<sup>19</sup>USPS-T-14 at 62.

<sup>20</sup>Tr. 11/ 5532-33.

1 Pouching, and Opening Units..."<sup>21</sup> Witness Moden also noted: "These operations act  
2 as a gateway through which mail for subsequent sorting operations must pass. It is  
3 critical to the success of the outgoing distribution operations that mail be processed ....  
4 as expeditiously as possible."<sup>22</sup>

5  
6 Allied operations support the distribution operations. They prepare the mail for the  
7 distribution operations, move it between them, and then move it for dispatch to the next  
8 processing facility or to the carrier stations. Witness Bradley incorporated the support  
9 nature of the allied operations into his analysis in a fundamental way: he used workload  
10 measures from the distribution operations as the cost drivers for the allied operations.  
11 All of the distribution workload measures are significant, showing that the time spent in  
12 allied operations is a function of piece handlings in the distribution operations. This  
13 operational interconnection and the significance of cost drivers are reasons why  
14 witness Sellick should have distributed mixed-mail and not-handling costs at allied  
15 operations across distribution operations.

16  
17 Just as allied operations are linked to each other and to the distribution operations, so,  
18 too, are the distribution operations linked to each other. Manual sorting, for example, is  
19 necessary when automated or mechanized sorting operations are overwhelmed by mail  
20 which must meet critical dispatch schedules. As critical dispatch times approach, a  
21 piece of mail may receive a manual, mechanized, or an automated sort, depending on  
22 mail volumes and the availability of machines. As witness Bradley stated: "In an  
23 automated environment, manual activities will serve as the backstop technology and  
24 these activities will be staffed so that they are available to sort the mail that cannot be  
25 finalized on automated equipment."<sup>23</sup>

---

<sup>21</sup>USPS-T-4 at 21-22.

<sup>22</sup>USPS-T-4 at 22.

<sup>23</sup>USPS-T-14 at 58.

Witness Moden also recognized the interactions between manual, mechanized, and automated operations, noting the shifting of mail to higher levels of mechanization and automation and the dependence of processing method on volume levels and dispatch schedules.<sup>24</sup> Thus, treating the manual, mechanized, and automated cost pools in isolation makes no sense. Witness Bradley recognizes this in his analysis, with the variability of distribution operations dependent on the manual ratio (the ratio of manual piece handlings to the sum of manual, automated, and mechanized piece handlings for both letters and flats). Both witness Degen, who intended to be consistent with witness Bradley, and witness Sellick, who intended to be consistent with witness Degen, should have distributed mixed-mail and not-handling costs across more aggregated groupings of distribution operations.

#### **VIII. Incorporating Cost Pool Interrelationships Into Witness Sellick's Distribution Would Lead To Very Different Results**

The interrelationships between allied and distribution operations and among manual, mechanized, and automated operations are well-documented. At a minimum, witness Sellick should have distributed the costs for allied operations across cost pools and the costs for distribution operations across manual, mechanized, and automated cost pools. Had witness Sellick done this, his proposed distributions would be very different.

To illustrate the potential impact on his proposed distribution, I performed some rudimentary calculations comparing the distribution of \$2.2 billion of mixed-mail and not-handling costs at allied operations under two different distribution assumptions: (1) costs are distributed on the basis of direct tally costs only at allied operations, and (2) costs are distributed on the basis of direct tally costs at all operations. The differences between these two distributions are very significant, particularly for Periodicals, Priority, and Standard B.

---

<sup>24</sup>USPS-T-4 at 4-5, 21.



2 Distributing allied costs on the basis of all direct tallies, rather than just direct tallies at  
 3 allied operations, would decrease the cost distributed to Periodicals and Priority Mail by  
 4 about forty percent and the cost distributed to Standard B by nearly fifty percent. The  
 5 impact for the larger classes is much less (See Table 1 for more detail). It is apparent  
 6 that witness Sellick's assumption that there is no interconnection between allied  
 7 operations and the distribution operations, which the allied operations support, has a  
 8 substantial impact on his proposed distribution, significantly overstating the costs for  
 9 Priority Mail, Periodicals, and Standard B mail.

10  
 11  
 12 **Table 1. Comparison of Distributions of Mixed and Not-Handling Costs**  
 13 **for Allied Operations<sup>25</sup>**  
 14

Class	Allied Distribution on Allied Cost Pools	Allied Distribution Across All Cost	Difference	
			Dollar	Percent
First-Class	\$1,242,176	\$1,370,962	\$128,786	10.4%
Priority	\$162,808	\$95,142	-\$67,666	-41.6%
Express	\$15,452	\$19,059	\$3,607	23.3%
Periodicals	\$177,956	\$107,838	-\$70,119	-39.4%
Standard A	\$470,655	\$442,952	-\$27,703	-5.9%
Standard B	\$52,994	\$27,340	-\$25,654	-48.4%

15  
 16  
 17 Witness Sellick admitted that an accurate measurement of costs is important.<sup>26</sup> He  
 18 also admitted that choosing a distribution methodology requires an evaluation of the

<sup>25</sup> Calculated from data in USPS-LR-23 and USPS-LR-146.

<sup>26</sup>Tr. 26/14239.

available alternatives.<sup>27</sup> Yet Sellick did not look at alternatives that use more appropriate cost drivers for allied operations. Furthermore, witness Sellick claims that: "The importance of assumptions which underlie an analysis depends on the impact a change in the assumptions would have on the final results."<sup>28</sup> It would appear that assumptions are very important in this case. Yet witness Sellick admits that he did not look at the assumptions in an "analytical way."<sup>29</sup>

**IX. Inefficiency and Slack Time Require Cross Pool Distributions if Inefficient Costs are Distributed at All.**

One of the key questions in this case and in preceding cases has been whether the rapid growth in not-handling costs is due to inefficiency in postal operations. Yet witness Sellick did not bother to examine this question,<sup>30</sup> although there is ample evidence of inefficiency in Postal operations in the record of this case (see my direct testimony, MPA-T-2).

In an audit of allied workhours, the Postal Inspection Service found that postal managers paid "little attention... to LDC 17 [opening units] components" as long as they were "making" the total budget.<sup>31</sup> One cause of this management inattention is that the Postal Service collects no piece-handling data for allied operations and consequently cannot calculate productivity for these operations. Assigning slack labor to allied operations therefore increases measured productivity at distribution operations while not decreasing measured productivity at any other operation. For this reason, supervisors "had employees clock into a non-distribution operation at the beginning of their tour until the supervisor made individual work assignments."<sup>32</sup> Further, when

---

<sup>27</sup>Ibid.

<sup>28</sup>Tr. 26/14195.

<sup>29</sup>Tr. 26/14241.

<sup>30</sup>Tr. 26/14238-9.

<sup>31</sup>USPS-LR-H-236. "National Coordination Audit: Allied Workhours" at 10.

<sup>32</sup>Id. at 19.

1 managers reassigned these employees to distribution operations, on occasion they  
2 never clocked into the distribution operations. Management's inattention has led to  
3 high costs in allied operations. Specifically, by increasing management attention, the  
4 audit found that the Postal Service could reduce opening unit workhours by more than  
5 ten percent.<sup>33</sup>

6  
7 The audit findings suggest that at least a portion of not-handling costs at allied  
8 operations is not caused by direct piece handlings in any operations. Rather, this  
9 portion of not-handling costs at allied operations is due to the fact that some employees  
10 have nothing to do at certain times during a shift. Because these costs are just as  
11 causally unrelated to piece handlings in distribution operations as to piece handlings in  
12 allied operations, an appropriate distribution method should distribute these not-  
13 handling costs, if at all, in proportion to direct and mixed-mail costs across all  
14 operations.

15  
16 **X. Witness Sellick Failed to Consider that Differences Between CAGs and Basic**  
17 **Functions Suggest It Is Appropriate to Distribute Mixed-Mail and Not-Handling**  
18 **Costs Within CAG and Basic Function.**

19  
20 Part of witness Sellick's rationale for distributing mixed-mail and not-handling costs  
21 within cost pools is based on the fact that there are differences in the levels of these  
22 costs among cost pools. As witness Sellick stated: "Some of the MODS pools  
23 constructed by witness Degen demonstrate different levels of not-handling costs with  
24 those pools. It would be an important factor to recognize that, and to ignore that, I  
25 believe would be incorrect."<sup>34</sup>

26  
27 There is also clear evidence on the record that there are differences in levels of mixed-  
28 mail and not-handling costs among CAGs and basic functions, but witness Sellick

---

<sup>33</sup>Id. at 10.

<sup>34</sup>See Tr. 26/14244.

1 ignored these differences. This is curious because one can distribute costs within CAG  
2 and basic function while avoiding the severe distortions in witness Degen's method  
3 (and now witness Sellick's) that result from ignoring many relevant cross-pool cost  
4 relationships.<sup>35</sup> No severe distortions result from distributing costs within CAG and  
5 basic function because CAGs and basic functions are cleaner separations; individuals  
6 do not often move between CAGs or between basic functions during a work shift.<sup>36</sup>

7  
8 As shown by witness Stralberg, there is wide variation in the percentage of mixed-mail  
9 costs in different CAGs, from a low of 4 percent of total costs in the smallest CAG to 13  
10 percent in the largest, CAG A. There are similar variations in the level of not-handling  
11 costs, from a low of 12 percent of total costs in the smallest CAG to 39 percent in the  
12 largest, a difference of more than 300 percent. Looking at individual categories of not-  
13 handling costs, costs associated with single or mixed shapes (activity codes 5610-  
14 5750) are 9 percent of total costs at MODS CAG B-D offices but almost 100 percent  
15 larger in CAG A offices at 17 percent of total costs.<sup>37</sup>

16  
17 Similarly, there are also large differences in not-handling and mixed-mail costs with  
18 respect to basic function at MODS facilities. Not-handling costs comprise 23.5 percent  
19 of costs for the incoming basic function, 27.5 percent for outgoing, and nearly fifty  
20 percent for transit. Also, mixed-mail costs are 14.2 percent of costs for the incoming  
21 basic function, 16.3 percent for outgoing, and 22.8 percent for transit.<sup>38</sup>

## 22 23 **XI. Conclusion**

24  
25 This rebuttal testimony shows that not-handling and mixed-mail costs are large and  
26 extremely important in determining the attributable costs of the classes and subclasses  
27 of mail. It also shows there is little evidence on the record explaining the cause of the

---

<sup>35</sup>Tr. 26/13874.

<sup>36</sup>Tr. 26/13826.

<sup>37</sup>Tr. 26/13883.

1 not-handling costs, their magnitude and growth, or their distribution among the various  
2 mail processing operations. My testimony also shows that UPS witness Sellick has  
3 uncritically accepted USPS witness Degen's distribution of these costs without either  
4 performing any independent analysis or having the knowledge or background to do so.  
5

6 Witness Sellick was incorrect in assuming that he could adopt witness Degen's  
7 approach while rejecting witness Bradley's analysis. Furthermore, witness Sellick  
8 ignored operational reality by confining cost distribution within cost pools, despite  
9 clearly demonstrated dependencies between allied and distribution operations.  
10

11 This testimony and my previous testimony in this case, MPA-T-2, show that both  
12 analytical and statistical considerations dictate against adoption of witness Sellick's  
13 proposal. In contrast, the distribution advocated by witness Stralberg and me are  
14 consistent with operational reality, are more reliable statistically, and limit departures  
15 from past practice in light of uncertainty as to the use of not-handling costs and their  
16 appropriate distribution.  
17

18 Witness Sellick's proposed distribution of mail processing costs is not well founded and  
19 should not be used by the Commission.

---

<sup>38</sup>Calculated from data in USPS-LR-H-23.

**CERTIFICATE OF SERVICE**

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



James R. Cregar

Washington, D.C.  
March 9, 1998

1 CHAIRMAN GLEIMAN: Two participants have requested  
2 oral cross examination of Witness Cohen, United Parcel  
3 Service and United States Postal Service.

4 Does any other participant wish to cross examine  
5 the witness?

6 [No response.]

7 CHAIRMAN GLEIMAN: If not, then Mr. McKeever, when  
8 you're ready, you can begin.

9 MR. MCKEEVER: Thank you, Mr. Chairman.

10 CROSS EXAMINATION

11 BY MR. MCKEEVER:

12 Q Good morning, Ms. Cohen.

13 A Good morning.

14 Q Ms. Cohen, could you turn to page 1 of your  
15 testimony, please? On that page, at lines 20 to 21, you  
16 state that Mr. Sellick's proposed distribution method cannot  
17 be used without also using Witness Bradley's results. Do  
18 you see that?

19 A Yes, I do.

20 Q Is it also true that it doesn't make sense to use  
21 Dr. Bradley's variability results without, at the same time,  
22 using Mr. Degen's proposed distribution methods?

23 A Well, I think that the attribution and  
24 distribution methodologies used must be consistent. I think  
25 Dr. Christensen put it pretty well in his testimony on

1 rebuttal. I would say that you have to use a similar  
2 framework.

3 I don't think -- as you know, in my direct  
4 testimony, I have suggested revisions to Witness Degen, but  
5 -- so, I don't think it had to be done exactly as Witness  
6 Degen had proposed it, but with the changes that I  
7 recommend, I do believe that those two would be acceptable  
8 together.

9 Q It is your testimony that certain LIOCATT  
10 distribution methods can be used while also using Witness  
11 Bradley's variability results. Is that right?

12 A I did not advocate going back to the LIOCATT  
13 method. We advocated using Witness Degen as a starting  
14 point, making the necessary modifications, and then we had a  
15 consistent set of attribution and distribution.

16 Q Don't you use some of the LIOCATT methods to  
17 distribute at least some costs?

18 A Well, for the mixed mail, where you really have to  
19 make a determination of the contents, we were unhappy with  
20 the item distribution, and we really substituted what was  
21 the basic function and CAG approach from the LIOCATT system,  
22 but within the same framework that Witness Degen had  
23 proposed.

24 Q What do you mean by "within the same framework"?

25 A Well, we didn't ignore the cost pools -- I mean,



1 in terms of setting up the variabilities, the cost pools,  
2 the consistency with cost drivers, all that would stay the  
3 same, but there are obviously, as you go forward in your  
4 distribution process, points where you have to make  
5 assumptions in terms to get to sub-class, and we felt using  
6 the basic function and CAG was a better approach at the  
7 current time.

8 Q Okay. Thank you.

9 Could you turn to page 4, please?

10 A Yes.

11 Q There, in footnote 2, you state that you cannot  
12 quantify -- this is at the end of the footnote -- that you  
13 cannot quantify how fast it has been increasing. What is  
14 the "it" that you are referring to there?

15 A Well, the particular grouping, they made some  
16 changes this time in terms of some things moving from not  
17 handling into mixed and some things moving from mixed to not  
18 handling. So, it was slightly different.

19 I did notice that Witness Degen, in his rebuttal,  
20 did examine another subset other than the one I had, which  
21 was overhead, and he looked at the set of the shape-specific  
22 and mixed shapes not handling category and showed the growth  
23 in that, as well.

24 So, I think we have that information on the  
25 record, also.

1           But in terms of the particular movement, where  
2 things that involved an item in container moved from not  
3 handling to mixed and something else moved back, which I  
4 will think of in a minute, but it's slightly different.

5           Q     I apologize, Ms. Cohen, but I lost in there what  
6 the "it" is. What is it that you could quantify that you're  
7 referring to in that sentence?

8           A     That the not handling category, as we're using it  
9 in this case, is somewhat different than the not handling  
10 category that we used in the preceding case in terms of what  
11 codes are in there and what parts of codes.

12          Q     Okay.

13                So, you couldn't identify the difference between  
14 not handling in the last case and not handling in the case?  
15 Do I understand you correctly?

16          A     You can identify comparable pieces, okay? So,  
17 like what Witness Degen did is he looked at the 5610 to 5750  
18 series. So, you can look at that.

19                And I had shown what happened with what was  
20 traditionally called overhead, which included the breaks and  
21 the clocking in and out and the moving empty equipment, but  
22 there are changes that -- with regard to empty equipment and  
23 the not handling that make this category this time slightly  
24 different, and my direct testimony -- I know it's confusing,  
25 and it was confusing -- tried to make it as clear as

1 possible -- I explained what, this time, the category had,  
2 but it's somewhat different.

3 I don't know how better to do it.

4 Q Okay. I'll just ask you one more question. You  
5 said the category, you tried to identify what the category  
6 included. What is the category?

7 A The not handling as defined by Witness Degen in  
8 this proceeding.

9 Q Okay. Thank you.

10 Still on page 4, at lines 11 to 15, you mention,  
11 among other things, sorting outside sacks mechanically, that  
12 activity.

13 A Actually, that should say outsides and sacks, but  
14 -- sorry.

15 Q Outside?

16 A Outsides and sacks.

17 Q Okay. That's helpful. Could you tell me -- could  
18 you describe for me that activity?

19 A Well, it is -- well, actually, it depends on where  
20 it is. Witness Bradley, actually, for this, used a proxy  
21 from the BMCs, but I think that, at MODS facilities, there  
22 are not that many, actually, that have this operation, but  
23 some do have sack sorting and outside sorting.

24 It is -- it can have a few different  
25 configurations, but it can be mostly a conveyor system to

1 get the sacks and outsides to a few different locations in  
2 the facility or more traditional sack sort of the type at a  
3 BMC.

4 Q Now, you note in lines 11 to 15 that not handling  
5 costs are 50-percent higher in the mechanical sack sorting  
6 activity than they are in the mechanical parcel sorting  
7 activity. Is that right?

8 A Yes.

9 Q And then, in the BMC operations that you discuss  
10 at lines 20 to 21, it's again the case that not handling  
11 costs are 50-percent higher in the case of the sack sorting  
12 machine than in the case of the parcel sorting machine. Is  
13 that right?

14 A Yes. I did notice that those are actually in  
15 comparable directions. I'm not sure that that makes me feel  
16 anymore comfortable about it.

17 I think we found -- I tried to illustrate a few  
18 cases. There are certainly others. In your own  
19 interrogatory to me, we compared LSMs and small parcel and  
20 bundle sorters, which had very different not handling  
21 percents, as well.

22 These were some examples, but there are others.

23 Q And they move in the same direction at about the  
24 same -- with about the same difference.

25 A No, not necessarily.

1 Q In the examples you cite.

2 A In the two -- the BMC and the MODS, which have  
3 similar kinds of mechanical sorting here, yes, it is in the  
4 same direction.

5 Q Okay.

6 Ms. Cohen, could you turn to page 6 of your  
7 testimony, please?

8 A Okay.

9 Q And in particular, lines 19 to 23.

10 A Okay.

11 Q There you criticize Mr. Sellick for not mentioning  
12 in his written testimony the conclusion of the 1992 Foster  
13 Associates report that, quote, "additional field operating  
14 data are necessary to determine the proper causative  
15 attribution of the break and sub-class costs in question and  
16 those other costs which are presently attributed as mixed  
17 mail or overhead activities," and you cite pages 14256 to  
18 14258 of Mr. Sellick's oral cross examination there. Is  
19 that correct?

20 A Yes.

21 Q Isn't it a fact that, despite your counsel's  
22 attempt to cut Mr. Sellick off in this middle of his answer  
23 to your counsel's question on that point, Mr. Sellick later  
24 went on to state, in the next page, after the ones you cite,  
25 that IOCS was modified to gather more information about

1 exactly the question raised in that part of the 1992 study?

2 I do have the transcript here if you would like to  
3 refer to it.

4 A That doesn't affect the field operating data.

5 Q Modifications to IOCS to collect data?

6 A Oh, that was clearly not what was intended here.

7 Q What was not intended where?

8 A Well, modifications to IOCS is not what this talks  
9 about. It talks about getting into the field and looking at  
10 operating data to determine what's actually going on in  
11 terms of staffing, operations. You would look at the IOCS  
12 as part of that. It's actually pretty similar to what I  
13 think we're going to start, hopefully, soon, to look at for  
14 periodicals.

15 Q Isn't it, in fact, the case that IOCS was modified  
16 to ask some additional questions to obtain data associating  
17 breaks with the activity that the employee was on break  
18 from?

19 A Yes.

20 Q And that was done after the 1992 report. Is that  
21 right?

22 A I don't remember exactly when that was -- when  
23 that went in.

24 Q Well, there is a variable F94-19. Are you  
25 familiar with that at all?

1           A     Okay.  I've got it in my book.  Do you want me to  
2 look at it?

3           Q     Yes, please.

4           A     92-19?

5           Q     94-19.

6           A     Okay.  Which question is it for IOCS?

7           Q     It's in 18, I believe, but I'll have that for you  
8 in just one moment.  Actually, this is -- you're looking at  
9 the IOCS booklet?  What library reference do you have?

10          A     Twenty-three.

11          Q     Twenty-three.  Okay.

12          A     IOCS dictionary.

13          Q     If you look at a page -- it's actually page 38 of  
14 that document, but it's labeled page 20 of 36 on the bottom  
15 of the page.  That refers to F94-19.

16          A     Okay.

17          Q     And that says title of item, type distribution on  
18 break from?  Is that correct?

19          A     Yes.

20          Q     Okay.

21                   Now, do you know what the structure of that SAS  
22 item number means?  Does the 94 symbolize anything?

23          A     I am not a SAS programmer.  I'm sorry.

24          Q     Doesn't that -- let me see if I can help you a  
25 little bit, and if you don't know, you don't know.  Doesn't

1 the 94 indicate when that question or when that particular  
2 item was put into the program, the year, 1994?

3 A I'll accept it subject to check.

4 Q Okay. You don't know one way or the other.

5 A No. I didn't use those codes. I mean they're  
6 used by my people, but I don't know.

7 Q Okay.

8 Ms. Cohen, is it your testimony that Mr. Degen's  
9 distribution keys are piece handlings for the various  
10 sub-classes in the various cost pools he deals with?

11 A That his distribution keys are?

12 Q Yes.

13 A No.

14 Q Is that your testimony?

15 A No.

16 Q Pardon me?

17 A No.

18 Q Okay.

19 Now, allied operations handle pre-sorted mail, do  
20 they not? Or I should say pre-sort mail is handled in  
21 allied operations. Is that correct?

22 A It can be.

23 Q Well, you say it can be. It is on occasion, at  
24 least?

25 A Yes.



1 Q Okay.

2 So, it's more than it theoretically can be. It  
3 actually is at times. Is that what we're saying? I want to  
4 make sure we're understanding each other.

5 A Well, I mean mail that is pre-sorted will  
6 sometimes be handled in various ways at allied operations.

7 Q Okay.

8 Piece sortation operations do not generally handle  
9 pre-sorted mail. Is that correct?

10 A Well, frequently you'll have an incoming  
11 secondary. It would mostly bypass outgoing operations.  
12 Some to carrier route would bypass the incoming secondary at  
13 all. It really depends on the pre-sort.

14 Q Okay. It is handled in piece sortation operations  
15 to a lesser extent than non-pre-sorted mail. Isn't that  
16 true?

17 A Yes.

18 Q Now, if an IOCS data collector at an allied  
19 operation observes mixed pre-sorted mail, do you know what  
20 activity code would be assigned to that observation in IOCS?

21 A I'm sorry. Tell me again?

22 Q Sure. If an IOCS data collector takes a tally at  
23 an allied operation and he observes mixed pre-sorted mail,  
24 do you know what activity code would be assigned to that  
25 observation?

1           A     Well, do you mean that the employee is clocked  
2 into the allied operations or he's actually at the allied  
3 operations?

4           Q     Let's assume they're the same for purposes of this  
5 question, that he's clocked in to that operation and that's  
6 what he's actually doing.

7           A     So, you are assuming he is clocked in and he is  
8 there.

9           Q     Yes.

10          A     Okay. They -- well, it would depend on what the  
11 mixed mail was. It probably could get a mixed all shapes of  
12 5750.

13          Q     5750. Could it get a 5610?

14          A     Not if he is at the allied operations. That's  
15 only used if there is a predominant shape association. You  
16 would get that if the employee was at the distribution  
17 operations.

18          Q     Only if he was at the distribution operations?

19          A     Yes.

20          Q     Am I correct that Mr. Degen's distribution method  
21 distinguishes large CAG offices which are in MODS from  
22 smaller CAG offices which are not MODS offices?

23          A     He separates the MODS and non-MODS offices.

24          Q     And aren't large CAG offices MODS offices and  
25 smaller CAG offices non-MODS offices?

1           A     Well, there's some overlap, but all the CAG A  
2 offices are in his MODS category.

3           Q     Do you know what proportion of the MODS pool of  
4 the MODS -- let me start over.

5                     Do you know what proportion of the MODS pool costs  
6 are in CAG A?

7           A     A substantial portion; I don't know the exact  
8 number right now.

9           Q     Could it be 90 percent or more? Do you know? Is  
10 that the right order of magnitude?

11          A     I think we were talking about 85 percent for MODS  
12 offices in general. I don't know. I'd say it's a lot. I  
13 don't know the number.

14          Q     Okay. Mr. Degen treats BMC costs separately,  
15 doesn't he?

16          A     Yes, he does.

17          Q     And in LIOCATT, BMCs are their own CAG or cost  
18 ascertainment grouping, aren't they?

19          A     Yes.

20          Q     Now I'd like to ask you a question about non-MODS  
21 offices. Do you know what percentage of total cost segment  
22 3 costs non-MODS offices account for?

23          A     I think if I'm remembering the right number that  
24 that was roughly the 85-15 split, but I'd have to check  
25 that.

1 Q So you think to the best of your recollection now  
2 it's about 15 percent?

3 A I think so.

4 Q Okay. Do you know what activity code is assigned  
5 by the IOCS system to an employee who is handling mixed  
6 mail?

7 A Is this a general question? I mean --

8 Q Yes.

9 A Let me ask the context.

10 Any IOCS data --

11 Q How about -- well, let me ask you this one. Yes,  
12 any IOCS data collector I assume --

13 A Okay.

14 Q That -- I'm looking for the IOCS system, okay?

15 A Okay.

16 Q Do you know what activity code is assigned under  
17 the IOCS system to not handling mail at an OCR machine? If  
18 an employee is at an OCR machine but not handling mail, do  
19 you know that activity code that would be assigned there?  
20 Is that possible to say?

21 A 5610, which is the shape-specific letters.

22 Q Okay. And what shapes of mail -- maybe you've  
23 just answered it, but let me make it clear. What shapes of  
24 mail are the basis of LIOCATT's distribution key for mixed  
25 mail activity code 5610? Do you know that?

1           A     The 5610 is letter-shape; 5620 is flat; 5700 is  
2 parcels.

3           Q     So for 5610 it would be all letter activity codes  
4 would be the basis of the LIOCATT distribution key?

5           A     Right, all letter shapes.

6           Q     Okay. Do you know if that includes Priority Mail  
7 letters?

8           A     To the extent that there are letters for Priority  
9 in the direct keys, yes.

10          Q     Do you know if in fact that happens?

11          A     I'd have to look at my numbers, but -- I could  
12 check for you. It would take a few minutes.

13          Q     Could you please?

14          A     Actually, I don't have it by shape here so I would  
15 have to -- well, no, I don't. I would have to go back and  
16 check. Sorry.

17          Q     Okay. Are you able to check with respect to  
18 Express Mail letters?

19          A     Yes, I can check for you.

20          Q     I mean you can't do it now though, in other words?

21          A     No.

22          Q     Okay -- and I take it you are not in a position to  
23 check now for presorted letters?

24          A     Well, we know that there are letters. I mean I  
25 think all these categories, to the extent there is letter

1 mail in the direct tallies there will be an assignment of  
2 the letter 5610.

3 MR. McKEEVER: That's all I have, Mr. Chairman.

4 CHAIRMAN GLEIMAN: Mr. Koetting.

5 MR. KOETTING: Thank you, Mr. Chairman.

6 CROSS EXAMINATION

7 BY MR. KOETTING:

8 Q Good morning, Ms. Cohen.

9 A Good morning.

10 Q I would like to start looking at Footnote 25 on  
11 page 13 of your testimony and if you could look at that in  
12 your --

13 A My cryptic footnote? Okay.

14 Q Right, and I don't want to belabor this but the  
15 footnote cites to LR-146 and earlier this week you filed a  
16 Work Paper 1.

17 A Yes.

18 Q Would you agree that your work paper does not  
19 contain any citations to data that are presented in H-146?

20 A The data itself is in H-23. That is where the raw  
21 data is and the programs are in 218 which you need to read  
22 146 to work with 218.

23 It's kind of not fun for people who don't do SAS,  
24 but --

25 Q I assume we can agree that actually now that

1 PMA-RT-1 Work Paper 1 is available that the footnote would  
2 now probably be more accurate and informative if it referred  
3 to that work paper, correct?

4 A Sure.

5 Q And would you agree that even before that work  
6 paper was available that a reference MPLR-1 might have been  
7 a little more helpful than 146?

8 A Well, I mean LR-1 pulls the data from 23, using  
9 146. I mean I'm sorry because there's a lot of Library  
10 References and it has the same data and that's why on the  
11 work paper I explained it could be gotten from either place.

12 Q Let's turn to the substance. I am still on page  
13 13 of your testimony, lines 5 through 9.

14 You are discussing Witness Sellick's proposals and  
15 presentations. Would it be a fair paraphrase of what you  
16 are saying on lines 5 through 9 there that you find Witness  
17 Sellick's distribution method significantly overstates the  
18 volume variable cost of Priority Mail, periodicals and  
19 Standard B relative to what you would consider a correct  
20 distribution method?

21 A Yes.

22 Q And are you drawing that conclusion from your  
23 analysis presented at Table 1 there on the bottom of the  
24 page?

25 A That's one of the reasons I say that.

1 Q Well, let's look at that table for a moment.

2 Does this analysis hold the variabilities constant  
3 between the two allied cost distributions that are  
4 presented?

5 A Yes. I mean in trying to do this illustration I  
6 used Witness Sellick's assumption that all costs were  
7 variable, and so I used the tally costs but reweighted them,  
8 but didn't do the variability adjustment.

9 Q Okay. The first column with numbers in it is  
10 labelled as the Allied Distribution on Allied Cost Pools,  
11 correct?

12 A Well, actually the first column is -- oh, I'm  
13 sorry. Are we looking at the work paper or the table?

14 Q I am sorry. I am looking at the table, Table 1.

15 A Right, okay.

16 Q Is the methodology, the allied distribution on  
17 allied cost pools methodology that is reflected in that  
18 first column, is that the same methodology as Witness  
19 Sellick's proposed method?

20 A No. This is a simplification. I mean I did not  
21 have Witness Sellick's work papers fully loaded. I really  
22 couldn't go through and do an exact calculation but I  
23 thought it was an important illustration to make, so I made  
24 some simplifying assumptions and I used the term  
25 "rudimentary" to describe what I had done.



1 I simply said if you looked at allied and only  
2 distributed on itself compared to if you distributed it on  
3 everything. In fact, he did it within cost pools for most  
4 of that. There were a couple of exceptions across pool but  
5 he would have done it within allied and he also would have  
6 used the items which I didn't play with here.

7 Q I think that's the basic point we're trying to get  
8 at, but just to make sure, the second column with numbers in  
9 it, the allied distribution across all costs, would you  
10 agree that that isn't actually being -- doesn't actually  
11 reflect your proposal or Witness Stralberg's either?

12 A Oh, I do propose that allied distribution should  
13 be done across all cost pools. Yes, that is exactly what I  
14 proposed.

15 Q But is this derived from your actual distribution  
16 keys for mixed mail and not handling mail?

17 A No, this is derived doing a comparison for Witness  
18 Sellick. I think that the points are -- can be generalized.  
19 I think the conclusions would hold no matter if you used  
20 mine.

21 Q If you could refer to your testimony at page 16.  
22 We're looking at lines 4 through 6, please, specifically  
23 where you state no severe distortions result from  
24 distributing costs within CAG and basic function because  
25 CAGs and basic function are cleaner separations.

1 Individuals do not often move between CAGs or between basic  
2 functions during a work shift.

3 I think we can all pretty readily agree that  
4 individuals don't often move between CAGs during work  
5 shifts, so if we can put that side of it aside for a moment,  
6 would you agree that basic function is an IOCS concept?

7 A Well, not really. I mean, I know Witness Degen  
8 said that in his rebuttal, but the concept of incoming and  
9 outgoing is certainly integrated in MODS as well. I think  
10 it's a well-known concept throughout the postal system. So  
11 perhaps the measurement, you know, as we define it there in  
12 the two pages he talks about, but I don't think it's an  
13 alien concept just used for IOCS.

14 Q Given IOCS sampling procedures, is it possible for  
15 an employee to be tallied twice during the same work shift?

16 A I think it is possible, but I don't think it  
17 happens.

18 Q Okay. So whether it's theoretically possible or  
19 not probably isn't a relevant question, but it doesn't  
20 happen.

21 A Right.

22 Q And doesn't that imply that there's no IOCS data  
23 with which your hypothesis -- your hypothesis being that  
24 employees do not often move between basic functions during a  
25 work shift -- there's no IOCS data that you could test your

1 hypothesis with. Is that correct?

2 A Well, it's not really as if that's an important  
3 idea. I think we were just trying to do a distinguishing.  
4 The fact that in the cost pools we know that people move  
5 pretty readily, whereas in basic function certainly at a  
6 certain point in the shift you may switch, you go from doing  
7 outgoing mail to incoming mail, but it's not the same  
8 fluidity that I think you might find in MODS, and that's  
9 what we were trying to distinguish. So I'm not saying I  
10 would test it or have a hypothesis that one could not find  
11 someone doing both on the same shift.

12 Q Well, let's explore that a little bit. In support  
13 of your statement down in the footnote you cite transcript  
14 page 26, 13826, which is page 12 of Witness Stralberg's  
15 direct testimony. Do you happen to have that with you?

16 A Yes, I do.

17 Q If you would look, please, at lines 6 through 8 on  
18 that page and footnote 5.

19 A Okay.

20 Q Would you agree that Witness Stralberg's argument  
21 is based on the postulation that there is a limited  
22 concurrency of the basic functions?

23 A I think he's talking about the general trends and  
24 the fact you know the cycle of the day, you know when the  
25 outgoing mail is, the period of time, then the switch to

1 incoming, you know, you see more transit during the day. I  
2 think that concept is what he's going for.

3 Q As you were preparing your testimony or any of  
4 your -- you know, I don't want to focus exclusively on your  
5 rebuttal testimony. I know you've been working on direct  
6 and everything. Did you ever attempt to verify this point  
7 using IOCS data?

8 A To look at whether you have different basic  
9 functions on the same tour?

10 Q Correct.

11 A I didn't look at it to see.

12 Q Okay. And we sent you some cross-examination  
13 exhibits --

14 A Yes, you did.

15 Q That I believe you received. And let me  
16 distribute those now.

17 A Okay.

18 Q Obviously I could well understand if you haven't  
19 had any opportunity to try to replicate these exhibits, but  
20 I take it you understand the basic source data that we  
21 worked with to come up with the exercise that's --

22 A Yes, you also used the same sources I did.

23 Q So would you accept for purposes of these  
24 discussions that these tables are an accurate representation  
25 of IOCS tally costs by basic function and time of the

1 reading?

2 A I'll accept that subject to check.

3 Q Now the statement from Witness Stralberg's  
4 testimony that you cited to that appears on that transcript  
5 page 13826 is -- there obviously is overlap. He says  
6 outgoing and incoming operations in postal facilities are  
7 mostly done on separate shifts. Would you agree that while  
8 his description may be technically accurate depending on how  
9 you interpret words like "mostly," that there is in fact a  
10 significant amount of concurrency of the basic functions  
11 except at the non-MODS offices?

12 A Well, if I look at the chart that's all office  
13 types, I would say I see a significant difference between  
14 them in terms of the outgoing being largest on tour 3,  
15 incoming predominant in tour 1, and a combination of  
16 incoming and transit on tour 2, which is exactly what he  
17 suggested.

18 Q Nevertheless you would agree that there are  
19 also -- is a significant amount of overlap.

20 A There is overlap.

21 Q And would you agree that at BMCs, for example,  
22 which is chart B, that there's nearly as much incoming as  
23 outgoing processing taking place at BMCs at nearly all times  
24 of the day?

25 A Well, I would like to back up one minute and say

1 one other thing also. It is a little hard to draw  
2 conclusions from this because this is really the aggregate  
3 data, and different facilities could have different cutoffs  
4 at times when they switch from one set of processing to  
5 another. So it's a little hard to tell when you look at the  
6 aggregate. I mean, you could have a cleaner break at  
7 particular facilities. But that said, looking at the BMCs,  
8 I would say that not surprisingly they have a more  
9 consistent mix.

10 MR. KOETTING: Mr. Chairman, at this point I would  
11 like to move that these Charts A through D be designated as  
12 USPS/MPA-RT-1 Cross-Examination Exhibit Number 1, and I  
13 would request that they be transcribed and I believe it  
14 would also be appropriate for them to be moved into  
15 evidence, since they do contain summations of information  
16 that is already on the record in a fairly well accepted  
17 format.

18 MR. CREGAN: Mr. Chairman, we would note that the  
19 sources are rather cryptic but we, subject to Ms. Cohen's  
20 acceptance of these charts subject to check, we have had no  
21 opportunity to analyze them obviously, we have no objection.

22 CHAIRMAN GLEIMAN: And I will direct that  
23 Cross-Examination Exhibit Number 1 be transcribed into the  
24 record and admitted into evidence.

25 [Cross-Examination Exhibit No.

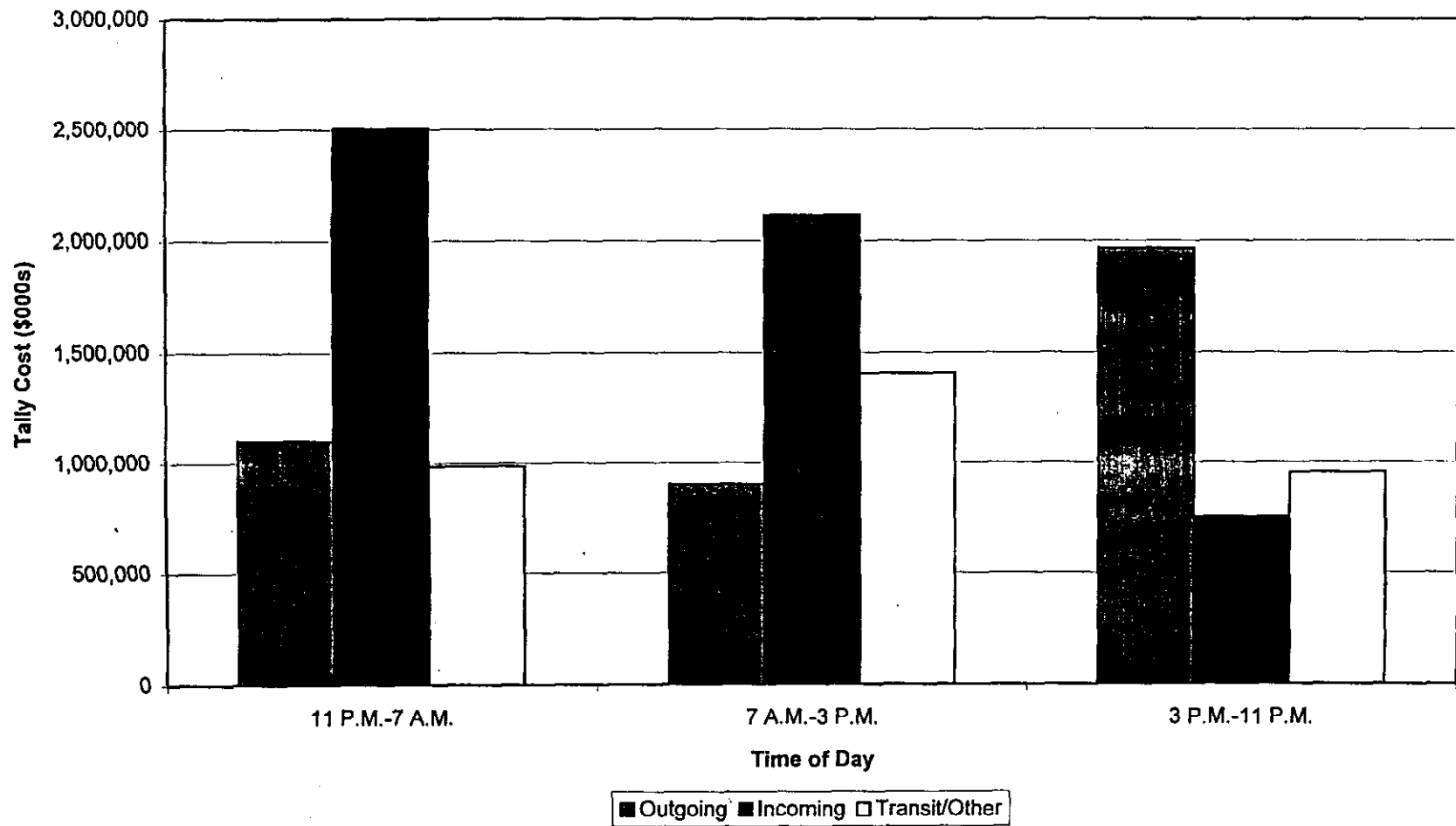
1                   USPS/MPA-RT-XE-1 was marked for  
2                   identification, received into  
3                   evidence and transcribed into the  
4                   record.]  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

USPS/MPA - RT1 - Cross X Exhibit 1

## CHART A

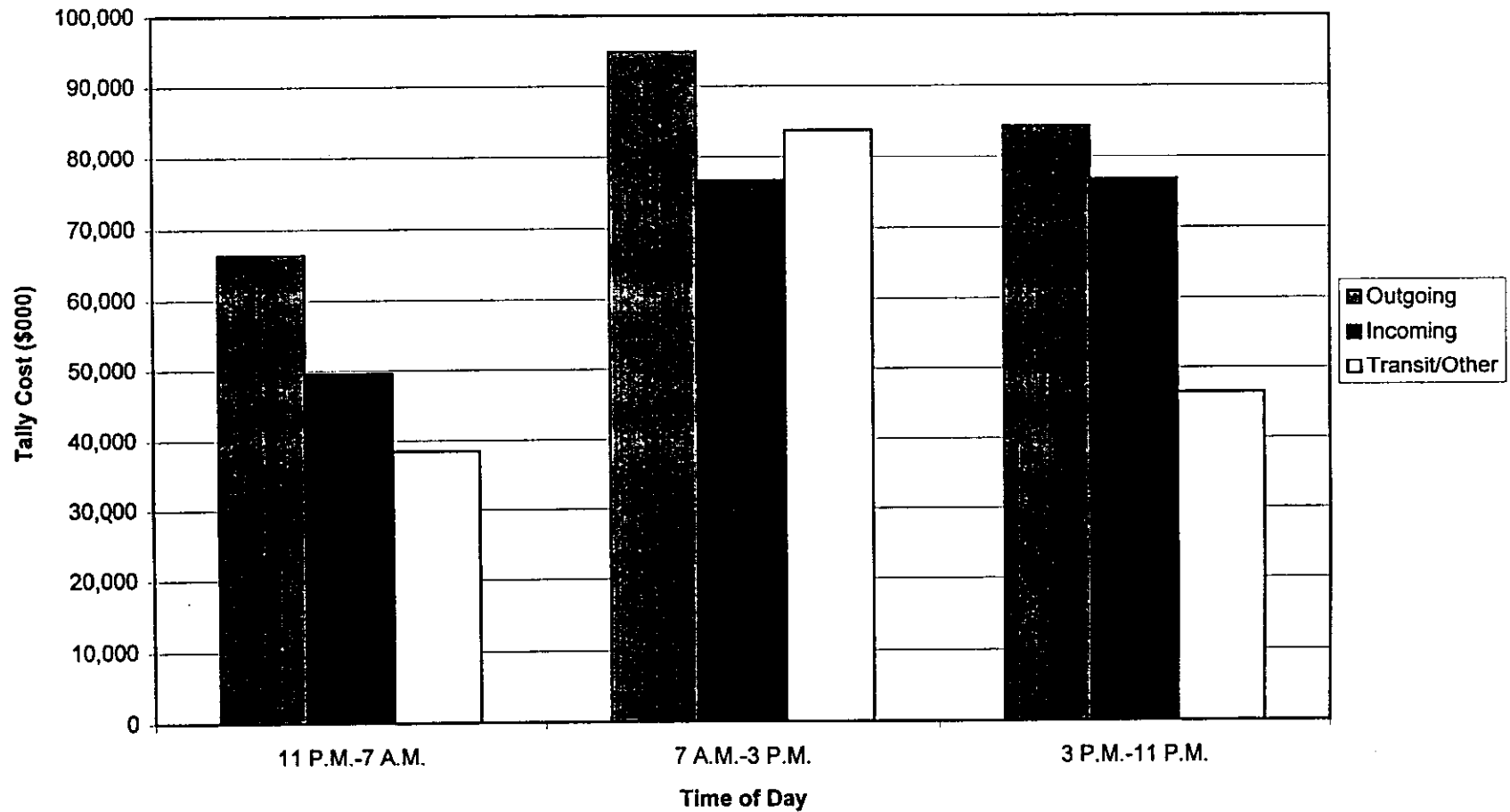
BY96 Mail Processing IOCS Tally Costs by Time of Day and Basic Function, All Office Types  
Source: LR-H-23 data; Mail Processing tallies identified using programs in LR-H-218





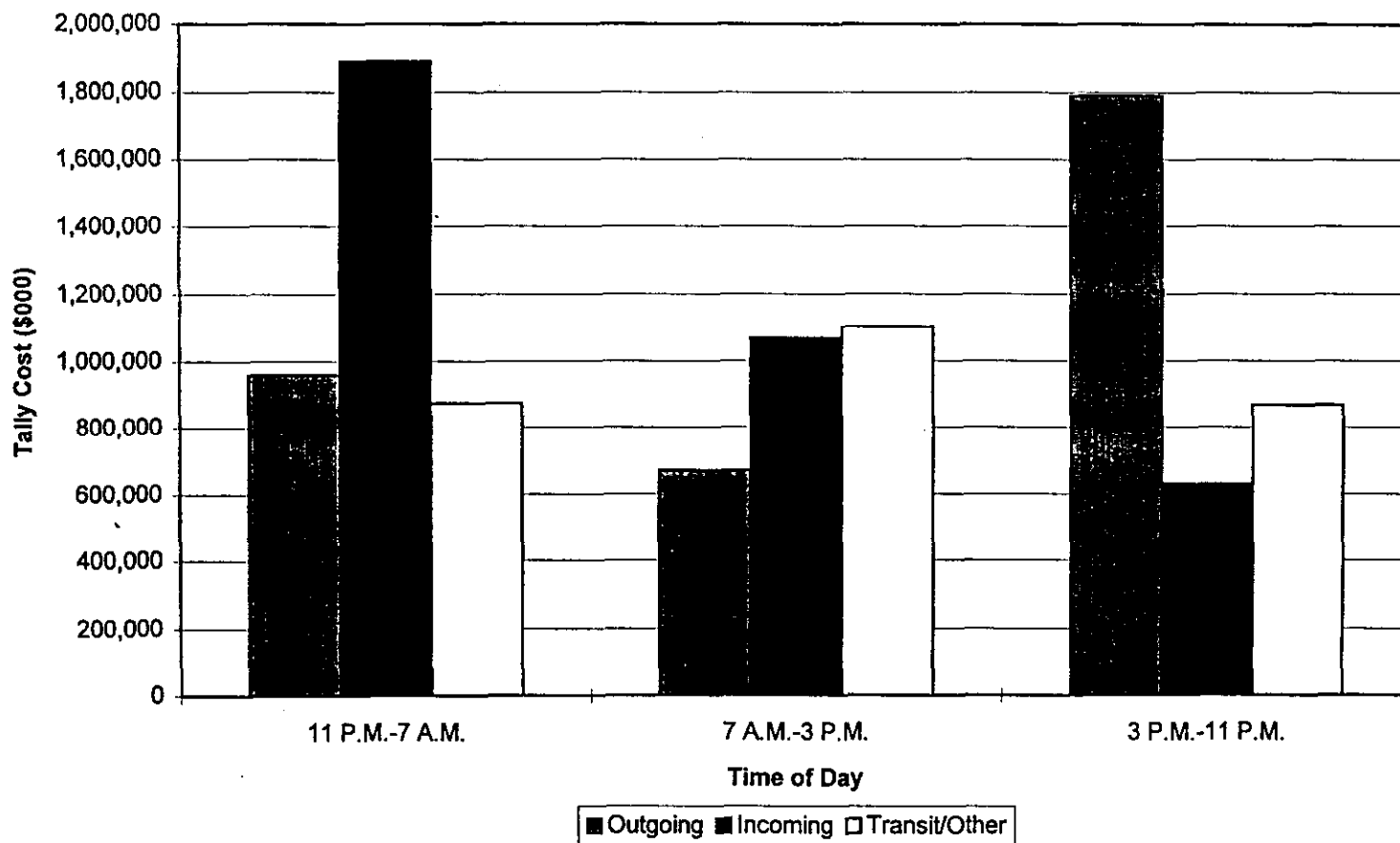
# CHART B

BY96 Mail Processing IOCS Tally Costs by Time of Day and Basic Function, BMCs  
Source: LR-H-23 data; Mail Processing tallies identified using programs in LR-H-218



# Chart D

Base Year 1996 Mail Processing IOCS Tally Costs, MODS 1 & 2 Offices  
Source: LR-H-23 data; Mail Processing tallies identified using programs in LR-H-218



1 BY MR. KOETTING:

2 Q And while we are on this same general topic, I  
3 would like to ask is it possible for someone to move to  
4 another basic function without moving between cost pools as  
5 cost pools are developed and utilized by Witness Degen?

6 A Well, the cost pools are an aggregation of  
7 individual three-digit codes, which include some outgoing  
8 and some incoming, and so you do have a combination of  
9 outgoing and incoming mail in each of the cost pools, and I  
10 think one of the nice things about using the basic function  
11 information is it allows you to distinguish that.

12 Q For example though, an employee working at a BCS  
13 for the duration of the shift could be processing on the  
14 outgoing scheme for part of the shift and processing on the  
15 incoming scheme for the remainder of the shift, is that --

16 A I think so.

17 Q -- a not infrequent occurrence?

18 A Could be. That could happen. I don't know the  
19 frequency.

20 Q Under the circumstances they would be staying  
21 within the same cost pool but they would be changing basic  
22 function?

23 A Right, and what I am saying is if you use basic  
24 function as part of the distribution you can capture that.

25 Q Well, let's go back to the statement in your

1 testimony on page 16 that we started with.

2 You say that basic functions, CAGs and basic  
3 functions are cleaner separations, and I guess if you could  
4 clarify cleaner separations than what?

5 A Than the MODS cost pools in terms of the ability  
6 of people or the frequency with which people can be moving  
7 between MODS cost pools.

8 Q Are you suggesting that there is no ambiguity in  
9 basic function when that is recorded by the IOCS data  
10 collector?

11 A They have been using it for 25 years. I think  
12 it's pretty clean.

13 Q Let's move to a topic that I think was covered  
14 briefly by Mr. McKeever but try to avoid rehashing exactly  
15 the same points.

16 Is the MODS CAT a stratum employed by you and  
17 Witness Stralberg an aggregate of multiple IOCS sampling  
18 strata?

19 A The MODS A, the CAG A facilities you're saying,  
20 including BMCs I guess, is that what you are asking me  
21 about?

22 Q Not including BMCs.

23 A Okay. Well, then what sense do you mean strata?

24 Q Are you aware for example that there are separate  
25 strata for the large mail processing plants and the customer

1 service facilities like stations and branches?

2 A Well, the Function 4 are the station and branches  
3 which are part of the MODS, yes.

4 Q Right, and the labor at mail processing plants,  
5 what is referred to in MODS and the NWRS is Function 1  
6 labor, correct?

7 A Right.

8 Q And the stations and branches is Function 4 labor?

9 A Right.

10 Q And is it your understanding that Witness Degen  
11 has separate cost pools for Function 1 and Function 4 labor  
12 in the MODS office groups?

13 A He separates those into different cost pools, yes.

14 Q Would you agree, on the other hand, that you and  
15 Witness Stralberg employ no directly comparable separation  
16 because despite the fact -- let me start over again.

17 Would you agree that you and Witness Stralberg  
18 employ no directly comparable separation despite the fact  
19 that there is a separate IOCS CAG A stratum for the large  
20 customer service operations?

21 A Well, you know, when Witness Bradley does his  
22 analysis he doesn't have separate variabilities for those  
23 either, so I think, yes, I would say that we treat those  
24 together but it is consistent with what Witness Bradley did.

25 Q For distribution purposes, does this make your

1 MODS CAG A group a less clean separation than it could be?

2 A Well, no, because people are not moving between  
3 them. I think that's what we were talking about, the fact  
4 that people could be clocked into one MODS operation and  
5 working in another or clocked into a MODS operation but  
6 functioning in some other place, but they are not going to  
7 be in a MODS facility and at the station and branch.

8 Q But doesn't this mean that you are basically  
9 pooling the handling categories at plants and at stations  
10 and branches?

11 A I am treating them together when I do the  
12 distribution with the IOCS codes.

13 Q So you are not keeping them within the same  
14 facility necessarily?

15 A Right. The tallies are distributed. Their  
16 tallies would go into the general pool that are distributed.

17 Q Still on page 16, lines 8 through 10 --

18 A Okay.

19 Q -- you note that there are variations in the  
20 percentages of mixed mail and not handling mail tally  
21 observations between the largest and the smallest CAGs.

22 By the smallest CAG do you mean CAG H?

23 A Yes.

24 Q Is it your understanding that the MODS, BMC,  
25 non-MODS distinction used by Witness Degen separates the

1 analysis of cost for the small CAGs from that of the largest  
2 CAGs?

3 A Yes.

4 Q If we could turn now to page 3 of your testimony,  
5 lines 27 through 28.

6 And I'm referring to the statement that reads: In  
7 spite of the significance and magnitude of not handling  
8 costs, the record in this case contains no evidence  
9 pertaining to the causality of these costs.

10 Is it your position that investigating the causal  
11 relationship between it's cost driver TPH and cost in the  
12 cost pool that Dr. Bradley somehow omitted what you call not  
13 handling cost from his cost pool?

14 A No, that's not what I said.

15 Don't you want me to elaborate?

16 Q No.

17 A I didn't think so. I have a good answer.

18 Q Well, I'm sure your counsel can handle that on  
19 redirect.

20 I think this is my last line, hopefully. On page  
21 11, lines 6 through 15, again I think there's a little bit  
22 of overlap here through -- with what Mr. McKeever went  
23 through, but maybe we can move through it quickly.  
24 Basically in that paragraph on page 11, you're emphasizing  
25 how the allied operations support direct distributions;

1 correct?

2 A Yes.

3 Q And isn't it true that there is a component of the  
4 allied operation workload that relates to mail that does not  
5 require piece distribution in that particular facility?

6 A Yes.

7 Q And would that mail specifically tend to be  
8 presorted mail?

9 A Yes. The reason that I proposed doing it over all  
10 distributions and not just -- over all operations and not  
11 just the distribution is recognition that there is in fact  
12 workload. Witness Christensen talked about that as well.  
13 He said you'd have to include the workload at the allied as  
14 well as the distribution. And that I propose to do.

15 Q On line 15 there on page 11 you're stating that  
16 that should be distributed across distribution operations.

17 A I mean to include across all operations. I'm  
18 sorry. That wasn't clear.

19 MR. KOETTING: That's all we have, Mr. Chairman.  
20 Thank you, Ms. Cohen.

21 CHAIRMAN GLEIMAN: Is there followup?

22 Questions from the bench?

23 Ms. Cohen, I have a couple of questions I need to  
24 ask you. When I go through these proceedings I kind of move  
25 back and forth between looking at trees and trying to see



1 the forest, and I'm at a point where I've moved away from  
2 some trees and I need to look at the forest a little bit.  
3 Perhaps you can help me understand.

4 Earlier on Mr. McKeever asked you some questions,  
5 and your response made reference to Witness Christensen and  
6 his endorsement of the immutable link as it appears to be  
7 between Witness Bradley and Witness Degen. You endorsed  
8 Bradley's attributions flat out and Degen's distributions,  
9 but only if they're modified. That is, in my mind you found  
10 some fault with Witness Degen, but not with Witness Bradley.  
11 Is that correct?

12 THE WITNESS: Yes.

13 CHAIRMAN GLEIMAN: Okay. Now again, having moved  
14 back from the -- maybe the buds on the trees to the forest,  
15 as I understand Bradley now, after all the discussion we've  
16 had in the hearing room, his attributions basically lower  
17 the level of the sea for everybody. Is that pretty much the  
18 case?

19 THE WITNESS: He shows lower attribution for mail  
20 processing costs. Yes. But it differs at different  
21 operations.

22 CHAIRMAN GLEIMAN: But everybody's attribution is  
23 basically good.

24 THE WITNESS: Well, some are close to 100 percent,  
25 but most of them are lower.

1 CHAIRMAN GLEIMAN: When one does this, that is,  
2 lowers the level of the sea, those closer to the margin,  
3 that is, those with the lowest markups, tend to benefit the  
4 most, do they not?

5 THE WITNESS: Well, if you continue the same  
6 markup, I mean I guess you have to accept that everything  
7 else stayed the same.

8 CHAIRMAN GLEIMAN: If you continued the same rate  
9 and you lowered the level of the sea.

10 THE WITNESS: Right. Those people who had less  
11 of -- received less of the institutional costs would  
12 benefit.

13 CHAIRMAN GLEIMAN: Would have a higher markup, and  
14 if someone then argued -- I don't mean to confuse you.

15 THE WITNESS: Okay.

16 CHAIRMAN GLEIMAN: If you lowered the attribution  
17 level on mail processing --

18 THE WITNESS: Right.

19 CHAIRMAN GLEIMAN: Those parties who are closest  
20 to the margin, if you kept the same markup would wind up  
21 with a lower rate.

22 THE WITNESS: Well --

23 CHAIRMAN GLEIMAN: No?

24 THE WITNESS: You have to adjust the markup if  
25 you're going to recover all the costs. I mean, you would

1 have a higher markup across the board.

2 CHAIRMAN GLEIMAN: But the parties, if you --  
3 let's take publications, for example. If the markup on  
4 publications was five percent, and you decided you wanted to  
5 continue a five-percent markup on publications, and you  
6 adopted Bradley's attribution levels --

7 THE WITNESS: Then rates would go down.

8 CHAIRMAN GLEIMAN: So people who are closer to the  
9 margin would benefit the most under that example.

10 THE WITNESS: Well, if you chose to keep the cost  
11 coverage the same and you lowered the attributable cost,  
12 everybody would have that same situation.

13 CHAIRMAN GLEIMAN: Let me ask you now a  
14 hypothetical. If the current level of attribution was .5  
15 and Bradley's econometric model raised the level of the sea  
16 to .9, would you still endorse the use of Bradley flat out?

17 THE WITNESS: Well, if Witness Bradley did a  
18 credible, good job on the variability and I accepted that he  
19 represented what the variability was, I would accept it.

20 CHAIRMAN GLEIMAN: Okay.

21 Thank you. That's what I needed to know. I have  
22 no further questions. Do you?

23 FURTHER CROSS EXAMINATION

24 BY MR. KOETTING:

25 Q Just to follow up on the Chairman's question, Ms.

1 Cohen, he was talking about changes in the overall level of  
2 variability and then he was talking about the results for  
3 specific cost coverages.

4           Somehow implicit in that question must be  
5 something about distributions if we are going to talk about  
6 specific subclasses, isn't there?

7           A     Distribution of the attributable costs or the  
8 institutional?

9           Q     Correct.

10                   [Laughter.]

11                   BY MR. KOETTING:

12           Q     Distribution of the attributable costs, I'm sorry.

13           A     Right.  Somehow when you take a new attribution  
14 level you will have presumably a new distribution of cost  
15 that goes with it.

16           Q     The same distribution -- but I mean if you are  
17 going to start talking about subclasses my point is you  
18 can't just talk about overall changes in variability without  
19 either implicitly or explicitly including the distribution  
20 methodology in there, correct?

21           A     That's correct.

22                   MR. KOETTING:  Thank you.

23                   CHAIRMAN GLEIMAN:  By the way, Ms. Cohen, did you  
24 do as detailed an examination of Witness Bradley's  
25 attributions as you did Witness Degen's distributions?

1 THE WITNESS: No. I mostly worked on Witness  
2 Degen. Witness Higgins, who testified on our behalf, picked  
3 up the ball for me and did a more credible job or an  
4 extensive job on Witness Bradley.

5 CHAIRMAN GLEIMAN: Extensive.

6 THE WITNESS: Extensive, right. I was correct.

7 CHAIRMAN GLEIMAN: Okay. That brings us to  
8 redirect, counsel.

9 MR. CREGAN: Can we have a few minutes?

10 CHAIRMAN GLEIMAN: Certainly. Let's take our  
11 10-minute break now and then] we'll pick up from there.

12 [Recess.]

13 CHAIRMAN GLEIMAN: Mr. Cregan, do you have any  
14 redirect?

15 MR. CREGAN: No redirect, Mr. Chairman.

16 CHAIRMAN GLEIMAN: No redirect. Well, Ms. Cohen,  
17 if that is the case then that ends your testimony before us,  
18 hopefully for this case. We appreciate your appearance here  
19 today and your contributions to the record.

20 I would like to note for the record that Diogenes  
21 is probably spinning in his grave. We found an honest  
22 person here -- not that everyone else isn't honest, but you  
23 are a seeker of the truth, it was clear from your answers to  
24 my last question there.

25 THE WITNESS: Thank you.

1 CHAIRMAN GLEIMAN: And if there is nothing  
2 further, you are excused.

3 THE WITNESS: Thank you.

4 [Witness excused.]

5 CHAIRMAN GLEIMAN: Our next witness is appearing  
6 on behalf of Time Warner. Mr. Stralberg is already under  
7 oath in the proceeding and I have no doubt that Diogenes  
8 would be happy to have Mr. Stralberg on the stand also --  
9 lest we show prejudice towards one witness or another.

10 Counsel, as soon as you are ready, you can proceed  
11 to introduce Mr. Stralberg's testimony.

12 MR. BURZIO: Good morning, Mr. Chairman. I am  
13 John Burzio, appearing on behalf of Time Warner. Appearing  
14 with me at counsel table is Timothy Keegan, and Time Warner  
15 calls Halstein Stralberg.

16 Whereupon,

17 HALSTEIN STRALBERG,  
18 a rebuttal witness, was called for examination by counsel  
19 for Time Warner, Inc., also on behalf of Alliance of  
20 Nonprofit Mailers, American Business Press, Coalition of  
21 Religious Press Associations, Dow Jones & Company, Inc.,  
22 Magazine Publishers of America, the McGraw-Hill Companies  
23 Inc., and National Newspaper association and, having been  
24 previously duly sworn, was further examined and testified as  
25 follows:

ANN RILEY & ASSOCIATES, LTD.  
Court Reporters  
1250 I Street, N.W., Suite 300  
Washington, D.C. 20005  
(202) 842-0034

## DIRECT EXAMINATION

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

BY MR. BURZIO:

Q Would you please identify yourself for the record?

A My name is Halstein Stralberg.

Q Do you have with you at the table, Mr. Stralberg, a document that has been marked for identification as TW-RT-1 and entitled, "Rebuttal Testimony of Halstein Stralberg on behalf of Alliance of Nonprofit Mailers, American Business Press, Coalition of Religious Press Associations, Dow Jones & Company, Inc., Magazine Publishers of America, the McGraw Hill Companies, Inc., National Newspaper Association, and Time Warner, Inc."?

A Yes, I do.

Q Did you prepare that testimony?

A Yes, I did.

Q If you were to deliver your testimony orally today, would it be the same as contained in this document?

A Yes, it would.

MR. BURZIO: Mr. Chairman, I move that TW-RT-1 be received in evidence and transcribed in the record, and let the record show that I am handing two copies to the reporter.

CHAIRMAN GLEIMAN: Are there any objections?  
Hearing none, Mr. Stralberg's testimony and exhibits are received into evidence and I direct that they be transcribed

1 into the record at this point.

2 I apologize for misidentifying the witness.  
3 Sometimes we get a little lost in all the papers and I did  
4 not say Time Warner, et al. and I appreciate the correction  
5 for the record, Mr. Burzio.

6 [Rebuttal Testimony and Exhibits of  
7 Halstein Stralberg, TW-RT-1, was  
8 received into evidence and  
9 transcribed into the record.]

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25



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

POSTAL RATE & FEE CHANGES, 1997

Docket No. R97-1

REBUTTAL TESTIMONY  
OF  
HALSTEIN STRALBERG

ON BEHALF OF  
ALLIANCE OF NONPROFIT MAILERS,  
AMERICAN BUSINESS PRESS,  
COALITION OF RELIGIOUS PRESS ASSOCIATIONS,  
DOW JONES & COMPANY, INC.,  
MAGAZINE PUBLISHERS OF AMERICA,  
THE MCGRAW-HILL COMPANIES, INC.,  
NATIONAL NEWSPAPER ASSOCIATION,  
AND  
TIME WARNER INC.

Communications with respect to this document may be sent to:

John M. Burzio  
Timothy L. Keegan  
Burzio & McLaughlin  
Canal Square, Suite 540  
1054 31st Street, N. W.  
Washington, D.C. 20007-4403  
(202) 965-4555 (office)  
(202) 965-4432 (facsimile)

Counsel for  
TIME WARNER INC.

March 9, 1998

## TABLE OF CONTENTS

		<u>Page:</u>
	AUTOBIOGRAPHICAL SKETCH .....	1
I	PURPOSE OF TESTIMONY .....	1
II	BRADLEY'S VARIABILITY RESULTS AT ALLIED OPERATIONS CONTRADICT SELICK'S RESTRICTION OF DISTRIBUTION TO MODS COST POOLS.....	3
III	THE DYNAMIC INTERACTION BETWEEN POOLS DEMONSTRATES THAT A POOL-BY-POOL DISTRIBUTION OF PROCESSING COSTS IS ERRONEOUS .....	6
IV	MODS WORKHOUR AND VOLUME DATA CAN BOTH PROPERLY BE RELIED ON WHEN THEIR LIMITATIONS ARE UNDERSTOOD ..	8
1.	MODS Volumes .....	8
2.	MODS Workhours .....	9
V	CONTRARY TO WITNESS NEEDS, COMMON SENSE AND OPERATIONAL REALITIES INDICATE THAT VOLUME VARIABILITY MUST BE LESS THAN 100 PERCENT.....	11
VI	CONCLUSIONS .....	13

## AUTOBIOGRAPHICAL SKETCH

1 My name is Halstein Stralberg. I am the manager of the Management Sciences  
2 Division at Universal Analytics Inc. (UAI), a management consulting firm in  
3 Torrance, California. For a detailed sketch of my autobiography, please see my direct  
4 testimony in this docket (TW-T-1).

### 5 I. PURPOSE OF TESTIMONY

6 The main purpose of this testimony is to rebut UPS witness Sellick (UPS-T-2). I also  
7 address and rebut the testimony of UPS witness Neels (UPS-T-1) with respect to his  
8 belief that "Common sense indicates that labor costs should be fully variable."

9 Sellick proposes a scheme for distributing clerk and mailhandler costs to subclasses  
10 that is almost exactly the same as proposed by USPS witness Degen, with one crucial  
11 difference. Degen's method was designed to implement witness Bradley's volume  
12 variability factors. His choice of "cost pools" (though not the distribution  
13 methodology he subsequently developed and applied to those pools) was  
14 determined by Bradley's econometric study of volume variability.

15 While rejecting the very basis upon which it was founded (i.e., Bradley's  
16 variabilities) Sellick is unreserved in his enthusiasm for Degen's approach. Having  
17 done nothing to determine whether Degen's approach reflects operational realities,  
18 having made no effort to validate any of Degen's numerous assumptions, Sellick  
19 opines that this approach "links the distribution of mixed mail and 'overhead' (not  
20 handling mail) costs with the operational characteristics of mail processing." UPS-T-  
21 2 at 4: Tr. 26/14163. Sellick is not qualified to make such a judgment. As his cross  
22 examination showed, he has only a vague conception of Degen's method and the  
23 numerous questions and implications it raises.<sup>1</sup>

---

<sup>1</sup> See, for example, Tr. 26/14260-62:

(footnote continued on next page)

1 An indispensable requirement for a correct cost distribution is that one must  
2 understand mail processing functions and the dynamic interactions among them,  
3 including the movements of mail and of people among processing functions and  
4 the constraints and incentives that drive postal managers' staffing and scheduling  
5 decisions. It is particularly necessary to understand the fundamentally different  
6 roles played by piece distribution operations and the various "allied" operations that  
7 serve them.

8 Witness Bradley's econometric models did recognize the dynamic interactions  
9 among piece distribution functions and between allied operations and piece  
10 distribution. Sellick -- like Degen before him -- ignores all such interactions, treating  
11 the numerous "cost pools" as separate compartments.<sup>2</sup> As I show in Section II, the  
12 approach adopted by Sellick is contradicted by Bradley in the one area where a direct  
13 comparison between Bradley's and Degen's results is possible, namely at the allied  
14 operations.

- 
- (1) Sellick stated that he has not examined Degen's particular cost pools to determine whether "they accurately segregate mail processing cost functions into discrete areas" and has not considered any alternative groupings (14260, ll. 13-23);
  - (2) he stated that he has no opinion as to whether manual sortation of incoming flats to carrier route and manual outgoing flat primary sortation for previously unsorted flats are part of the same Degen cost pool, whether it makes any sense for them to be in the same pool or whether the two functions differ in their relative composition of First Class, Periodicals and Standard A mail (14262-64);
  - (3) when asked "whether Degen followed Bradley's analysis in order to determine his cost pools," he answered that there is some "relationship between the two," that he "doesn't recall which one was the origin of the other," but that he does know "they have the same - generally the same set of pools" (14260, l. 24-261, l. 7).

<sup>2</sup> Even UPS witness Neels appeared in his cross-examination to recognize some of the dynamic interactions between mail processing activities, particularly the tendency to use manual sorting as a reserve capacity in the automated environment, and the fallacy of treating different activities as separate from each other. Tr. 28/15792-93. Sellick shows no sign of even having considered these issues, which are crucial for correct cost distribution.

1 The most serious problems with the Sellick/Degen approach are rooted in an  
2 incorrect interpretation of the MODS/IOCS data on allied operations. Section III  
3 below demonstrates that some of the interaction between these operations and piece  
4 distributions can be analyzed using available data.

5 Sellick attempts to justify his "Degen without Bradley" proposal by claiming that  
6 there are problems with the MODS volume data but no problem at all with the  
7 MODS workhour data. In fact, problems with both have been reported in this  
8 docket. Section IV presents an analysis of the MODS system, based on my  
9 observations of that system over almost 25 years, and shows that both the volume  
10 and workhour data in MODS can be used for the purposes to which Bradley puts  
11 them, as long as one properly recognizes their limitations.

12 Finally, Section V describes some common sense reasons why volume variability in  
13 mail processing must be substantially less than 100%, contrary to the testimony of  
14 witness Neels (UPS-T-1 at 5, 48: Tr. 28/15591, 15634).

15 **II. BRADLEY'S VARIABILITY RESULTS AT ALLIED OPERATIONS CONTRADICT**  
16 **SELICK'S RESTRICTION OF DISTRIBUTION TO MODS COST POOLS.**

17 As discussed in the next section, the MODS/IOCS data at allied operations indicate  
18 that Sellick and Degen over-attribute costs at allied operations to flat mail and  
19 under-attribute costs to letter mail. Indications to the same effect can be extracted  
20 from witness Bradley's results, which Degen was supposed to implement.

21 In his analysis of four major "allied" MODS cost pools, including the platform pool,  
22 Bradley used as "cost drivers" two variables each (including one "lag" variable) for  
23 piece handlings at automated, mechanized and manual letter operations, and at  
24 mechanized and manual flat operations. For each such cost driver, Bradley  
25 estimated a coefficient representing the contribution that the corresponding type of  
26 mail makes to the cost variability at each allied operation.

27 Bradley's results are summarized in his Table 8 (USPS-T-14 at 63.) Adding up the  
28 variability coefficients (including lag variable coefficients) for the platform cost pool

1 that are related to letters gives a total variability at platforms associated with letters  
2 equal to 56.6%. The corresponding variability associated with flats is 16%. The  
3 variability in platform costs due to letters is more than 3.5 times larger than the  
4 variability due to flats. Stated differently, the letter-related marginal costs at  
5 platforms are 3.5 times larger than the flat-related marginal costs.

6 I have compared these numbers with Degen's results, as expressed by the tables in  
7 USPS LR-H-320. According to those tables, Degen attributed 34% of the volume  
8 variable costs at platforms to flat mail. Since he used a variability factor of 0.726, he  
9 attributed  $0.726 \times 34 = 24.7\%$  of all accrued MODS platform costs to flats, whereas  
10 according to Bradley the variability relative to flats is only 16%. For letters, Degen  
11 attributed 38.1% of accrued (50% of the volume variable) platform costs, even  
12 though Bradley found a 56.6% variability relative to letters. Degen's ratio of  
13 attributed letter to flat costs is 1.47 to one, versus the 3.5 ratio indicated by Bradley's  
14 results.<sup>3</sup>

15 Only 37% of the costs incurred at the MODS platform cost pool involve handling of  
16 mail. The remaining 63% are not handling costs. Sellick approves of Degen's  
17 attributing the 63% based on the 37% that involve mail handling. But if this results  
18 in a 1.47 ratio of letter to flat costs while the ratio of total marginal costs for letters  
19 and flats, according to Bradley, is 3.5 to 1, this can only mean that most platform not  
20 handling costs are causally related to letters and not to flats, that Degen's  
21 assumptions are contradicted by the only record evidence on causality, and that  
22 Degen's distribution is wrong. Sellick has not subjected Degen's assumption to  
23 critical examination, and he is apparently unaware that those assumptions embody  
24 empirical claims that can be evaluated against substantial existing evidence of what  
25 actually occurs in the mail processing system. Sellick's uncritical and uninformed  
26 adoption of Degen's method, therefore, is without probative value and deserves no  
27 weight in the Commission's consideration of the issues that Sellick addresses.

---

<sup>3</sup> Since the tables in USPS LR-H-320 exclude Priority and Express Mail, it is possible that Degen in reality has attributed even more cost to flats than indicated above.

1 The conclusion that letters represent most of the marginal costs at platforms is  
2 reasonable when one considers that postal managers must staff for peak volumes of  
3 high priority mail. The major peak affecting mail processing in MODS facilities is  
4 that associated with the late afternoon/early evening arrival of collection mail,  
5 which is mostly letter mail. Anyone watching the platform in a major mail  
6 processing facility in the late afternoon will have seen how the scene changes from  
7 one of almost complete calm to complete bedlam in a relatively short time, and  
8 then returns to relative calm with only occasional truck arrivals again two or three  
9 hours later.<sup>4</sup>

10 Flat mail also arrives at postal platforms and requires handling. But a large portion  
11 of this volume is brought by bulk mailers who for the most part make arrangements  
12 with facility managers to come at a convenient time, i.e. to enter their mail outside  
13 the main processing peaks, when employees that otherwise would be unoccupied  
14 are available to handle it. It is therefore not surprising that Bradley's regression  
15 analysis found high platform costs to be strongly associated with high letter  
16 volumes, but much less associated with high flats volumes.

17 Sellick adopts one of Degen's major hypotheses, that not handling costs are causally  
18 related only to the handling costs within the same cost pool and therefore should be  
19 attributed with the same attribution ratios as those found for the handling costs.  
20 But the only actual analysis of causality available to Sellick, or Degen, is Bradley's  
21 analysis of volume variability, and his results contradict Degen's hypothesis.

---

<sup>4</sup> As Bradley points out: "The platform activity is a good example of a support activity that has some basic functions that must be performed which are not highly correlated with volume. Mail handlers must be readily available to unload trucks as they come to the facility. The arrival of trucks is not perfectly predictable and is subject to peaking. The platform activity must therefore provide some reserve capacity and this reserve capacity does not increase proportionately with volume." USPS-T-14 at 62.

1 III. THE DYNAMIC INTERACTION BETWEEN POOLS DEMONSTRATES THAT A  
2 POOL-BY-POOL DISTRIBUTION OF PROCESSING COSTS IS ERRONEOUS.

3 Developing models to represent the movement of mail and people between mail  
4 processing operations, and the multiple factors that affect the assignment of  
5 personnel and cost accrual at these operations (e.g. mail arrival patterns, dispatch  
6 schedules, work restrictions), and developing meaningful groupings of processing  
7 operations that can be tied to groupings of MODS numbers are challenging tasks in  
8 modeling a single facility, and even more difficult if one tries to model a large group  
9 of facilities such as all MODS offices. Sellick has no experience in this area,  
10 undertook no independent analysis and appeared to have no knowledge about the  
11 interactions among cost pools.

12 The most difficult modeling task involves "allied" operations, where employees  
13 perform many different activities. Generally, their tasks include preparing mail for  
14 piece distribution, bringing the prepared mail to distribution operations and  
15 retrieving mail that already has been sorted, and preparing for dispatch the sorted  
16 mail as well as the "direct" mail that, due to presortation, bypasses the piece  
17 distribution functions. These activities cannot be segregated by MODS numbers, for  
18 the simple reason that it would be impractical to have employees clock in and out  
19 each time they switch to a new activity. The task of modeling allied labor costs is  
20 further complicated by the tendency for temporarily inactive personnel to be sent to  
21 the allied operations, where productivity is not monitored.

22 These complications become formidable if one attempts to distribute allied labor  
23 costs among subclasses. To do so accurately, one must distinguish between activities  
24 that serve the letter, flat and parcel sorting operations, and activities that serve  
25 "direct" mail that, due to presortation, bypasses piece sorting operations. Generally,  
26 mail that bypasses piece distribution also incurs relatively little handling at allied  
27 operations. However, because this mail produces mostly "direct" IOCS tallies, under  
28 the Sellick/Degen approach it is burdened with a large portion of the mixed mail  
29 and not handling costs at allied operations.



1 A way to reduce this bias is by using the IOCS shape specific information on mixed  
 2 mail and not handling tallies that is available in LIOCATT but ignored by Sellick.<sup>5</sup>  
 3 In my direct testimony I tabulated (Table A-4, TW-T-1 at A-14: Tr. 26/13884) the  
 4 shape specific not handling costs recorded at the various MODS cost pools and  
 5 showed that many of these costs are incurred by employees clocked into the allied  
 6 cost pools, presumably before or after they bring mail to be sorted at piece  
 7 distribution operations. For example, at the preferential opening unit cost pool  
 8 (1Oppref) the letter specific volume variable not handling costs are \$22.401 million,  
 9 3.69 time larger than the \$6.069 million flat specific costs. Similar ratios apply to  
 10 other allied cost pools and to the shape specific mixed mail costs (see table at page 6  
 11 of my response to USPS/TW-T-2: Tr. 26/13923), even though the direct costs for flats  
 12 at these pools are almost as large as the direct costs for letters.<sup>6</sup>

---

<sup>5</sup> Sellick reveals his ignorance of this information in his description of the treatment of mixed mail costs under the "old" method, i.e. the LIOCATT:

The old method was much less refined; it assumed that mixed mail observed in OCR operations was similar to all direct mail at postal facilities of a similar size and Basic Function. The old method ignored the fact that mixed mail at OCR operations is more likely to resemble direct mail at OCR operations than direct mail at OCR and non-OCR operations. In fact, the old method completely ignored available operational data which recognize the different character of various mail processing operations. [UPS-T-2 at 8: Tr. 26/14167]

In reality, when an employee is seen at a letter specific operation (e.g., an OCR), whether he is handling mixed mail or not handling anything, the LIOCATT makes use of this information to distribute both mixed mail and not handling costs at letter operations on letter mail only. It does the same for flats and parcels. It is Sellick who ignores this important information.

<sup>6</sup> At the nine allied cost pools combined, the shape specific not handling costs are 66% letter related, 21% flat related and 13% parcel related. For shape related mixed mail costs, the corresponding percentages are 64% letter related, 24% flat related and 12% parcel related.

The total shape specific costs incurred by allied operation employees are undoubtedly larger than the costs I distributed directly to letters, flats and parcels in my testimony, because when an allied (e.g., opening unit) employee delivers mail to be sorted at, for example, an OCR, he will receive a shape specific code only when seen at the OCR, but a mixed shapes code when seen at the opening unit where he starts and ends his trip. Additionally, almost as much time is spent handling empty containers as containers with mail in them, and only containers with mail lead to shape specific codes. Mail that goes to piece distribution also undergoes additional preparation (e.g., traying, bundle breakage) that is not needed for the mail that bypasses piece distribution at allied operations.

1 In view of the unambiguous record evidence, the Commission must recognize the  
2 unique character of allied operations and treat separately the allied costs specifically  
3 related to letter, flat and parcel distribution, as outlined above. In addition, the  
4 remaining allied mixed mail and not handling costs should be distributed over all  
5 mail, not just mail receiving direct handling at the allied operations, since general  
6 functions such as loading, unloading and preparing mail for dispatch are performed  
7 for all mail.

8 In TW-T-1 I proposed to use the traditional breakdown by CAG and basic function  
9 instead of cost pools. Sellick, following Degen, has repeatedly asserted that a  
10 breakdown by MODS cost pools is the "superior" approach. A breakdown of costs by  
11 CAG is justified for the following reasons: (1) the percentage of not handling varies  
12 greatly across CAG's, from 42% in CAG A to 12% in CAG H; (2) different types of  
13 mail receive different portions of their handling in large and small facilities; (3)  
14 clerks and mailhandlers frequently migrate across pools but not across CAG's; and  
15 (4) CAG's are the basis upon which the IOCS sampling scheme is designed. Basic  
16 function is significant because some classes of mail are mostly processed as  
17 "incoming," and much less as "outgoing."

18 **IV. MODS WORKHOUR AND VOLUME DATA CAN BOTH PROPERLY BE**  
19 **RELIED ON WHEN THEIR LIMITATIONS ARE UNDERSTOOD.**

20 Although Sellick alleges severe problems with the MODS volume data used by  
21 Bradley, he asserts there are no problems at all with the MODS workhour data used  
22 by Degen. In the following I discuss how the MODS volume and workhour data can  
23 and cannot be used.

24 **1. MODS Volumes**

25 MODS provides two types of volume estimates at piece sorting operations. First  
26 handling pieces (FHP) is the number of letters, flats and parcels that receive piece  
27 sorting at least once in the given facility. FHP estimates do not necessarily reflect the  
28 workload in a facility, since each piece is counted only once, even if it undergoes

1 several sorts. Nor do they correspond to total mail volume, since they exclude  
2 pieces that bypass all piece sorts.

3 Total piece handlings (TPH) on the other hand, do represent workloads at piece  
4 sorting operations, i.e. the total number of sorts performed, and were therefore  
5 appropriately used by Bradley to analyze the relationship between changes in  
6 workload (TPH) and changes in workhours. The only question with regard to  
7 Bradley's volume data is therefore whether the TPH estimates are reliable. For  
8 automated and mechanized sorting operations, TPH are derived directly from  
9 machine readings. There is no evidence of any problem with these machine  
10 readings, and consequently no doubt about the appropriateness of the workload  
11 measures Bradley used for the BCS, OCR, LSM and FSM cost pools. These pools also  
12 provide most of the cost driving volume in Bradley's analysis of allied cost pools.

13 For manual distribution operations (e.g., the Manl, Manf and Manp MODS pools),  
14 TPH estimates are derived from first handling pieces (FHP) estimates, which again  
15 result from a combination of cancellation machine readings and applications of  
16 conversion factors to either pounds or linear feet. Even if these conversion factors  
17 are not accurate, a systematic bias would not affect Bradley's analysis of variations in  
18 volume and workhours. If, for example, conversion factors during the period  
19 studied by Bradley consistently doubled the true volumes, this would not affect his  
20 estimates of variability. The only thing that could affect Bradley's analysis at  
21 manual pools would be significant changes in the true conversion factors during the  
22 period that he analyzed. But such changes, if they did occur, are most likely to have  
23 been caused by what Bradley called "manual ratios," which he explicitly accounted  
24 for in his models. USPS-T-14 at 16-17 and 60.

## 25 2. MODS Workhours

26 The MODS workhour data show how much time employees were clocked into each  
27 three-digit MODS number and therefore each Bradley/Degen/Sellick cost pool.  
28 Used with the pay data system, MODS also provides the accrued costs at each cost  
29 pool in MODS offices. On the other hand, MODS provides no information on what  
30 employees were actually doing, only what operation they were clocked into. To the

1 extent that there are conflicts between the operation an employee was clocked into  
2 and the employee's location and type of activity as reported by the IOCS clerk, the  
3 IOCS observation must be used to assure a correct cost distribution.

4 Sellick does not appear to have studied the appropriateness of using MODS  
5 workhour data as basis for the distribution he proposes. He simply asserts that  
6 Degen has adequately responded to questions about "misclocking." Neither Sellick  
7 nor Degen appears to have grasped that so-called "misclocking" is not the major  
8 issue affecting use of MODS workhour data. Two other factors are of much greater  
9 importance:

10 (1) Mail processing employees clocked in at certain operations, particularly  
11 allied operations, are often legitimately present at other operations, as when  
12 an opening unit employee brings mail to be sorted at a letter operation after  
13 it has been prepared for sorting (e.g., trayed) at the opening unit.

14 (2) Not handling costs have skyrocketed, for which no rational explanation has  
15 been offered other than that increased not handling could be expected at  
16 automated operations; yet most not handling occurs at manual operations  
17 that in the past did fine without it. This, combined with incentives for  
18 managers to send idle employees to operations where productivity is not  
19 being monitored (e.g., opening units), indicates that one cannot simply  
20 assume these not handling costs are a function only of the cost pools where  
21 the employees are clocked.

22 I indicated in Section III that the first of these factors could be at least partially  
23 accounted for, even in a pool-by-pool cost distribution, by using the shape related  
24 information about some mixed mail and not handling costs that is provided by the  
25 IOCS. Unfortunately, I see no reliable way to distribute the remaining very large not  
26 handling costs at allied and other manual operations. Since no plausible  
27 explanation exists other than that these high costs are somehow related to  
28 automation, in ways never precisely identified, I chose in TW-T-1 to treat these costs  
29 conservatively as an equal responsibility of all processed mail, i.e., as general  
30 overhead, although it might be more correct to assign a larger share of such costs to  
31 the most automated mail.

32 Sellick and Degen simply ignore these issues, reflecting their lack of understanding  
33 of the dynamic interactions across operations that drive mail processing costs.

1 "Misclocking" (working at one pool while clocked into another) clearly does occur,  
2 although to what precise extent is not known. However, the main arguments  
3 presented here and in TW-T-1 do not depend on the existence of misclocking.

4 **V. CONTRARY TO WITNESS NEELS, COMMON SENSE AND OPERATIONAL**  
5 **REALITIES INDICATE THAT VOLUME VARIABILITY MUST BE LESS THAN 100**  
6 **PERCENT.**

7 In TW-T-1 I gave two reasons for accepting Bradley's finding that volume variability  
8 is less than 100% in mail processing: (1) that it is intuitively obvious; and (2) that  
9 with the very large slack time in today's mail processing, evidenced by high not  
10 handling costs, increased volume would give the Postal Service an opportunity to  
11 make more efficient use of its employees, rather than simply hiring more.

12 Regarding my comment that it is "intuitively obvious" that mail processing costs  
13 are less than 100% volume variable (TW-T-1 at 3: Tr. 26/13817), I have since noticed  
14 witness Neels' claim that "Common sense indicates that labor costs should be fully  
15 variable" (UPS-T-1 at 5: Tr. 28/15591) and OCA's reaffirmation in its trial brief (at 32-  
16 33) of its faith that 100% is the intuitively obvious figure for mail processing  
17 volume variability. Evidently, some further elaboration is needed on what indeed  
18 is "intuitively obvious."

19 To claim that mail processing costs are 100% volume variable is equivalent to  
20 claiming that there are no economies of scale in the system, so that it costs the Postal  
21 Service as much to process the last 100 million pieces that enter the system as the  
22 first 100 million pieces; as much per individual to train ten clerks as a hundred, or a  
23 thousand; as much per machine to buy 20 OCR's as 200; and that the additional  
24 OCR's and BCR's the Postal Service buys in response to increased volume will have  
25 no technological improvements over the ones they bought originally. Mail  
26 processing facilities are similar to manufacturing plants, with the arriving unsorted  
27 mail representing the raw materials and mail ready for delivery by carriers  
28 representing the final product. It is impossible to think of any manufacturing  
29 industry where it is not believed that higher volumes will lead to improved  
30 efficiency and lower unit costs.

1 Within Postal Service mail processing activities, there are numerous examples  
2 where increased economies will result from higher volumes, even assuming no  
3 change in the current high level of not handling costs.<sup>7</sup> Perhaps the simplest  
4 example is the largest and most costly sorting scheme, referred to as "incoming  
5 secondary," where mail already sorted to the five-digit ZIP code level is further  
6 broken down to carrier route. It is the largest sorting scheme because most presorted  
7 mail bypasses all preceding sorts. It is performed using manual, mechanized or  
8 automated sorting methods. The problem facing postal managers is that the  
9 number of five-digit zones they must sort the mail to far exceeds the number of  
10 machines available for sorting, and a machine can sort to only one or at most two  
11 zones at a time. Furthermore, most of this sorting must be done in a relatively  
12 short time period before dispatch to delivery units. The result is a series of short  
13 runs, in between which substantial setup time is needed to clear the machine of the  
14 mail to the zone just sorted and set up for the next zone.

15 Consider sorting on flat sorting machines (FSM's). There are about 800 FSM's and  
16 over 400 SCF's, so that an SCF is likely to have no more than a few machines while  
17 it may have over 100 zones to which the mail must be sorted. Assume that mail  
18 volume doubled and that the Postal Service eventually adjusted by doubling the  
19 number of FSM's. It could then not only double the length of its sorting runs,  
20 cutting average setup costs in half, but would be able to use FSM sorting to  
21 additional zones where, due to insufficient volumes, manual sorting is today  
22 considered more economical.

---

<sup>7</sup> It is fallacious to assume that the Postal Service would respond to increased volume by building more facilities rather than expanding existing ones or utilizing any excess capacity that may already exist. The Postal Service in fact has for many years been closing small offices and consolidating its operations into large plants, in order to achieve volume efficiencies. When it builds completely new facilities it is generally because of practical problems in expanding existing buildings in downtown areas, or because of the need to serve growing suburbs. When there is more than one processing plant in the same area, there is usually a division of processing functions, again due to the pursuit of volume efficiencies.

1 VI. CONCLUSIONS.

2 Over the last ten years, mail processing cost distribution under IOCS has produced  
3 sharply counterintuitive results, for reasons the Postal Service cannot explain. In  
4 this docket, much new information has become available that could improve  
5 understanding of the factors that drive mail processing costs and help in  
6 determining what information is still needed in order to reliably attribute these  
7 costs. However, the ignorance and disregard exhibited by Sellick, of operational  
8 realities, of historical trends, and of much useful information collected by IOCS  
9 clerks -- which derives from Degen's disregard of these matters -- has resulted in  
10 proposals that in fact are much worse than the system they would replace.

11 In TW-T-1 I presented numerous reasons for rejecting these proposals. Due to the  
12 paucity of data required for a truly accurate distribution of mail processing costs, I  
13 proposed, as a conservative interim solution, an alternative approach that, like  
14 Degen's, implements Bradley's variability analysis but that otherwise retains most of  
15 the features of the LIOCATT method.

16 The arguments I presented in TW-T-1 and in my interrogatory responses do not  
17 need to be repeated. In this rebuttal testimony I have provided reasons for rejecting  
18 the Sellick/Degen approach, focusing in particular on allied operations where the  
19 pool-by-pool method causes the largest distortions, due to its failure to consider the  
20 multifaceted nature of these operations and their interaction with other cost pools.

21 The main fallacy in the Sellick/Degen approach is the treatment of cost pools as  
22 separate compartments, ignoring the interaction between these pools that has been  
23 discussed in detail in my testimony and recognized in this docket by witnesses  
24 Bradley, Moden and even Neels. As I have shown, Degen's results, and therefore  
25 Sellick's, are inconsistent with Bradley's in the one area where a direct comparison  
26 is possible.

27 I believe the conservative approach presented in my direct testimony is the best  
28 available at this time. In particular, the Commission should not ignore the clear  
29 record evidence in this docket on the unique nature of allied operations, which are

1 much less homogenous than other processing functions. Almost \$700 million in  
2 accrued costs is spent by allied labor personnel just in bringing mail to and from  
3 letter, flat and parcel piece distribution operations, and the distribution should  
4 reflect this.

5 Additionally, the Commission should adopt the volume variability factors  
6 computed by Bradley. If the experience of postal managers did not confirm that  
7 there are economies of scale to be achieved through higher volumes, they would  
8 not have embarked on their long range program of consolidating processing  
9 functions into larger plants and eliminating small offices. I have shown above that  
10 the arguments against use of MODS TPH data are mostly ill-conceived or trivial,  
11 and I have provided some further, non-statistical common sense reasons that  
12 confirm Bradley's conclusions.



## CERTIFICATE OF SERVICE

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



James R. Cregan

March 9, 1998

1 CHAIRMAN GLEIMAN: Two participants requested oral  
2 cross examination of Witness Stralberg -- United Parcel  
3 Service and the United States Postal Service.

4 Does any other participant wish to cross examine  
5 the witness? If not, then Mr. McKeever, when you are ready  
6 to begin.

7 MR. MCKEEVER: We have no questions, Mr. Chairman.

8 CHAIRMAN GLEIMAN: Mr. Koetting?

9 MR. KOETTING: Thank you, Mr. Chairman.

10 CROSS EXAMINATION

11 BY MR. KOETTING:

12 Q Good morning, Mr. Stralberg.

13 A Good morning.

14 Q I would like to start on page 6 of your testimony,  
15 lines 26 and 27.

16 A Okay.

17 Q You state that mail that bypasses piece  
18 distribution produces mostly directly IOCS tallies, correct?

19 A Yes.

20 Q What is the basis for that statement?

21 A Generally what is called direct mail in the mail  
22 processing facilities, mail that because of its presort can  
23 bypass sorting in that particular facility. This generally  
24 is mail that comes from the mailers and therefore it  
25 contains identical pieces.

1 Q So what you are stating at least as one of the  
2 bases for your statement is that it is primarily identical  
3 pieces?

4 A Yes, that is one way that you would produce direct  
5 tallies.

6 Q Okay. Now for an identical mail item or  
7 container, to turn into an identical mail tally doesn't the  
8 data collector have to be able to identify the mail as  
9 identical?

10 A When you say "identical mail tally" you mean for  
11 him to identify it as being identical mail?

12 Q Correct -- yes.

13 A So by definition he has to identify it as  
14 identical mail.

15 Q If the item is subject to the top piece rule, is  
16 there any reason why a mailer-prepared item would be more  
17 likely to receive a direct tally than a Postal Service  
18 prepared item?

19 A Yes -- as far as letter in flat trays and bundles  
20 are concerned, most of those are subject to the top piece  
21 rule and so they would also produce direct tallies.

22 Q But if it is an item that is subject to the top  
23 piece rule, is there any reason why a mailer-prepared item  
24 would be more likely to receive a direct tally than a Postal  
25 Service prepared item?

1           A     In the case of the top piece rule items you are  
2 not talking about items in containers. You are talking  
3 about individual items being handled, so in those, in the  
4 case of individual items being handled that are subject to  
5 the top piece rule the chances are about the same.

6           Q     Let's go back to the question I had earlier about  
7 the necessity to be able to identify identical mail as  
8 identical in order for it to be tallied as such.

9                     If the data collector is trying to determine  
10 whether in fact the mail is identical, wouldn't that task be  
11 harder, for example, if the item is shrink-wrapped?

12          A     shrink-wrapped? Are you talking about the pallet  
13 for example or a bundle or --

14          Q     Anything that would be shrink-wrapped -- pallets I  
15 suppose would certainly be an example.

16          A     Well, yes. If he cannot clearly see through the  
17 shrink-wrap, if he sees a bundle of magazines inside the  
18 shrink-wrap, he will generally know that it's one magazine.

19          Q     If an item is being cross-docked, do you think it  
20 is more or less likely that the shrink-wrap would be broken  
21 relative to the case where the item is destined for a direct  
22 operation in the plant?

23          A     First of all, you are talking about an item in a  
24 strict IOCS sense now, an individual sack being  
25 cross-docked?

1 Q I apologize. Let's say a pallet is being  
2 cross-docked.

3 A A pallet is being cross-docked. And what was the  
4 question about it?

5 Q Right -- let's assume we are talking about a  
6 shrink-wrapped pallet.

7 A Yes.

8 Q And the question is is it more or less likely that  
9 the shrink-wrap will be broken if it is being cross-docked  
10 relative to a shrink-wrapped pallet where the item is  
11 destined for direct operations in the plant?

12 A Generally if it is being cross-docked in most  
13 cases that would be -- well, it could be shrink-wrapped  
14 sacks also, which the IOCS clerks have no ways of  
15 identifying, but if it is a -- so that would be a mixed  
16 tally, but if it is let's say a pallet with Time Magazine it  
17 would be pretty easy for the data collector to see what it  
18 is through the shrink-wrap.

19 Q Since you mentioned Time magazine, let's imagine a  
20 pallet with Time magazine and Sports Illustrated on the same  
21 pallet. Would that properly be recorded as identical mail  
22 tally?

23 A Well, I don't believe that ever occurs. It could  
24 happen in the case of copalletization, which is practiced to  
25 some extent by some periodicals. As far as Time and Sports

1 Illustrated, first of all, they publish at different times  
2 of the week, and they would in any case not appear together.

3 Q Okay. Well, let's leave my more colorful perhaps  
4 but artificial hypothetical and move to a more general  
5 hypothetical, as you mentioned, just two periodicals that  
6 are being copalletized and appear on a shrink-wrapped  
7 pallet. You I believe did just suggest that that in fact  
8 can occur.

9 A It does occur, although it's a fairly limited  
10 extent at this point in time.

11 Q And when that does occur, would that properly  
12 generate an identical mail tally?

13 A It could if the data collector thinks it's only  
14 one magazine, but if he sees there's two, then it should --  
15 or if he doubts if they're all the same he should generate a  
16 mixed pallets tally.

17 Q If a sampled employee's driving a tow motor and  
18 pulling one or more rolling containers across the platform  
19 at the time the data collector is making the observation, do  
20 you think it is more or less likely that the data collector  
21 will be able to obtain the identical mail information  
22 necessary to record it as an identical mail tally relative  
23 to the case where the employee is handling a single rolling  
24 container manually?

25 Do you understand my question?

1           A     Yes. I am not sure what the rule is in that case,  
2 if he's pulling multiple containers. I think there is rules  
3 about taking the first container in that case. In other  
4 words, when he's handling more than one, looking at only a  
5 single container. In any case, there are very few  
6 containers with identical mail on them. At least they  
7 represent a very small portion of the IOCS samples.

8           Q     Would you say that the mail we're talking about  
9 here that bypasses the piece distributions would usually be  
10 either on a pallet or on a rolling container?

11          A     That's most likely except in a -- if you have a  
12 facility with a sack sorter machine. It might actually go  
13 on a sack sorter and end up at some other part of the dock  
14 or a different platform.

15          Q     But it would arrive as either a pallet of sacks or  
16 a rolling container of sacks probably?

17          A     Well, generally in that case it comes out in a  
18 sorters area, and they put it on the -- they usually do some  
19 distribution of the sacks there. It comes out in what they  
20 call a sorters area, which is an area where they do a  
21 further distribution to individual trucks.

22          Q     But I believe you did agree that it would more  
23 frequently be either on pallets or in rolling containers.

24          A     Most of the stuff that gets crossed up nowadays is  
25 pallets or rolling containers. Yes.

1 Q Let's talk about rolling containers first then.  
2 In general, do you know how often observations of rolling  
3 containers result in direct tallies?

4 A Well, as I mentioned earlier, it's fairly  
5 infrequent.

6 Q Would you agree, however, that there is a fair  
7 amount of presorted mail that arrives in rolling containers?

8 A Presorted letters do; yes.

9 Q I'm staying on this general topic, but I would  
10 like to refer you to Exhibit 4 of your direct testimony. It  
11 appeared at transcript 26 page 13863, and if you don't have  
12 it or if it's inconvenient --

13 A I do have my direct testimony. Give me a minute  
14 to find it. Exhibit 4, you said?

15 Q That's correct, and I will distribute copies to  
16 anybody else who might not have that in front of them.

17 A And that exhibit has four pages. Which page did  
18 you say?

19 Q Table 4-1 on the first page.

20 A Okay.

21 Q Okay?

22 A Okay. I've got it.

23 Q On that table there are a number of columns, and  
24 there's one column -- actually there are two columns that  
25 have the phrase mixed over them, and underneath that there



1 is a counted column and an uncounted column. And I would  
2 like to direct your attention to the what I will refer to as  
3 the mixed uncounted column, which would be the third column  
4 of numbers on the table.

5 Are you with me?

6 A Yes.

7 Q Would it be correct to say that that mixed  
8 uncounted column reflects nonempty item tallies which have  
9 mixed mail activity codes?

10 A Yes, they have mixed mail activity codes.

11 Q And let's look at the pallet line on that table.  
12 In that mixed, you know, counted column, do you see the  
13 number of 4374?

14 A Four million; yes.

15 Q And in the same line, total nonempty pallet costs  
16 are 15099 million; correct?

17 A Yes.

18 Q If we were to divide the first number, 4374, by  
19 the second number, 15099, I get approximately 29 percent.

20 You can either, if you prefer, accept that subject  
21 to check, or I have a calculator here if you'd like to do  
22 the division, or --

23 A You're dividing the uncounted by the counted, by  
24 the total.

25 Q Exactly, the mixed uncounted of 4374 by the total

1 nonempty of 15099.

2 A Yes, the mixed pallets that were not counted.

3 Q And so uncounted pallets then, if that number is  
4 properly calculated at 29 percent, the uncounted mixed  
5 pallets number is about 29 percent of the total nonempty  
6 pallet costs. Correct?

7 A That's what it appears; yes.

8 Q Now let's look at the total items line, which is  
9 the very last line on the bottom of the page. And I  
10 basically would just like to do the same exercise in the  
11 total uncounted column. See the number of 66,012? Correct?

12 A Yes.

13 Q And in the total nonempty column we see the number  
14 of 1139820; correct?

15 A Yeah, that's when you include the top piece rule  
16 items as well.

17 Q Correct.

18 A Okay.

19 Q And if we do the -- obtain the same percentage, we  
20 divide the 66 number by the 1139 number and according to my  
21 calculation that's about 5.8 or 6 percent. Does that seem  
22 to be a --

23 A Well, I'll accept that.

24 Q Based on your exhibit, doesn't this therefore  
25 suggest that pallets are more likely to result in a mixed

1 mail tally in the IOCS relative to all items?

2 A Well, I think this comparison really makes very  
3 little sense. As I indicate in my direct testimony, pallets  
4 would more probably be considered with containers. They --  
5 a pallet is a container that can contain sacks, trays, or  
6 bundles. And for a shrink-wrapped pallet, for example, to  
7 compare that with an individual letter tray really doesn't  
8 make too much sense. But I'll agree with your arithmetic.

9 Q Isn't the calculation we have done simply an  
10 exercise to show the proportion of times that pallets  
11 receive mixed mail tallies relative to all items?

12 A Well, like I said, I agree with your arithmetic.

13 Q Say that pallets were treated as containers, would  
14 they be more or less likely to receive mixed mail tallies  
15 under the current IOCS rules?

16 A They would probably be more likely to receive  
17 mixed mail tallies, like other containers who receive almost  
18 all mixed mail tallies.

19 If you take a comparison of an APC with a letter  
20 tray, although the individual -- the container as a whole  
21 may be mixed, if you take an individual letter tray on it,  
22 it would probably be a direct tally.

23 Q I would like to go to page 5 of your testimony.  
24 Here I am back with your rebuttal testimony.

25 A Okay.

1 Q And I am looking at the first paragraph, in  
2 general, if you want to take a look at that.

3 A Okay.

4 Q On lines 5 through 9, you describe a scenario in  
5 which the peak of activity in the platform operation in a  
6 major mail processing facility would be in the late  
7 afternoon and be relatively -- a relative level of  
8 inactivity on the platform two or three hours later. Is  
9 that a fair characterization of what you say on those lines?

10 A That is what I am saying, yes. I maybe shouldn't  
11 have said major because it, in fact, occurs -- is even more  
12 clear in smaller mail processing facilities. But that is  
13 what I am saying here.

14 Q So you would say that this would hold true at  
15 major and small facilities?

16 A Mail processing plants, yes.

17 Q Do you know if there are peaks on the platforms at  
18 any other times of the day?

19 A Well, there tends to be peaks on the platform.  
20 This, of course, depends on the facility. But there is also  
21 generally a peak when they have to distribute the mail to  
22 the stations and branches and associate offices later in the  
23 morning, during Tour 1, there tends to be more activity.  
24 Individual facilities may, of course, have minor peaks at  
25 other times. But, really, the one associated with outgoing

1 mail -- with originating mail, in my opinion, is the most  
2 dominant.

3 Q You mentioned a peak in the early morning as mail  
4 is dispatched to the stations and branches, correct?

5 A Yes.

6 Q What about a peak later in the night, that is  
7 relative later, relative to when the collection mail that  
8 you are talking about comes in? Might there might not be a  
9 peak later in the night that is related to the incoming mail  
10 processing windows?

11 A To the incoming mail processing windows. Incoming  
12 mail, this all depends on truck schedules, of course.  
13 Trucks arrive at facilities from many places and, for the  
14 most part, they are spaced out. It depends on driving  
15 distances and so on. A star route, for example, may have to  
16 stop at several facilities. What is most concentrated is,  
17 again, the peaks that I am referring to.

18 Q Did you attempt to use the IOCS tally information  
19 that was available to plot out platform tallies by time of  
20 day?

21 A No. I would have the same comment to that as on  
22 the basic function chart you showed Ms. Cohen, that  
23 individual facilities really have different schedules. So  
24 if you try to test that kind of information with IOCS, which  
25 really may only have a few samples from each facility, it is

1 not clear that the information will be meaningful. It may  
2 be very clear in an individual facility.

3 Q But it is your opinion that employees working  
4 platform operations are the ones that handle collection mail  
5 in most plants?

6 A In the processing plants, they generally -- the  
7 platform people are the ones that pull the mail off the  
8 trucks, and usually, there has to be a lot of staging at  
9 that point, and they then bring it inside to the  
10 cancellation area, where other employees will take over.

11 Q So, it's not -- in your understanding, the  
12 collection mail is mostly unloaded by employees -- by either  
13 the truck drivers or the employees working the cancellation  
14 mail prep operation 010.

15 A It all depends on the facility.

16 Generally speaking, we have mail handlers on the  
17 platforms, at least in the larger facilities, who will do  
18 that.

19 In smaller facilities, they may not necessarily  
20 have mail handlers; it may be the same people who will go  
21 out and get the mail and also take it inside and start  
22 preparing it.

23 Q Are there mail handlers assigned to the  
24 cancellation mail prep operation for that purpose? Do you  
25 know?

1 A Yes, I believe there may be.

2 MR. KOETTING: That's all we have, Mr. Chairman.

3 Thank you, Mr. Stralberg.

4 CHAIRMAN GLEIMAN: Is there any follow-up?

5 [No response.]

6 CHAIRMAN GLEIMAN: Questions from the bench?

7 [No response.]

8 CHAIRMAN GLEIMAN: Would you like some time with  
9 your witness before rebuttal? Five minutes?

10 MR. BURZIO: Yes.

11 [Recess.]

12 CHAIRMAN GLEIMAN: Mr. Burzio?

13 MR. BURZIO: Thank you, Mr. Chairman.

14 REDIRECT EXAMINATION

15 BY MR. BURZIO:

16 Q Mr. Stralberg, in your colloquy with Mr. Koetting  
17 about your Exhibit 4 from your direct testimony, do you  
18 recall he asked you some questions about the item under the  
19 mixed, uncounted table where the number of 4374 appears for  
20 pallets, and I believe that, in the course of your answers,  
21 you indicated that pallets would be less likely to be  
22 treated as a direct tally than other containers. Did you  
23 mis-speak?

24 A Well, we were talking about the hypothetical case,  
25 if pallets were treated like other containers, which I

1 believe would be more appropriate, and I may have mis-spoken  
2 and said they would be less likely to produce direct  
3 tallies. Compared to other containers, they would be much  
4 more likely to produce direct tallies.

5 MR. BURZIO: That's all we have, Mr. Chairman.

6 CHAIRMAN GLEIMAN: Thank you, Mr. Burzio.

7 Is there any recross?

8 [No response.]

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

13 THE WITNESS: Thank you.

14 [Witness excused.]

15 CHAIRMAN GLEIMAN: Appearing next is Postal  
16 Service Witness Degen. Mr. Degen is already under oath in  
17 these proceedings, and as soon as everybody gets settled in,  
18 Counsel, you can proceed to introduce his rebuttal  
19 testimony.

20 Whereupon,

21 CARL G. DEGEN,  
22 a rebuttal witness, was called for examination by counsel  
23 for the United States Postal Service and, having been  
24 previously duly sworn, was examined and testified as  
25 follows:



## 1 DIRECT EXAMINATION

2 BY MR. KOETTING:

3 Q Mr. Degen, could you please identify yourself  
4 formally for the record?

5 A Yes. My name is Carl Degen.

6 Q I'm handing you a copy of a document entitled  
7 "Rebuttal Testimony of Carl G. Degen on Behalf of the United  
8 States Postal Service," which has been designated as  
9 USPS-RT-6. Are you familiar with that document?

10 A Yes, I am.

11 Q Was it prepared by you or under your supervision?

12 A Yes, it was.

13 Q Does the copy that I have handed you exclude the  
14 materials on pages 31, 32, and 33 that were stricken by the  
15 presiding officer's ruling earlier this week?16 A Yes. As far as I understood the order, I think  
17 that's all been excluded.18 Q If you were to testify orally today, would this be  
19 your testimony?

20 A Yes, it would.

21 MR. KOETTING: Mr. Chairman, I'm going to hand the  
22 two copies of USPS-RT-6, Rebuttal Testimony of Carl G. Degen  
23 on Behalf of the United States Postal Service, to the  
24 reporter and request that they be accepted into evidence in  
25 this proceeding.

1 CHAIRMAN GLEIMAN: Are there any objections?

2 [No response.]

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

7 [Rebuttal Testimony and Exhibits of  
8 Carl G. Degen, USPS-RT-6, was  
9 received into evidence and  
10 transcribed into the record.]

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

USPS-RT-6

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

POSTAL RATE AND FEE CHANGES, 1997

Docket No. R97-1

REBUTTAL TESTIMONY  
OF  
CARL G. DEGEN  
ON BEHALF OF THE  
UNITED STATES POSTAL SERVICE

TABLE OF CONTENTS

	<u>PAGE</u>
CONTENTS.....	i
LIST OF TABLES AND FIGURES.....	iv
AUTOBIOGRAPHICAL SKETCH.....	v
I. The purpose and scope of my testimony is to explain that the underlying theory dictates the required distribution methodology and to rebut criticisms of the new method. ....	1
II. The distribution methodology is dictated by the theory underlying the development of marginal cost as unit volume variable costs. ....	1
<u>THE NEW METHOD ADDRESSES THE MAIN CRITICISMS OF LIOCATT</u>	
III. The new method substantially reduces reliance on not-handling tallies.....	2
IV. The new method improves the accuracy of mixed-mail distribution. ....	4
V. The new method replaces the assumption of 100 percent variability with econometric estimates of variability.....	5
<u>RESPONSE TO CRITICISM OF THE NEW METHOD</u>	
VI. The assumptions of the new method are not new. The new method, LIOCATT, and the Stralberg/Cohen method all assume that mixed-mail costs have the distribution of direct costs within a cost pool.....	6
VII. The new method is no more untested than LIOCATT or the Stralberg/Cohen method. ....	7
VIII. Tradition is no reason to accept the biases in LIOCATT and the Stralberg/Cohen method. ....	8
IX. Pool definitions for the distribution of mail processing costs must be evaluated for bias using knowledge of mail processing. ....	9
X. Operation, item, and container-based cost pools reduce bias and more accurately account for shape when distributing mixed-mail costs. ....	12

- XI. The new method eliminates bias by incorporating across-LDC wage differences. 14
- XII. The new method's MODS-based costs pools have no sampling error and less non-sampling error than cost pools based on basic function and mixed-mail codes because the MODS-based pools are from an accounting system rather than a sampling system. .... 16
- XIII. The new method does not create sample thinness problems—the CVs for the new method are comparable to the CVs for the old method. Even if the new method had substantially higher CVs, it would still be preferred because it has less bias. .... 17

OTHER ISSUES RAISED BY INTERVENORS

- XIV. Proportions of not-handling costs cannot be compared between 1986 and 1996 because of a substantial change in data collection instructions. .... 20
- XV. The growth in not-handling costs is not evidence of inefficiency—not-handling costs represent productive work that is integral to all operations, though the proportions may vary across operation groups. .... 20
- XVI. There is no evidence of automation refugees—not handling costs are rising in non-Allied operations faster than they are rising in Allied operations. .... 25
- XVII. The increase in Periodicals mail processing costs is being exaggerated, and the actual increase in recent years appears to be explained by the use of more aggregate pallets. .... 26
- XVIII. Comparisons of Periodicals unit costs to other subclasses are meaningless without adequate control for the relevant work-causing characteristics such as shape and presort level. .... 33
- XIX. Changes in the relative cost shares of subclasses under the new method do not result in unfair increases to the presort subclasses—they are corrections of the understatement of presort costs and relief to the single-piece subclasses that had been previously overstated. .... 35
- XX. The Postal Service has initiatives underway that will improve service, control costs, and work with mailers for further improvements. .... 37
- XXI. The Christensen Associates' possible benchmarking results cannot be correctly characterized as inefficiencies associated with not-handling costs. .... 41
- XXII. Declining productivities by operation group are an expected and well understood result of automation—not evidence of inefficiency. .... 43

XXIII. Partitioning non-MODS office costs into operational subgroups does not change the overall non-MODS variability or subclass distribution.....44

XXIV. I am not aware of any analysis that indicates that the number of Postal Service facilities varies with volume. In fact, such a conclusion would be counter to my understanding of Postal Service operations.....47

## LIST OF TABLES AND FIGURES

FIGURES

Figure 1 – Not-handling Costs as a Proportion of Total Mail Processing Costs, 1986-1996 .....	4
Figure 2 – Comparison of Regular Periodicals Mail Processing Costs and Clerk and Mailhandler Wages (1986=1) .....	29
Figure 3 – Comparison of Regular Periodicals Mail Processing Costs and Clerk and Mailhandler Wages (1989=1) .....	29
Figure 4 – Comparison of Regular Periodicals Mail Processing Costs and Regular Periodicals Wages (1989=1) .....	30
Figure 5 – Comparison of Regular Periodicals Volume Variable Mail Processing Unit Costs and Regular Periodicals Wages (1989=1).....	30

TABLES

Table 1 – 1Canc MPP Mixed Mail Distribution New Method v. Stralberg/Cohen .....	14
Table 2 – Coefficients of Variation, Comparison of LIOCATT vs. MODS-Based Distribution, 1996.....	19
Table 3 – Percent of Not-Handling Time by Cost Pool .....	24
Table 4 – Percent of Not-Handling Time for Allied and Non-Allied Operations FY 1986-FY 1996.....	26
Table 5 –       STRICKEN	
Table 6 – Cost Shares by Subclass, LIOCATT v. New Methodology.....	36
Table 7—Comparison of Subclass Cost Shares for Non-MODS Offices.....	46

USPS-RT-6

Rebuttal Testimony  
of  
Carl G. Degen

AUTOBIOGRAPHICAL SKETCH

1 My name is Carl G. Degen. I am Senior Vice President of Christensen  
2 Associates, which is an economic research and consulting firm located in Madison,  
3 Wisconsin. My education includes a B. S. in mathematics and economics from the  
4 University of Wisconsin-Parkside and an M. S. in economics from the University of  
5 Wisconsin-Madison. I earned an M. S. by completing the course work and qualifying  
6 exams for a Ph.D., but did not complete a dissertation. While a graduate student, I  
7 worked as a teaching assistant for one year and a research assistant for two years. In  
8 1980 I joined Christensen Associates as an Economist, and was promoted to Senior  
9 Economist in 1990 and Vice President in 1992. In 1997 I became Senior Vice  
10 President.

11 During my tenure at Christensen Associates I have worked on research  
12 assignments including productivity measurement in transportation industries and the  
13 U. S. Postal Service. I have also provided litigation support and expert testimony for a  
14 number of clients. In Docket No. R94-1, I gave testimony before the Postal Rate  
15 Commission on the reclassification of second-class in-county tallies for the In-Office  
16 Cost System. In Docket No. MC95-1, I gave direct testimony on letter bundle handling  
17 productivities and the makeup of First-Class presort mailings. I also gave rebuttal  
18 testimony on savings from automation, the demand for greeting cards, and analysis of  
19 qualifiers for the proposed Publications Service subclass. In Docket No. MC96-2, I



USPS-RT-6

Rebuttal Testimony  
of  
Carl G. Degen

AUTOBIOGRAPHICAL SKETCH

- 1 gave testimony regarding corrections to Periodicals-Classroom unit costs, the
- 2 associated standard errors, and possible changes to the sampling system. In this
- 3 proceeding, Docket No. R97-1, I have given direct testimony on the Postal Service's
- 4 costing methodology and the reliability of MODS data.

USPS-RT-6

1 I. The purpose and scope of my testimony is to explain that the underlying  
2 theory dictates the required distribution methodology and to rebut criticisms of  
3 the new method.

4  
5 My direct testimony in this proceeding described enhancements to the Postal  
6 Service's costing methodology. The new method develops costs by mail processing  
7 operation pools, estimates variability factors<sup>1</sup> and volume variable costs for each pool,  
8 and distributes the volume-variable costs to subclass using a method consistent with  
9 the variability analysis. I will explain why the distribution of mail processing costs must  
10 be done the way the Postal Service has done it in order to provide economic marginal  
11 cost. I will also explain why the new method produces more accurate estimates of  
12 costs than past Postal Service and current intervenor methods. In the process of  
13 explaining these points I will rebut the unfounded and incorrect criticisms by the  
14 intervenor witnesses.

15 The supporting documents for my analysis appear as Library Reference LR-H-  
16 348, which was prepared under my direction, and I sponsor it as part of my testimony. I  
17 will reference specific sections below.

18  
19 II. The distribution methodology is dictated by the theory underlying the  
20 development of marginal cost as unit volume variable costs.

21  
22 Several intervenors seem to want to choose among the components of the new  
23 methodology. In particular, witnesses Cohen, Shew, and Stralberg recommend the  
24 adoption of Dr. Bradley's estimated mail processing variabilities and their application to

---

<sup>1</sup> The mail processing variability analysis was conducted by Witness Bradley (USPS-T-14).

USPS-RT-6

1 cost pools. But, they then call for distribution methods that are inconsistent with the  
2 causal relationships between costs and cost drivers demonstrated in Dr. Bradley's  
3 results. This is wrong. The new costing methodology is an integrated, consistent  
4 system, designed to produce estimates of marginal cost in the form of unit volume-  
5 variable costs.

6 The theory underlying the new costing methodology was set forth in the  
7 testimony of Dr. Panzar (USPS-T-4). The development of the costs pools, the  
8 estimation of variabilities, and the distribution keys that are applied to each cost pool  
9 follow the road map to marginal cost that Dr. Panzar specified. Picking and choosing  
10 from the proposed enhancements, as if ordering from a menu, undermines the  
11 economic basis for the system. Each piece of the new costing system is as it is,  
12 because it needs to be, to form accurate estimates of marginal cost. Testimony by Dr.  
13 Christensen (USPS-RT-7) corroborates Dr. Panzar's underlying theory and the need for  
14 consistent application of the methodology.

15 Failure to distribute costs as the new method specifies will result in bias and  
16 double counting, in addition to being inconsistent with the theory. I discuss this further  
17 below.

18

19 THE NEW METHOD ADDRESSES THE MAIN CRITICISMS OF LIOCATT

20 **III. The new method substantially reduces reliance on not-handling tallies.**

21 In my direct testimony, I described past criticisms of the Postal Service's costing  
22 methodology as falling into three categories. The first of these is the increase in not-

USPS-RT-6

1 handling tallies. It is true that the new method does not reduce the number of not-  
2 handling tallies. However, the new method minimizes reliance on not-handling tallies.  
3 LIOCATT is dependent on not-handling tallies to estimate the costs associated with  
4 each pool (basic function). The new method replaces the estimation of costs by pool  
5 with accounting data from the National Workhour Reporting System and MODS. Under  
6 the new method, not-handling tallies are effectively ignored in most cost pools.<sup>2</sup>

7       The growth in the number of mixed and not-handling tallies is being incorrectly  
8 interpreted as evidence of inefficiency. It is not. Part of the growth in not-handling  
9 tallies is simply the result of a change in the IOCS question 20 instructions.<sup>3</sup> Beginning  
10 in FY1992, the Postal Service instructed data collectors not to ask employees to pick up  
11 mail if the employee was not handling mail at the time of the reading.<sup>4</sup> This change was  
12 designed to eliminate any possible bias due to non random sample of employee  
13 activities. Figure 1 shows that the increase in not-handling costs occurs in FY1992 and  
14 FY1993 when these reporting changes were taking effect.<sup>5</sup>

15       Another reason the proportion of mixed and not-handling tallies has increased is  
16 that the technology of mail processing has changed. More centralized mail processing  
17 in larger facilities, and increased automation are contributing to higher proportions of

---

<sup>2</sup> Where not-handling tallies are used, they only determine the distribution of costs between mail and special services.

<sup>3</sup> IOCS question 20 responses are used to determine whether or not an employee was handling mail.

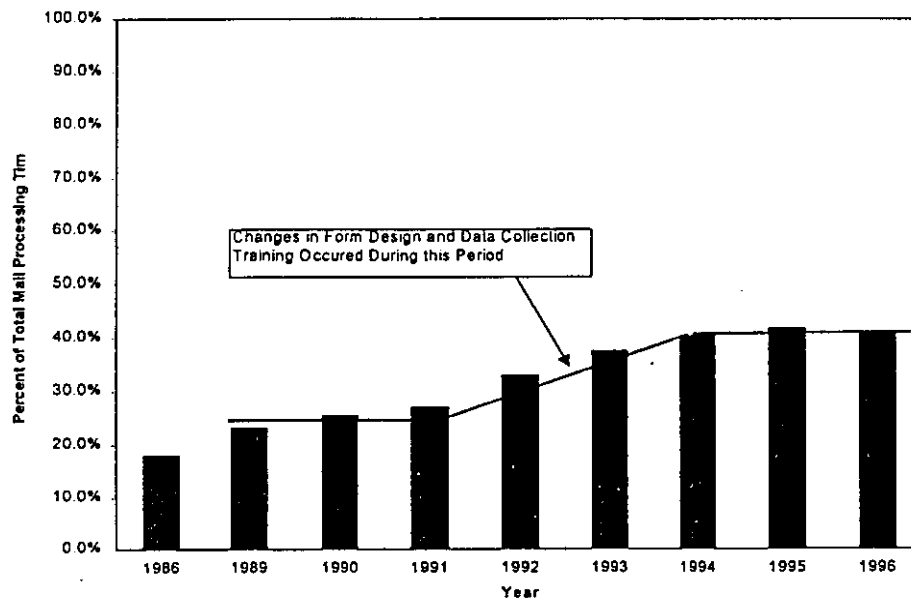
<sup>4</sup> There had never been any instruction that data collectors should ask employees to pick up mail, but there was concern that this was happening.

<sup>5</sup> For FY1996 data collectors were instructed to choose mail from the machine being operated—the not-handling proportion declines in FY1996.

USPS-RT-6

1 not-handling tallies. The proportions of not-handling costs vary across cost pools  
 2 because the not-handling activities of the operations in each pool vary. I will discuss,  
 3 below, the essential and productive nature of the large portion of employees' effort that  
 4 does not involve handling mail.

Figure 1  
 Not-handling Costs as a Proportion of Total Mail Processing Costs, 1986 - 1996



5

6 **IV. The new method improves the accuracy of mixed-mail distribution.**

7 The second category of past criticism is the accuracy of mixed-mail distribution  
 8 methods. Accuracy has two dimensions, bias and efficiency. Historical criticisms of  
 9 LIOCATT have focused on bias, arguing that LIOCATT fails to account for  
 10 compositional differences between mixed-mail and direct mail (Docket No. R94-1, TW-  
 11 T-1, at 11, Tr. 15/7134). The new method also eliminates any bias that results from the  
 12 distribution of costs from an operation to subclasses that are not handled in that

USPS-RT-6

1 operation. I further discuss the bias in different mixed-mail distribution methods in  
2 Section X.

3 To the best of my knowledge, efficiency of the mixed-mail distribution has not  
4 been a major criticism of LIOCATT, however, it has been raised as criticism of the new  
5 method. I discuss efficiency in Section XIII.

6 **V. The new method replaces the assumption of 100 percent variability with**  
7 **econometric estimates of variability.**

8  
9 The final category of past criticisms discussed in my direct testimony was the  
10 traditional assumption of 100 percent variability. Dr. Bradley has answered that issue  
11 well, as described in his testimony. It must be clear, however, that his methods dictate  
12 that all volume-variable costs within each pool must be distributed to the subclasses  
13 handled in the operations in that pool. Several intervenors embrace Dr. Bradley's less  
14 than 100 percent variability estimates, but overzealously seek to further reduce variable  
15 costs—picking through cost pools for institutional costs that they can pare away from  
16 their subclasses before calculating volume variable costs. This is wrong.

17 When Dr. Bradley estimates variabilities, he is using all the costs in each cost  
18 pool as his dependent variable. The fact that Dr. Bradley's variability estimates are less  
19 than one indicates some of each cost pool's costs are not related to mail volume.  
20 When his estimated variability is applied to each cost pool, it produces volume-variable  
21 costs—the subset of that pool's costs that is volume related. It would be double  
22 counting to first try to identify which of the costs in each pool are not volume variable  
23 and remove them, and then apply the variability estimate only to the remaining costs.

USPS-RT-6

1           The new costing methodology has squarely addressed each of the categories of  
2 past criticism that I described in my direct testimony. The new method nearly  
3 eliminates reliance on the not-handling tallies. The improved distribution of mixed-mail  
4 represent a less biased and equally efficient method of mixed-mail distribution. The  
5 new method properly estimates marginal costs when the estimates of variability and the  
6 distribution method are consistently applied as the theory dictates.

7

8 RESPONSE TO CRITICISM OF THE NEW METHOD

9 **VI. The assumptions of the new method are not new. The new method,**  
10 **LIOCATT, and the Stralberg/Cohen method all assume that mixed-mail costs have**  
11 **the distribution of direct costs within a cost pool.**

12

13           The Postal Service's new cost distribution method for mail processing has been  
14 criticized as relying on new assumptions. The Postal Service's new method, LIOCATT,  
15 and the Stralberg/Cohen method all make the same assumption for distribution of  
16 mixed-mail processing costs. Each method assumes that, for each cost pool, the costs  
17 for which the subclass distribution is not known, have the same underlying distribution  
18 as the costs for which the subclass distribution is known. The question comes down to:  
19 which partitioning of costs into pools produces unbiased estimates under this  
20 assumption. LIOCATT and the Stralberg/Cohen method use very aggregate cost pool  
21 definitions derived exclusively from sample results (basic function).

22           The Postal Service's new method uses very specific operation, item, and  
23 container-based cost pools. Operations, items, and containers can have very strong  
24 subclass associations. (Tr. 26/14048) Cost pools defined along these dimensions will,

USPS-RT-6

1 therefore, have less bias, because each pool's costs are only distributed to the  
2 subclasses of mail handled in that pool's operations and associated with that item or  
3 container type.

4 Witness Stralberg recognizes the value of precisely defined cost pools when he  
5 argues for the treatment of pallets as items (Tr. 26/13838). His reasoning would seem  
6 to directly contradict his proposed method which relies on very aggregate cost pools.

7 The Stralberg/Cohen method and LIOCATT redistribute not-handling costs in a  
8 complicated way. The new method uses not-handling costs only to determine the  
9 relative share of not-handling costs between mail and special services.

10

11 **VII. The new method is no more untested than LIOCATT or the Stralberg/Cohen**  
12 **method.**

13

14 The Postal Service's new method is criticized as being untested. (Tr. 26/14046)

15 During my oral testimony I indicated I had not done any testing of the distribution  
16 assumptions, though I made it clear that my methods were determined by the need to  
17 be consistent with Dr. Bradley's work (Tr.12/6666). Dr. Bradley's regression results  
18 relate costs to the mail handled in that operation group. In that sense, Dr. Bradley's  
19 work could be viewed as confirmation of the assumptions of the new distribution  
20 method.

21 Witnesses Panzar and Christensen show formally that the Postal Service  
22 methodology actually estimates the underlying causal relationships between volume-  
23 variable costs and the subclasses of mail. Dr. Christensen also shows that LIOCATT



USPS-RT-6

1 and the Stralberg/Cohen method are inconsistent with economic theory even under the  
2 untested and, I believe, untrue assumption that there is cross-pool causality.

3 It is ironic that intervenor witnesses argue that the new mail processing  
4 distribution method should be rejected because it is based on untested assumptions.  
5 The methods they would have us fall back on (LIOCATT or Stralberg/Cohen) are based  
6 upon truly untested assumptions. Instead of rejecting the new method because it  
7 makes different assumptions than LIOCATT, a careful comparison of the assumptions  
8 of each distribution method should be used to determine which system more accurately  
9 estimates the unknown distribution of mixed-mail costs.

10

11 **VIII. Tradition is no reason to accept the biases in LIOCATT and the**  
12 **Stralberg/Cohen method.**

13

14 While the Postal Service's new method is fully grounded in reliable operational  
15 data and economic theory, Witness Stralberg argues for adoption of the method that he  
16 and Witness Cohen propose on the grounds that their method is "closer to the  
17 traditional approach" (Tr.26/13819). I am not aware of any cost causality tests that  
18 supported the "traditional approach." Indeed, Dr. Christensen indicates that it is unlikely  
19 that LIOCATT properly represents any empirically verifiable patterns of causality  
20 (USPS-TR-7). An abundance of criticisms have been leveled at LIOCATT by numerous  
21 intervenors—including witnesses Cohen and Stralberg. Indeed, in Docket No. R94-1,  
22 witness Stralberg contended that the LIOCATT mixed-mail distribution assumptions—  
23 the basis for his current proposal—were "highly questionable" (Docket No. R94-1, TW-

USPS-RT-6

1 T-1 at 10, Tr. 15/7133) and that the resulting cost distribution was "in all likelihood  
2 severely distorted" (Tr. 15/7135). Witness Stralberg specifically criticized LIOCATT for  
3 distributing mixed and not-handling costs to subclasses that could not have caused  
4 those costs (see Docket No. R94-1, Tr. 15/7136-40).

5 We know that the proportions and composition of direct, mixed, and not-handling  
6 tallies vary across the MODS-based cost pools. This fact alone would argue definitively  
7 for the use of these cost pools. It also should not be surprising to anyone with a good  
8 understanding of mail processing. I have observed these operations in many plants.  
9 Employees actually have mail or items in their hand only a surprisingly small portion of  
10 the time, and that portion depends on the nature of the operation.

11

12 **IX. Pool definitions for the distribution of mail processing costs must be**  
13 **evaluated for bias using knowledge of mail processing.**

14  
15 The major point of departure between the new method and LIOCATT is the  
16 definition of the cost pools. The cost pools in the new method are defined using  
17 technological and operational distinctions that have been used in the Postal Service for  
18 more than twenty years, while LIOCATT defines cost pools using basic function<sup>6</sup>. Basic  
19 function is a nebulous, ill-defined concept of mail processing activity created by IOCS  
20 and used only by IOCS.<sup>7</sup> Witness Stralberg argued in his testimony that MODS-based  
21 cost pools should not be used because they are "impure". Under cross-examination,

---

<sup>6</sup> The critics may argue that I have left off the CAG dimension. While it is true that there is also a CAG dimension, the great majority of mail processing costs occur in only one CAG (CAG A plants).

<sup>7</sup> There are more than two pages in the IOCS operating procedure handbook devoted to explaining the rules for assigning a basic function to a tally. (See USPS LR-H-49, pages 135-138.)

USPS-RT-6

1 witness Stralberg conceded that basic function is impure in the same way in which he  
2 criticized MODS-based pools as impure (Tr. 26/13985).

3       The choice of a basic function by a data collector depends on the data collector's  
4 knowledge of mail processing operations and understanding of IOCS reporting rules.  
5 MODS hours data are based on the same clock ring data that support the payroll  
6 system. These data have been used by the Postal Service and the Inspection Service  
7 for years. MODS is the source of operational data for Postal operations.

8       Basic function was employed in LIOCATT in recognition of the fact that outgoing  
9 and incoming mail would be likely to have different underlying operational mixes and,  
10 therefore, different subclass profiles. Using that same reasoning leads naturally to the  
11 further refinement of the cost pools in the new method. Distributing mixed-mail costs  
12 within a basic function ignores the canonical technological and operational boundaries.  
13 The result is a bias against non-presorted mail, because non-presorted mail has a high  
14 proportion of its cost in operations where it is likely to be observed as a single piece  
15 (and result in a direct tally). Thus, the costs associated with tallies of containers in  
16 opening units, where presorted mail is relatively more common and is likely to result in  
17 "mixed" tallies, are distributed to the subclasses which dominate piece-sortation  
18 operations.

19       Witness Stralberg argues that LIOCATT is biased to overstate Periodicals costs  
20 because items and containers that are known to have fewer pieces will be recorded as  
21 direct tallies (Tr. 26/13831). Witness Stralberg argues that, within operations where  
22 mail is being handled as a container or an item, Periodicals will make up a larger

USPS-RT-6

1 proportion of the direct tallies than of all mail being handled in the operation. This is  
2 wrong.

3 Item and container handling costs are distributed using the distribution of direct  
4 and, as applicable, counted item costs within a cost pool. There is no evidence that  
5 brown sacks, with Periodicals in them, are any more likely to be counted than brown  
6 sacks that have other classes. In fact, data collectors expect all brown sacks to contain  
7 Periodicals because that is standard operating procedure.

8 Similarly, there is no evidence that mixed-mail costs would not have the same  
9 subclass distribution as the direct costs in a pool defined by operation group and item  
10 or container type. Most mixed-mail tallies are the result of a data collector observing an  
11 employee who is not handling mail, but who is working in a sortation operation. The  
12 data collector records these facts and IOCS assigns a mixed-mail code. Witness  
13 Stralberg would have us believe that there is some important difference between the  
14 underlying distribution of direct costs and the distribution of costs associated with  
15 mixed-mail. It is difficult to see how this could be true when most mixed mail costs are  
16 not associated with any particular mail, but rather, the presence of the employee in a  
17 particular operation group.

18 Witness Stralberg's assertion that data collectors are more likely to count certain  
19 mailings is simply an assertion, but an assertion with which witness Cohen does not  
20 appear to agree (Tr. 26/14148). He points to the varying proportions of counted items  
21 and containers by type, but does not consider in which operations each item or  
22 container is counted and how the exigencies of that operation or the preparation of

USPS-RT-6

1 items, such as the shrinkwrapping of sacks on pallets, would cause different proportions  
2 of counting. However, his accurate observation, that the proportion of counted items  
3 varies by type, clearly argues for item as a mixed mail distribution category.

4

5 **X. Operation, item, and container-based cost pools reduce bias and more**  
6 **accurately account for shape when distributing mixed-mail costs.**

7

8       Instead of large cost pools defined by basic function, the new methodology  
9 makes use of the MODS operation, item, and container information to restrict  
10 distribution of mixed-mail costs. The distribution of mixed-mail costs by cost pool  
11 requires two straightforward assumptions: 1) that the subclass distribution of  
12 uncounted items is the same as the subclass distribution of counted items within each  
13 cost pool, and 2) that items in containers have the same subclass distribution as items  
14 handled individually within each cost pool.<sup>8</sup> Common sense tells us that these  
15 assumptions are true or at least more nearly true for the detailed MODS-based cost  
16 pools than for basic functions.

17       By arguing for the use of the shape-specific activity codes, witnesses Stralberg  
18 and Cohen are endorsing, no doubt unwittingly, operation-based cost pools. Shape-  
19 specific mixed-mail codes are defined by operation groupings in IOCS. They are  
20 primarily created when an employee is observed not handling mail within an operation  
21 that has a dominant shape association. The new method extends that compelling line

---

<sup>8</sup> For uncounted items in platform, the pool is broadened to include all allied operations in recognition of the fact that many items are not directly handled until they reach other allied operations.

USPS-RT-6

1 of reasoning by using operation-based pools even in the absence of a dominant shape  
2 relationship, recognizing that there may still be a strong subclass association. The new  
3 method also defines the operational cost pools using the MODS data—eliminating  
4 sampling error and tally weighting bias in determining total costs for the operation.

5         Witness Cohen (Tr. 26/14048), in an apparent attempt to discredit the use of  
6 item and container type to define cost pools, presents substantial evidence of the  
7 strong correlation between item type and subclass distribution. She argues that, since  
8 this correlation is not perfect, use of item distributions or mixed-mail proxies is invalid.  
9 She completely misses the point. The existence of any correlation between item type  
10 and subclass means that bias will likely result if item type is not used to partition mixed-  
11 mail costs. LIOCATT and the Stralberg/Cohen method make the more questionable  
12 assumption: that the contents of uncounted items and containers have the same  
13 subclass distribution as all direct costs associated with mail being handled in all  
14 operations throughout the plant, regardless of item or container type, at that general  
15 time.<sup>9</sup>

16         To illustrate the point that the MODS-based cost pools distribute costs to the  
17 subclasses handled in an operation better than the Stralberg/Cohen method, we  
18 analyzed the cancellation and mail preparation cost pool 1Canc MPP. This cost pool is  
19 not exclusively cancellation (Tr. 12/6138), but that is the predominant activity. We  
20 looked at the distributed volume-variable costs occurring in this cost pool. Table 1

---

<sup>9</sup> Time of processing can be viewed as an approximation of basic functions: outgoing (tour 3) and incoming (tour 1).

USPS-RT-6

1 compares the distribution of these costs under the Postal Service's new method to the  
 2 proposed Stralberg/Cohen method. The Postal Service's new method distributes these  
 3 costs by item and container type in proportion to direct costs within 1Canc MPP. The  
 4 Stralberg/Cohen method distributes these costs in proportion to all direct costs by basic  
 5 function. The results are very different. Clearly the MODS-based method is more  
 6 consistent with our understanding of cancellation operations. The Stralberg/Cohen  
 7 method distributes over 40 percent of mixed flat costs from cancellation to Periodicals  
 8 and Standard (A).

Table 1  
 1Canc MPP Mixed Mail Distribution  
 New Method v. Stralberg/Cohen

Subclass	Letters		Flats	
	New Method	Stral/Cohen 5610	New Method	Stral/Cohen 5620
First	95.5%	83.1%	79.1%	49.2%
Periodicals		0.2%	4.7%	12.3%
Standard A	2.5%	13.9%	3.6%	28.7%
Standard B			0.6%	0.3%
Priority			10.5%	5.6%
Express			0.5%	1.5%
Other	2.0%	2.8%	1.1%	2.5%

9

10

11

12 **XI. The new method eliminates bias by incorporating across-LDC wage**  
 13 **differences.**

14

15 Wages for mail processing labor vary greatly across LDCs. The new method  
 16 allows the implicit wage rate to vary across LDCs eliminating any bias in estimated  
 17 costs. However, the tally cost weights used in the LIOCATT system and in the  
 18 alternative distribution proposed by witness Buc don't take this into account. For  
 19 example, LIOCATT overestimates the costs associated with single piece

USPS-RT-6

1 letters to some extent, because letters are processed in automation and remote  
2 encoding operations where wages are lower. Presort subclasses will have a much  
3 smaller proportion of their costs in these low-wage operations. During cross-  
4 examination, Witness Buc confirmed that cost distributions could be biased when there  
5 are wage differences across operations and the cost distribution does not account for  
6 them (Tr. 28/15451-15455, 15470-15473).



USPS-RT-6

1 XII. The new method's MODS-based costs pools have no sampling error and  
2 less non-sampling error than cost pools based on basic function and mixed-mail  
3 codes because the MODS-based pools are from an accounting system rather  
4 than a sampling system.

5  
6 Use of MODS codes to assign costs to cost pools replaces a sample-based  
7 assignment with a reliable, accounting-based assignment. MODS data are compiled  
8 from the same clock-ring data that are used to generate employees' paychecks. Both  
9 the employees and the Postal Service have strong incentives to get them right. It is  
10 true that employees are sometimes misclocked in MODS. However, the robust  
11 relationships that Dr. Bradley finds between hours and workload strongly suggest that  
12 this is not a problem for the level at which the operation groups have been defined.  
13 However, to whatever limited extent there are misclockings present in the cost pools,  
14 they are the same as those used by Dr. Bradley to estimate variabilities. Intervenors,  
15 who accept Dr. Bradley's estimated variabilities and recommend their use, cannot  
16 credibly argue that MODS misclockings are a problem or that cost pools can be defined  
17 any other way than the way that they were constructed for estimation of those  
18 variabilities.

19 As an accounting system, MODS contains no sampling error and, the recording  
20 of MODS codes in ICOS should embody less non-sampling error than basic function  
21 since having data collectors determine the nature of an observed employee's activity is  
22 subjective. (Tr. 26/13984-13985) The Stralberg/Cohen method also relies on the  
23 shape-specific mixed-mail activity codes which depend on data collectors' ability to

USPS-RT-6

1 consistently identify a sampled employee's activity. These are certainly subject to more  
2 non-sampling error than MODS operation recording.

3 **XIII. The new method does not create sample thinness problems—the CVs for**  
4 **the new method are comparable to the CVs for the old method. Even if the new**  
5 **method had substantially higher CVs, it would still be preferred because it has**  
6 **less bias.**

7  
8 Witnesses Buc and Cohen have tried to suggest that LIOCATT must be  
9 preferred over the new method simply because the number of distribution keys in the  
10 new method is too large and number of sample points underlying some of the keys is  
11 too small. They argue that partitioning costs into operation group yields distribution  
12 keys that are too "thin" (Tr. 28/15378). Witness Buc offers several pages of analysis  
13 arguing that the distribution keys have coefficients of variation that are too large to  
14 support reliable cost distribution.

15 There are two problems with this line of reasoning: 1) elimination of bias is the  
16 top priority which nearly always take precedence over efficiency, and 2) the most  
17 meaningful measure of efficiency for a costing system is the efficiency of the final cost  
18 estimates. As I discuss above, the new method uses a more detailed partitioning of  
19 costs to eliminate bias. As it turns out, this reduced bias has not caused any  
20 appreciable decline in efficiency.

21 The arguments of Witness Buc and Cohen focus on the large number of pools  
22 with "thin" distribution keys. What they don't point out is that these "thin" distribution  
23 keys apply to very small pools of costs. Any meaningful analysis would have to account  
24 for this fact. I can only surmise that they had to resort to these partial, misleading

USPS-RT-6

1 analyses because coefficients of variation could not be obtained for final estimates from  
2 the different methods.

3 In response to these criticisms, we have used bootstrapping techniques to  
4 estimate coefficients of variation for the mail processing cost estimates for both the new  
5 method and LIOCATT. The results in Table 2 show the efficiency of the final estimates,  
6 including the effects of mixed-mail cost distribution. This is now a meaningful  
7 comparison, and the new method has only marginally higher CVs. Section B of LR-H-  
8 348 describes our methods. These results make it clear that the elimination of bias was  
9 achieved with no significant loss of efficiency.

USPS-RT-6

**Table 2**  
**Coefficients of Variation**  
**Comparison of LIOCATT vs. MODS-Based Distribution 1996**

Subclass	LIOCATT CV	MODS-Based CV	Difference (LIO - MODS)
<u>First Class</u>			
Letters and Parcels	0.4%	0.4%	0.0%
Presort Letters and Parcels	1.2%	1.4%	-0.1%
Postal Cards	20.7%	21.1%	-0.4%
Private Mailing Cards	2.8%	3.6%	-0.8%
Presort Cards	5.9%	6.8%	-1.0%
Priority	1.8%	1.7%	0.1%
Express	4.1%	3.8%	0.3%
<u>Periodicals</u>			
Within County	10.9%	10.5%	0.4%
Regular	1.8%	2.0%	-0.2%
Non Profit	4.1%	4.7%	-0.6%
Classroom	17.0%	20.5%	-3.5%
<u>Standard (A)</u>			
Single Piece Rate	4.2%	4.9%	-0.7%
Regular Carrier Route	2.5%	2.7%	-0.1%
Regular Other	0.9%	1.0%	-0.2%
Non Profit Carrier Route	7.0%	8.2%	-1.3%
Non Profit Other	1.9%	2.1%	-0.3%
<u>Standard (B)</u>			
Parcels - Zone Rate	2.7%	3.4%	-0.7%
Bound Printed Matter	4.2%	4.8%	-0.6%
Special Rate	4.0%	4.4%	-0.4%
Library Rate	8.6%	9.5%	-0.8%
USPS	4.2%	4.8%	-0.6%
Free for Blind/Handicapped	11.9%	11.1%	0.8%
International	2.0%	2.5%	-0.5%
Registry	3.1%	4.3%	-1.2%
Certified	5.9%	7.6%	-1.7%
Insurance	38.2%	40.2%	-2.0%
COD	21.1%	24.0%	-2.9%
Special Delivery	25.5%	33.9%	-8.4%
Other Special Services	3.4%	3.8%	-0.5%

USPS-RT-6

1 OTHER ISSUES RAISED BY INTERVENORS

2 **XIV. Proportions of not-handling costs cannot be compared between 1986 and**  
3 **1996 because of a substantial change in data collection instructions.**

4  
5 The IOCS is designed to sample employees at designated points in time. As I  
6 have discussed, a large portion of some employees' productive time will not be handling  
7 mail. In the early 1990s data collectors were overzealous in terms of associating a  
8 piece of mail with a sampled employee. This may not appear to be a problem but,  
9 when an employee is not actually handling mail, the data collector must make a  
10 subjective determination which can result in non-sampling error, or even bias. Once  
11 aware of this problem, the Postal Service took steps to correct this misperception  
12 among its data collectors. Section C of LR-H-348, describes the change that the Postal  
13 Service made to its data collection and includes the relevant excerpts from the training  
14 materials. Since there has been a change in data collection methods, one cannot  
15 conclude that the increase in the proportion of not-handling tallies indicates inefficiency.

16

17 **XV. The growth in not-handling costs is not evidence of inefficiency—not-**  
18 **handling costs represent productive work that is integral to all operations,**  
19 **though the proportions may vary across operation groups.**

20

21 Witness Cohen argues that the "explosion" in not-handling tallies is prima facie  
22 evidence of inefficiency, with the large portion of not-handling in activity codes 5750  
23 and 6523 being particularly suggestive (Tr. 26/14061). Witness Cohen's statement that  
24 "costs for these codes, almost by definition, indicate inefficiency" is wrong. It denies the  
25 reality that some activities involve a portion of time not handling by their nature and that

USPS-RT-6

1 equipment must be maintained and moved around a facility. Even the process of  
2 equipment movement and maintenance involves return trips, etc., where sometimes  
3 even empty equipment is not being handled. To suggest that the Postal Service could  
4 operate efficiently, in a system where every employee was always handling mail, is  
5 absurd.

6 Pony Express riders may have always been able to keep their saddlebags full,  
7 but today's mechanized mail processing plants rely on the handling of mail in  
8 containers. These containers require movement which results in not-handling time, that  
9 IOCS accurately records. Witnesses Stralberg and Cohen have both admitted that  
10 there are valid reasons why not-handling costs are observed and that the associated  
11 costs can be directly related to handling certain types of mail (Tr. 26/14017, 14149-  
12 14150). In addition, witness Cohen admits that she doesn't "...know what the number  
13 is for not handling" (Tr. 26/14152). When witnesses Stralberg and Cohen recommend  
14 that all not-handling costs be treated as institutional, they are recommending that we  
15 deliberately understate costs for subclasses of mail that are handled in operations with  
16 inherently high levels of not-handling time, because they believe some of these costs  
17 are unproductive.

18 Witnesses Stralberg and Cohen justify treating all not-handling costs as  
19 institutional with the simple fact that the proportion of not-handling costs is rising (Tr.  
20 26/13818-13819, 14017-14018). As I explained above and will explain further below,  
21 there are valid reasons for the increase in not-handling tallies. However, even absent  
22 an explanation for increasing not-handling proportions, I am disturbed by the

USPS-RT-6

1 suggestion that we should misallocate not-handling costs we know to be directly related  
2 to specific subclasses on the pure conjecture that some not-handling costs represent  
3 inefficiency. The proposal is even more disturbing given that witnesses Stralberg and  
4 Cohen would have us remove these costs before calculating volume variable costs, so  
5 they would be double counted.

6 Application of the variability factors allows us to identify non-volume variable  
7 costs by cost pool and not distribute these to subclasses. When Witness Sellick (Tr.  
8 26/14174) uses the new distribution method with 100 percent variability, he is  
9 assuming, not only that mail processing is 100 percent variable overall, but, that every  
10 cost pool has the same volume variability and it is 100 percent (Tr. 26/14174). Based  
11 on my understanding of operations, I would not expect any econometric analysis by  
12 cost pool to find the same variability for all cost pools.

13 For the Stralberg/Cohen proposal (treating all not-handling costs as institutional)  
14 to make any sense at all, it would be necessary that we estimate volume variabilities  
15 after these costs are removed from the cost pool. Further, there would have to be  
16 some evidence that the vast majority of not-handling cost were, in fact, non-productive  
17 volume-variable costs. This is simply not the case. On the contrary, my first-hand  
18 observation of hundreds of work floor situations and my understanding of Postal  
19 Service incentive and accountability leads me to conclude that nearly all not-handling  
20 costs are associated with productive activities.

21 All operations involving movement of mail from one point to another will have  
22 very large proportion not handling. For example, dock operations like loading and

## USPS-RT-6

1 unloading trucks can have upwards of fifty percent not handling because waiting time is  
2 all not handling, and moving in and out of the truck is at least half not handling.

3 The reality of the workroom floor is that there are many essential and productive  
4 activities that do not involve handling mail or empty items or containers. Here are some  
5 other examples:

- 6 • walking to another machine to work there while the machine you were working  
7 on is being repaired
- 8 • turning back to the belt to pick up another piece after you have pitched the one  
9 you were holding
- 10 • walking back to the pallet of mail to pick up another bundle after depositing a  
11 heavy bundle that could not be accurately pitched in a sack or container.

12 In nearly every activity, a thoughtful observer would see that there are large  
13 portions of time where employees do not actually have mail in their hands. The data  
14 collectors are instructed to sample an employee at an instant in time. There should be  
15 many such instances. The results of Table 3 show the variation in the proportion of  
16 not-handling costs by cost pool. Operations involving mail movement and waiting time,  
17 like platform, opening, and bulk prep, have larger proportions of not-handling costs than  
18 the piece sortation operations.



USPS-RT-6

**Table 3**  
**Percent of Not-Handling Time by Cost Pool**

<u>Cost Pool</u>	<u>1996</u>
11 bcs/	33%
11 ocr/	32%
12 1SackS_m	55%
12 fsm/	30%
12 lsm/	25%
12 mecparc	41%
12 spbs Oth	42%
12 spbsPrio	44%
14 express	67%
14 manf	32%
14 mani	30%
14 manp	41%
14 priority	41%
14 Registry	55%
15 LD15	36%
17 1Bulk pr	51%
17 1CancMPP	38%
17 1EEQMT	29%
17 1MISC	77%
17 1OPbulk	43%
17 1OPpref	45%
17 1Platfrm	56%
17 1POUCHNG	45%
17 1SackS_h	51%
17 1SCAN	55%
17 1SUPPORT	92%
18 BusReply	43%
18 MAILGRAM	70%
18 REWRAP	64%
41 LD41	48%
42 LD42	32%
43 LD43	34%
44 LD44	33%
44 LD48 Exp	79%
44 LD48 Oth	72%
48 LD48_SSv	65%
49 LD49	43%
79 LD79	80%
BM BMCs	45%
NM Non Mods	25%
<u>Total</u>	<u>41%</u>

USPS-RT-6

1 XVI. There is no evidence of automation refugees—not handling costs are rising  
2 in non-Allied operations faster than they are rising in Allied operations.

3

4 The allegation that excess employees are sent to allied operations is completely  
5 counter to my understanding of field operating procedures.<sup>10</sup> I am not aware of any  
6 supervisors or managers at any level who would allow excess labor to be charged to  
7 their operation. Further, having clerks clock into mailhandler-dominated operations,  
8 like platform, is problematic given the strong delineation of jobs enforced by the  
9 unions.<sup>11</sup>

10 The pattern of increase in not-handling proportions is not consistent with the  
11 current version of the automation refugee theory. The data in Table 4 clearly show that  
12 the proportion of not-handling costs in allied operations has increased about 50  
13 percent, while in the non-allied operations, the not-handling proportion has almost  
14 tripled. This directly contradicts the theory that employees are being sent to allied  
15 operations in increasing numbers.

---

<sup>10</sup> See also the testimony of Postal Service witness John Steele (USPS-RT-8).

<sup>11</sup> See the earlier testimony of witness Stralberg (Docket No. R90-1 Tr. 27/13284) and Regional Instruction 399, part of the agreement between the Postal Service and the National Postal Mailhandlers' Union.

USPS-RT-6

Table 4  
Percent of Not-Handling Time for Allied and Non-Allied Operations  
FY 1986 - FY 1996

	Percent Not-Handling	
	Allied	Non-Allied
1986	37%	12%
1989	43%	16%
1990	45%	18%
1991	46%	20%
1992	49%	25%
1993	53%	31%
1994	54%	33%
1995	55%	35%
1996	55%	33%

Growth in Non-Handling by Epoch

Epoch	Allied	Non-Allied
86-89	16%	34%
89-91	8%	21%
91-94	19%	68%
94-96	2%	-1%
<u>86-96</u>	<u>51%</u>	<u>170%</u>

1

2

3

4 **XVII. The increase in Periodicals mail processing costs is being exaggerated,**  
5 **and the actual increase in recent years appears to be explained by the use of**  
6 **more aggregate pallets.**

7

8       Witness Stralberg and others have argued that Periodicals unit costs are rising  
9 faster than the inflation in overall Postal Service costs since 1986. This basic assertion  
10 is true, but the rate of increase is being exaggerated, and what real increase occurs  
11 appears to be explained by a change in mail preparation. Figure 2 is a plot of mail  
12 processing unit costs for regular rate Periodicals. It certainly creates the impression  
13 that Periodicals costs are outstripping the increase in the average wages of clerks and

USPS-RT-6

1 mailhandlers. Figure 3 is the same plot with the series rebased to be equal in 1989.  
2 Figure 3 is more informative, in that it is easier to see that Periodicals costs increased  
3 faster than wages in 1987-1989, tracked wages closely in 1990-1991, declined  
4 substantially relative to wages in 1992, and then increased somewhat relative to wages.  
5 By 1996, Periodicals costs were slightly higher in real terms<sup>12</sup> than they had been in  
6 1989.

7 In Figures 2 and 3 the inflation measure is the average wage for clerks and  
8 mailhandlers. With the opening of Postal Service-operated remote encoding centers  
9 (RECs) beginning in 1993, the growth in the average wage for all clerks and  
10 mailhandlers has slowed because REC site clerks, who are predominantly transitional  
11 employees paid at relatively low wages, are increasing as a proportion of the total.  
12 Only letter mail benefits from the use of REC sites. Periodicals, which are  
13 predominantly flats, get minimal benefits from any REC site labor. The phenomenon of  
14 REC site wages pulling down the average will stop once the REC site share is stable.  
15 Hence, the comparison of mail processing unit costs for Periodicals to the average clerk  
16 and mailhandler wage, over the 1993-1996 period, is misleading.

17 We have calculated the average wage for clerks and mailhandlers as an index  
18 using average clerk and mail handler wages by LDC. The details of these calculations  
19 appear as Section D in LR-H-348. The weights for the index are based on the cost  
20 shares of regular rate Periodicals for each LDC. That index is based to the overall clerk

---

<sup>12</sup> By real terms we mean adjusted for inflation. If inflation rises five percent and costs rise five percent over some period, we say prices have not changed in real terms.

USPS-RT-6

1 and mailhandler wage index in 1993 and the result is plotted in Figure 4. Now we see  
2 that the substantial decline relative to inflation in 1992 has not quite been offset by  
3 1996.

4 The issue of increased Periodicals costs has been used to argue for rejection of  
5 the enhancements to the costing methodology. The changes to the distribution of mail  
6 processing costs are not causing Periodicals costs to rise faster. In fact, if we apply the  
7 MODS-based methodology to 1993 and compare the resulting unit costs to 1996, we  
8 see that under the new methodology, the unit costs of regular rate Periodicals grow  
9 even less than under LIOCATT. See Figure 5.

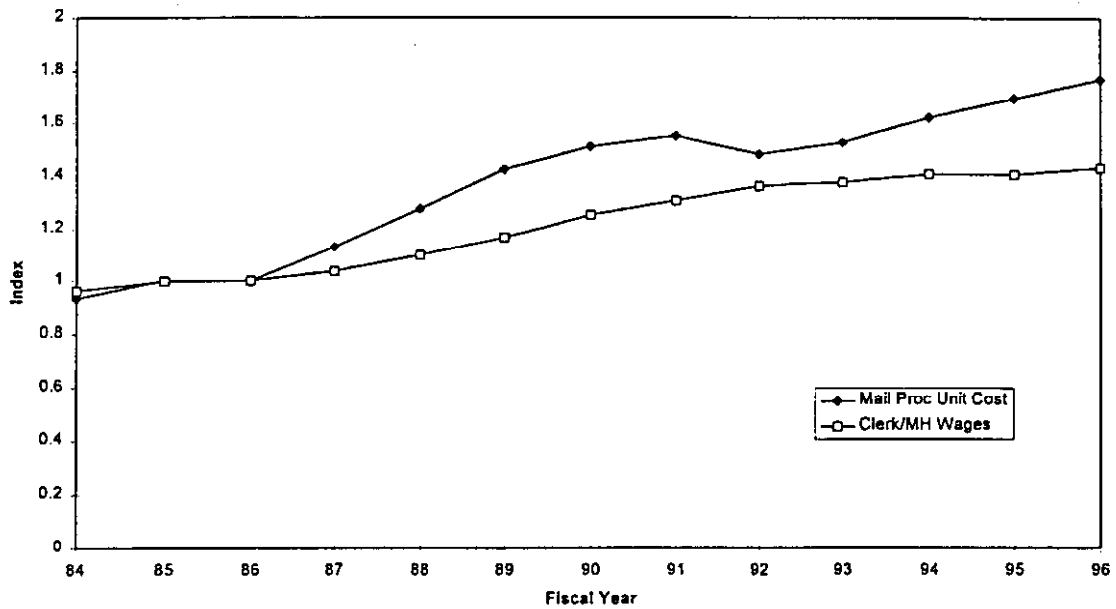
10 Overall, this is a far less disturbing picture than the one painted by the intervenor  
11 witnesses. From 1989 to 1996, Periodicals real unit costs have declined somewhat.  
12 Nonetheless, the increase in mail processing unit costs relative to inflation since 1991  
13 still warrants analysis.

14 Since the early 1990s, there has been a significant increase in container and  
15 bundle handlings. Bundle-based rate qualifications, meaning a 5-digit bundle on an  
16 SCF pallet would be paid at the 5-digit rate, were introduced in 1983. Previously, that  
17 bundle had to have been in a 5-digit sack to be paid at the 5-digit rate. Bundle-based  
18 rate qualifications were part of the Postal Service's movement away from sacks, toward  
19 pallets. The change in qualifications did not immediately cause a big shift to pallets, but  
20 increased mailer awareness and printers' realization that mailings were less costly to  
21 prepare on more aggregate pallets have greatly increased the use of pallets.

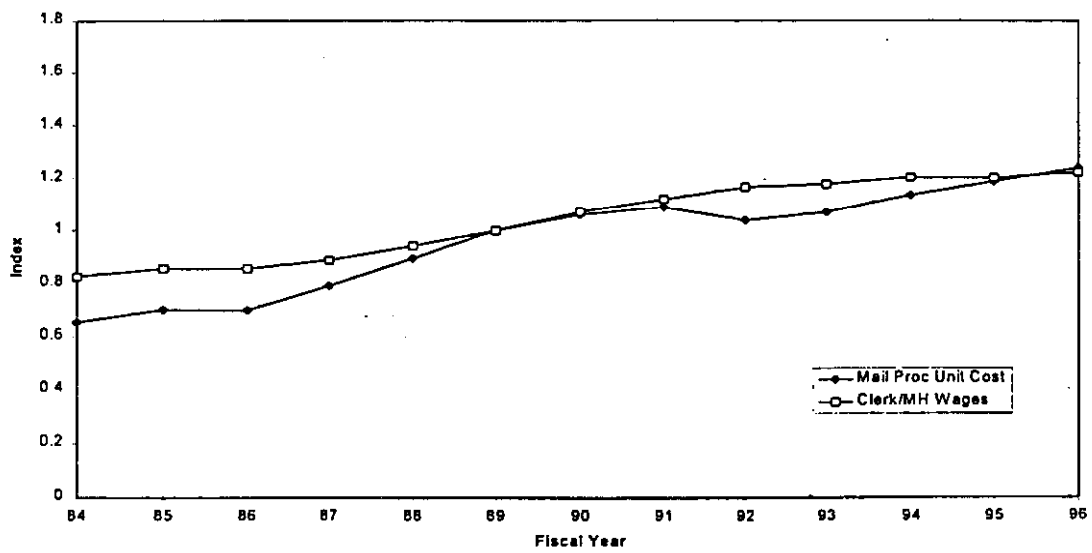
22 Comparing the 1993 and 1996 mail characteristics studies, we see that the

USPS-RT-6

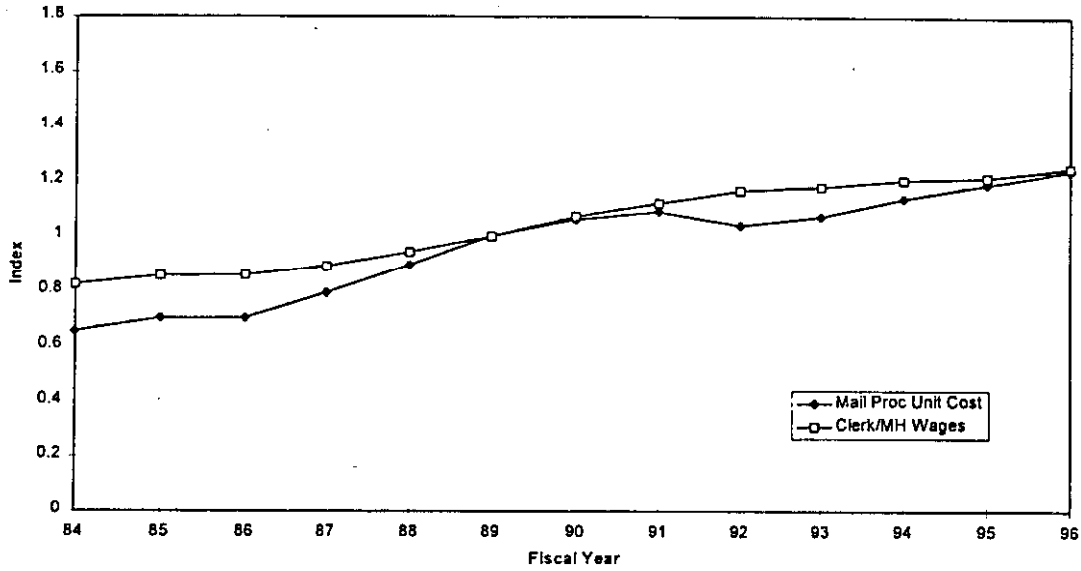
**Figure 2**  
**Comparison of Regular Periodicals Mail Processing Costs**  
**and Clerk and Mailhandler Wages**  
**(Indexed, 1986 = 1)**



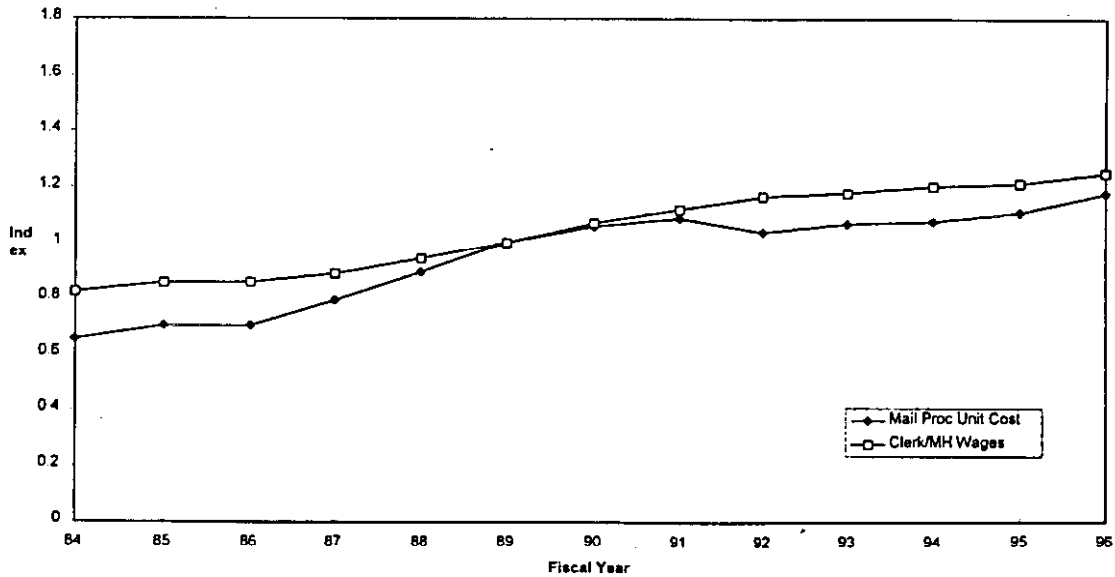
**Figure 3**  
**Comparison of Regular Periodicals Mail Processing Costs**  
**and Clerk and Mailhandler Wages**  
**(Indexed, 1989 = 1)**



**Figure 4**  
**Comparison of Regular Periodicals Mail Processing Costs**  
**and Regular Periodicals Wages (Using LDC Weights)**  
**(Indexed, 1989 = 1)**



**Figure 5**  
**Comparison of Regular Periodicals Volume Variable Mail Processing Unit**  
**Costs\* and Regular Periodicals Wages (Weighted by LDC)**  
**(\* Variable Costs computed for FY 93 - FY 96, Linked to CS 3.1 in FY 93)**  
**(Indexed, 1989 = 1)**



USPS-RT-6

1 percentage of palletized mail on 5-digit pallets has decreased from 43 percent to 11  
2 percent. Further details of the comparison showing the movement to more aggregate  
3 pallets appear in Section A of LR-H-348. The trend toward more aggregate pallets has,  
4 undoubtedly, been partially driven by drop shippers wanting to improve the cube  
5 utilization of their trailers. Less aggregate pallets reduce weight per unit of floor space  
6 even when stacked to allowable levels.

7 Bundle-based rate qualifications have allowed a migration toward more  
8 aggregate pallets, (e.g., 3-digit pallets replacing 5-digit pallets) so that the Postal  
9 Service is having to do more bundle sortation. The workload of breaking down pallets  
10 and sorting the bundles sometimes falls into the platform and opening unit operations—  
11 precisely where some of the "unexplained" cost increases are occurring.

12

13

14

Material Stricken By Ruling at Tr. 34/18196

15

16

17

18

19

20

21

22



USPS-RT-6

1

2

3

4

5

6

7

8

9

10           The evidence that the use of more aggregate pallets has increased costs is very  
11 strong. My discussions with field personnel support the fact that bundles on pallets  
12 requiring several sorts are driving up costs. Bundle handlings may be cheaper than  
13 sack handlings, but more aggregate pallets mean more bundle handlings. Moreover,  
14 the fact that bundles average fewer pieces than sacks means that the cost of handling  
15 a bundle is spread over fewer pieces.<sup>13</sup> Repeated handlings also cause bundle  
16 breakage that results in piece handlings.

17           More aggregate pallets appear to be causing the increase in unit mail processing  
18 costs, but more aggregate pallets should be reducing certain preparation costs for  
19 mailers. It is the net effect that matters. The increase in postage costs should probably  
20 be offset, at least partially, by mailers' savings from the use of more aggregate pallets.

---

<sup>13</sup> The average number of pieces per bundle has also declined, as the result of a substantial decline in 5-digit bundle size only partially offset by increases in other bundle sizes. These changes also mean more workload for the Postal Service.

USPS-RT-6

1           As my analysis demonstrates, Periodicals costs are not out of control. The  
2 increase in Periodicals costs relative to inflation has been exaggerated. The increases  
3 we do observe appear to be very correlated with the increases in the use of more  
4 aggregate pallets. However, none of this discussion is relevant for evaluation of the  
5 enhancements to the costing system. If it were, it would argue in favor of the new  
6 method, since, under it, measured Periodicals costs would rise less than they have  
7 under LIOCATT as shown in Figures 4 and 5.

USPS-RT-6

1 XVIII. Comparisons of Periodicals unit costs to other subclasses are  
2 meaningless without adequate control for the relevant work-causing  
3 characteristics such as shape and presort level.

4  
5 Witness Little includes in his testimony a plot of unit costs for various classes of  
6 mail over time and uses it to argue that Periodicals costs are out of control (Tr.  
7 27/14543-14547). He is correct that unit costs grow at different rates for different  
8 classes, but his conclusion that Periodicals costs are out of control is simply not justified  
9 by this naïve analysis. Comparing unit costs by class is extremely misleading.

10 Letter automation programs have greatly reduced letter sorting costs, so that any  
11 class with a higher than average proportion of letters will show faster declines or slower  
12 growth in its unit costs. Flat automation has also been deployed during the period, but  
13 the proportional savings from flat automation are much smaller than those for letters.  
14 Additionally, flats may have different levels of machineability by class. Obviously, the  
15 more machineable classes will experience the faster declines or slower increases in  
16 units costs. Mail preparation has a substantial impact on costs. Increases in  
17 presortation, drop shipping, or mail piece readability can all have substantial impact on  
18 the observed trend in aggregate unit costs.

19 The few factors listed above are just some of the factors that must be considered  
20 before trying to draw any conclusions from a comparison of unit costs across classes. I  
21 have not studied the issue sufficiently to offer a comprehensive plan for a meaningful  
22 analysis. My point is only that witness Little's analysis fails to provide any useful  
23 insights.

USPS-RT-6

1

2 **XIX. Changes in the relative cost shares of subclasses under the new method**  
3 **do not result in unfair increases to the presort subclasses—they are corrections**  
4 **of the understatement of presort costs and relief to the single-piece subclasses**  
5 **that had been previously overstated.**

6

7

8 Table 6 compares cost shares by subclass under the new method with those  
9 from LIOCATT. It shows that there have been shifts in the cost shares among the  
10 different subclasses. There is a pattern of cost share increases for presort subclasses  
11 and decrease for single-piece subclasses. The previous allegations of bias were  
12 correct, but until the corrected methods were fully implemented the direction of the bias  
13 was *not clear*. Under the new method, presort categories no longer get any substantial  
14 costs from operations like cancellation, but they now get a larger share of some of the  
15 allied operations and their overall share of volume variable costs has increased.  
16 Single-piece First-Class, with proportionately more piece sortation, was being charged  
17 with costs that were caused by the presorted subclasses.

17

18

19

20

21

22

23

24

This may be a surprise to some, but it is not surprising to anyone with a good  
understanding of how the different subclasses are processed. Under LIOCATT, single-  
piece First-Class volumes were incorrectly being charged a disproportionate share of  
mixed and not-handling costs from allied operations because piece handling operations  
were disproportionately represented among direct tallies. The distribution of mixed-mail  
costs, using item and container type by MODS-based pool, eliminates this bias.

USPS-RT-6

Table 6  
 Cost Shares by Subclass  
 LIOCATT v. New Methodology

Subclass	LIOCATT	New Methodology
<u>First Class</u>		
Letters and Parcels	47.7%	46.2%
Presort Letters and Parcels	10.2%	10.6%
Postal Cards	0.0%	0.0%
Private Mailing Cards	1.5%	1.4%
Presort Cards	0.4%	0.4%
Priority	4.0%	4.8%
Express	0.6%	0.8%
Mailgrams	0.0%	0.0%
<u>Periodicals</u>		
Within County	0.1%	0.2%
Regular	4.1%	4.6%
Non Profit	0.7%	0.8%
Classroom	0.0%	0.1%
<u>Standard (A)</u>		
Single Piece Rate	0.8%	0.8%
Regular Carrier Route	2.4%	2.6%
Regular Other	15.2%	15.4%
Non Profit Carrier Route	0.3%	0.3%
Non Profit Other	3.7%	3.7%
<u>Standard (B)</u>		
Parcels - Zone Rate	1.6%	1.6%
Bound Printed Matter	0.8%	0.7%
Special Rate	0.8%	0.7%
Library Rate	0.2%	0.2%
USPS	0.8%	0.8%
Free for Blind/Handicapped	0.1%	0.1%
International	2.3%	2.1%
Registry	0.5%	0.4%
Certified	0.3%	0.2%
Insurance	0.0%	0.0%
COD	0.0%	0.0%
Special Delivery	0.0%	0.0%
Special Handling	0.0%	0.0%
Other Special Services	0.8%	0.8%

USPS-RT-6

1 XX. The Postal Service has initiatives underway that will improve service,  
2 control costs, and work with mailers for further improvements.

3

#### 4 EQUIPMENT DEPLOYMENTS

5

6 The Postal Service has some significant deployments and/or modifications of  
7 flats processing equipment scheduled for FY98. First, all 812 of the model 881 Flat  
8 Sorting Machines (FSMs) will be retrofitted with an Optical Character Reader (OCR).  
9 Deployment of the OCR modification will begin in June, 1998 and is scheduled to be  
10 completed in July, 1999. This modification should help to improve the overall barcode  
11 utilization, since some barcoded flats are inadvertently keyed today because of the lack  
12 of segregation of barcoded and nonbarcoded flats. The modification functions so that  
13 barcoded flats are processed by the barcode reader (BCR) and nonbarcoded flats are  
14 processed by the OCR. This modification should help improve service since it  
15 eliminates the potential for keying errors when the FSM is operated in OCR/BCR mode.

16 Another significant initiative is the deployment of an additional 240 FSM 1000s.  
17 The FSM 1000 can process a wider variety of flats including flats that are non-  
18 machineable on the FSM 881. For instance, the FSM 1000 can process some larger  
19 tabloid size flats as well as flats that are enclosed in non-certified shrinkwrap. Today,  
20 sites that do not have an FSM 1000 must process non-machineable flats (per FSM 881  
21 machineability requirements) manually. The initial deployment of the first 100 FSM  
22 1000s was completed in May, 1997, and the deployment of the additional 240 FSM  
23 1000s to smaller sites started in July, 1997 and should be completed by July, 1998. As

USPS-RT-6

1 FSMs proliferate throughout the nation, plants should be able to reduce manual flat  
2 processing.

3 The Postal Service's Board of Governors recently approved the addition of  
4 barcode readers to all 340 of the FSM 1000s. Deployment of this modification is  
5 scheduled to begin in July, 1998 and be completed by February, 1999. All of the  
6 aforementioned flats processing equipment initiatives are intended to increase the  
7 proportion of flats that the Postal Service can process on the flat sorters as well as  
8 improve the efficiency with which they are processed.

#### 9 MAIL PREPARATION INITIATIVES

10 The Postal Service recognizes that the mail preparation requirements and  
11 options provided to Periodical mailers have a direct impact on the level of service that  
12 they receive. Accordingly, the Postal Service has acted upon input received from many  
13 Periodical mailers, publishers, and their associations regarding mail preparation  
14 requirements. Just recently, the Postal Service reinstated the SCF sack as an optional  
15 level of preparation solely for Periodical flats. Although the SCF sack adds an  
16 additional level of sort to the existing preparation hierarchy, the Postal Service  
17 recognized that allowing Periodical mailers to prepare an SCF sack would help keep  
18 mail at the local plant level. Therefore, the Postal Service reinstated the SCF sack as a  
19 optional level of preparation in January of this year. Moreover, the SCF sack will  
20 become a required sack level in Periodicals effective with the implementation of this  
21 rate case.

USPS-RT-6

1 Another change to mail preparation that was recently proposed in the Federal  
2 Register, 63 FED.REG. 153-56 (Jan. 5, 1998), is to eliminate the mailer's option to  
3 prepare mixed pallets of flat packages. Many mailers are preparing carrier-route and 5-  
4 digit packages on mixed pallets. While this level of preparation may yield reduced costs  
5 to the mailer in a production environment, it is far from optimal from a service  
6 standpoint. Packages on mixed pallets must be distributed by origin plants to ADC  
7 separations and then require additional distribution(s) once they reach the destinating  
8 ADCs. In contrast, if these packages were instead placed in a 5-digit or 3-digit sack per  
9 the specified sacking requirements, it is conceivable that many of these packages  
10 would not require sortation until they reached the destinating plant or delivery office.  
11 Therefore, in order to improve the levels of service on packages that are not prepared  
12 to direct pallets because of a lack of density, the Postal Service has proposed that  
13 packages that are currently prepared on mixed pallets will be prepared in sacks upon  
14 implementation of the final rule later this year.

#### 15 JOINT INDUSTRY/POSTAL WORK GROUPS

16  
17 Over the past year, several joint Mailers Technical Advisory Committee (MTAC)  
18 and Postal Service work groups have been formed to study various issues affecting the  
19 mailing industry. One of these work groups is specifically focused on identifying  
20 opportunities to improve Periodical mail service. The work group is comprised of  
21 publishers, printers, and postal representatives that are all familiar with various aspects  
22 of the preparation, movement, and processing of Periodicals. While the work group is  
23 still in its infancy, opportunities to improve service have already surfaced during the first



USPS-RT-6

1 couple of meetings. For instance, many of the work group's members identified the  
2 need for an SCF sack in Periodicals and were therefore strong proponents of its  
3 reinstatement. The work group members possess a vast level of knowledge and  
4 experience related to Periodicals and are working together to identify concerns that are  
5 affecting service as well as possible solutions to those concerns.

6 Another joint MTAC/USPS work group is working on initiatives related to presort  
7 optimization. As I mentioned, earlier in my testimony, mailers are making more  
8 aggregate levels of pallets. Initial findings of this work group have indicated that  
9 packages are often prepared on these aggregate levels of pallets inadvertently because  
10 other mail for the same service area was prepared on finer level pallets. For instance,  
11 mail for an SCF service area may inadvertently fall back to an ADC pallet because a 5-  
12 digit or 3-digit pallet was prepared for other mail that is part of the same service area.  
13 This work group is working to define the logic that is needed in presort software in order  
14 to retain more mail on SCF pallets and minimize the amount of mail that falls back to an  
15 ADC pallet. Retaining more mail at the SCF pallet level could help qualify more mail for  
16 DSCF dropship discounts and also improve service since the mail would otherwise be  
17 prepared on an ADC pallet.

#### 18 SUMMARY

19  
20 The initiatives that will be occurring this year represent significant changes to  
21 how Periodicals are prepared by mailers and processed by the Postal Service.  
22 Accordingly, the sum of the various initiatives should have a positive impact on  
23 Periodicals service. These initiatives may also slow down, stop, or reverse current unit

USPS-RT-6

1 cost trends for Periodicals. The Postal Service recognizes that there are opportunities  
2 to improve service and control costs. My understanding is that the Postal Service will  
3 continue to work jointly with publishers and printers to explore those opportunities.

4

5 **XXI. The Christensen Associates' possible benchmarking results cannot be**  
6 **correctly characterized as inefficiencies associated with not-handling costs.**

7

8 Witness Cohen cites a Christensen Associates report entitled "Performance

9 Analysis of Processing and Distribution Facilities: Sources of TFP Improvement" dated  
10 February 22, 1994. The report includes an estimate of possible cost savings from a  
11 benchmarking effort that was never completed. Witness Cohen applies that estimate to  
12 mixed and not-handling costs to obtain what she terms "inefficient mixed- and not-  
13 handling costs" (Tr. 26/14060-14061). Witness Cohen's application of the result of our  
14 report to mixed and not-handling costs is inappropriate and incorrect.

15 The benchmarking process involves identifying the most efficient facilities and  
16 finding comparable, but less efficient, facilities that could learn from them. In the case  
17 of the Postal Service, the first step is development of a statistical model of workload to  
18 measure efficiency. Any workload dimensions not measured in the model will show up  
19 as cost differences. The actual benchmarking process involves in-depth study  
20 comparing the facilities. This may result in identification of ways to increase efficiency  
21 or it may results in identification of additional workload dimensions not included in the  
22 statistical model. Examples of additional elements of workload could include  
23 congestion, weather, and average quality of the local labor force.

USPS-RT-6

1           Our preliminary analysis was designed to demonstrate how a benchmarking  
2 analysis can be built on a workload model. The underlying workload model is still under  
3 development today. At this point, no in-depth study of facilities has been undertaken,  
4 so no actual estimate of inefficiency exists. Our report also undertook a very crude  
5 analysis of the possible sources of savings.

6           Witness Cohen's use of the possible savings estimate from our report is  
7 misleading because the report clearly identifies portions of the estimate that are not  
8 included in Cost Segment 3.1 (such as supervisory time) and portions that have no  
9 direct connection to mixed and not-handling costs (such as overtime and automation  
10 deployment).<sup>14</sup> The possible savings estimate includes savings from additional  
11 deployment of automation. This makes witness Cohen's application of this estimate to  
12 historical mixed and not-handling costs particularly ironic, given her theory that  
13 automation deployment increases not-handling costs.

14           Finally, Witness Cohen's use of the possible savings estimate from  
15 benchmarking mischaracterizes the estimate as inefficiencies rather than what it is:

---

<sup>14</sup> In the context of our benchmarking analysis "use of automation" refers to deployment of equipment.

USPS-RT-6

1 costs that have not been explained by the variables in the model. In fact, our  
2 continuing work on the model has reduced the unexplained variation in costs across  
3 facilities. We have not updated the benchmarking potential estimate, but, using the  
4 newer model, I would expect to find much lower possible savings estimates for a  
5 benchmarking analysis. However, as I explained above, even an updated result could  
6 not be correctly used in the way witness Cohen proposes to use it.

7 Lest we be accused of having misled anyone, I should point out that the report  
8 was clearly labeled "DRAFT - Not for Distribution." The Commission should ignore the  
9 misapplication of this inchoate result by Witness Cohen.

10

11 **XXII. Declining productivities by operation group are an expected and well**  
12 **understood result of automation—not evidence of inefficiency.**

13

14 Witness Cohen uses the MODS data to calculate an estimate of the cost of  
15 inefficiency due to declining productivity. The premise of her analysis is wrong.  
16 Declines in productivity by operation are an expected and well understood result of  
17 automation deployment. When new technologies are first deployed, the mail with the  
18 highest expected success rate is segregated for that operation. In the case of letter  
19 sorting operations this meant the cleanest, most readable mail went to the OCRs first.  
20 This had the effect of reducing LSM and manual productivities. As more OCRs were  
21 deployed, the readability of the mail being processed on the OCRs declined and OCR  
22 productivity declined. The quality of the mail remaining in LSM and manual operations  
23 also declined resulting in declining productivities. The benefit of automation comes

USPS-RT-6

1 from the shift of mail to the newer technology. Overall mail processing productivity can  
2 be increasing while productivities are declining in individual operations.

3 Even when new technology is not being deployed, there are other factors that  
4 impact productivity by operation. These would include address readability, mail piece  
5 design, and required sortation accuracy.<sup>15</sup> Any estimate of efficiency would have to  
6 control for all such factors before a decline in productivity could be interpreted as a loss  
7 of efficiency.

8 Clearly, Witness Cohen's estimate of "inefficiency," based on the declining  
9 productivities by operation group, is a fallacy and the Commission should not give it any  
10 credence.

11

12 **XXIII. Partitioning non-MODS office costs into operational subgroups does not**  
13 **change the overall non-MODS variability or subclass distribution.**

14

15 Witness Andrew argues that the application of the overall MODS variability of  
16 78.7 percent to non-MODS office costs ignores the fact that the "impact of the  
17 interaction between individual cost pool variabilities and distribution key can distort the  
18 differences between shapes" (Tr. 22/11711). The issue of using the overall MODS  
19 office productivity for non-MODS offices was addressed by Dr. Bradley in response to  
20 OCA's interrogatory (Tr. 11/5357). Dr. Bradley uses a partition of non-MODS costs into  
21 subgroups, prepared by me, to calculate an average non-MODS variability. This

---

<sup>15</sup> If management requires that workers achieve a higher level of sortation accuracy, they may have to sort at a slower rate to do so. This would appear as a decline in productivity, but could not be correctly interpreted as inefficiency as witness Cohen suggests.

USPS-RT-6

1 method produces an overall non-MODS variability of 77.9 percent, essentially the same  
2 as Dr. Bradley's assumption.

3       Witness Andrew argues that one also needs to distribute non-MODS costs by  
4 subgroups. We have done so. Table 7 compares the subclass distribution for non-  
5 MODS offices from the Postal Service's proposed method with the results based on  
6 distribution by subgroup. The results show how little difference it makes. Witness  
7 Andrew's criticism may have theoretical validity, but, in this instance, the empirical  
8 results show that it is not a problem.

USPS-RT-6

**Table 7**  
**Comparison of Subclass Cost**  
**Shares for Non-MODS Offices**

Subclass	Postal Service New Method	Using Subgroups
<u>First Class</u>		
Letters and Parcels	43.5%	45.1%
Presort Letters and Parcels	11.7%	12.2%
Postal Cards	0.1%	0.0%
Private Mailing Cards	1.4%	1.4%
Presort Cards	0.4%	0.4%
Priority	3.6%	3.1%
Express	1.1%	0.7%
Mailgrams	0.0%	0.0%
<u>Periodicals</u>		
Within County	0.3%	0.3%
Regular	5.0%	5.1%
Non Profit	0.8%	0.8%
Classroom	0.1%	0.1%
<u>Standard (A)</u>		
Single Piece Rate	0.7%	0.6%
Regular Carrier Route	4.4%	4.7%
Regular Other	16.4%	16.7%
Non Profit Carrier Route	0.4%	0.4%
Non Profit Other	3.3%	3.3%
<u>Standard (B)</u>		
Parcels - Zone Rate	1.1%	1.1%
Bound Printed Matter	0.7%	0.6%
Special Rate	0.5%	0.4%
Library Rate	0.1%	0.1%
USPS	0.9%	0.8%
Free for Blind/Handicapped	0.0%	0.0%
International	0.4%	0.3%
Registry	0.8%	0.2%
Certified	0.7%	0.2%
Insurance	0.0%	0.0%
COD	0.1%	0.0%
Special Delivery	0.0%	0.0%
Special Handling	0.0%	0.0%
Other Special Services	1.6%	1.3%

USPS-RT-6

1 XXIV. I am not aware of any analysis that indicates that the number of Postal  
2 Service facilities varies with volume. In fact, such a conclusion would be counter  
3 to my understanding of Postal Service operations.  
4

5 During cross-examination, witness Neels indicated that he believed that the  
6 number of Postal Service facilities could be expected to vary with volume and that  
7 witness Bradley's models fail to account for this fact (Tr. 28/15791). Witness Neels  
8 does not reference any studies or analysis that support his opinion. In fact, under  
9 subsequent cross-examination, he explains that the nature of the mail flow is such that  
10 the entire system is impacted by an increase in volume because mail flows throughout  
11 the network (Tr. 28/15810).

12 Given witness Neel's apparent understanding that the workload associated with  
13 increased volume cannot be isolated to a single location, I cannot believe that he could  
14 conclude that additional overall volume could be handled by building a new facility.  
15 Witness Neels also seems to understand that the growth in MODS offices should not be  
16 misinterpreted as evidence that the number of facilities varies with volume (Tr.  
17 28/15810). Existing facilities are constantly being added to the MODS system to  
18 improve accountability. Very few of the "new" MODS offices since 1988 are actually  
19 new facilities. I am at a loss to explain how witness Neels could have reached his  
20 opinion that the number of facilities varies with volume.

21 When there is an overall volume increase, every facility in the country will  
22 experience additional workload which, in virtually all instances, will be absorbed without  
23 building new facilities. The additional mail pieces cannot be segregated for processing  
24 at a single new facility or group of new facilities that will then process the new mail.



USPS-RT-6

1           Manufacturers can produce their products wherever it is most economical to do  
2 so, and ship them wherever consumers are willing to buy them. But, the Postal Service  
3 is a delivery service. Processing facilities exist to process the mail that originates and  
4 destinate in a particular area. In the relatively infrequent case where a new facility is  
5 added to the system (as opposed to simply replacing an existing facility), the new  
6 facility is dedicated to a particular area that was previously served by one or more  
7 existing facilities.<sup>16</sup> However, this is, as I said, an infrequent occurrence. Nearly all  
8 volume growth is absorbed by existing facilities. Incremental workloads are too small to  
9 justify redefining service areas and building new facilities to serve them.

10           The system-wide interdependence of the Postal Service requires that we think of  
11 increases in overall volumes as increases in every plant in the country—exactly as  
12 witness Bradley does in deriving his variability factors.

---

<sup>16</sup> There are many factors, besides volume growth, that enter into the decision to build a new mail processing facility.

1 CHAIRMAN GLEIMAN: Three participants requested  
2 oral cross examination of the witness -- the Advertising  
3 Mail Marketing Association, the Alliance of Non-Profit  
4 Mailers, and the American Business Press.

5 Does any other party wish to cross examine the  
6 witness?

7 MR. KEEGAN: Yes, Mr. Chairman. Timothy Keegan  
8 representing Time-Warner, Inc. We did not file a notice of  
9 intent to cross examine, but we would like to reserve the  
10 right for follow-up cross examination.

11 CHAIRMAN GLEIMAN: Certainly. That's not a  
12 problem.

13 There is no other party, as best I can tell.

14 So, in that case, Mr. Wiggins, if you're ready,  
15 you can proceed.

16 MR. WIGGINS: Thank you, Mr. Chairman.

17 CROSS EXAMINATION

18 BY MR. WIGGINS:

19 Q Mr. Degen, Frank Wiggins for the Advertising Mail  
20 Marketing Association.

21 You discuss in the section of your testimony --  
22 your capacious testimony -- marked as Roman numeral XXIII,  
23 beginning in page 44, the testimony of Gary Andrew. Do you  
24 have that handy?

25 A Yes, I do.

1 Q And over on page 45, beginning on line 3, you say  
2 Witness Andrew argues that one also needs to distribute  
3 non-MODS costs by sub-groups.

4 You go on to say, down at the end of that  
5 paragraph, Witness Andrew's criticism may have theoretical  
6 validity, but in this instance, the empirical results show  
7 that it is not a problem, and you then, in the course of  
8 that, refer to Table 7, which shows up on page 46 of your  
9 testimony.

10 A Yes.

11 Q I take it that it's your belief that Table 7  
12 demonstrates why it is that Dr. Andrew's theoretically valid  
13 objection to the distribution of mail processing costs from  
14 non-MODS offices is not a problem. Is that right?

15 A Yes.

16 Q I'm having a little difficulty making the  
17 connection, and maybe you can help me out. Witness Andrew  
18 testified that, if you redistributed the mail processing  
19 costs of the non-MODS offices, the thing that you said is  
20 theoretically valid, it would result in a decrease in the  
21 measured cost of parcels of 2.3 cents. Was that your  
22 understanding of his testimony?

23 A I'm afraid I don't have the ability to recall it  
24 at this point. I'd be happy to look at it.

25 Q Do you have his testimony handy? If not, I do.

1 If this will be quicker, I'll just hand you Tables 4 and 5  
2 of his testimony, which demonstrate --

3 A That would be fine.

4 Q -- his development of that.

5 MR. WIGGINS: If I may approach the witness, Mr.  
6 Chairman.

7 CHAIRMAN GLEIMAN: You certainly may, sir.

8 BY MR. WIGGINS:

9 Q Have you had a chance to look at Tables 4 and 5 of  
10 Witness Andrew's testimony, which I believe demonstrates his  
11 redistribution of the non-MODs office costs and, at Table 5,  
12 demonstrates a restated parcel cost which is 2.33 cents less  
13 than what resulted from the Postal Service analysis

14 A Yeah, I mean I haven't replicated his analysis or  
15 gone into it in depth, but that appears to be what he is  
16 doing here.

17 Q Do you have a problem with his calculation? In  
18 your analysis, is the 2.33 cents of decrease in parcel costs  
19 an accurate application of his theoretically valid objection  
20 to what the Postal Service did?

21 A No, I am really not comfortable with drawing that  
22 parallel. My impression from reading his testimony, and not  
23 specifically these tables, was that he was theorizing that  
24 the distribution of costs, if the distribution of costs was  
25 done by subgroups within the non-MODs offices, we would get

1 a very different distribution of mail. And my statement in  
2 my testimony is that might be true, but I tried it and it  
3 didn't change.

4 I really didn't mean to offer a specific opinion  
5 to any of his tables here, and I am not comfortable with you  
6 saying that what I said might have been theoretically  
7 correct has anything to do with these tables. When I was  
8 talking about his theory, I was talking specifically about  
9 my interpretation of what he was saying, which is that the  
10 distribution of costs within subgroup for non-MOD offices  
11 would be different than it is in the aggregate, and I showed  
12 that it wasn't, and that's -- that's as far as I went. I  
13 can't endorse the theory behind these tables, I really  
14 haven't studied that.

15 Q You can't endorse it, but you can't specifically  
16 dispute it, is that correct?

17 A No, and I don't think I have attempted to in my  
18 testimony.

19 Q What Dr. Andrew did here was a redistribution of  
20 the non-MODs office cost by shape, correct? Distinguishing  
21 between parcels and flats.

22 MR. KOETTING: I think this is getting beyond the  
23 scope of Witness Degen's rebuttal testimony. He  
24 specifically cites one page of Dr. Andrew's testimony, which  
25 is in fact an Interrogatory response. And, again, as he

1 just stated, his analysis was limited to that particular  
2 statement as illustrated in that Interrogatory response by  
3 Dr. Andrew, and he responded to that point and he didn't  
4 address the substance of Dr. Andrew's direct testimony at  
5 all.

6 MR. WIGGINS: Well, the testimony to which the  
7 citation -- there are two citations, I believe. The first  
8 of them on lines 16 through 18 of page 44 of Witness Degen's  
9 testimony says, "The impact of interaction between  
10 individual cost pool variabilities and distribution key can  
11 distort the differences between shapes." And the witness  
12 goes on to say, "The empirical results show that it is not a  
13 problem."

14 I am citing him to the portions of Dr. Andrew's  
15 testimony that show the results of Dr. Andrew's shape  
16 redistribution, and I am just trying -- I don't see in Table  
17 7 a shape redistribution or a contest with Dr. Andrew's  
18 results. I am just trying to bridge that gap, Mr. Chairman.

19 CHAIRMAN GLEIMAN: I think you can continue with  
20 your line of questioning.

21 BY MR. WIGGINS:

22 Q What Dr. Andrew does in the two tables that I have  
23 put in front of you is to demonstrate the redistribution of  
24 non-MODs mail processing costs by shape, is it not, Mr.  
25 Degen?

1           A     Well, I think I have already said, and I just want  
2 to say this very clearly, --

3           Q     Sure.

4           A     -- I am not familiar with what he did with respect  
5 to redistribution by shape at all.

6           Q     Okay. And you don't offer any redistribution by  
7 shape?

8           A     Well, inasmuch as he alleged that the shape  
9 effects were related to the failure or to not do sub-cost  
10 pool distribution -- distribution of costs within subgroups  
11 of non-MODs, I went through the exercise of doing that  
12 distribution by subgroup and non-MODs and, from the point of  
13 view of the overall subclass distribution, I don't see a  
14 chance. To the extent his theory regarding shape relies on  
15 the fact that that subclass distribution is different, that  
16 is the point I have addressed.

17                   I am not addressing his specific alternative shape  
18 redistribution in my testimony and, to the extent it is  
19 independent of the fact that I have shown that the subclass  
20 redistribution doesn't change, then it would stand on its  
21 own. To the extent it relies on that fact, then I guess I  
22 am disagreeing with it.

23           Q     Understood. Thank you.

24                   MR. WIGGINS: Mr. Chairman, I have nothing  
25 further.

1 CHAIRMAN GLEIMAN: The Alliance of Nonprofit  
2 Mailers.

3 [No response.]

4 CHAIRMAN GLEIMAN: That moves us to the American  
5 Business Press.

6 CROSS EXAMINATION

7 BY MR. STRAUS:

8 Q Good morning, Mr. Degen, I am David Straus for  
9 American Business Press. How many non-handling codes are  
10 there?

11 A Could you be more specific? You mean how many  
12 different activity codes can be assigned to a person who is  
13 not observed handing a piece of mail or an item?

14 Q Yes.

15 A I don't know off the top of my head. There would  
16 be several classes of such codes.

17 Q Are you familiar with the major codes?

18 A Perhaps you could direct me to what you consider  
19 to be the major codes and I will tell you if I am familiar  
20 with them or not.

21 Q How about 5610, 5620, 5670 and 5040?

22 A I need a little refreshing on what 5040 is.

23 Q But you know what 5610 and 5620 are?

24 A I believe those are letter and flat shape,  
25 respectively, in the case of someone who is observed not



1 handling mail but in a shape dominant operation.

2 Q And 5700?

3 A I understand that to be all shapes, all classes,  
4 the most general mixed mail activity code.

5 Q Would you have any way to check what you  
6 recollection of 5700 is, because I believe it is parcel  
7 shape?

8 A Yes, I think you are right, I'm sorry.

9 Q And the mixed would be 5750?

10 A Yeah, I think I had those backgrounds. I'm sorry.

11 Q And 5620, did we do that one?

12 A Yeah. Wasn't that flats?

13 Q Yes.

14 A Yeah.

15 Q Well. Okay. So --

16 A And there is one in there you asked me about that  
17 we haven't repeated, 5740.

18 Q 5040. Well, let's just move on.

19 A Okay. All right.

20 Q If an employee is seen near a flat case, but is  
21 not handling, will that result in a 5620 tally?

22 A I am not comfortable with the characterization of  
23 seen near a flat case. I mean is he --

24 Q If the IOCS observer observes him standing next to  
25 a flat case but he is not handling mail, what kind of a

1 tally would produce?

2 A Okay. Can I assume that the data collector has  
3 determined that he is working there? Or is this somebody  
4 walking by?

5 Q He's just there.

6 A I am not comfortable with that kind of question.  
7 I mean --

8 Q Well, why not? I mean is the data collector any  
9 more comfortable with it?

10 A I believe so. I think the data collector has the  
11 wherewithal to reasonably ascertain whether this person is  
12 working there. For instance, if they are standing in front  
13 of the case, it would make a difference than if they are  
14 standing behind it. I mean I think data collectors do have  
15 the sense to determine whether or not somebody appears to be  
16 working in the flat operation.

17 Q If the data observer saw that he had just  
18 delivered mail to that flat opening unit, and now is doing  
19 nothing, having just delivered that mail, then how would  
20 that observation be recorded?

21 A Is it the instant he is let go and he is about  
22 ready to turn around and go back, or --

23 Q Yes.

24 A I mean the data collector understands that this  
25 mail has been delivered to the operation and that he had

1 been functioning to deliver mail to that operation?

2 Q Yes.

3 I am trying to find the tally in that case.

4 A Yeah. I don't believe it would be 5620. Was this  
5 a flat case?

6 Q Yes.

7 A Yeah. I don't believe it would be 5620. I don't  
8 think he would be associated with the flat operation at that  
9 point.

10 Q Even though the data collector knew he just  
11 delivered flats to the flat case?

12 A Right. I mean if he knew his purpose there was to  
13 bring them from the platform, I don't believe they would  
14 associate that under the 5620 rule.

15 Q What would it be?

16 A I think the 5750. Well, no, I'm sorry, I think it  
17 would be straight not handling.

18 Q With no shape reference at all?

19 A I don't think so. If he is on his way back from  
20 having delivered mail, I don't think they would force that  
21 shape connection.

22 Q What -- you said straight not handling. What  
23 activity code do you have in mind?

24 A 5750, no shape connection.

25 Q Are any employees logged into opening units

1 recorded as 5620 entries?

2 A I'm not sure. I would have to check that, and  
3 even if they were that would not necessarily counter your  
4 example inasmuch as the data collector may have mistakenly  
5 determined that the employee was working in that operation  
6 rather than just delivering mail to it?

7 Q Maybe you should explain to me why an employee who  
8 the data collector knows has just been handling flats,  
9 brought them to a flat case, and is about to return would  
10 not be recorded with a flat-shaped indicia of 5620?

11 A My understanding of the 5620 activity code is that  
12 it specifically handles cases where a person is working in a  
13 shape-dominant operation but not specifically handling mail  
14 at the time of sampling, but if the data collector doesn't  
15 determine that this person is working in that operation, but  
16 rather sees him in transit from that operation I don't know  
17 that that is what was intended by that rule.

18 Q What functions are typically performed by opening  
19 unit employees?

20 A Opening units generally have responsibility for  
21 processing containers and items that are entering or leaving  
22 the facility. In terms of an incoming opening unit, their  
23 function would be to look at sacks and trays and determine  
24 whether that needs to be sorted for direct outgoing dispatch  
25 and determine which of those containers or items need to be

1 directed to piece sortation operations or bundle handling  
2 operations within the plant.

3 Q Would an opening unit employee be traying letter  
4 mail and putting the trays on an APC?

5 A Certainly when letter mail was bundled, you saw  
6 some of that. Now that, you know, bundles are essentially  
7 gone, that is a relatively infrequent activity.

8 They would be handling whole trays of letter mail.  
9 They certainly wouldn't be traying up any collection mail or  
10 loose letter mail. I mean that is not the function of the  
11 opening unit.

12 Q But they could be loading trays onto an APC?

13 A Yes. They could be loading whole trays onto an  
14 APC.

15 Q And then pushing that APC to another station?

16 A Possibly yes.

17 Q And while pushing that container, while the  
18 employee is pushing that container would that be a mixed  
19 mail cost?

20 A If the -- well, it would fall into that area if  
21 the contents of the container are counted. It would be a  
22 counted item cost that would be distributed based on the  
23 proportion, the item proportions inside of it.

24 Q But he is pushing an entire container.

25 A Yes, he is.

1 Q And typically that would be -- you said if they  
2 are counted, but typically that would be a mixed mail cost,  
3 wouldn't it?

4 A Yes, mixed mail in the broadest sense, but it is  
5 not the same as mixed -- we don't have any idea what is  
6 going on here. It is mixed in the sense of we have a  
7 container, we know what kind of items are inside of it, and  
8 we'll distribute those items in proportion to the kind of  
9 mail we find in those items.

10 Q So if you have two employees in an opening unit,  
11 one has letters in trays, one has flats in trays, and they  
12 both -- the letter employee puts the letter trays in an APC  
13 and the flat guy puts the flat trays in an APC and they both  
14 start pushing their APCs off to the next station, would you  
15 distinguish those costs by container type in your approach?

16 A I would to the extent the data collector counts  
17 the container in each case. We would distribute the  
18 container containing the letter trays according to the kinds  
19 of mail we find in letter trays, and we would distribute the  
20 costs associated with the flat tubs, if you will, according  
21 to the kind of mail we find in flat tubs.

22 Q So the answer is at times yes, you would  
23 distinguish, so that the letter cost would be imposed upon  
24 letter mail and the flat cost on flat mail?

25 A Well, I think more than "at times" -- to the

1 extent the contents of those containers are counted it would  
2 always happen.

3 Q Okay. Now let's assume that these two employees  
4 reach their station as we discussed before and they let go  
5 of the cart and they are standing there talking to the  
6 person at the next station or just getting ready to move  
7 back to the loading dock, or maybe they are waiting for an  
8 empty cart to bring back to the loading dock.

9 Is this wasted time in your opinion or is it  
10 associated with a function?

11 A Well, you slipped in a new wrinkle there in that  
12 he is standing there chatting with the guy at the case.

13 Q Forget the chatting part.

14 A Okay. No, I don't view that as wasted time. I  
15 view that as productive time.

16 Q And how again would that time be recorded?

17 A I believe 5750.

18 Q Do you know the extent of the 5610 costs in  
19 opening units?

20 A No, I don't. Not off the top of my head.

21 Q What about in pref. opening units?

22 A No, I don't have those data in front of me.

23 Q What would account for the 5610 costs in a pref.  
24 opening unit? What kinds of activities?

25 A I believe it would be the data collector's

1 understanding that at the point such an employee was  
2 observed that they were associated with a letter sortation  
3 operation.

4 Q At an opening unit.

5 A Well, or if they're delivering mail and the data  
6 collector misinterprets them as actually working in that  
7 unit and gives them a 5610 code, I believe that's where that  
8 would come from.

9 Q So if there are say \$30 million of 5610 costs at  
10 pref. opening units, 5610 not handling costs -- we're still  
11 on not handling.

12 A Right.

13 Q Again, what kinds of activities would that be?

14 A If at the time that tally was taken the data  
15 collector associated that employee with one of the  
16 operations for which they're instructed to classify not  
17 handling as 5610.

18 Q Right. But you're telling me what the observer  
19 does. And what kinds of observations by -- of the employees  
20 would lead the collector to record a 5610?

21 A I think that's what I just answered.

22 Q No, I think you gave me a general description, and  
23 I'm asking for a specific activity. You said if he thought  
24 it was associated with a letter-opening activity. I'm  
25 saying what specifically -- what kinds of activity.



1 A If it looked like the employee was working there.

2 Q Like what? Doing what?

3 A Sorting mail, moving mail from the container onto  
4 ledges, for instance. In your example we're leaving the  
5 container --

6 Q Aren't those handling costs rather than not  
7 handling costs? I'm looking for the 5610 not handling costs  
8 at the pref. opening unit.

9 A Well, they're not all handling costs. If you're  
10 unloading a container when you have the piece you're taking  
11 out of the container and putting it to the ledge, you're  
12 handling. If you're going back to container, you're not  
13 handling. There's a lot of opportunity to observe someone  
14 not handling, even though they're in an operation that we  
15 would all generally associate with handling mail.

16 Q So you're saying then that if somebody is moving  
17 back from the ledge to get more letter-shaped mail it would  
18 be a 5610. But if someone --

19 A No, I'm not saying that. I'm saying if the data  
20 collector believes that employee is working in that  
21 operation, they correctly associate the fact that that  
22 person isn't handling mail with the 5610 activity code,  
23 because they believe them to be associated with a  
24 piece-handling operation.

25 Q But if that same employee is seen delivering that

1 tray or having just delivered that mail to an opening  
2 unit -- from an opening unit -- that would not be a 5610.

3 A No, if it's clear you're on the way back, I don't  
4 believe so.

5 Q But if you are on the way back from the ledge to  
6 the container it would be?

7 A Because in some cases the unloading of containers  
8 would be performed by employees working in that operation,  
9 and in other instances, time permitting, the opening unit  
10 person may be helping out.

11 Q Okay. So, the employee who has just delivered  
12 letters from the opening unit, his time would not be  
13 recorded as a letter cost.

14 A Could you be more specific?

15 Q For example, if the man -- the employee -- excuse  
16 me -- who delivered the cart, the APC, dropped it off and is  
17 starting his return trip.

18 A And a portion of his time will be recorded as  
19 letter cost to the distribution of mixed mail within the  
20 opening unit operation.

21 Q But unrelated to his activity at the time, though.  
22 It wouldn't matter what he was doing at that time, it still  
23 would have been distributed the same way.

24 A No. We use the fact that he's clocked in to the  
25 opening unit to distribute his time into proportion of the

1 kinds of mail that are handled in the opening unit. So, his  
2 activity is very much taken into account.

3 Q His activity in delivering letters to a letter  
4 sorter is not taken into account, is it?

5 A Inasmuch as -- I would say that, to the extent  
6 that that activity is a certain proportion of general  
7 opening unit activities, it would be precisely taken into  
8 account.

9 Q Yes, but you only take into account on the basis  
10 in proportion to the direct tallies, don't you?

11 A Yes, specific to that opening unit.

12 Q So, the ratio of direct tallies would tell you how  
13 you would distribute all of the costs of bringing mail from  
14 the opening unit to processing stations.

15 A No. It would only tell you how to distribute the  
16 costs associated with the return trip when the employee is  
17 not observed with an item or container in his hand.

18 Q What about the trip going if it's a mixed mail  
19 cost?

20 A Well, if it's a mixed mail cost, then I'll assume  
21 for purposes of this discussion that it's a counted  
22 container that he's using. Then we use the fact that that  
23 -- are we talking a flat case here or a letter case --  
24 letter case.

25 Q Letter case.

1           A     If he's observed pushing a pie cart, if you will,  
2 full of trays and we know that it's full of trays, those  
3 costs are all basically going to go to the kind of mail  
4 that's in trays, which is letters.

5           Q     Please look at page 1 of your testimony.

6           A     Yes, I have it.

7           Q     On line 10 and 11, you use the phrase "economic  
8 marginal cost." Could you define that, please?

9           A     I understand marginal cost to be the cost  
10 associated with producing an additional unit of volume.

11          Q     I asked about the phrase "economic marginal cost."

12          A     Perhaps "economic" is a little redundant in that  
13 phrase. I'm not sure people outside of economics talk about  
14 marginal cost.

15          Q     You aren't using -- you didn't mean economic  
16 marginal cost as opposed to some other kind of marginal  
17 cost.

18          A     No, I did not.

19          Q     So that sentence means that you must distribute  
20 processing costs the way you've proposed here in order to  
21 determine the marginal cost?

22          A     There's a couple elements to my distribution  
23 methodology perhaps that maybe have not been adequately  
24 distinguished to this point.

25          Q     Is this in response to my question?

1           A     Yes, it is.

2           Q     Okay.

3                     One element of my distribution methodology is what  
4     to do with mixed mail, and how you estimate, you know, what  
5     the underlying sub-class detail of mixed mail is certainly  
6     not dictated by the desire to get marginal cost.

7                     When I'm referring to my distribution methodology,  
8     I'm specifically referring to the fact that Dr. Bradley has  
9     estimated for me the portion of each cost pool that is  
10    volume variable, and I need to keep those costs associated  
11    with the mail that's being handled in that particular cost  
12    pool, and in that sense, my distribution methodology needs  
13    to be done the way I do it independent of my mixed mail  
14    distribution.

15                    And that is the only way to determine marginal  
16    costs?

17            A     The sentence I have in lines 9 and 10 says, "I  
18    will explain why the distribution of mail processing costs  
19    must be done the way the Postal Service has done it in order  
20    to provide economic marginal cost."

21                    What I am really saying there is given the cost  
22    pool framework and Dr. Bradley's variability estimates, my  
23    distribution methodology is the piece that completes that  
24    puzzle.

25                    I do not mean to say that there is not some

1 completely different approach that might get to you to  
2 marginal cost.

3 Q Please turn to page 3 of your testimony, the  
4 sentence beginning on line 5. You say, "Under the new  
5 method not handling tallies are effectively ignored in most  
6 cost pools."

7 What happens to those tallies?

8 A The tallies themselves are not used. The costs  
9 associated with those tallies -- well, all the costs  
10 associated with the cost pool are part of the pool of costs  
11 to which I apply Dr. Bradley's variability.

12 Dr. Bradley's variability analysis for the pool as  
13 a whole segregates nonvolume variable costs from volume  
14 variable costs. Some of those nonvolume variable costs may  
15 be not handling. Some of the nonvolume variable costs may  
16 be direct. But he has done the causality test to determine  
17 that some portion of that pool's costs are not volume  
18 related and in terms of what happens to those, we do not  
19 distribute them to classes of mail but my understanding is  
20 they are collected in the form of markup on the final  
21 attributed costs.

22 Q But you do distribute the nonhandling costs?

23 A No, that is not an accurate statement.

24 I distribute the portion of costs that Dr. Bradley  
25 has associated with volume variable -- the portion of costs

1 that Dr. Bradley has identified as volume variable.

2 Some of those may be not handling. Some of those  
3 may be direct.

4 Q When you say they are effectively ignored, you  
5 mean they are not part of the distribution key?

6 A No. I mean more than that.

7 Under LIOCATT the formation of cost pools uses the  
8 not handling tallies to determine the size of the cost pool.

9 My cost pool costs are independently determined  
10 through use of NWRS and MODS data so I don't need to rely on  
11 the not handling costs to measure that portion of my cost  
12 pool.

13 Q On that same page you discuss the growth in the  
14 not handling and mixed mail costs and say that it is in part  
15 due to a change in the IOCS Question 20 instruction in 1992.

16 A Yes.

17 Q Do you see that? And that instruction was that  
18 collectors should not ask an employee to pick up mail?

19 A That's correct.

20 Q How much did that change affect the mixed mail  
21 costs?

22 A I don't know off the top of my head.

23 Q You wouldn't expect it to be large, would you?

24 A I'd have to think about it to offer an opinion  
25 either way.

1 Q Well, it is true, isn't it, that prior to that  
2 change instruction there was no contrary instruction? They  
3 were not asking people to pick up a piece of mail. They  
4 just more or less in 1992 clarified that they should not do  
5 it.

6 MR. KOETTING: Could I get a clarification on what  
7 I think is the question that is still under discussion here?

8 You asked about the effect of the change on not  
9 handling costs or on mixed mail costs?

10 MR. STRAUS: I don't remember, but the witness  
11 heard the question and gave me an answer so I don't --

12 MR. KOETTING: I would like for the record to be  
13 clear as to what the question was so that the witness can  
14 make sure that he heard the question correctly.

15 MR. STRAUS: I am sure the record is clear. My  
16 memory is not.

17 MR. KOETTING: Well, then I would ask that it be  
18 read back -- if counsel doesn't remember what the question  
19 was.

20 CHAIRMAN GLEIMAN: Can you read the question back?

21 [The reporter read the record as requested.]

22 MR. KOETTING: I think the question really was  
23 phrased in terms of a mixed mail cost when the previous  
24 conversation had been in terms of a not handling cost.

25 CHAIRMAN GLEIMAN: Well, I am glad that you now



1 understand what the question was. You can move on now, Mr.  
2 Straus.

3 BY MR. STRAUS:

4 Q Do you know how much of a change in not handling  
5 costs resulted from the instruction in 1992?

6 A If you mean can I specifically quantify the change  
7 in not handling costs associated specifically with that  
8 change in instruction, the answer is no, I cannot.

9 Q Was that instruction then reversed in 1996? Your  
10 footnote at page three.

11 A I would not characterize it as a reversal. I  
12 believe additional instructions were given so that employees  
13 could associate a piece of mail with a sampled employee in a  
14 non-subjective manner.

15 Q Even with the 1992 change, didn't the not handling  
16 costs increase from less than 20 percent in 1986 to about 28  
17 or 29 percent in 1991, which is before the change in  
18 instruction? I'm looking at your graph on page four.

19 A Yes, that's approximately correct. I don't have  
20 the actual specific numbers associated with each bar, but  
21 that's approximately correct.

22 Q That's about a 40 percent increase in not handling  
23 costs?

24 A Well, to go from, what did you say, 20 to about  
25 30, is about ten points.

1 Q From 20 to about 28.

2 A So it'd be about eight points.

3 Q About 40 to 50 percent increase in not handling  
4 costs prior to the change in instruction? I'm not saying  
5 percentage point increase. I'm saying a percentage  
6 increase. I understand it's --

7 A You are looking at the percentage change in the  
8 percentage?

9 Q Yes. If it goes from 20 percent to 30 percent,  
10 that's a 50 percent increase in the percentage; isn't that  
11 right?

12 A Yes, that's the percentage change in the  
13 percentage; yes.

14 Q So we could then say that between 1986 and 1991,  
15 as a percentage, the not handling costs increased in excess  
16 of 40 percent?

17 A Well, the percentage went up about eight points  
18 and the percentage increase in the percentages,  
19 approximately 40 percent.

20 Q From 1986 to 1996, they about doubled; right?

21 A The percentage of not handling approximately  
22 doubled; yes.

23 Q On page eight of your testimony, the sentence  
24 beginning on line six.

25 A I have it.

1 Q My high school English teacher would charge you  
2 for dangling that participle there, and the reason is you  
3 can't understand what it means. You say "instead of  
4 rejecting the new method," who are you talking about there,  
5 the Postal Rate Commission, the Postal Service? Who would  
6 be doing the rejecting in that sentence?

7 A Anyone. I basically mean to say no one should  
8 reject the new method because it makes different assumptions  
9 in LIOCATT, that there should be different criteria used to  
10 evaluate it.

11 Q Are you suggesting that the Rate Commission or the  
12 Postal Service should test the assumption underlying your  
13 method?

14 A No, I think I'm much more along the lines of Mr.  
15 Stralberg when he invokes the application of common sense  
16 and our operational knowledge to the evaluation of the  
17 assumptions.

18 Q So you think that a comparison of assumptions is  
19 just as good as a testing of assumptions?

20 A I think I've tried to make it clear in my  
21 testimony that these aren't really the kinds of assumptions  
22 you are testing. There doesn't seem to be a dispute in this  
23 record that the sub-class distribution across cost pools  
24 differs, and I find that's sufficient information to say  
25 that costs should be distributed -- mixed mail costs should

1 be distributed within the cost pool.

2 I've seen testimony from several Intervenors  
3 making it very clear that when you find a tray in the  
4 collection operation, it's probably going to have first  
5 class single piece in it, and to me, that tells me that if I  
6 take the mixed mail costs associated with collection mail  
7 and distribute them on a broader key, that is not as good an  
8 assumption as saying a tray in collection that we don't know  
9 the contents of is more likely going to have the contents of  
10 the other trays we do know the contents of within the  
11 collection operation.

12 Q Again, I mean that's a nice answer and it's long,  
13 but you are relying still on comparing the common sense of  
14 assumptions rather than testing those assumptions, and you  
15 say Mr. Stralberg did not test assumptions. He's not in a  
16 position to conduct those tests, is he?

17 A I'm not sure really any of us are in a position to  
18 conduct those tests, and your earlier characterization that  
19 I rely only on common sense is not true. I thought my  
20 answer made it clear that I'm also relying on what I believe  
21 is the consensus in the record that the sub-class  
22 distributions do differ by cost pool. I mean that's an  
23 important point. If there were a dispute about that, we  
24 might want to test it, but my understanding is there is  
25 agreement about that, and given that, I don't think it's a

1 big leap of faith to say that cost distribution should be  
2 done within the cost pool.

3 Q You do testify on page 9 that the proportions and  
4 composition of direct mixed and not handling tallies vary  
5 across cost pools. Isn't that right?

6 A Yes.

7 Q Does the extent of clocking into one pool and  
8 working in another pool also vary across cost pools?

9 A To the extent that I think that's a negligible  
10 amount, I think it's a negligible amount in all cost pools,  
11 and to that extent I wouldn't say it varies -- the variation  
12 in it would matter.

13 Q Your conclusion that it's a negligible amount, is  
14 that common sense or is that an assumption or is that  
15 tested?

16 A It's tested to the extent that Dr. Bradley's  
17 estimates are robust in terms of his ability to explain the  
18 hours associated with a particular cost pool by the cost  
19 drivers he uses for that pool.

20 Q Do you agree with Postal Service Witness Steele  
21 that a good manager shifts employees around to maximize  
22 productivity?

23 A Yes, I do.

24 Q And do you know whether those shifted employees  
25 reclock every time they're shifted?

1           A     My understanding is they don't reclock every time  
2 they're shifted, but to the extent we're talking about cost  
3 pools, my understanding is that they do reclock when they're  
4 shifted, so that you may move from one three-digit MODS  
5 operation to another within a general group of operations.  
6 Maybe, you know, you've switched from incoming to outgoing  
7 within a manual distribution operation.

8           My understanding is that that reclocking is not  
9 always done, but those employees are generally under the  
10 supervision of a single supervisor. I think supervision is  
11 closely aligned with the cost pool definitions we've  
12 created, so that I would find it unusual for people to move  
13 among supervisory domains without reclocking.

14          Q     What are brown sacks supposed to be used for?

15          A     In general they're used for periodicals.

16          Q     And you understand that not everything in brown  
17 sacks is periodicals?

18          A     Yes, I do.

19          Q     Do you understand that some periodicals are not in  
20 brown sacks?

21          A     Yes, I do.

22          Q     Have you ever discussed sack shortages with  
23 printers or Postal Service field personnel?

24          A     I must have, because I'm certainly aware of the  
25 problem.

1 Q And to the extent there are sack shortages, you  
2 might find stuff in the wrong-color sacks.

3 A That could be a possible reason; yes.

4 Q You say, beginning on line 8 of page 11, something  
5 I think you expounded upon before in one of your answers,  
6 which is that you say there's no evidence that mixed mail  
7 costs would not have the same subclass distribution as  
8 direct costs in a pool defined by operation group and item  
9 or container type. Is there any evidence that they would?

10 A Yes.

11 Q And what is that evidence?

12 A Well, I'll go back to my earlier example about  
13 collection mail, that when we observe a tray in a collection  
14 operation and for whatever reason we don't invoke a top  
15 piece rule or we associate a non-handling tally with it, the  
16 evidence is clear that presort mail should not be passing  
17 through cancellation. I mean, it may happen, but most of  
18 the time, it doesn't, and so there is strong operational  
19 evidence that the containers observed in that cost pool have  
20 a very focused, a very specific distribution, if you will,  
21 related to the kinds of mail that are handled in that cost  
22 pool, just the same way that I would not expect, you know,  
23 the time spent in letter sorting operations to be related to  
24 flats or vice versa.

25 I mean, it may happen, but there's clearly a

1 dominant subclass distribution in cost pools that differs  
2 from other cost pools.

3 Q But the extent of that domination differs among  
4 cost pools, and you have given some examples in which your  
5 conclusion, you believe, is strongly reinforced. There are  
6 others where the relationship is less dominant; isn't that  
7 the case? Such as opening units.

8 A No, I -- I think I have given examples that are  
9 very clean, you know, for illustrative purposes. That  
10 doesn't mean to suggest that I don't believe that the  
11 underlying subclass distribution in any cost pool isn't  
12 strong enough to warrant distributing costs within it.

13 I mean, I gave an example where there would be a  
14 pattern of a single underlying subclass, but if you had a  
15 pattern of three or four, that would not weaken my assertion  
16 at all.

17 Q Your assertion is based I think you said on your  
18 belief.

19 A No. The operational realities of the work room  
20 floor was my basis.

21 Q That could be tested, though, couldn't it, by  
22 counting the mixed mail samples at the same cost pools where  
23 the direct tallies are observed?

24 A I think we went through this when I testified on  
25 direct, that, you know, once you count them, they're not



1 mixed anymore. I mean, my understanding is, for whatever  
2 reason the mixed aren't countable, to test that, you somehow  
3 have to override those or predict, absent the presence of  
4 your testing people, which ones, in fact, would have been  
5 mixed. I think you have to make a lot of assumptions to try  
6 and create such a test.

7 Q Well, you say uncountable. That's uncountable in  
8 the terms of interfering with the ongoing mail processing,  
9 but a special test to determine the validity of your thesis,  
10 anything is countable, isn't it?

11 A I think that's technically true, but I have never  
12 been aware of the Postal Service's willingness to tolerate  
13 holding up the mail. I mean, my understanding is they've  
14 never compromised that.

15 Q As the old joke goes, it happens all by itself?

16 A It's an old joke.

17 Q Getting back to common sense and assumptions, on  
18 page 12 of your testimony, on line 11, you list the first of  
19 what you call a straightforward assumption, which is that  
20 the subclass distribution of uncounted items is the same as  
21 the subclass distribution of counted items within the cost  
22 pool. Are you recommending that the Commission reverse the  
23 determination it made in R94-1?

24 A If it's contrary to that, I am.

25 Q And then after stating your second assumption, you

1 say that common sense tells you that the assumptions are  
2 true or more nearly true than the alternative. Are mail  
3 processing costs 100 percent variable?

4 A I do not believe they are.

5 Q Didn't common sense tell us for about 25 years  
6 that mail processing costs were 100 percent variable?

7 A I think that may have been more of convenience  
8 than common sense.

9 Q And Dr. Bradley tested that conclusion and found  
10 it to be wrong, didn't he?

11 A Dr. Bradley tested the volume variability of costs  
12 within cost pool. The previous assumption of 100 percent  
13 variability applied generally to mail processing costs but  
14 did not apply specifically to the cost pools as I have  
15 defined them.

16 Q Well, wait a minute. If it's 100 percent across  
17 all cost pools, how can it be something other than 100  
18 percent within each individual cost pool?

19 A I can explain that.

20 Q Okay.

21 A And the reason is because under LIOCATT, not  
22 handling mail costs were not distributed within cost pools.  
23 In essence, not handling mail costs were treated as variable  
24 with respect to all mail processing, but not variable with  
25 respect to a specific cost pool, and that's an important

1 difference.

2 Q Nevertheless, Dr. Bradley's conclusion about less  
3 than 100 percent variability would require, if adopted, the  
4 Commission to cast aside what everyone assumed to be the  
5 case for 25 years.

6 A Well, my recollection is that previous dockets are  
7 filled with people questioning that assumption, so your  
8 characterization that everyone assumed it to be true I think  
9 is wrong.

10 Q Well, the Postal Service assumed it to be true.

11 A I am not even sure that's true. I mean they used  
12 it because it was there. I mean it was the best assumption  
13 they could make.

14 Q Even though they didn't -- and they didn't think  
15 it was a valid assumption but they used it anyway?

16 A They didn't have any evidence to the contrary.

17 Q Did they try to develop evidence to the contrary?

18 A I am not in a position to address that other than  
19 the work with which I am familiar that supports their  
20 proposal in this docket.

21 Q Is Dr. Bradley's work dependent upon some new  
22 invention or theory that was developed only in the past year  
23 or two, or could that study have been done 10 or 15 years  
24 ago?

25 A It would have been very difficult to do it 10 or

1 15 years ago.

2 Q It was difficult to do it now, wasn't it?

3 A I don't think so, I think it was very  
4 straightforward.

5 Q I would like to direct your attention to page 16  
6 of your testimony.

7 A I have it.

8 Q You say that employees and the Postal Service have  
9 strong incentives to have the clock ring data correct. Do  
10 you see that? Line 9.

11 A Yes, I do.

12 Q What do you mean by employees there?

13 A Well, I mean that if employees want to get paid,  
14 they need to be clocked into an operation.

15 Q But they don't need to be clocked into the right  
16 operation, do they?

17 A Not in terms of getting paid.

18 Q So their real incentive is to clock in as quickly  
19 as possible, not to clock in as accurately as possible,  
20 isn't that right?

21 A I don't believe that is true. I think they are  
22 penalized for clocking in too early or too late from a  
23 designated start time.

24 Q Are they penalized for clocking into the wrong  
25 operation?

1           A     Not in terms of their pay, but I would expect that  
2 if they were found clocked into the wrong operation, it  
3 would bring some kind of supervisory reprimand.

4           Q     So if there's -- if the start time is exactly 8:00  
5 o'clock a.m. and there's one place to clock in that's two  
6 feet away, another that is 200 yards away, in neither case  
7 would that employee be clocking in too early, -- never mind,  
8 I'll withdraw that.

9                     You call, on line 19, you call MODS an accounting  
10 system. Could you tell me what you mean by that?

11          A     Yes. When I refer to it as an accounting system,  
12 I am really referring to the underlying time and attendance  
13 system from which MODS hours are derived.

14          Q     So you are saying the data are from an accounting  
15 system?

16          A     The hours data, yes.

17          Q     Was the MODS system designed to relate costs of  
18 operations to subclasses?

19          A     Not directly.

20          Q     I would like to direct you to page 21 of your  
21 testimony, specifically, the statement beginning at line 13.  
22 You saw that both Witnesses Stralberg and Cohen recommend  
23 that all not handling costs be treated as institutional. Is  
24 that a correct statement? Is your testimony correct?

25          A     Given the way you are asking it, I am sure there

1 is some detail I have overlooked, so --

2 Q Well, let me ask you about your reference. What  
3 did you read from which you concluded that?

4 A I don't have a specific reference and you will  
5 probably make me wish I had put the word "essentially" in  
6 there somewhere.

7 Q No, I wish you had put "not all" instead of "all".

8 A Yeah. Okay.

9 Q I am just wondering, you know, you reach this  
10 conclusion that they recommend all not handling costs. Do  
11 you have their testimony with you, that you are rebutting?

12 A Yeah, I think I have both of theirs here.

13 Q Could you make take a quick look at, say, Ms.  
14 Cohen's testimony and see what you might have had in mind  
15 with that statement?

16 A Well, I can explain what I had in mind with that  
17 statement.

18 Q I know what you had in mind by explanation. I  
19 want to know what in her testimony you relied on for your  
20 conclusion.

21 A I relied on the recommendation that not handling  
22 costs be removed from the cost pools. And I don't think we  
23 need specific citations for that, I think that is pretty  
24 clear in both of their testimonies, that we not distribute  
25 not handling costs within a cost pool.

1 Q Let me read you from Ms. Cohen's testimony, page  
2 36, beginning at line 15.

3 A This is her rebuttal testimony or the direct  
4 testimony?

5 Q No, the testimony that you rebutted from which you  
6 drew this conclusion.

7 A What page were you on, sir?

8 Q Page 36.

9 A Okay.

10 Q She says, "I recommend that the Commission  
11 similarly use its statutory discretion in this case to  
12 refrain from attributing to classes and subclasses of mail  
13 the portion of volume variable mixed mail and not handling  
14 costs that is due to inefficient operations. Do you  
15 translate the portion that is due to inefficient operations  
16 to mean all?

17 A No, I do not.

18 Q Do you know what portion she was talking about  
19 there?

20 A Well, I think there has been considerable  
21 discussion in this docket that we -- that she -- I think,  
22 and I can't quote the exact spot, but at one point she says  
23 I don't know what the number for not handling is. So I  
24 don't think I can say proportion she was referring to, and I  
25 believe she has admitted in her testimony that she doesn't

1 know what the number is.

2 Q Do you know what she actually used?

3 A No. But that does not change the conclusion of  
4 the sentence to which you originally directed me.

5 Q Does Witness Stralberg distribute the same costs  
6 as you do?

7 A Could you be more specific?

8 Q The same segment 3 costs as you do, the same  
9 amount of costs.

10 A In total?

11 Q Yes.

12 A Yes.

13 Q So does he -- he distributes them, but he treats  
14 them as institutional, is that what you are saying?

15 A Perhaps my phraseology there as institutional was  
16 misleading. But the point I was trying to make there is the  
17 point that I made earlier, and that is, under the LIOCATT  
18 method, even though it is nominally an assumption of 100  
19 percent variability, that is 100 percent variability with  
20 respect to mail processing as a whole, and while he does  
21 distribute all those costs to subclass, he does not do it  
22 within cost pool. And it would be wrong to do it after we  
23 have applied Dr. Bradley's variabilities which serve the  
24 function of telling us what the correct number is in terms  
25 of which costs should stay in the cost pool and which should



1 not.

2 Q Let me direct you to Ms. Cohen's testimony on page  
3 38.

4 A I have it.

5 Q Have you read that before?

6 A The page?

7 Q Yes.

8 A Yes, I have.

9 Q If you look at the top half of that page, does  
10 that refresh your recollection on the amount or the  
11 percentage of costs that Ms. Cohen recommends be treated as  
12 institutional?

13 A Yes.

14 Q And that is about 20 percent?

15 A Yes. But I don't agree with it.

16 Q No, but it is certainly not -- 20 percent isn't  
17 the same all.

18 A That is correct.

19 CHAIRMAN GLEIMAN: Mr. Straus, do you have a sense  
20 of how much longer you are going to go?

21 MR. STRAUS: Half an hour.

22 CHAIRMAN GLEIMAN: I think we will take a 10  
23 minute break now then. It is my intention to finish up with  
24 this witness, and then when we finish up with this witness,  
25 we will take a lunch break. So parties who are interested

1 in witnesses who come later in the day can plan accordingly.  
2 My guess is we are looking at lunch around 1:00 o'clock,  
3 coming back around 2:00 and picking up with Witness Sellick  
4 at that time, give or take a little bit. Either 20 percent  
5 or all.

6 [Recess.]

7 CHAIRMAN GLEIMAN: Mr. Straus, are you ready to  
8 pick back up?

9 MR. STRAUS: Yes.

10 BY MR. STRAUS:

11 Q Mr. Degen, we are now on page 22 of your  
12 testimony.

13 A I have it.

14 Q On line 18 you use the phrase, to describe your  
15 firsthand experience, "hundreds of work floor situations".  
16 I am not exactly sure what you mean, so could you explain  
17 what hundreds of work floor situations means?

18 A They would be the situations you observe in  
19 spending hundreds of hours on work room floors looking at  
20 what people are doing.

21 Q You are not contending, are you, that you have  
22 more firsthand observation experience than Mr. Stralberg?

23 A I am not familiar with his, but I would give you  
24 even money on it.

25 Q My question remains, are you contending that you

1 do?

2 A No.

3 Q Are you contending that you have more experience  
4 than Ms. Cohen?

5 A No.

6 Q Are you, in essence, a full-time Postal  
7 employee/consultant?

8 A Not quite.

9 Q Over the past five years, how much of your time do  
10 you suppose you have devoted to Postal matters?

11 A Do we just want to do five?

12 Q So far.

13 A Ninety percent.

14 Q When you say that nearly all non-handling costs  
15 are associated with productive activities, are you including  
16 or excluding break time?

17 A Excluding break time, given that it is a  
18 contractual requirement. It's just the cost of doing  
19 business.

20 Q How do you explain the increase in break time?

21 A I don't know, I haven't studied that.

22 Q Do your observations tell you anything?

23 A I don't have any theories developed to the point  
24 that I would care to share them now.

25 Q Please turn now to page 26 of your testimony.

1 There you have Table 4 which shows increases in the  
2 percentage of not handling time for both allied and,  
3 separately, non-allied operations. What is your most  
4 important, or most significant explanation for the increase  
5 in allied not handling time?

6 A I believe that the -- well, in general, the  
7 increase in not handling time reflects a changing technology  
8 of processing the mail, an increased move to  
9 containerization, increased use of automation, floor  
10 layouts, et cetera. I believe it is a manifestation of  
11 changes in the underlying technology for both allied and  
12 non-allied.

13 Q So you don't distinguish between the two, you  
14 don't have any different explanations for allied growth or  
15 non-allied growth?

16 A If I spent some time, I could probably come up  
17 with, you know, with has affected each differently, but not  
18 off the top of my head.

19 Q I'd like to turn to a different subject now, which  
20 is the disagreement over the importance of and the results  
21 of comparing the costs of handling periodicals with the  
22 Postal Service's wage costs.

23 One of your conclusions at page 27, line 5, based  
24 upon your analysis is that by 1996 periodicals' costs were  
25 slightly higher in real terms than they had been in 1989, do

1 you see that?

2 A That is not really a conclusion of mine. That is  
3 a conclusion reached from the graphs that are being  
4 discussed in the section above it. I don't -- I believe I  
5 go on to explain why I think that is not quite true because  
6 of the illegitimacy of the comparison.

7 Q By saying it was a conclusion of yours, I was  
8 simply trying to explain that. I don't necessarily agree.

9 A Okay.

10 Q Have there been changes between 1989 and 1996 in  
11 the amount of work-sharing done by periodicals mailers?

12 A Yes, I believe there have.

13 Q Isn't it true that there's been a significant  
14 increase in the amount of barcoding?

15 A Yes, I believe there has.

16 Q In fact, isn't it true that between fiscal year  
17 1993 and fiscal year 1996 the amount of Level A barcoding  
18 has more than doubled and the amount of Level B barcoding  
19 has nearly doubled?

20 A I am a little concerned that I have given an  
21 impression here that I am saying that this barcoding  
22 represents work-sharing -- I mean in the order you have  
23 asked these questions. I wouldn't want that implication to  
24 be made.

25 Q All right. Forgetting about the characterization,

1 isn't it true that barcoding has about doubled between --  
2 just between fiscal year '93 and fiscal year '96?

3 A I am not comfortable saying that. I don't really  
4 have those numbers at my fingertips.

5 Q Well, will you accept it subject to check?

6 A I will agree that it has increased.

7 Q Well, will you accept that it has nearly doubled  
8 based upon the Postal Service's own mail characteristics  
9 data?

10 A If I accept it, then it is my responsibility to go  
11 check it?

12 Q Yes, it is.

13 A No.

14 Q To the extent that it has increased and you have  
15 admitted it is increased, that would reduce mail processing  
16 costs by the Postal Service, would it not?

17 A To some extent, yes.

18 Q How big is the barcode discount for Level A?

19 A I don't know off the top of my head.

20 Q Well, can you accept subject to check --

21 A Can I correct my earlier answer?

22 We were talking specifically about barcoding and  
23 its ability to reduce costs.

24 Q Yes.

25 A I think that is an open question -- you know? I

1 know that there are machines out there deployed with barcode  
2 readers but there are certainly contentions that at this  
3 point there isn't full enough deployment to warrant  
4 segregating barcoded mail and so I can't agree that that has  
5 necessarily resulted in decreasing costs.

6 Q You are saying that the Postal Service does not  
7 segregate prebarcoded periodicals from non-prebarcoded  
8 periodicals?

9 A Not in every instance, and there is also the issue  
10 of whether or not the barcode is on a piece that is from a  
11 practical standpoint machinable.

12 My understanding is there are some issues out  
13 there like that and I have not studied it so I am not  
14 comfortable agreeing with you.

15 Q I'll accept that you haven't studied it.

16 Doesn't the Postal Service offer a discount in the  
17 neighborhood of 3 cents apiece for prebarcoded periodicals?

18 A That sounds reasonable.

19 Q And don't you think they do that because they  
20 think they save about 3 cents apiece in processing costs?

21 A I am sure that was the plan when the discount was  
22 offered.

23 Q What is the average processing cost for a  
24 periodical?

25 A I don't know off the top of my head.

1 Q Give me an estimate. Is it 15 cents or a buck and  
2 a half or how much do you think it is?

3 A Closer to 15 cents than a buck and a half.

4 Q Do you know what the average postage per  
5 periodical is?

6 A Closer to 15 cents than a buck and a half.

7 Q Do you think it's maybe in the low 20s?

8 A Seems reasonable.

9 Q And so a three cent discount is a pretty hefty  
10 percentage of the total postage and therefore an even bigger  
11 percentage of the processing costs, isn't that right?

12 A That is not how I usually use the phrase "pretty  
13 hefty."

14 Q Has there been an increase in the amount of  
15 presortation, the depth of presortation between 1989 and  
16 1996?

17 A Are you referring to presort level of bundles or  
18 containers?

19 Q Pieces for periodicals.

20 A I believe there has been an increased depth of  
21 sort.

22 Q Would you accept that the amount of Level C  
23 presort has increased 50 percent in that period?

24 A I'll accept that it has increased.

25 Q But you won't -- I guess you won't accept subject



1 to check because you don't want to check whether it is 50  
2 percent?

3 A That's right.

4 Q Well, Mr. Degen, you have got testimony here which  
5 tries to explain the trends between mail processing costs  
6 and wage costs and you point to -- and we will get to this  
7 in a minute -- palletizing practices, which you apparently  
8 have gone into in some depth, and you even hypothesized  
9 about truckers wanting to fill up trucks.

10 I am curious as to why you -- why neither you nor  
11 anyone else has investigated these other cost driving  
12 factors -- the amount of presort, the amount of barcoding,  
13 to get a complete picture of where costs are going and  
14 should have gone compared to wage rates.

15 Can you explain that to me?

16 A The focus of my analysis has been more recent than  
17 what you have given me, and most of the examples you are  
18 giving me are over a longer time period than I looked at.

19 We have looked at some of the billing determinants  
20 in recent years and they have not changed to the extent you  
21 are indicating they have changed since 1989, so my analysis  
22 was focused on a more narrow period than most of the numbers  
23 you have put out here today.

24 Q The barcoding numbers I gave you began in 1993,  
25 didn't they?

1 A I don't remember.

2 Q Well, they did.

3 A Okay.

4 Q When does your pallet analysis begin?

5 A In '93.

6 Q So you looked at the pallet changes since 1993,  
7 what you believe them to be, but you didn't look at the  
8 barcode changes since 1993?

9 A No, I accepted that the barcoding had increased  
10 quite a bit, but I expressed some doubt as to whether those  
11 costs had been fully realized over that period.

12 I thought I addressed that pretty squarely.

13 Q Does Postal Service management share your view  
14 that there is significant doubt that the barcode discounts  
15 make any sense?

16 A I didn't characterize them as not making any  
17 sense.

18 Q Well, if there's no savings they make no sense,  
19 right?

20 A The timing of realizing savings can be a difficult  
21 thing. You have to generate mail flows of that type so that  
22 you can deploy automation and operating procedures that  
23 capture them, and all I am saying is that I am not sure that  
24 the instant barcoded mail appeared that it achieved those  
25 savings.

1 Q There were a billion barcoded pieces, prebarcoded  
2 periodicals, in 1993. Isn't that enough to start realizing  
3 some cost savings?

4 A You have to know a lot more about it than that.

5 You have to know about the practical machinability  
6 of the pieces and the way they are deployed.

7 To the extent some of those pieces are in delivery  
8 units it wouldn't even matter.

9 Q Let me go to the pallets then for a minute.

10 Your hypothesis, and we will get to it again, is  
11 that mail has shifted from five-digit pallets to three-digit  
12 pallets and that has increased costs.

13 A Yes.

14 Q And am I correct that the increase in costs is  
15 limited to one additional bundle handling?

16 A No.

17 Q Well, have you calculated what the additional cost  
18 is of a three-digit pallet on a per piece -- that is, a per  
19 magazine, basis?

20 A No, I have not.

21 Q Do you know whether it is less than or more than 3  
22 cents apiece?

23 A No, I do not.

24 Q So you haven't quantified this pallet shift at  
25 all?

1           A     No.

2           Q     But you have hypothesized that this is a  
3 significant contributing factor to the handling cost of  
4 periodicals?

5           A     Well, I think "hypothesized" doesn't do it  
6 justice.

7                     I have met with a number of field operating  
8 personnel who when asked about why periodicals' costs appear  
9 to be rising talk about the increased handling associated  
10 with more aggregate pallets and the resulting piece  
11 handlings from breakage of those bundles due to additional  
12 handlings.

13                    This analysis is not presented here to be a  
14 complete explanation of why periodicals' costs have risen,  
15 and I don't hold myself up as an expert in that. This was  
16 done for rebuttal in a very limited timeframe, and what I am  
17 saying is there is a makeup trend that does seem to coincide  
18 closely with both the decline in periodicals' unit costs and  
19 their subsequent rise in the 1990s.

20           Q     Let's turn now to your analysis of the  
21 relationship between periodical processing costs and wage  
22 rates.

23                    Now what you have done, as I understand it, is you  
24 have used in Figures 2 and 3, you have compared regular rate  
25 periodicals' mail processing costs with all clerk and mail

1 handler wages and you have indexed them in Figure 2 to 1986  
2 and in Figure 3 to 1989, is that right?

3 A That's correct.

4 Q Have you had a chance to examine the various  
5 similar charts provided to you yesterday as a potential  
6 cross examination exhibit?

7 A Yes, I have.

8 Q Do you have that with you?

9 A Yes, I do.

10 MR. STRAUS: Mr. Chairman, I'd like to distribute  
11 copies of that.

12 To save time, I'm going to be distributing two  
13 charts, one with the weighted and one with un-weighted clerk  
14 and mail handler costs, and we'll do them separately.

15 CHAIRMAN GLEIMAN: Mr. Straus, you'd better  
16 distribute faster. This is counting against your half-hour.

17 BY MR. STRAUS:

18 Q Mr. Degen, please look at the chart marked  
19 "Comparison of Regular Periodicals Mail Processing Cost and  
20 Clerk and Mail Handler Wages." Have you had a chance to  
21 verify the accuracy of those graphs?

22 A I didn't know I was supposed to.

23 Q Does that mean you've had a chance but didn't do  
24 it or didn't have a chance and didn't do it?

25 A My attorney gave them to me yesterday, and I

1 looked them over, and they're reasonable, but I'm not  
2 prepared to attest to their accuracy.

3 Q Well, when you compare starting points of '86  
4 through '93, as these graphs do, with your two graphs which  
5 are indexed at two of those years, '86 and '89, do you see  
6 any differences?

7 A No. I think all the plots on this chart are  
8 consistent with my verbal description of, year by year,  
9 what's happened to periodical costs relative to inflation.

10 Q What's your explanation for the very rapid  
11 increase shown on the bottom two charts, the one beginning  
12 in '92 and the one beginning in '93?

13 A I can't say with certainty that I know why those  
14 costs have changed, but I observed that, in general, there  
15 has been a move toward less aggregate pallets during that  
16 period.

17 In fact, I think if you look at the third plot  
18 down in the left-hand column, that shows you a very good  
19 picture of costs declining in '92, when I understand there  
20 was a significant movement toward pallets but, you know, a  
21 relatively large percentage of five-digit pallets, and my  
22 understanding from discussions with field personnel and just  
23 comparing mail characteristics data is that, since 1992,  
24 there's been a movement away from those five-digit pallets  
25 in favor of three-digit or SCF pallets.

1           So, I offer that as an explanation. I can't say  
2 for certainty that that's what's happened, but it's a more  
3 plausible explanation than costs are just out of control.

4           MR. STRAUS: Mr. Chairman, I'd like to ask that  
5 this document be copied into the -- identified as ABP --  
6 these have been done several different ways in this case.  
7 The simplest way would be ABP-XE-1, but some parties have  
8 identified them with the party.

9           CHAIRMAN GLEIMAN: Your marking is fine. Do you  
10 want to mark both of these that way and have both of them  
11 in?

12           MR. STRAUS: No, let's just do the first one  
13 first.

14           CHAIRMAN GLEIMAN: I think the reporter can mark  
15 the copies, if he's sure he knows which of the two you're  
16 making reference to.

17   [Cross-Examination Exhibit No.  
18   ABP-XE-1 was marked for  
19   identification.]

20           MR. STRAUS: And I'd ask that it be admitted into  
21 evidence.

22           MR. KOETTING: No objection.

23           CHAIRMAN GLEIMAN: Thank you, Mr. Koetting. I  
24 appreciate that.

25           BY MR. STRAUS:

1 Q Now, Mr. Degen, turning to your Figure 4 --

2 CHAIRMAN GLEIMAN: Excuse me, Mr. Straus. I'll  
3 direct that the cross examination exhibit designated as  
4 ABP-XE-1 be transcribed into the record and entered as  
5 evidence.

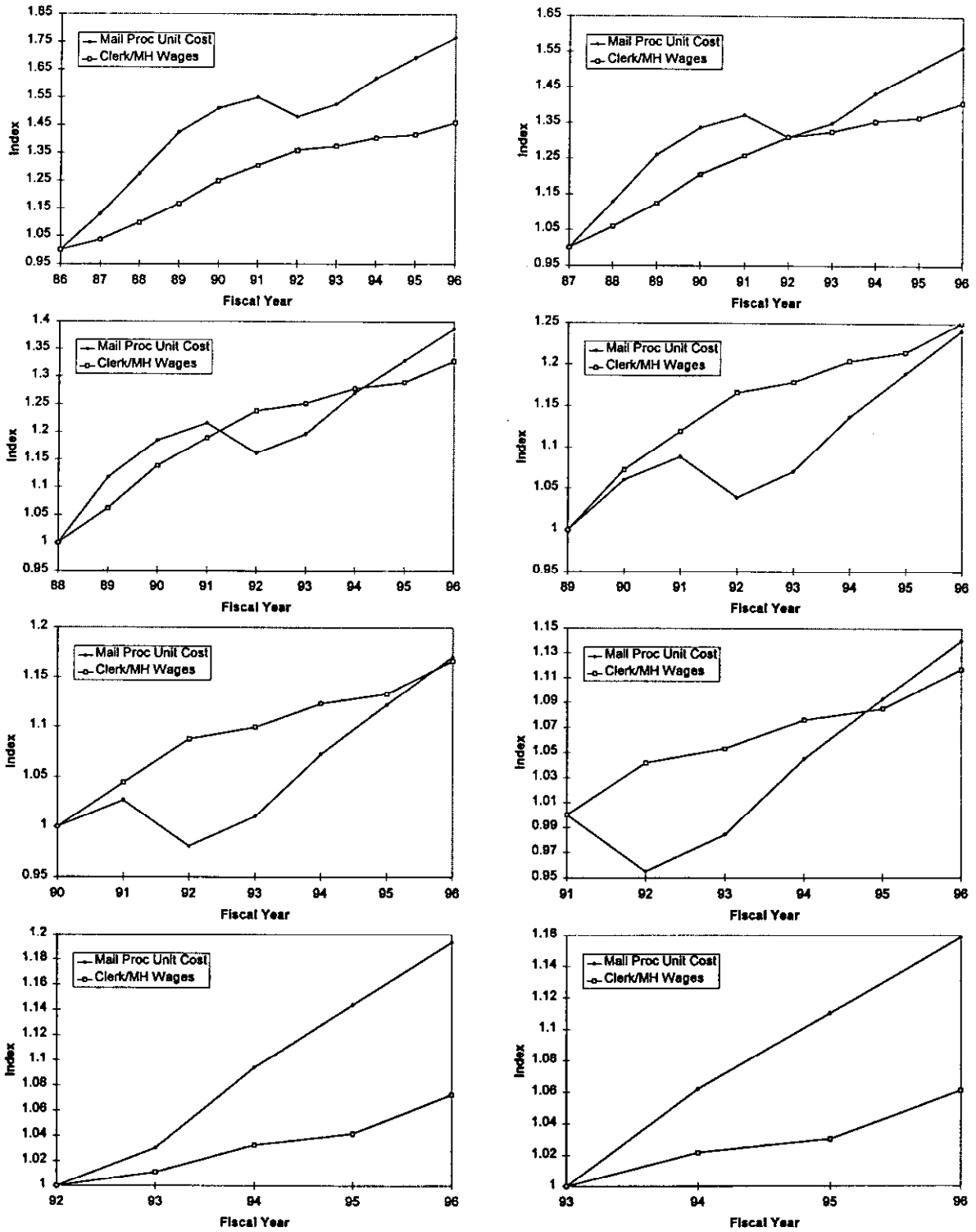
6 [Cross-Examination Exhibit No.  
7 ABP-XE-1 was received into evidence  
8 and transcribed into the record.]

9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25



ABP-XE-1

# Comparison of Regular Periodicals Mail Processing Costs and LDC-Weighted Clerk and Mailhandler Wages



Source: LR-H-348, chartdat.xls, W/S Data, Figure 4 data

1 BY MR. STRAUS:

2 Q Turning to your Figure 4, Mr. Degen, I'm confused,  
3 because I guess I don't understand the terminology. You  
4 describe it at page 27. You say that index is based to the  
5 overall clerk and mail handler wage index in 1993. But the  
6 index shown on Figure 4 is 1989. Is one of those numbers  
7 wrong, or am I just not understanding the line in the  
8 testimony?

9 A Could you direct me to the line on page 27 you  
10 want me to look at?

11 Q It begins at the very bottom on page 20 and runs  
12 over to the top of page 21 -- excuse me -- line 1 on page  
13 28. I'm reading the testimony that it's a '93 index, but  
14 I'm reading the chart that it's an '89 index, and I may just  
15 not understand what you're saying in the testimony.

16 A Okay. What I mean to say there is that we only  
17 did the LDC-based index from '93 forward.

18 So, the '93 index was based to the -- the LDC  
19 index was scaled so that its '93 value was equal to the  
20 value corresponding to an overall clerk and mail handler  
21 index that's based to one in 1989.

22 If you will, we pasted on those last four years,  
23 using the same number for 1993 and then growth rates based  
24 on the LDC index going forward.

25 Q It's safe to say, isn't it, that in 1996, for

1 example, you show that the two points are virtually on top  
2 of each other, both for mail processing costs and for wages.

3 A Yes.

4 Q And have you had a chance to look at the cross  
5 examination exhibit provided to you yesterday that was  
6 titled "Comparison of Regular Periodicals Mail Processing  
7 Costs and LDC-Weighted Clerk and Mail Handler Wages"?

8 A Yes, I have.

9 Q And are those charts, those graphs, the equivalent  
10 of yours, but rather than a 1989 index, using various  
11 indices other than 1989, in addition to 1989.

12 A That, along with changing scales to make the  
13 differences more pronounced as you use shorter and shorter  
14 time periods.

15 Q Do those -- by using a different index here from  
16 1989, do those graphs typically show a different result?

17 A Well, it's not really a different result. What  
18 you achieve in the bottom two graphs, for instance, is you  
19 take out the big decline in periodicals' costs between 1991  
20 and 1992, and that's really what's going on here, that cost  
21 -- let's look at the left-hand column, the third one down I  
22 think is a good illustration.

23 In 1991 and 1992, periodicals' unit costs actually  
24 declined relative to inflation, and then since 1992, they  
25 have risen relative to inflation. That basic story doesn't

1 change no matter how you plot it, and that issue is  
2 explicitly stated in my testimony.

3 Q What about from 1986 to 1989, how do those costs  
4 do during that time period?

5 A Let me go back to my --

6 Q Can't we just look at the upper left-hand chart?

7 A I'd prefer mine. They're a little more readable.  
8 The other one was a fax. Between 1986 and 1989, mail  
9 processing unit costs rose relative to inflation. Between  
10 1989 and 1990, they were pretty constant, relative to  
11 inflation; between 1990 and 1991, they declined slightly; by  
12 1992, they declined considerably and then they rose relative  
13 to inflation in the remaining years.

14 Q What was the percentage increase between 1986 and  
15 1989?

16 A Percentage increase in what?

17 Q Mail processing unit costs.

18 A Mail processing unit costs? About 30 percent.

19 Q And in wages, LDC weighted wages?

20 A About 20 percent, maybe a little less.

21 Q You can't explain that difference with the pallet  
22 changes you believe occurred in the 1990's; right?

23 A Well, unfortunately, what I found is even trying  
24 to look back to 1993 is an extremely difficult proposition  
25 and I didn't even attempt to go back to 1989, just because

1 data on mail preparation are very hard to obtain.

2 MR. STRAUS: Mr. Gleiman, I'd like to have marked  
3 as ABP-XE-2, this chart we were just discussing with various  
4 alternative ways to graph the comparison of periodicals'  
5 mail processing costs against LDC weighted clerk and mail  
6 handler wages, and ask that it be copied into the record and  
7 admitted into evidence.

8 [Cross-Examination Exhibit No.  
9 ABP-XE-2 was marked for  
10 identification.]

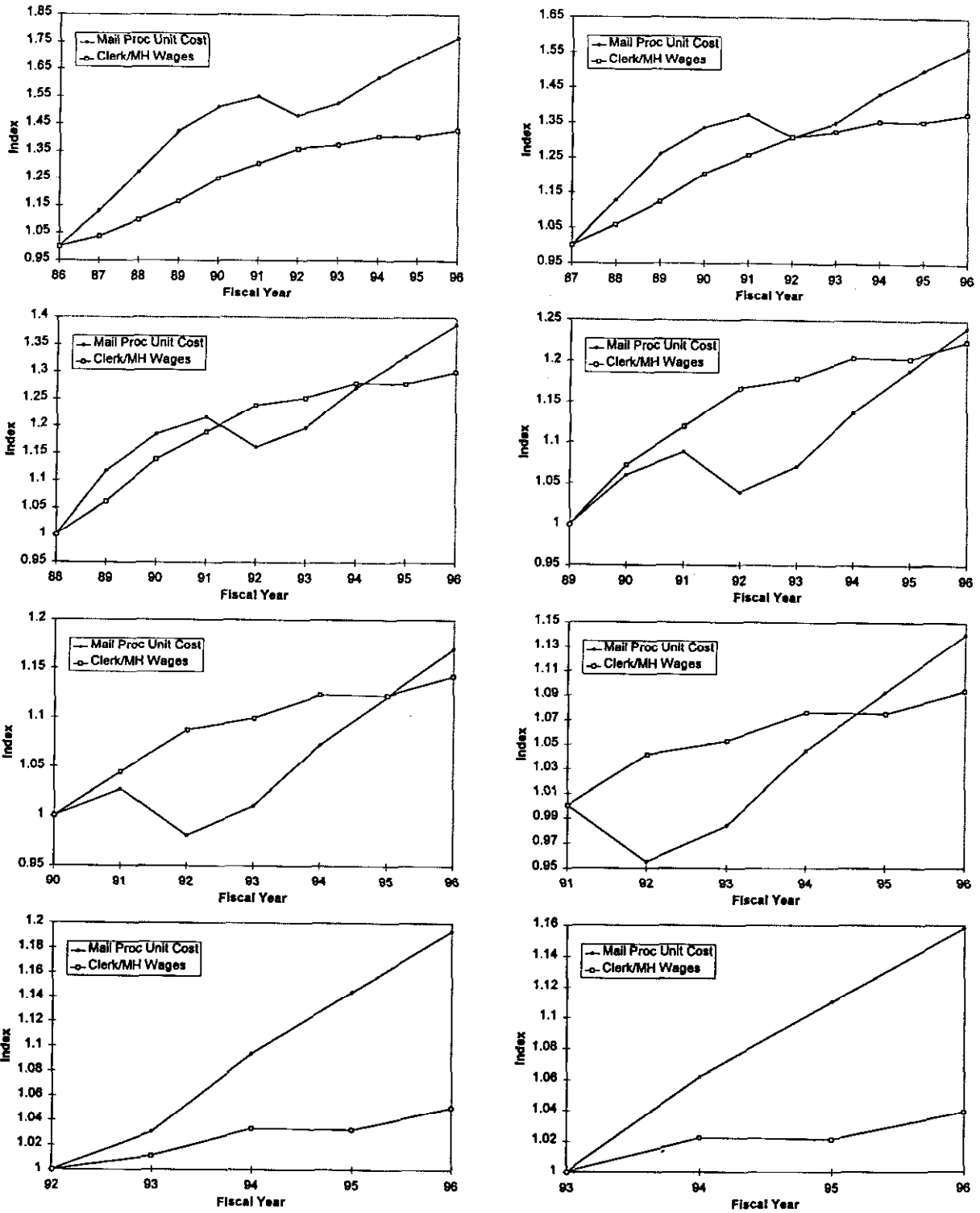
11 CHAIRMAN GLEIMAN: It is so directed.

12 [Cross-Examination Exhibit No.  
13 ABP-XE-2 was received into evidence  
14 and transcribed into the record.]

15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

ABP-XE-2

# Comparison of Regular Periodicals Mail Processing Costs and Clerk and Mailhandler Wages



Source: LR-H-348, chartdat.xls, W/S Data, Figure 2 data

1 BY MR. STRAUS:

2 Q Finally getting to pallets. What do you mean by  
3 an aggregate pallet?

4 A By a more aggregate pallet. I specifically mean,  
5 and I think I indicate somewhere in my testimony that by  
6 more aggregate, I mean, for example, a three digit pallet  
7 rather than a five digit pallet, something with a lower  
8 level of presortation.

9 Q The theory that more aggregate pallets is a  
10 contributor to the cost increases for periodicals, was that  
11 a theory that you developed or that somebody at the Postal  
12 Service suggested to you?

13 A I mean you could say I developed it but it was  
14 based on discussions. Actually, it wasn't an issue so much  
15 that I was raising as just feedback that I was getting from  
16 people in the fields complaining about getting mail on more  
17 aggregate pallets and how it was driving their costs up.  
18 You know, subsequent to my suggesting that as a possible  
19 explanation, we had more structured discussions with field  
20 personnel. It seemed to be generally confirmed by people  
21 who were even more familiar with operations than I am.

22 Q Which drop shippers did you -- with which drop  
23 shippers did you discuss their wanting to improve the cube  
24 utilization of trailers?

25 A Most of that is probably secondhand from DMU

1 personnel. DMU is detached mail units. So, it would have  
2 been obtained secondhand from talking to postal acceptance  
3 clerks associated with printing plants. Some of that would  
4 have been my own discussions. Some of that would have been  
5 discussions of my associates with such people.

6 Q These are discussions with Postal people, not with  
7 the truckers or the printers or publishers?

8 A I don't think I've personally had any discussions  
9 with the printers themselves. Some of my associates may  
10 have.

11 Q You blamed some of the -- "blamed" isn't the right  
12 word. You attribute some of the increase in periodical  
13 processing costs to what you claim is a trend of mail moving  
14 from five digit pallets to three digits; is that right?

15 A That's correct.

16 Q And that leads to more bundle handlings as a  
17 result of having to open those pallets at a three digit  
18 unit?

19 A That's correct.

20 Q And the Postal Service performed three studies  
21 that you have examined on the -- there was an 1989 study and  
22 a 1993 study of pallet make up?

23 A I think I looked at 1993 and 1996.

24 Q Was there one for 1989?

25 A My understanding is that there was, and we



1 obtained data from that docket but could not in the time  
2 available feel comfortable using it, so we did not use it.

3 Q Now your claim is that the 1993 study shows 43  
4 percent five-digit pallets; is that right?

5 A No, my claim was that our corrected numbers from  
6 1993 show that. When we looked at the 1993 data, we  
7 observed that there was an apparent inconsistency with  
8 billing determinants from 1993 because the mix of sack mail  
9 and pallet mail in that study seemed to be out of line to  
10 us, and actually our understanding of how those data were  
11 collected confirmed that it did not do a good job of  
12 estimating the relative proportions of sack versus pallet  
13 mail.

14 So in order to deem those -- in order to use those  
15 data, we felt compelled to reweight the sack pallet volumes  
16 such that they would accurately reflect the billing  
17 determinants we had available, and the 43-percent number is  
18 the result of that process.

19 Q Have you reviewed the potential cross-examination  
20 exhibit provided to your counsel yesterday marked USPS  
21 Periodical Pallet Volumes 1993?

22 A Yes, I have.

23 MR. STRAUS: Mr. Chairman, I'd like to distribute  
24 copies to the relevant parties.

25 CHAIRMAN GLEIMAN: Certainly, Mr. Straus.

1 BY MR. STRAUS:

2 Q Did you examine this?

3 A Yes, I did.

4 Q After examining it, have you concluded that the  
5 43-percent total is correct? Remains correct?

6 A Yes.

7 Q Do you -- have you determined whether the data on  
8 this chart are -- accurately portray the data that were on  
9 the sources shown?

10 A No, I haven't really had time to do that. I mean,  
11 we got this when we were out here, and our office is in  
12 Madison, so we weren't in a position to replicate the  
13 analysis.

14 Q Well, the data come from Postal Service library  
15 references, do they not?

16 A Well, they do.

17 Q You must have access to those while at the Postal  
18 Service.

19 A I do, but I don't have access to all of my staff  
20 and the computer facilities to do it.

21 Q Well --

22 A I mean, I just didn't have time to do it.

23 Q Let me give you my hypothesis. You can tell me  
24 where I'm making a mistake. You see the presort code D?

25 A Yes.

1 Q On the left. And that's marked three-digit  
2 carrier route, and if you -- and that's 390 million pieces.  
3 Right?

4 A That's correct.

5 Q Now do you consider the three-digit carrier route  
6 pallet to be a five-digit pallet?

7 A I don't believe we did for purposes of calculating  
8 the 43-percent number, but I'd have to check that.

9 Q Well, can you tell me how you got to the  
10 43-percent number without it?

11 A I can't off the top of my head. I mean, I'm not  
12 that familiar with the spreadsheet.

13 Q What's a carrier route pallet? That's presort  
14 code B.

15 A I believe it's a pallet with carrier route bundles  
16 on it.

17 Q Is there such a thing as a carrier route pallet?  
18 Other than a five-digit carrier route or a three-digit  
19 carrier route, which are separately identified?

20 A The study would seem to indicate there are, but  
21 I'm not sure that that's a legitimate makeup.

22 Q This study you're referring to is what?

23 A The 1993 mail characteristics study.

24 Q Have you seen the instructions for completing  
25 record of pallet contents, form C, from that pallet study?

1 A Not recently.

2 Q Let me hand you a copy.

3 A Okay.

4 Q Now, would you confirm that the pre-sort codes  
5 listed there, A through K, are consistent with those shown  
6 on this cross examination exhibit?

7 A Yes.

8 Q And for pre-sort code A, firm, it says not  
9 applicable, does it not?

10 A Yes.

11 Q And then this exhibit would show a zero. Is that  
12 right?

13 A That's correct.

14 Q And what does it say for pre-sort code B, carrier  
15 route?

16 A Not applicable.

17 Q But the study showed how much volume on pre-sort  
18 code B pallets?

19 A Three hundred and seventy-six million.

20 Q Can you explain why, if it's not applicable, there  
21 are 376 million pieces on such pallets?

22 A No, I cannot.

23 Q Can you explain why -- well, never mind.

24 MR. STRAUS: Mr. Chairman, we believe that the  
25 witness has made an arithmetic mistake and that adding up

1 the five-digit pallets from these numbers, from this study,  
2 don't produce the 43 percent he said but produce 35 percent.

3 CHAIRMAN GLEIMAN: I'm not sure why you're  
4 addressing me on this matter at this point in time, Mr.  
5 Straus.

6 MR. STRAUS: All right.

7 CHAIRMAN GLEIMAN: I think you ought to continue  
8 with your cross examination.

9 BY MR. STRAUS:

10 Q Mr. Degen, would you check your math and see  
11 whether the 43 percent is -- whether the five-digit  
12 percentage is 43 percent or some lower number and report  
13 back?

14 A Do I have to?

15 Q You swore that your testimony was the truth, and  
16 if you made a mistake, I think you'd want to correct it.

17 CHAIRMAN GLEIMAN: Postal Service does have an  
18 obligation, if there are errors that they discover or that  
19 are pointed out to them, to correct their testimony, and you  
20 know, we have a continuing flow of corrections flowing in --  
21 coming into this place on almost a daily basis.

22 MR. KOETTING: I guess my objection, if it has to  
23 be an objection, is asked and answered. It was asked if the  
24 43 percent came directly from the study and, as I recall,  
25 the witness said no, the data from the study were adjusted

1 to reconcile them with billing determinate information.

2 MR. STRAUS: That's not the adjustment I'm talking  
3 about.

4 MR. KOETTING: Okay.

5 CHAIRMAN GLEIMAN: If there is an error, I expect  
6 the witness to report back on a piece of paper to the Postal  
7 Rate Commission in response to this cross examination that  
8 there is an error and to provide the corrected figures --  
9 figure or figures.

10 The Postal Service has an obligation to do that.  
11 We have to understand what the numbers are. You're the only  
12 people that have the numbers.

13 You can proceed with your cross examination.

14 MR. STRAUS: Thank you.

15 BY MR. STRAUS:

16 Q Mr. Degen, when you do that, I would like you to  
17 examine both the three-digit carrier route pallet entry in  
18 this study from which you derived your 43 percent and the  
19 pre-sort code B carrier route pallet entry to determine  
20 whether those are -- either of those or both of those are  
21 appropriately included within five-digit pallets.

22 MR. STRAUS: At this point, I would like this  
23 document entitled "USPS Periodical Pallet Volumes, 1993" to  
24 be marked, copied into the record, and admitted into the  
25 evidence marked as ABP-XE-3.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

CHAIRMAN GLEIMAN: It is so directed.

[Cross-Examination Exhibit No.  
ABP-XE-3 was received into  
evidence, and transcribed into the  
record.]

ABP-XE-3

## USPS PERIODICAL PALLET VOLUMES, 1993

Pallet Volumes Of Regular Rate Periodicals Flats Per LR-MCR-4		
Presort Code <sup>1</sup>	Container Presort	Volume (1,000's) <sup>2</sup>
A	Firm	0
B	Carrier Route	376,247
C	5-Digit Carrier Route	442,458
D	3-Digit Carrier Route	390,165
E	Five-Digit	938,742
F	Optional City	100,130
G	Three Digit	2,268,626
H	Optional SCF	293,438
I	Optional SDC	134,507
J	State	28,961
K	Mixed States	0
	<b>Total</b>	<b>4,973,274</b>
B+C+E	<b>Total Five-Digit Pallets</b>	<b>1,757,447</b>
	<b>Percent 5-D</b>	<b>35.34%</b>

<sup>1</sup> See "Instructions For Completing Record Of Pallet Contents - Form C", LR-MCR-4 at 131, Docket MC95-1.

<sup>2</sup> These volumes can be computed from spreadsheet pallets.xls in USPS LR-H-348 by summing the numbers in rows 2-591 of column BD, subject the characters in the corresponding rows of column BH being respectively A, B, C, etc., representing the various codes for container presort level used in the LR-MCR-4 survey.



1 BY MR. STRAUS:

2 Q Are you pretty confident in your number that the  
3 number of five-digit pallets by 1996 was 11 percent of total  
4 palletized mail?

5 A With respect to that, I'm confident that there has  
6 been a significant decline in the percentage of palletized  
7 mail on five-digit pallets, and that's the extent to which I  
8 rely on those numbers. I don't mean to offer it as  
9 necessarily accurate, you know, right to the last digit.

10 Q But you've forecast a 75 -- you've forecast a  
11 decline from 43 percent to 11 percent in only three years.  
12 That's a 75-percent decline, isn't it?

13 A In terms of the change in the percentages, yes,  
14 but again, I didn't forecast that. I believe -- I mean  
15 those are the numbers that I have obtained looking at this  
16 study, and even -- and my point is the same. Even if it's  
17 35 percent to 11 percent, I'm simply observing that there  
18 has been what I believe to be a significant increase in  
19 five-digit pallet use in '92 and '93 and then a decline  
20 therefrom in subsequent years.

21 Q Is Time-Warner one of the biggest palletizers of  
22 periodicals?

23 A In terms of today?

24 Q Yes.

25 A Yes.

1 Q Did you look at the Time-Warner numbers  
2 introduced, the palletization numbers for Time-Warner  
3 introduced in the pallet case and introduced in this case to  
4 see what kind of five-digit volumes they were producing and  
5 what their trend was?

6 A I've seen them. You gave them to me as a cross  
7 examination exhibit. I hadn't gone back and looked at them,  
8 but I don't find them relative, because they're lacking they  
9 key element, which is what was the pallet profile in 1992  
10 and '93.

11 Q Did you ask for 1993 data?

12 A Last night I offered to personally buy dinner for  
13 anybody on my staff who could find a Time Warner pallet  
14 profile for '92 or '93. That's how bad I wanted one.

15 MR. KOETTING: I would add for the record, Mr.  
16 Chairman, that the Postal Service has exactly the kind of  
17 information the Postal Service sought to obtain through the  
18 discovery process in the earlier phase of the case. So the  
19 information has been requested.

20 MR. STRAUS: And Time Warner provided some  
21 information, as did some of the other publishers, about  
22 palletized data, but not everything that was requested. Is  
23 that right?

24 MR. KOETTING: I would believe that's correct, and  
25 I'm sure that the record will show whether or not it

1 included any information from 1993 or not.

2 MR. STRAUS: Well, let me state that it did not,  
3 but that when Mr. Degen's rebuttal testimony began to be  
4 analyzed, 1993 data have now been dug out for some of the  
5 periodicals, the major ones, and if the Postal Service would  
6 like to see it as badly as Mr. Degen says, I'd be happy to  
7 offer into evidence an affidavit by Mr. James O'Brien from  
8 Time Warner. I believe Mr. O'Brien is in the room and could  
9 personally swear to the veracity of this data.

10 MR. KOETTING: The Postal Service would most  
11 vehemently object to that at this late date in this  
12 proceeding.

13 MR. STRAUS: That's what I thought.

14 CHAIRMAN GLEIMAN: Do I take it then that you're  
15 not trying to move that in, and that I don't have to rule on  
16 the objection?

17 MR. STRAUS: I don't like to lose.

18 BY MR. STRAUS:

19 Q What's the biggest -- what's the  
20 highest-circulation periodical in the country?

21 A I believe it's TV Guide.

22 MR. KOETTING: Was that question circulation by  
23 mail or total circulation?

24 BY MR. STRAUS:

25 Q By mail. Your answer is still TV Guide, I assume.

1           A     Yes, that was the context with which I was  
2     answering.

3           Q     And that would be about 8 million a week or about  
4     400 million a year?

5           A     Oh, I don't have those numbers at my fingertips.  
6     I just have a general sense of the ordering.

7           Q     Well, you don't have them at your fingertips. Do  
8     you have your stricken testimony?

9           A     No, it was stricken.

10          Q     And you threw it away?

11                 Well, let's assume subject to -- will you assume  
12     subject to check that it's about 8 million a week? That's  
13     not a hard one to check.

14          A     I'd just as soon not check it, but sounds  
15     reasonable to me.

16          Q     Well, I think I'm going to ask you again, or maybe  
17     ask counsel, will you accept subject to check that TV Guide  
18     has a circulation of 8 million a week?

19                 CHAIRMAN GLEIMAN: I think you need to ask the  
20     witness subject to check, not counsel subject to check.

21                 MR. STRAUS: Well, maybe counsel's willing to  
22     check it if the witness isn't.

23                 CHAIRMAN GLEIMAN: Would you ask the question of  
24     the witness, please, so that we can move on.

25                 BY MR. STRAUS:

1 Q Assume that it's eight million a week, okay? Is  
2 TV Guide predominantly palletized on five-digit pallets?

3 A That's my understanding. I wouldn't say  
4 predominantly, but it's -- it uses a higher proportion of  
5 five-digit pallets than most other large publications I'm  
6 familiar with.

7 Q You wouldn't say predominantly?

8 A I'm not -- I don't have the numbers at my  
9 fingertips. I am comfortable at this point saying that they  
10 are -- their proportion of five-digit pallets is higher than  
11 most large publications.

12 Q Do you ever recall writing something that said  
13 that said that TV Guide's five -- is predominantly a  
14 five-digit palletizer?

15 A Yes.

16 MR. KOETTING: Mr. Chairman, at this point I'm not  
17 sure exactly on what basis I want to interject here, but  
18 there are a couple of things going on. Having moved to  
19 strike portions of Mr. Degen's testimony, Mr. Straus now  
20 seems intent on conducting oral cross-examination of it  
21 nonetheless, and he obviously is venturing into territory of  
22 mailer-specific information, which is exactly the area that  
23 the Postal Service had concerns about, which led fairly  
24 directly I believe to that testimony being stricken.

25 So therefore I'm -- I can't say that I have a

1 specific objection or anything, but I do want to point out  
2 that there are some problems with this line of inquiry on  
3 that basis.

4 CHAIRMAN GLEIMAN: If you didn't make a specific  
5 objection, I guess I don't have anything specific to say  
6 about it. And my string of untarnished procedural rulings  
7 will continue.

8 [Laughter.]

9 MR. KOETTING: I raise it, Mr. Chairman, merely to  
10 set the background for whenever there is an objection, we  
11 don't have to go into it again.

12 [Laughter.]

13 CHAIRMAN GLEIMAN: Thank you, sir. I appreciate  
14 that help.

15 BY MR. STRAUS:

16 Q Mr. Degen, would you accept, subject to check,  
17 that TV Guide is 6.72 percent of all regular-rate Second  
18 Class pieces?

19 A No. I mean, I don't want -- I don't want  
20 homework.

21 Q Did you check to see what percentage of the total  
22 pallets in this -- in 1996, the total five-digit pallets are  
23 TV Guide pallets?

24 A No, that's not a -- well, let me ask you to ask  
25 that again. Maybe I'm missing --

1 Q Let me go through some arithmetic that you won't  
2 accept subject to check.

3 A Okay.

4 Q Let's assume that TV Guide is 6.72 percent of all  
5 regular-rate periodicals and that as you say 56 percent of  
6 all periodicals were palletized -- no, not five digits -- 56  
7 percent of all periodicals were palletized to any extent in  
8 1996. Then TV Guide would be 11 to 12 percent of all  
9 palletized mail.

10 A Where did I say the 56 percent?

11 Q Isn't that what you say for the total  
12 palletization for 1996?

13 A Could you point me to that?

14 Q Library Reference 190 -- are you --

15 A Library Reference what?

16 Q 190.

17 A What's the name of that one?

18 Q It's Christensen Associates study of  
19 palletization.

20 A Okay. All right. Okay.

21 Q Mail Characteristics Study.

22 A Yes.

23 MR. KOETTING: I would point out that that wasn't  
24 entered into evidence by this witness.

25 BY MR. STRAUS:

1 Q Okay. But does it say 56 percent of the  
2 periodicals are palletized?

3 A I'll accept that subject to check.

4 Q Is Meredith a big palletizer?

5 MR. KOETTING: Mr. Chairman, at this point, I am  
6 going to inject an objection because Mr. Degen, as a  
7 consultant for the Postal Service, has limitations imposed  
8 on the use with which he can make of the information that he  
9 examines from Postal Service records. It's not clear to me  
10 that he can really proceed without having some problems in  
11 that regard.

12 BY MR. STRAUS:

13 Q Well, let me ask you, Mr. Degen. Did you review  
14 the information provided by Mr. Littell of Meredith to the  
15 Postal Service in response to its discovery requests?

16 A Yes, I did.

17 Q Do you have any reason to believe that has to  
18 remain confidential?

19 A No.

20 Q Is Meredith a heavy palletizer?

21 A I am not comfortable subjectively characterizing  
22 people as heavy or big, and the truth is because this  
23 portion of my testimony was stricken, I have not recently  
24 familiarized myself with the statistics to which you are  
25 trying to point me. I'm just not comfortable making the



1 kinds of characterizations you are asking me to make.

2 Q The statement that only 11 percent of the  
3 palletized mail is five digit was not stricken, was it?

4 A No, it was not.

5 Q Yet, we have data in the record from Time Warner  
6 showing that 11 percent of their pallets, roughly 11/12  
7 percent, for their major magazines, are five digit. We have  
8 T.V. Guide, which is the biggest mailer in the country,  
9 which you admit is predominately five digit. We have Mr.  
10 Littell submitting discovery responses from Meredith saying  
11 that 35 percent of Better Homes and Gardens is five digit.

12 I'm asking you whether in light of all those  
13 facts, you still contend that only 11 percent of the pallets  
14 are five digit pallets?

15 A Yes, there is a lot of other periodicals out  
16 there.

17 Q Do you know what percentage of the total  
18 periodicals consist of Time Warner periodicals -- total  
19 number of pieces are published by Meredith, Time Warner and  
20 T.V. Guide?

21 A Not off the top of my head.

22 Q Do you think it's half?

23 A I don't have an opinion.

24 Q What's the minimum pallet weight?

25 A I believe it's currently 250 pounds.

1 Q How long has it been 250 pounds?

2 A I think somewhere in the early '90s.

3 Q Is it easier or harder to make up a 5-Digit  
4 pallet -- well, let me back up.

5 Before it was 250 pounds, how many pounds was it?

6 A I believe before that it was 500 and 650 before  
7 that.

8 Q So as the weight reduced, did it become easier or  
9 more difficult to make up 5-Digit pallets?

10 A Easier in what sense?

11 Q Easier to accumulate enough weight to make up a  
12 pallet to a 5-Digit zip code?

13 A Yes, one would need fewer pieces to make up a 250  
14 pound pallet than they would for a 500 pound pallet.

15 Q What pallet options are available to a mailer with  
16 at least 500 pounds to a 5-Digit zip?

17 A They should be making up a 500 pound pallet.

18 Q To a 5-Digit zip?

19 A To a 5-Digit zip, yes.

20 Q You say they should be. Are they required to?

21 A You mean in practice or in the regs?

22 Q The Domestic Mail Manual is the regulations. Does  
23 the Domestic Mail Manual require you to prepare a 5-Digit  
24 pallet when you have 500 pounds?

25 A I believe it does.

1 Q You know how the average weight of periodicals in  
2 1996 compares with 1993?

3 A No, not as I sit here right now.

4 Q Do mailers have incentives to make up 5-Digit  
5 pallets?

6 A What kind of incentives did you have in mind?

7 Q I am asking you whether you know whether -- but I  
8 had in mind for example service, better service.

9 A Service is certainly an incentive that would argue  
10 for smaller pallets.

11 I think, you know, savings in make-up and  
12 transportation might argue for larger pallets, so there  
13 might be other incentives.

14 Q When you say smaller and larger, are you saying --

15 A More aggregate. I am equating the notion of a  
16 more aggregate pallet with a heavier and bigger pallet.

17 Q Isn't it true that effective January 1, 1997 the  
18 Postal Service implemented rules that could reduce the use  
19 of 5-Digit pallets?

20 A I think that is true but I am not real familiar  
21 with those.

22 Q Why do they do that?

23 A I am not sure.

24 Q To increase costs, do you think? To decrease  
25 costs? You have no idea?

1           A     I am not familiar with the reasoning for the  
2 change in regs.

3           Q     To the extent that mail has shifted from sacks to  
4 pallets, would that increase or decrease processing costs?

5           A     I think there's really not enough information in  
6 that statement for me to offer an opinion.

7                     If you mean to the extent that used to be in  
8 5-Digit sacks is now in 5-Digit pallets, I believe that  
9 should decrease costs, processing costs.

10                    If mail that was in 5-Digit sacks is now on all  
11 mixed pallets, I don't think it would.

12           Q     Has the Postal Service encouraged mailers to move  
13 out of sacks and onto pallets?

14           A     I believe they have.

15           Q     Do you know why?

16           A     I believe they expect That to lower costs.

17           Q     You don't share that expectation?

18           A     I do. I don't think anywhere here I have said  
19 that I think 5-Digit mail or a 5-Digit pallet is more costly  
20 to handle than a 5-Digit sack. I believe my testimony and  
21 my discussion here has all been with respect to the change  
22 in the make-up of the container.

23           Q     Please look at page 34.

24           A     I have it.

25                   MR. STRAUS: Well, before we do that, maybe we

1 ought to put into the -- get marked an exhibit we discussed.

2 Q You had I guess on your own mentioned that we had  
3 provided you with Time Warner palletization data from 1991  
4 and 1997. You said that you wished you had had the 1993,  
5 but the 1991 and 1997 data we did provide you a cross  
6 examination exhibit, did we not?

7 A That's correct.

8 Q And the source of that data is contained in the  
9 records and the Postal Rate Commission proceedings, isn't  
10 that right?

11 A That is what the table indicates.

12 Q Do you have any reason to doubt the validity of  
13 the data?

14 A No, I do not.

15 MR. STRAUS: Mr. Chairman, I would like to  
16 distribute this document and have it marked as ABP-XE-4,  
17 transcribed into the record and admitted into evidence.c

18 MR. KOETTING: No objection.

19 CHAIRMAN GLEIMAN: It is so ordered.

20 [Cross-Examination Exhibit ABP-XE-4  
21 was received into evidence and  
22 transcribed into the record.]

23

24

25

ABP-XE-4

## TIME WARNER PALLETIZATION PROFILE 1991 / 1997

	5 DIGIT	3 DIGIT *	SCF	ADC/SDC
TIME 1991	1.60%	90.30%	5.60%	2.50%
TIME 1997	11.81%	86.85%	0.33%	1.02%
CHANGE	10.21%	-3.45%	-5.27%	-1.48%
SI 1991 **	0.30%	94.00%	6.60%	2.70%
SI 1997	11.63%	87.15%	0.34%	0.88%
CHANGE	11.33%	-6.85%	-6.26%	-1.82%
PEOPLE 1991	0.20%	78.30%	13.80%	7.80%
PEOPLE 1997	12.58%	85.40%	0.55%	1.47%
CHANGE	12.38%	7.10%	-13.25%	-6.33%
EW 1991	0.00%	39.90%	35.80%	24.40%
EW 1997	1.56%	78.53%	8.76%	11.15%
CHANGE	1.56%	38.63%	-27.04%	-13.25%
FORTUNE 1991	1.30%	60.10%	15.90%	22.80%
FORTUNE 1997	2.79%	74.49%	8.80%	13.92%
CHANGE	1.49%	14.39%	-7.10%	-8.88%
MONEY 1991	0.30%	80.80%	7.70%	11.30%
MONEY 1997	4.21%	88.48%	2.59%	4.71%
CHANGE	3.91%	7.68%	-5.11%	-6.59%
LIFE 1991	0.00%	70.00%	12.90%	17.10%
LIFE 1997	0.00%	75.12%	12.57%	12.31%
CHANGE	0.00%	5.12%	-0.33%	-4.79%
* - 3 DIGIT INCLUDES OPTIONAL MULTI CODED CITY, UNIQUE 3 DIGIT, AND 3 DIGIT MULTI CODED CITY WAS ELIMINATED JULY, 1996				
** - TOTAL SUMS TO 103.6% DUE TO MINOR ERROR IN UNDERLYING DATA.				
SOURCE OF 1991 DATA: MC91-3, TR. 1231				
SOURCE OF 1997 DATA: R97-1, TR. 16826, 16827, 16828, 16829, 16830, 16831, 16832				

1 CHAIRMAN GLEIMAN: Mr. Straus, what was the page  
2 number you were referring to in the testimony?

3 MR. STRAUS: 34 is where we are going next.

4 CHAIRMAN GLEIMAN: Thank you.

5 BY MR. STRAUS:

6 Q There you are critical of MPA Witness Little for  
7 comparing, for relying on a comparison of costs of classes  
8 of mail, isn't that right?

9 A Yes, that's correct.

10 Q Isn't it true that Mr. Little not only compared  
11 between classes but also compared costs with wage rates?

12 A I believe that's true.

13 Q Isn't it also true that in R94-1 Postal Service  
14 Witness Barker did a cross-class comparison of processing  
15 costs by class?

16 A I am not familiar with that.

17 Q Again revisiting a subject you had discussed  
18 earlier in your testimony -- we did some cross examination  
19 on it -- page 34, lines 16 through 18 -- where you say that  
20 presortation, drop shipping and mail piece readability can  
21 have a substantial impact on the observed trend and  
22 aggregate costs.

23 Now you confirmed, did you not, that there is more  
24 presortation of periodicals than there used to be?

25 A With respect to pieces in bundles, yes, I did.

1 Q And there is more -- is there more drop shipping?

2 A I believe that's true.

3 Q And what did you mean by mail piece readability?

4 A I probably should have said machinability there is  
5 a broader term, but what I meant was, you know, the ability  
6 of machines to read the barcode.

7 Q And there is more of that as well?

8 A You are talking about periodicals?

9 Q Yes.

10 A Certainly it's the case that there are more  
11 barcodes on mail.

12 Q And so in each of these three respects, these  
13 factors should have led to a reduction in aggregate unit  
14 costs, should they not, taken in isolation?

15 A Yes, taken in isolation I would expect that to  
16 have been true.

17 Q And again, you did not attempt to quantify either  
18 the degree of change or the cost effect of any of these  
19 changes, did you?

20 A No, I did not.

21 Q On page 38, beginning on line 3, you discuss the  
22 Postal Service Governors' approval of the addition of  
23 barcode readers to the FSM-1000 sorters, flat sorters. This  
24 is underneath a heading that says that the Postal Service  
25 has initiatives underway that will improve service, control



1 costs, and work with mailers for further improvements.

2 A Yes.

3 Q So the barcode readers on the FSM-1000s, will they  
4 control costs?

5 In other words, will they reduce costs?

6 A I believe that is the expectation.

7 Q And when will the mailers see the benefits of  
8 those reduced costs?

9 A My understanding is that the component of the  
10 roll-forward in this case accounts for additional FSM  
11 deployments. I don't have any first-hand knowledge as to  
12 whether an element of that is the deployment of barcode  
13 readers or not, so I am not really in a position to say.

14 Q Well, the deployment of barcode readers doesn't  
15 affect the rates paid by mailers, does it?

16 A I think to an extent that an adjustment is made in  
17 the roll-forward process to determine test year costs, I  
18 believe it does have an impact.

19 Q Let me be more direct then. When will there be a  
20 presort discount associated with these barcode readers on  
21 the FSM-1000s?

22 MR. KOETTING: Mr. Chairman, that is clearly  
23 beyond the scope of this witness's testimony, to predict  
24 when there is going to be a presort discount in the future.

25 CHAIRMAN GLEIMAN: Sustained.

1 MR. STRAUS: I'm finished.

2 CHAIRMAN GLEIMAN: Does that mean you don't have  
3 any other questions?

4 [Laughter.]

5 MR. STRAUS: I've got Bonnie Blair coming to  
6 finish for me.

7 CHAIRMAN GLEIMAN: Is there any follow-up?

8 MR. KEEGAN: Yes, I'm sorry to say there is, Mr.  
9 Chairman.

10 CHAIRMAN GLEIMAN: It's okay. We spend more than  
11 90 percent of our time on postal matters.

12 [Laughter.]

13 CROSS EXAMINATION

14 BY MR. KEEGAN:

15 Q Good afternoon, Mr. Degen. I am Timothy Keegan,  
16 representing Time Warner.

17 A Good afternoon.

18 Q I just want to follow up on several of Mr.  
19 Straus's lines of cross examination. I expect this will be  
20 brief. I will try to make it so.

21 You mentioned that mail processing, periodicals  
22 mail processing costs, had declined relative to postal wages  
23 in 1992, is that correct?

24 A Yes.

25 Q Do you know whether that decline may be due in any

1 part to changes in the IOCS in that year or do you have an  
2 opinion on that?

3 A I don't have the exact timing but I am aware of  
4 some changes to IOCS that have improved the identifications  
5 of periodical mail that may be more accurately measuring  
6 periodicals' costs, but I am not prepared to discuss the  
7 details of that or the exact timing or its impact.

8 Q Would you refer to page 3 of your testimony at  
9 line 8, where you are discussing a change in the IOCS and  
10 you say beginning in FY 1992.

11 A Yes.

12 Q And then describe the change. Do you happen to  
13 know whether the changes were made all at the same time, as  
14 opposed to a series of changes at different times?

15 A I don't know the exact timing of the changes. I  
16 don't think they were as one big change. It may have been  
17 ongoing.

18 Q Okay. A different subject, and this is from very  
19 early on in Mr. Straus's cross examination you were  
20 discussing 5610 tallies, which are, as I understand it,  
21 letter-specific mixed-mail tallies, and in particular you  
22 were discussing -- I'm sorry letter-specific tallies, and in  
23 particular, Mr. Straus was asking about 5610 not handling  
24 tallies and the circumstances in which one might have such a  
25 tally. Is that correct?

1 A I believe that was the gist of the conversation.

2 Q Just to follow up on that a bit, I would like you  
3 to assume that an employee is clocked into an opening unit  
4 and that that employee is recorded by IOCS with a 5610 not  
5 handling tally.

6 A Okay.

7 Q In that instance, would you characterize that as a  
8 case of mis-clocking?

9 A No.

10 Q Would you say that the employee in that instance  
11 -- let me go back one step. Let me stipulate -- I think I  
12 did -- the employee is clocked into an opening unit  
13 operation.

14 A That's correct.

15 Q In that case, would you say that the employee was  
16 properly clocked into the operation but nevertheless, he was  
17 recorded at a letter operation not handling mail?

18 A Well, it's your hypothetical, so I have to say,  
19 you know, was he or was he not properly clocked in. Which  
20 would you like me to assume?

21 Q This hypothetical involves about \$100 million, and  
22 which we have such tallies. Let me ask if it is one of the  
23 possibilities that in that case, the employee is properly  
24 clocked into an opening unit, but is in fact observed by the  
25 IOCS data collector at a letter operation not handling mail?

1 A What's the question?

2 Q The question is if you assume that the employee is  
3 clocked into an opening unit and is recorded with a 5610 not  
4 handling tally, is it possible that what that situation is  
5 recording is an employee who is properly clocked into the  
6 opening unit but who is observed by the IOCS data collector  
7 at a letter opening operation not handling mail?

8 A Yes, that's a possibility under your hypothetical.

9 Q Well, can you tell me what other possibilities  
10 there are? You have said mis-clocking is not -- you would  
11 not conclude there is mis-clocking, so in addition to those  
12 two --

13 A I didn't say mis-clocking wasn't a possibility. I  
14 said I wouldn't necessarily conclude that.

15 Q In addition to those two possibilities then, what  
16 other possibilities do you think are covered by the  
17 assumptions that I have given you?

18 A Well, that the data collector incorrectly applied  
19 the 5610 rule in terms of incorrectly determining that the  
20 person was really working in that operation, but in terms of  
21 does that create an error, I don't think it presents a  
22 problem in terms of my mixed mail distribution because in  
23 fact, it has the effect of associating that employee with  
24 the shape of mail with which he was working.

25 Q Would you turn to page nine of your testimony, and

1 I'd like to ask you about lines five through seven, which  
2 Mr. Straus also asked you about, and I just wanted to follow  
3 up a bit.

4           You state starting at line five on page nine, "We  
5 know that the proportions and composition of direct, mixed  
6 and not handling tallies vary across the MODS based cost  
7 pools. This fact alone would argue definitively for the use  
8 of these cost pools." Is that a correct reading of your  
9 testimony?

10           A     Yes, it is.

11           Q     Would you again hypothetically for me just assume  
12 that you take all your MODS cost pools and put them into a  
13 blender and turn on the blender and then turn it off and  
14 come out of the blender with a set of random cost pools,  
15 covering the same total costs, but randomly organized. In  
16 that event, would you expect that the proportions and  
17 composition of direct, mixed, and not handling tallies would  
18 vary across the resulting cost pools?

19           A     If I understand your hypothetical correctly, you  
20 are just introducing random variance into these cost pools  
21 which essentially destroys what we know about the cost  
22 pools, as I use them from an operational basis.

23           Q     That's correct.

24           A     I think you are saying if you make these things  
25 completely random, am I going to be surprised that they are

1 completely random, and I think the answer is no.

2 Q I'm not asking you that. I'm asking you whether  
3 you would expect that the proportions and composition of  
4 direct, mixed and not handling tallies would vary across  
5 those random cost pools.

6 A I think if your blender does a good job and the  
7 sample is large enough, they wouldn't.

8 Q They would not? All right.

9 A If I understand your hypothetical properly, I  
10 don't believe they would. If by your blender, you mean that  
11 you distribute them so that the cost pools are homogeneous,  
12 I'm expecting they will be homogeneous.

13 Q That's fair. I accept that. Let's change the  
14 hypothetical and throw in only half the MODS cost pools into  
15 the blender. Same question. Would you expect that the  
16 resulting set of pools would show proportions -- for the  
17 resulting set of pools, the proportions and composition of  
18 direct, mixed and not handling tallies would vary across the  
19 pools?

20 A I would expect there would be a variation that is  
21 dampened by having homogenized half of the tallies in the  
22 cost pools, but the underlying operation based variation, I  
23 think, would still be present.

24 Q In that case, would you conclude that the mere  
25 fact of that variation argued definitively for the use of

1 those pools?

2 A Yes, even the fact that half of these things  
3 hadn't been tossed into that blender means there is some  
4 information there based on our operational breakdown, and I  
5 think that argues definitively for their use.

6 Q The pools in which half are entirely random and  
7 half for your original pools?

8 A Yes, because there is still information there. I  
9 think you want me to say we should chuck it all back  
10 together, but until you put the whole thing in the blender,  
11 there's no point to that.

12 Q Is the implication of what you are saying that the  
13 set of pools that displayed the greatest possible degree of  
14 variation would be the set of pools to be preferred over all  
15 others?

16 A No, I don't think that's what I'm saying at all.  
17 If you mean that the pools with the largest single sub-class  
18 association should be preferred over the others, no, I don't  
19 think so. I mean that's just the operational reality of  
20 that pool versus another that doesn't have such a strong  
21 sub-class association, but I don't believe I've relied on  
22 sub-class -- individual sub-class association as a criterion  
23 in any of my discussion.

24 Q Nor did I ask you about it. I asked you simply  
25 about variation in terms of the proportions and composition



1 of direct, mixed and not handling, however you wish -- those  
2 are your words, however you wish to interpret them.

3 My question is would variation of that sort, with  
4 the greatest possible extent of the variation of that sort  
5 mean you had the optimal cost pools?

6 A No, unless -- the important thing is that the  
7 variation is not the result of a blender. The important  
8 thing is that to the extent that we know there are strong  
9 operational differences among cost pools that give us a  
10 strong a priori reason to believe that the underlying  
11 sub-class distribution in that pool is different from  
12 another pool, then we should separate them.

13 Q One final line of questions, and this has to do  
14 with the possibility of testing your assumptions, which as  
15 you rightly pointed out, did come up on your cross  
16 examination on your direct testimony. Correct me if I'm  
17 wrong, I think you indicated that with respect to testing,  
18 for example, assumptions about counted items and the  
19 representativeness of counted items, of uncounted items,  
20 that's really not a testable assumption, as you see it?

21 A I haven't put a lot of effort into studying that,  
22 but I see a problem in trying to discern a priori which  
23 would have been counted and which wouldn't have. You'd need  
24 some kind of hypothesis to say, you know, but for us doing  
25 this test, this one would have been counted and this one

1 wouldn't have. I see that as very problematic.

2 Q Let me give you a scenario and tell me what's  
3 wrong with it. Suppose that for the next three months,  
4 random selection of mail processing facilities that you were  
5 satisfied was representative, you had two sets of data  
6 collectors and as soon as the first data collector decided  
7 that we have here a mixed mail tally for a container, and at  
8 that point, the second data collector would come along and  
9 count it. At the end of those three months, you would  
10 compare the actual counts with the proportion between the  
11 counted and the uncounted mixed tallies and see whether they  
12 were comparable. Could that be done?

13 A I think once you've done the first one, the word's  
14 out that you're there, and the behavior of the data  
15 collectors could be modified by the fact that the study's  
16 going on. That's one of my concerns.

17 Another of my concerns is that there are reasons  
18 why some items are not counted, and as I pointed out  
19 earlier, an important one is the exigency of dispatch of the  
20 mail, and clearly Mr. Straus didn't think that was that  
21 important. But I think the Post Office takes that very  
22 seriously, and if you're sampling an employee at a point in  
23 time that he's wheeling the last container on a truck and  
24 they want to close that door, I can tell you from firsthand  
25 experience, it's very difficult from an operations

1 standpoint to be able to count that mail. We've tried.

2 Q So that such a test in your view is simply an  
3 impossible sort of dream and not worth investigating or --

4 A Well, I think I've fully explained why I don't  
5 think it's necessary, since we seem to have consensus that  
6 the underlying subclass profiles differ. I don't see the  
7 point to it, and I'm sure that if I came in here offering  
8 such a test, these are the kind of criticisms I'd face for  
9 it. So I'm not sure that we'd gain a whole lot doing it.

10 Q I misspoke when I asked you about counting  
11 containers, did I not? Isn't it items that are counted?

12 A Well, we talk about counted containers in terms of  
13 estimating the proportion of the container that is related  
14 to each item type, so I was willing to let you go.

15 Q But in fact containers -- containers themselves  
16 are never counted.

17 A Well --

18 Q The pieces in containers are not counted when you  
19 have a container tally?

20 A The items in containers are counted. The pieces  
21 inside of the items in containers are not counted.

22 Q Thank you.

23 MR. KEEGAN: That's all, Mr. Chairman. Thank you.

24 CHAIRMAN GLEIMAN: There are no questions from the  
25 bench.

1           That brings us to redirect. Mr. Koetting, would  
2 you like an opportunity to consult with your witness before  
3 determining whether you want to do redirect?

4           MR. KOETTING: Yes, Mr. Chairman.

5           CHAIRMAN GLEIMAN: In that case you can have an  
6 hour and 15 minutes to consult. And we'll come back --  
7 gosh, it's quarter to two. That'll make it three o'clock  
8 when we get back here from lunch. You all should be  
9 prepared for a long evening.

10           [Whereupon, at 1:45 p.m., the hearing was  
11 recessed, to reconvene at 3:00 p.m., this same day.]

12

13

14

15

16

17

18

19

20

21

22

23

24

25

## AFTERNOON SESSION

[3:00 p.m.]

1  
2  
3 Whereupon,

4 CARL G. DEGEN,

5 the witness on the stand at the time of the recess, having  
6 been previously duly sworn, was further examined and  
7 testified as follows:

8 CHAIRMAN GLEIMAN: Yes, sir, Mr. Koetting, do you  
9 have some rebuttal?

10 MR. KOETTING: Redirect.

11 CHAIRMAN GLEIMAN: Redirect, I'm sorry.

12 MR. KOETTING: Mr. Chairman, I'm afraid that an  
13 hour and 15 minutes was not sufficient time. With another  
14 half an hour I think we would have been down to no redirect.

15 [Laughter.]

16 We got stuck in the middle with a few questions.

17 CHAIRMAN GLEIMAN: Well, let's do a cost-benefit  
18 analysis here. How much redirect do you think you have? Is  
19 it more than a half-hour? Because if it's more than a  
20 half-hour, we'll let you have another half-hour to talk, and  
21 we'll come out ahead on this, as I understand the way things  
22 work.

23 MR. KOETTING: I agree with your analysis, but I  
24 think I can assure you that I'm not going to be doing a half  
25 an hour of redirect.

1 CHAIRMAN GLEIMAN: I can only hope that you'll  
2 agree with my analysis when we issue our decision.

3 MR. KOETTING: Hope springs eternal.

4 [Laughter.]

5 CHAIRMAN GLEIMAN: Doesn't it, though. For lots  
6 of folks in the room.

7 [Laughter.]

8 Why don't you fire away, Mr. Koetting.

9 REDIRECT EXAMINATION

10 BY MR. KOETTING:

11 Q Mr. Degen, in your conversations with counsel for  
12 ABP and Time we had a lot of talk about different types of  
13 tallies being coded under a variety of very specific fact  
14 situations. I'd just like for you to try to clarify for the  
15 record, do the data collectors on the scene make the  
16 assignment to the activity codes such as those  
17 shape-specific not handling activity codes that were  
18 discussed at some length this morning?

19 A No. In fact, none of the activity codes are  
20 assigned by the data collector. They're assigned by  
21 programs contained in Library Reference H-21. I think one  
22 of them that does a significant number of assignments is ALB  
23 40. But the data collectors report or answer the questions  
24 such as 18 and 19 that ask questions about the activity, and  
25 then the coding is done by the computer program.

1 Q Could you turn to page 21 of your rebuttal  
2 testimony, line 14.

3 A I have it.

4 Q Again, there was some conversation this morning  
5 regarding your statement regarding the recommendation about  
6 Witnesses Stralberg and Cohen treating not handling costs as  
7 institutional. I would like -- do you have Dr. Stralberg's  
8 direct testimony with you?

9 I would like you to look at the bottom of page 39  
10 of that, starting around line 27.

11 A Yes, I have it.

12 Q Could you read the statements made by Mr.  
13 Stralberg at that point in his testimony?

14 A Yes. It begins: In particular, little is known  
15 about what really causes the \$3,727 million accrued, and  
16 then parenthetically, 2,733 million in volume variable, end  
17 of parentheses, costs referred to above as general overhead  
18 or not handling costs. All that can be said with certainty  
19 about these costs is that they grew anomalously during the  
20 past ten years, when the automation program was being  
21 implemented. The Commission should seriously consider  
22 treating these costs as institutional until the Postal  
23 Service provides more reliable information about what causes  
24 them.

25 Q Was that the type of statement you had in mind

1 when you wrote your testimony on page 21 that we were just  
2 discussing at line 14 and following?

3 A Yes. While I wasn't able to point to it  
4 specifically, it certainly created the impression in my mind  
5 that he was calling for institutionalization of all of these  
6 costs.

7 Q Moving to another topic, does your methodology  
8 assume that the tallies associated with the handling of  
9 brown sacks will always be entirely associated with  
10 periodicals?

11 A No. We do -- you know, brown sacks is one of the  
12 item types that we define, but the actual distribution of  
13 those costs is based on the -- what the exact class --  
14 subclass distribution that is observed in those brown sacks.  
15 I think there's quite a bit of information in this record  
16 that indicates that it is not 100 percent periodicals, but  
17 it is a very high percentage, and again we use the strong  
18 association as a reason for delineating that item type, but  
19 the actual distribution reflects what's actually found in  
20 those sacks.

21 MR. KOETTING: Thank you, Mr. Degen. That's all.

22 COMMISSIONER HALEY: Did the redirect generate any  
23 further cross exam?

24 MR. KEEGAN: Yes, Commissioner Haley. Thank you.

25

RE CROSS EXAMINATION



1 BY MR. KEEGAN:

2 Q Mr. Degen, would you return to page 39 of Mr.  
3 Stralberg's testimony, from which you read a sentence a  
4 moment ago?

5 A I have it.

6 Q Could you read that sentence again, please?

7 A All of the sentences that I read?

8 Q The sentence beginning at line 27 with the words  
9 "In particular."

10 A "In particular, little is known about what really  
11 causes the 3727 million accrued, 2733 million volume  
12 variable costs referred to above as general overhead not  
13 handling costs."

14 Q Were you aware the first time you read that  
15 sentence, you read it as general overhead or not handling  
16 costs?

17 A No, I was not. I am sorry.

18 Q Is it your understanding that Mr. Stralberg uses  
19 the term "general overhead not handling costs" synonymously  
20 with the term "not handling costs?"

21 A No, I don't believe he does.

22 MR. KEEGAN: That's all. Thank you.

23 COMMISSIONER HALEY: Very good. Mr. Koetting?

24 MR. KOETTING: Nothing, Commissioner Haley. Thank  
25 you.

1 COMMISSIONER HALEY: All right. Well, then, Mr.  
2 Degen, we certainly appreciate your appearance here today  
3 and your contributions to the record. If there is nothing  
4 further, then you are excused.

5 THE WITNESS: Thank you.

6 [Witness excused.]

7 COMMISSIONER HALEY: I'm sure you thank us.

8 Our next witness is appearing on behalf of the  
9 United Parcel Service, Mr. Sellick. I believe he's already  
10 been sworn in.

11 MR. McKEEVER: That's correct, Commissioner Haley.

12 COMMISSIONER HALEY: Mr. McKeever, will you  
13 introduce your witness?

14 MR. McKEEVER: United Parcel Service calls to the  
15 stand Stephen E. Sellick.

16 COMMISSIONER HALEY: Mr. Sellick, since you have  
17 been sworn, we'll just get together today.

18 Whereupon,

19 STEPHEN E. SELLICK,  
20 a rebuttal witness, was called for examination by counsel  
21 for the United Parcel Service and, having been previously  
22 duly sworn, was further examined and testified as follows:

23 COMMISSIONER HALEY: We will enter his rebuttal  
24 testimony into evidence.

25 MR. McKEEVER: Thank you, Commissioner Haley.

## DIRECT EXAMINATION

BY MR. MCKEEVER:

Q Mr. Sellick, I've just handed you a copy of a document entitled Rebuttal Testimony of Stephen E. Sellick on behalf of United Parcel Service, and marked as UPS-RT-1. Was that document prepared by you or under your direction and supervision?

A Yes, it was.

Q And if you were to testify orally here today, would your testimony be as set forth in that document?

A Yes, it would be.

MR. MCKEEVER: Mr. Chairman, I move that the rebuttal testimony of Stephen E. Sellick on behalf of United Parcel Service and marked UPS-RT-1 be admitted into evidence and transcribed into the record. I do have two copies for the Reporter.

CHAIRMAN GLEIMAN: Are there any objections?

[No response.]

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

[Rebuttal Testimony and Exhibits of Stephen E. Sellick, UPS-RT-1, was received into evidence and

transcribed into the record.]

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

UPS-RT-1

BEFORE THE  
POSTAL RATE COMMISSION

---

POSTAL RATE AND FEE CHANGES, 1997

---

DOCKET NO. R97-1

---

REBUTTAL TESTIMONY OF  
STEPHEN E. SELICK ON BEHALF  
OF UNITED PARCEL SERVICE

---

TABLE OF CONTENTS

	<u>Page</u>
OVERVIEW .....	1
SUBCLASS PROXY ASSUMPTIONS .....	2
DISTRIBUTION WITHIN COST POOLS .....	7
DATA THINNESS.....	8
CONCLUSION .....	10
Table 1: Are Sack Types Associated with Certain Mail Classes?.....	4

BEFORE THE  
POSTAL RATE COMMISSION

POSTAL RATE AND FEE CHANGES, 1997

DOCKET NO. R97-1

REBUTTAL TESTIMONY OF  
STEPHEN E. SELICK ON BEHALF  
OF UNITED PARCEL SERVICE

1 My name is Stephen E. Sellick. My rebuttal testimony addresses  
2 criticisms made by some witnesses of the methodology recommended by the  
3 Postal Service for distributing mail processing costs in Cost Segment 3. I have  
4 previously submitted testimony designated as UPS-T-2 and UPS-ST-2.

5 **OVERVIEW**

6 Several intervenor witnesses – including Rita D. Cohen (MPA-T-2),  
7 Halstein Stralberg (TW-T-1), and Lawrence Buc (DMA-T-1) – have filed direct  
8 testimony in this case criticizing the Cost Segment 3 cost distribution  
9 methodology proposed by the Postal Service as explained by Postal Service  
10 witness Degen (USPS-T-12). These witnesses urge the Commission to ignore  
11 significant methodological improvements proposed by the Postal Service and  
12 Mr. Degen. They would have the Commission disregard what the Postal  
13 Service's count of a substantial number of mixed mail IOCS tallies tells us: that  
14 distributing mixed mail costs in proportion to direct IOCS tallies clearly yields





1 insight as to the contents of uncounted mixed mail items. In response to a series  
2 of interrogatories from the Postal Service, she states, for example, that "[n]either  
3 the Postal Service nor I have any data on how common Express Mail is in mixed-  
4 mail blue & orange sack tallies."<sup>2</sup>

5 Ms. Cohen states that "[a]n item does not always contain the subclasses  
6 or classes of mail 'associated' with that item," and she provides a table in  
7 support of her statement.<sup>3</sup> Based on that table, she concludes that counted and  
8 direct sacks containing 63% to 90% of one particular class of mail are not  
9 sufficiently associated with that class of mail to distribute the costs of uncounted  
10 sacks of the same type in the same proportion as the counted and direct sack  
11 costs. For example, mixed mail Orange & Yellow sacks – which, when counted,  
12 are found to be comprised of 86% Priority Mail – are, according to Ms. Cohen,  
13 not sufficiently associated with Priority Mail to be distributed 86% to Priority Mail,  
14 with the remaining 14% distributed to the other classes of mail found in the  
15 counted and direct Orange & Yellow sacks.

16 Table 1 below reproduces the information in Ms. Cohen's Table 4 and  
17 compares that data with how Ms. Cohen would distribute the costs in question.

- 
2. Tr. 26/14111. The same observation for other classes of mail can be found at Tr. 26/14112-15.
  3. Tr. 26/14048. Mr. Degen's cost distribution method does not "always" distribute all of the costs of an item type to the subclass of mail associated with the item type. Rather, Mr. Degen uses the proportions of all mail subclasses found in counted and direct item types to distribute the costs of the uncounted item types.

**Table 1****Are Sack Types Associated with Certain Mail Classes?**

Sack Color or Type	Associated Class	% of Associated Class in Sack Type	Cohen Mixed Mail Distribution to Associated Class
Blue & Orange	Express	76%	0.6%
Brown	Periodicals	72%	4.6%
Green	First Class	73%	60.0%
International	International	90%	2.5%
Orange & Yellow	Priority	86%	3.4%
White	Standard A	63%	22.3%

Source: MPA-T-2, Table 4 (Tr. 26/14048) and Tr. 26/14092.

As Table 1 shows, Ms. Cohen's distribution (and, to a similar extent, the LIOCATT distribution) would distribute only 3.4% of the cost of a mixed mail Orange & Yellow sack to Priority Mail, for example, even though postal operations define these sacks as being used for Priority Mail and, when counted, 86% of what they contain is Priority Mail – over 25 times more than Ms. Cohen's approach would distribute to Priority Mail. On the other hand, under the Postal Service's method 86% of the cost of uncounted Orange & Yellow sacks would be distributed to Priority Mail, with the remaining 14% distributed to the other subclasses actually found in the counted Orange & Yellow sacks.

Ms. Cohen attempts to minimize this considerable discrepancy by pointing out that while her technique would allocate only 3.4% of the costs of mixed Orange & Yellow sacks to Priority Mail, her method would also allocate 3.4% of the cost of Brown sacks to Priority Mail (even if no Priority Mail were found in brown sacks), so that, somehow or other, it all balances out in the end.<sup>4</sup> In short, in her view, two wrongs make a right.

<sup>4</sup> Tr. 26/14094.

1           In her Docket No. R94-1 testimony, Ms. Cohen acknowledged what she is  
 2 reluctant to admit in this case, i.e., that different sack types are used by the  
 3 Postal Service for different classes of mail; in Docket No. R94-1 she replied  
 4 "Yes" to the question, "[t]he intent of having different colored sacks is to signify  
 5 to postal processing personnel the type of mail in the sack. Is that correct?"  
 6 Docket No. R94-1, Tr. 26A/12396-97.

7           Ms. Cohen's own Table 4 data show that item type is an important  
 8 predictor of the mail contained within items. Mr. Degen makes use of this fact,  
 9 whereas Ms. Cohen and the existing LIOCATT system ignore it.<sup>5</sup>

10           In Docket No. R94-1 Ms. Cohen relied on a chi squared test to determine  
 11 whether the types of mail in (1) the counted mixed mail sample, (2) the  
 12 uncounted mixed mail sample, and (3) the container sample were significantly  
 13 different from each other.<sup>6</sup> This test is designed for the purpose of determining  
 14 whether a known population (in this case, counted mixed mail) accurately  
 15 represents an unknown population (uncounted mixed mail). She concluded that  
 16 for the data available in Docket No. R94-1, counted mixed mail was not  
 17 representative of uncounted mixed mail.

18           The data available in this case is significantly better than the data that  
 19 were available in Docket No. R94-1. A substantially greater proportion of  
 20 eligible items was counted in this case -- 52% versus 27% in Docket No. R94-  
 21 1.<sup>7</sup> I have applied the same test used by Ms. Cohen in R94-1 to the expanded

5.     The association between sack type and mail class is slightly less strong  
 for counted sacks alone (as opposed to counted and direct sacks  
 together), but the conclusion remains the same.

6.     Docket No. R94-1, Tr. 26A/12358.

7.     See USPS/MPA-T2-20(b), Tr. 14133-34. The 52% figure is derived by  
 dividing the cost of uncounted items by the cost of all items subject to  
 counting.

1 data available in this case, using the same methods and variables which she  
2 used.<sup>8</sup> The hypothesis tested is that counted mixed mail is not statistically  
3 different from uncounted mixed mail. For counted mixed mail compared to  
4 uncounted mixed mail not in containers, the test reveals that, for 11 out of the 14  
5 variables tested, the hypothesis cannot be rejected at a stringent 99.5%  
6 confidence interval (the same standard used by Ms. Cohen in Docket No. R94-  
7 1). That is, the result in this case of Ms. Cohen's Docket No. R94-1 test is that  
8 for these 11 variables, *counted mixed mail is not statistically different from*  
9 *uncounted mixed mail not in containers.*

10 Of the remaining three variables, two are variants on Basic Function. If  
11 the confidence interval is adjusted to the commonly used 95% level, one of  
12 these would pass the test (i.e., the conclusion is that counted mixed mail is not  
13 significantly different from uncounted mixed mail for that variable). One of the  
14 other two variables is the data derived from the answer to IOCS question 18D  
15 Part 2, which is related to the type of mail processing operation sampled. Since  
16 Mr. Degen's distributions are stratified by MODS pools (which are related to mail  
17 processing operations), any differences between counted and uncounted mixed  
18 mail should be mitigated by virtue of his stratification. Finally, while for the  
19 remaining variable counted mixed mail does not pass the test, this one result  
20 does not negate the overwhelming conclusion that, on the whole, counted mixed  
21 mail is not statistically significantly different from uncounted mixed mail.

22 Similar results are found in comparing counted mixed mail to the mixed  
23 mail in containers. For 12 out of the 14 variables tested, the hypothesis cannot  
24 be rejected at a stringent 99.5% confidence interval; adjusting the confidence  
25 interval to 95% causes an additional variable to pass the test. The remaining

---

8. One variable used in Ms. Cohen's analysis, F266, does not appear in the current data set and therefore is not included in this analysis.

1 variable is derived from the answer to IOCS question 18D Part 2. As stated  
2 before, since Mr. Degen's distributions are stratified by MODS pools, any  
3 differences between counted mixed mail and uncounted mixed mail in containers  
4 should be mitigated by virtue of this stratification.

5 As noted, these results are likely due to the fact that the Postal Service  
6 has made significant gains in the proportion of eligible mixed mail that is  
7 counted. In Docket No. R94-1, a little more than one-fourth (approximately 27%)  
8 of eligible mixed mail was counted; in this case, more than half (52%, or almost  
9 double the proportion in Docket No. R94-1) of eligible mixed mail has been  
10 counted. Mr. Degen has based his proposed distributions on the more robust  
11 data provided by this expanded count of mixed mail.

12 In Docket No. R94-1 Ms. Cohen also conducted t-tests in an attempt to  
13 investigate Mr. Stralberg's asserted suspicion that IOCS data collectors were  
14 more likely to count items with fewer pieces. She examined whether data  
15 collectors were more likely to count (1) certain item types, (2) mail in certain  
16 types of operations, or (3) mail in certain facility types.<sup>9</sup> Since Mr. Degen's  
17 proposed distributions in this case essentially stratify the distributions of mixed  
18 mail by these very variables (item type, MODS/BMC/Non-MODS, and, within  
19 MODS, operation-based cost pools), Ms. Cohen's Docket No. R94-1 findings in  
20 this regard are no longer relevant in this proceeding .

21 **DISTRIBUTION WITHIN COST POOLS**

22 Witnesses Stralberg and Cohen have asserted that Mr. Degen's use of  
23 cost pools as strata within which he distributes mixed mail and overhead costs  
24 should be rejected because of an alleged "automation refugee" problem. They

---

9. Docket No. R94-1, Tr. 26A/12359-62.

1 assert that the Postal Service systematically sends surplus employees to  
2 operations where productivity is not measured, thus generating higher not  
3 handling mail costs in those operations. The result, they claim, unfairly  
4 penalizes those subclasses of mail with direct IOCS tallies in these operations.

5 There is no proof of this claim. The asserted automation refugee  
6 phenomenon was "reasoned" to be the cause of increases in Periodicals mail  
7 processing costs by witnesses Stralberg and King in Docket No. R90-1.<sup>10</sup>

8 Whether one believes that differing degrees of not handling mail costs by  
9 mail processing operation (in this case, MODS cost pools) are the result of  
10 shifting employee assignments or instead a manifestation of evolving mail  
11 processing environments, increased containerization, and other factors, the fact  
12 remains that not handling mail costs are higher in certain operations than in  
13 others. Mr. Degen merely proposes that the classes of mail which are handled  
14 in an operation bear the costs of not handling mail in that same operation.

15 Rather than inferring inefficient or devious Postal Service staffing  
16 decisions over a multi-year period, Mr. Degen uses actual data on the incidence  
17 of not handling costs by operation. This represents an improvement over  
18 LIOCATT, which allocated not handling costs at the most aggregate level.

19 **DATA THINNESS**

20 Several intervenors have expressed the concern that by parsing counted  
21 and direct mixed mail data into item and container types within defined cost  
22 pools, in some cases Mr. Degen has insufficient data points in his distribution  
23 keys. There are three important points to note on this issue: (1) using Ms.  
24 Cohen's own definition to determine the extent of the problem, it is limited to less  
25 than 5.7% of mixed mail costs; (2) the existence of data thinness in Mr. Degen's

---

10. See Tr. 26/14030.

1 distributions is significantly reduced relative to the distribution proposal that was  
2 before the Commission in Docket No. R94-1; and (3) the existing distribution  
3 system (LIOCATT) and the intervenors' counterproposals in this case also  
4 exhibit data thinness.

5 Ms. Cohen appears to agree that in this case 5.7% of mixed mail costs  
6 are distributed on the bases of five tallies or less.<sup>11</sup> However, that is not the  
7 same criterion she put forward in Docket No. R94-1. At that time, she stated that  
8 "[g]enerally accepted statistical practices dictate that there should be at least  
9 five observations in a cell to represent adequately a distribution."<sup>12</sup> While the  
10 difference may seem small (five tallies or fewer versus fewer than five tallies),  
11 using Ms. Cohen's original standard reduces the affected costs to 4.9% rather  
12 than 5.7%.

13 In either event, this result is a significant improvement over the situation  
14 the Commission faced in Docket No. R94-1. In that case, *at least 14%* of mixed  
15 mail costs would have been distributed on the basis of five or fewer tallies –  
16 three times more than is the case under Mr. Degen's improved approach here.<sup>13</sup>

17 There is less "thinness" in this case in part because, unlike in Docket No.  
18 R94-1, Mr. Degen removes CAG as a stratification level. By aggregating many

---

11. See Tr. 26/14101-02 and MPA-LR-9.

12. Docket No. R94-1, Tr. 26A/12365. Also, in oral cross-examination in that case Ms. Cohen replied "Yes" when asked, "And when you say adequate data, your test was five data points or more?" Docket No. R94-1, Tr. 26A/12381-82.

13. Docket No. R94-1, Tr. 26A/12382.

1 of the smaller CAG offices into a single Non-MODS strata, he provides a more  
2 robust set of distribution keys.<sup>14</sup>

3 It is important to recognize that data thinness is not unique to Mr. Degen's  
4 proposal. LIOCATT also exhibits thinness issues, as does Ms. Cohen's  
5 proposal.<sup>15</sup> In short, the data thinness concerns raised in this proceeding are  
6 not unique to Mr. Degen's approach. The significant improvements his  
7 distribution methods achieve should not be rejected because of a concern that is  
8 also applicable to the available alternatives.

9 **CONCLUSION**

10 Mr. Degen's approach is a significant improvement over both LIOCATT  
11 and the Docket No. R94-1 proposal previously reviewed by the Commission.  
12 LIOCATT is not without its own faults and assumptions. With his pool-based  
13 approach, Mr. Degen has made use of the expanded (relative to Docket No.  
14 R94-1) counted mixed mail data and has improved upon the R94-1 proposal.  
15 Intervenor criticisms of his approach are not compelling, especially in light of the  
16 shortcomings in the alternatives to it.

17 I strongly urge the Commission to adopt the cost distributions provided in  
18 my supplemental testimony, which result from Mr. Degen's approach and are  
19 based on returning the variability assumptions to those previously determined by  
20 the Commission.

---

14. For the Non-MODS pools, Mr. Degen retains the Basic Function strata used in LIOCATT.

15. See UPS/MPA-T2-7(d)-(e), (f), Tr. 26/14101-02.



1           CHAIRMAN GLEIMAN: On March 17th, Witness Sellick  
2 filed a revised response to Presiding Officer's Information  
3 Request No. 16, and I'm going to hand two copies of the  
4 revised response to the Reporter and ask that it be included  
5 in the record at this point.

6  
7                           [Revised Response of UPS Witness  
8 Sellick to POIR-16 was received  
9 into evidence and transcribed into  
10 the record.]

11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

RESPONSE OF UPS WITNESS SELICK TO  
PRESIDING OFFICER'S INFORMATION REQUEST NO. 16

1. In UPS LR-8 and LR-8 Replacement, the SAS program MOD1DIR creates the data file CONTEMP at line 1151 in the log and stores the file in the subdirectory c:\iocspoir\mod1dir. The log "NOTE" reports that the data file CONTEMP has 6,261 observations.

According to the logs in the library references, the file CONTEMP is not used again until the SAS program MOD3CONT uses it at line 1730 of the log to make changes in variable definitions and assign the name MIX to the resulting file. In this instance the file CONTEMP is accessed from the subdirectory c:\iocscases3\mod1dir. The NOTE following the operation reports that there are 6,478 observations in the file MIX.

Please confirm that the file CONTEMP as used at line 1730 in the program MOD3CONT should be the same file that is created at line 1151 in the program MOD1DIR and MIX should have 6,261 observations.

If confirmed, please run the programs MOD1DIR through MOD4DIST and submit the output, logs and revised programs.

If not confirmed, please explain why MIX has 6,478 observations and identify the SAS operations that created the file CONTEMP in the subdirectory c:\iocscases3\mod1dir.

**RESPONSE:** Confirmed. Attached to this response are the results of running the programs MOD1DIR through MOD4DIST. The other requested materials are being filed as Library Reference UPS-LR-9.

**RESPONSE TO POIR # 16**  
**MOD4DIST.LST RESULTS CHANGED TO CORRECT**  
**FOR MISSTATED LIBNAME STATEMENT**

Class	Original	Corrected	Change	Pct Change
1-1C LP	4,414,637	4,413,941	(696)	-0.02%
2-1C PR	946,642	946,394	(247)	-0.03%
3-PSTLC	2,561	2,562	1	0.03%
4-PVTC	128,683	126,648	(35)	-0.03%
5-PRSTC	31,718	31,704	(15)	-0.05%
6-PRIOR	585,003	584,875	(128)	-0.02%
7-EXPRS	106,693	106,661	(33)	-0.03%
8-MGRAM	88	88	0	0.04%
9-2C211	11,614	11,562	(52)	-0.45%
9-2C212	421,290	421,315	25	0.01%
9-2C213	74,028	74,035	7	0.01%
9-2C214	4,137	4,137	0	0.00%
10-3COZ	63,390	63,350	(41)	-0.06%
11-3CRGP	202,496	202,580	84	0.04%
12-3CRGC	1,269,035	1,268,891	(144)	-0.01%
13-3CNPP	22,935	22,940	5	0.02%
14-3CNPO	323,342	323,180	(162)	-0.05%
15-4CPCL	82,954	82,925	(29)	-0.04%
16-4CPRN	35,869	35,858	(12)	-0.03%
17-4CSPC	27,871	27,870	(1)	0.00%
18-4CLIB	7,817	7,818	1	0.01%
19-USPS	70,608	70,576	(33)	-0.05%
20-FREE	9,416	9,384	(32)	-0.34%
21-INTL	202,386	202,393	6	0.00%
22-REGIS	80,610	80,645	36	0.04%
23-CERT.	15,609	15,642	33	0.21%
24-INS.	278	279	1	0.19%
25-COD	1,224	1,225	2	0.13%
26-SP DL	749	751	2	0.21%
27-SP HD	127	127	0	0.37%
28-OTHSV	68,539	68,570	31	0.05%
5020	757	758	1	0.08%
5040	18,458	18,480	21	0.12%
5050	362	362	0	0.12%
5060	50	50	0	0.15%
5070	750	750	1	0.09%
5080	1,471	1,473	2	0.12%
5090	105	105	0	0.07%
5110	381	382	1	0.13%
5120	377	377	0	0.05%
5130	207	208	0	0.15%
5170	2,192	2,194	2	0.10%
5180	123	123	0	0.04%
6000	4,268	4,270	4	0.08%
6010	13,675	13,693	17	0.13%
6020	6,692	6,698	6	0.10%
8030	4,569	4,574	4	0.10%
8040	1,923	1,925	2	0.12%

**RESPONSE TO POIR # 16**  
**MOD4DIST.LST RESULTS CHANGED TO CORRECT**  
**FOR MISSTATED LIBNAME STATEMENT**

Class	Original	Corrected	Change	Pct Change
6045	875	876	1	0.14%
6050	231	231	0	0.07%
6070	1,137	1,138	1	0.11%
6073	646	647	1	0.10%
6080	484	484	0	0.11%
6110	537	538	1	0.14%
6120	1,003	1,004	1	0.06%
6130	368	368	0	0.11%
6140	49	49	0	0.15%
6170	34,822	34,857	34	0.10%
6180	668	667	1	0.12%
6200	2,132	2,134	2	0.10%
6210	107,797	107,922	124	0.12%
6220	3,498	3,502	4	0.12%
6230	58,947	58,989	42	0.07%
6240	17,506	17,527	22	0.12%
6320	9,049	9,068	19	0.21%
6330	9,103	9,112	9	0.10%
6420	13,073	13,095	22	0.17%
6430	40,473	40,527	54	0.13%
6480	2,090	2,093	3	0.15%
6480	8,614	8,632	18	0.21%
6495	2,896	3,000	4	0.15%
6500	2,039	2,036	3	0.17%
6511	966	967	1	0.08%
6512	520	520	1	0.10%
6514	80	81	0	0.44%
6518	2,160	2,165	5	0.23%
6519	14,635	14,666	31	0.21%
6521	12,220	12,236	15	0.12%
6523	383	384	0	0.10%
6610	19,396	19,427	31	0.16%
6620	10,751	10,775	24	0.12%
6630	339,561	339,963	403	0.12%
6640	3,128	3,130	3	0.08%
6650	17,701	17,717	16	0.09%
6660	4,970	4,977	7	0.16%
7521	165,549	165,795	246	0.15%
7523	39,742	39,956	213	0.54%
<b>TOTAL</b>	<b>10,225,602</b>	<b>10,225,602</b>	<b>0</b>	<b>0.00%</b>

RESPONSE OF UPS WITNESS SELICK TO  
PRESIDING OFFICER'S INFORMATION REQUEST NO. 16

2. In response to POIR Number 11, the total Segment 3 costs reported is \$16,456,634 thousand (UPS witness Sellick, Workpaper 2-A, BSE100.XLL, CS 3 Sheet, page 3) which exceeds the Postal Service Segment 3 costs of \$16,456,099 thousand (USPS-T5A at 2) by \$535 thousand. Please explain why the total Segment 3 costs do not match and identify changes that need to be made to eliminate the difference.

RESPONSE: I have been unable to identify the specific reason for the .0003% difference between my calculations and those of the Postal Service. To correct for this difference, I would multiply the total Cost Segment 3 cost in each component by .999967490 to adjust it so that the total would match the Postal Service's.

1 CHAIRMAN GLEIMAN: Two participants have requested  
2 oral cross examination of Witness Sellick, Magazine  
3 Publishers of America and United States Postal Service.  
4 Does any other party wish to cross examine the witness?

5 [No response.]

6 CHAIRMAN GLEIMAN: If not, Mr. Gold, please  
7 proceed when you are ready.

8 MR. GOLD: Thank you, Mr. Chairman.

9 CROSS EXAMINATION

10 BY MR. GOLD:

11 Q Good afternoon, Mr. Sellick.

12 A Good afternoon.

13 Q I'd like to begin with page four of your  
14 testimony.

15 A I have that.

16 Q Specifically, table one.

17 A Yes.

18 Q In that table, you show certain sack types that  
19 are associated with certain mail classes; is that correct?

20 A Yes, it is.

21 Q The source of this table is Ms. Cohen's table four  
22 from MPA-T-2; is that correct?

23 A In part, yes.

24 Q You prepared this table, this is not her  
25 testimony, this is your table; correct?

1 A That's correct.

2 Q In fact, Ms. Cohen did not distribute the costs  
3 this way, did she?

4 A No, she did not.

5 Q Basically, this is an implicit distribution that  
6 you have derived from various sources?

7 MR. McKEEVER: Mr. Chairman, may I ask for  
8 clarification? There are two columns of numbers there. May  
9 I ask which column Mr. Gold is referring to?

10 MR. GOLD: Well, my questions went to the table,  
11 but specifically to the last column where it says Cohen,  
12 mixed mail distribution to associated classes.

13 MR. McKEEVER: Thank you, Mr. Chairman.

14 BY MR. GOLD:

15 Q Mr. Sellick, do you know the general magnitude of  
16 not handling and mixed mail costs in this record?

17 A Not handling and mixed mail together? Something  
18 on the order of \$2 to \$3 billion.

19 Q Isn't it more on the order of \$7 billion?

20 A That's I believe if you count overhead as well,  
21 but mixed mail and not handling separately I think are two  
22 to three.

23 Q Of course, overhead is part of not handling; is it  
24 not?

25 A Overhead is typically defined as the break -- the

1 billion.

2 A I'm not sure that's an appropriate way of looking  
3 at this, because the overhead costs are distributed on top  
4 of direct and mixed and counted mixed and distributed mixed  
5 costs, so it isn't necessarily that order. But this amounts  
6 to \$45 million.

7 Q Well, Mr. Sellick, I wasn't suggesting that this  
8 table implies any distribution of those overhead costs.  
9 What I'm trying to establish is the general magnitude of the  
10 cost that you're focusing on with the pool of costs that Ms.  
11 Cohen was focusing on, and in that light is my .7 percent  
12 about right?

13 A I'll accept the calculation.

14 Q And if we looked just at mixed mail costs, the --  
15 would you accept that those are approximately \$1-1/2  
16 billion? Does that sound about right?

17 A For mixed mail?

18 Q For mixed mail.

19 A All mixed mail, not limited to items.

20 Q Correct.

21 A I'll accept that number.

22 Q And again doing the arithmetic, that's  
23 approximately three point -- this table represents  
24 approximately 3.1 percent of the total pool of costs that  
25 she was discussing with respect to mixed mail.



1           A     Again, I'll accept the calculation, but again  
2 point out that the discussion might be appropriately more  
3 limited to item type distribution, which is the basis of  
4 sacks.

5           Q     Now this table was first derived and discussed in  
6 UPS/MPA-2-T-1. Is that not correct?

7           A     I believe that's correct. Yes.

8           Q     Do you have a copy of that interrogatory?

9           A     I don't believe I do with me; no.

10          MR. GOLD: Does counsel?

11                   And for the record, that's at transcript 26,  
12 14091.

13          MR. McKEEVER: Do you want me to give it to him?

14          MR. GOLD: Go ahead, unless you want me to.

15          THE WITNESS: I have that citation now.

16          BY MR. GOLD:

17          Q     Okay. And would you look at question B under that  
18 interrogatory?

19          A     I have that. Question B or answer B?

20          Q     Well, first question B. In that question UPS  
21 asked her to confirm the distribution of the costs.

22          A     Yes.

23          Q     Is that not correct?

24          A     Yes.

25          Q     And her answer was I cannot confirm -- cannot

1 confirm, because I do not know how you calculated the  
2 percentages in the Cohen distribution to associated class  
3 column. I did not perform such a calculation because I  
4 distributed mixed mail costs by activity code, not by mail  
5 type.

6 And then she goes ahead and gives a table  
7 comparing the direct and mixed mail costs and shows that  
8 they're closely associated, does she not?

9 A Yes, she does.

10 Q And looking at question C in that interrogatory --

11 A Yes.

12 Q The question was please confirm that with the  
13 exception of green sacks your distribution methodology would  
14 result in a significantly reduced proportion of mixed mail  
15 sacks, sack costs being distributed to their associated  
16 classes relative to Witness Degen's distribution.

17 Is that a correct reading of that interrogatory?

18 A Yes, I believe it is.

19 Q And would you look at her answer to that?

20 A I have that.

21 Q And there she suggests that there is strong  
22 evidence on the record that such associations would be far  
23 weaker in mixed mail sack tallies than in direct sack  
24 tallies, particularly identical sack tallies.

25 Do you see that in her answer?

1           A     I do see that. I recall her response and I see it  
2 here. Yes.

3           Q     Do you have any reason to disagree with that?

4           A     No. Identical sack tallies would tend to, when  
5 combined with ~~accounted~~ <sup>counted</sup> mixed, would tend to increase the  
6 proportion, as I believe I point out in a footnote in my  
7 rebuttal testimony, that the association on page 5, footnote  
8 5, the association between sack type and mail class is  
9 slightly less strong for counted sacks alone, as opposed to  
10 counted and direct sacks together, but the conclusion  
11 remains the same.

12          Q     And getting to the broader question in this  
13 regard, doesn't she say that the question seems to suggest  
14 that there is a known association between classes and sack  
15 type for mixed sack tallies, and she seems to believe that  
16 there's not.

17          A     She -- yes, she does believe that there is not. I  
18 do not agree with that belief.

19          Q     In essence your table is based on an average, is  
20 it not, an aggregation across 50 cost pools?

21          A     I'm not sure I understand your question.

22          Q     Well, did the Postal Service distribute these  
23 costs in this way? Didn't they do it within cost pools?

24          A     They did it within cost pool by item type where  
25 appropriate. Yes.

1 Q Would you turn to your testimony that begins on  
2 the bottom of page 7?

3 A I have that.

4 Q From page seven to page eight, you spend  
5 approximately 21 lines on this area of testimony; is that  
6 correct?

7 A That seems about the right number of lines.

8 Q Is this the summary of all your criticisms about  
9 this area?

10 A It says what it says. It represents points I wish  
11 to make on rebuttal testimony.

12 Q Specifically looking at lines eight to 14, page  
13 eight, would you look at that?

14 A I have that.

15 Q That says whether one believes that differing  
16 degrees of not handling mail costs by mail processing  
17 operation, in this case, MODS cost pools, are the result of  
18 shifting employee assignments or instead, a manifestation of  
19 evolving mail processing environments, increased  
20 containerization and other factors, the fact remains that  
21 not handling mail costs are higher in certain proportions  
22 than in others. That's your testimony, is it not?

23 A Actually, with one small correction, certain  
24 operations than in others.

25 Q I'm sorry.

1 A Yes.

2 Q Certain operations than in others. Is it your  
3 position that the various sub-classes of mail that are  
4 "handled in an operation" should bear those costs regardless  
5 of whether they caused those costs?

6 A That is the effect of distributing those costs,  
7 that they bear the overhead costs in those pools.

8 Q When you say they bear those costs, does that  
9 necessarily mean they cause those costs?

10 A It is not necessarily the conclusion that they  
11 cause those costs, no.

12 Q Would you turn to your section on data thinness?

13 A I have that.

14 Q Do you agree that there needs to be five  
15 observations for each cell in a distribution?

16 A I'm not sure -- I have not put that out as a  
17 standard. I am commenting on Ms. Cohen's previous standard  
18 that she established in that regard.

19 Q Do you have an opinion in that regard?

20 A Actually, having reviewed Mr. Degen's rebuttal  
21 testimony and looking at his calculations on the coefficient  
22 of variation, I believe that's a good way of looking at  
23 determining whether the distribution method results in  
24 significantly more variance than the LIOCATT system.

25 Q Does this mean that if there are six classes of

1 mail observed in an item type, there would need to be 30  
2 observations for there to be adequate data to do the  
3 distribution?

4 A I'm sorry. Could you repeat the question?

5 Q We established that you need five observations for  
6 each cell; correct?

7 A Well --

8 MR. McKEEVER: Objection, Mr. Chairman. Mr.  
9 Sellick indicated that was Ms. Cohen's test. If Mr. Gold, I  
10 believe, is now trying to ask him what is Ms. Cohen's test.

11 MR. GOLD: I withdraw the question.

12 BY MR. GOLD:

13 Q You do agree that coefficient of variation is the  
14 proper way to address this issue, do you not?

15 A In reviewing Mr. Degen's rebuttal testimony, it  
16 seems to me that it's a good way to look at it.

17 Q In fact, the record in this case reveals that for  
18 coefficients that she examined, for 70 percent of the  
19 numerators, the coefficient of variations were so large that  
20 there is no basis to suggest that the numerators are not  
21 zero? Do you recall that testimony?

22 A I do recall some testimony to that effect, but I  
23 was specifically referring to Mr. Degen's point that the  
24 best measure, as I recall his testimony, is the final cost  
25 estimates and the coefficient of variation of those final

1 cost estimates, which are ultimately the numbers that are  
2 used.

3 Q Would you turn to page ten of your testimony?

4 A I have that.

5 Q And at the very end of your testimony you state:  
6 I strongly urge the Commission to adopt the cost  
7 distributions provided in my supplemental testimony which  
8 result from Mr. Degen's approach and are based on returning  
9 the variability assumptions to those previously determined  
10 by the Commission.

11 Is that your testimony?

12 A Yes, it is.

13 Q Is it your position that you can implement the  
14 Degen approach if all cost pools are assumed to have the  
15 same variability?

16 A The -- my position is that you can use the  
17 approach I have taken, and that is taking costs using Mr.  
18 Degen's approach with the previous Commission assumptions of  
19 volume variability. I only state that -- restate that  
20 slightly, in that although the cost pools for purposes of  
21 running the SAS programs are returned to 100-percent  
22 variability, implicitly some of them are not, because they  
23 are treated as fixed mail processing and so on as discussed  
24 in some of my work papers. But yes, I do believe that Mr.  
25 Degen's approach can be used as I have used it.

1 Q Do you have an opinion about whether this distorts  
2 the cost distributions to allied activities?

3 A Distorts in what regard?

4 Q The fact that the -- all the cost pools are  
5 assumed to have the same variability.

6 A I don't -- I'm sorry.

7 Q Do you have any opinion about the effect of that  
8 on allied activities?

9 MR. MCKEEVER: Objection, Mr. Chairman. I believe  
10 that's beyond the scope of the rebuttal testimony, which  
11 does not deal with allied operations at all, it deals with  
12 two very narrowly defined subjects.

13 CHAIRMAN GLEIMAN: I believe Mr. Gold just nodded  
14 his head in agreement.

15 MR. GOLD: I withdraw the question.

16 That's all I have, Your Honor -- Mr. Chairman.

17 CHAIRMAN GLEIMAN: The Postal Service?

18 MR. KOETTING: We have no questions, Mr. Chairman.

19 CHAIRMAN GLEIMAN: And? Is there any followup to  
20 Mr. Gold's cross-examination?

21 No.

22 And there are no questions from the bench that I'm  
23 aware of.

24 That brings us to redirect. Would you like some  
25 time with your witness?



1 MR. MCKEEVER: Yes, Mr. Chairman, I'd appreciate  
2 just a few minutes.

3 CHAIRMAN GLEIMAN: Okay. Why don't you take five  
4 minutes?

5 MR. MCKEEVER: Thank you.

6 [Recess.]

7 CHAIRMAN GLEIMAN: Mr. McKeever.

8 MR. MCKEEVER: We have no questions, Mr. Chairman.

9 CHAIRMAN GLEIMAN: Inasmuch as there's no  
10 redirect, I want to thank you, Mr. Sellick. We appreciate  
11 your appearance here today and your contributions to the  
12 record. And if there's nothing further, you're excused.

13 [Witness excused.]

14 CHAIRMAN GLEIMAN: Mr. Todd, I believe -- I  
15 thought I saw you over there somewhere. I believe your  
16 witness is the next witness. If you could identify him, so  
17 that I can swear him in.

18 MR. TODD: The Mail Order Association of America  
19 would like to present as its witness Mr. Roger C. Prescott.  
20 Whereupon,

21 ROGER C. PRESCOTT,  
22 a witness, was called for examination by counsel for the  
23 Mail Order Association of America and, having been first  
24 duly sworn, was examined and testified as follows:

25 DIRECT EXAMINATION

1 BY MR. TODD:

2 Q Mr. Prescott, do you have in front of you a  
3 document entitled Rebuttal Testimony of Roger C. Prescott,  
4 which has been marked as MOAA-RT-1?

5 A Yes, I do.

6 Q And was this testimony prepared by you or under  
7 your direction?

8 A Yes, it was.

9 Q And do you adopt it today as your testimony in  
10 this case?

11 A Yes, I do.

12 MR. TODD: Mr. Chairman, I am handing two copies  
13 of the identified testimony to the reporter with a request  
14 that it be admitted into evidence and transcribed into the  
15 record at this time.

16 CHAIRMAN GLEIMAN: Are there any objections?

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

20 [Rebuttal Testimony and Exhibits of  
21 Roger C. Prescott, MOAA-RT-1, was  
22 received into evidence and  
23 transcribed into the record.]

24

25

MOAA-RT-1

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

\_\_\_\_\_  
POSTAL RATE AND FEE CHANGES, 1997 )  
\_\_\_\_\_) )

Docket No. R97-1

REBUTTAL TESTIMONY  
OF  
ROGER C. PRESCOTT  
Vice President  
L. E. Peabody & Associates, Inc.

On Behalf Of  
MAIL ORDER ASSOCIATION OF AMERICA

Communications with respect to this document may be sent to:

David C. Todd  
Patton, Boggs, L.L.P.  
2550 M Street, N.W.  
Washington, D.C. 20037  
(202) 457-6000

Counsel for Mail Order  
Association of America

Due Date: March 9, 1998

TABLE OF CONTENTS

	<u>Page</u>
I. PURPOSE OF THE TESTIMONY .....	1
II. SUMMARY AND CONCLUSIONS .....	3
III. COMPARISON OF USPS' AND WITNESS HALDI'S PROPOSED RATES .....	5
IV. IDENTIFICATION OF "BOTTOM-UP" COSTS .....	9
V. WITNESS HALDI'S RATE PROCEDURES .....	12
A. Witness Haldi's Procedures .....	12
B. General Critique .....	15
VI. SORTATION DISCOUNTS PROPOSED BY USPS AND WITNESS HALDI .....	17

LIST OF EXHIBITS

<u>ITEM</u> (1)	<u>TITLE</u> (2)
Appendix A	Statement of Qualifications
Exhibit __MOAA-RT-1A	Summary of Witness Haldi's Constructed Rates for Letters
Exhibit __MOAA-RT-1B	Appendix B: Errors and Assumptions In Witness Haldi's Procedures



1 on behalf of Val-Pak Direct Marketing Systems, Inc., Val-Pak Dealers' Association, Inc. and  
2 Carol Wright Promotions, Inc. (collectively referred to herein as "VP-CW"). Specifically, I  
3 have been asked to evaluate the appropriateness of the adjustments proposed by Witness Haldi  
4 to the USPS' rate schedule for the ECR subclass. Witness Haldi's proposed rates are  
5 summarized in Table 6 to his testimony (Tr. 27/15087).

6 The results of my analyses are summarized under the following topics:

- 7 II. Summary and Conclusions
- 8 III. Comparison of USPS' and Witness Haldi's Proposed Rates
- 9 IV. Identification of "Bottom-Up" Costs
- 10 V. Witness Haldi's Rate Procedures
- 11 VI. Sortation Discounts Proposed By USPS and Witness Haldi

1

## II. SUMMARY AND CONCLUSIONS

2

Based on my review of the USPS' proposed rates in this proceeding and the direct testimony

3

of VP-CW's Witness Haldi, I conclude the following:

4

1. The rates proposed by VP-CW's Witness Haldi for the ECR subclass are based on an approach that contains numerous errors in logic and mathematics and the rates, therefore, should be rejected;

5

6

7

2. Witness Haldi's proposed rates reflect an increase to the sortation discounts. His proposed discounts for ECR high-density and saturation mail are increased between 0.4 cents per piece and 0.8 cents per piece for letters and 0.6 cents per piece for nonletters over the USPS' proposal;

8

9

10

11

3. In order for Witness Haldi's proposal to be revenue neutral with the USPS' proposal, Witness Haldi had to increase the USPS' proposed base rates for ECR mail by 0.3 cents per piece, i.e., from 16.4 cents per piece to 16.7 cents per piece. In addition, the USPS' proposed base rate per piece for pound rated mail had to be increased under Witness Haldi's proposal from 5.5 cents per piece to 5.8 cents per piece;

12

13

14

15

16

4. The per piece and per pound discounts proposed by USPS related to destination entry for letters and non-letters were not adjusted by Witness Haldi. In addition, Witness Haldi has accepted the USPS' proposed rate for pound-rated nonletters of \$0.53 per pound.

17

18

19

20

5. Witness Haldi's proposed rates for letters and nonletters are not based on "bottom-up" costs because he has not relied on costs reflective of the different functions and activities for each rate cell and he has utilized arbitrary criteria in developing his rate proposal. In order for rates to be based on "bottom-up" costs for each rate cell, specific data would need to be gathered in the USPS' cost system reflecting the specific functions and activities of each rate cell;

21

22

23

24

25

26

6. Witness Haldi's rate proposal relies on his claimed calculation of "bottom-up" costs for mail delivered to the Bulk Mail Center ("BMC"). Even assuming his cost procedures are correct, his proposal ignores the underlying "bottom-up" costs that were developed for the other ECR mail, i.e., mail without any destination entry or mail delivered to the Sectional Center Facility ("SCF") or Destination Delivery Unit ("DDU"); and,

27

28

29

30

31

7. Witness Haldi's analysis contains numerous mathematical errors. In addition, Witness Haldi's analysis is based on numerous assumptions which include the use of average

32

- 1 costs, faulty criteria for allocating costs, and arbitrary procedures for calculating rates.
- 2 Each of these conclusions is discussed in detail in the remainder of my testimony.



1           **III. COMPARISON OF USPS' AND WITNESS HALDI'S PROPOSED RATES**

2           The USPS proposed rate structure for the ECR subclass of Standard (A) mail incorporates  
3           sortation discounts for automation (letters only), high-density and saturation mail. Destination  
4           entry discounts are also offered for mail entered at the BMC, SCF or DDU. The USPS'  
5           proposed rates were developed and presented by Witness Moeller (USPS-T-36, page 31).

6           Val-Pak's<sup>1/</sup> mail consists exclusively of letter-shaped mail "entered at the Standard (A) Mail  
7           ECR Saturation Rate" (Tr. 27/15044). For this mail, "98 percent is entered at the destination  
8           Sectional SCF" and "2 percent is entered at BMCs..." (Tr. 27/15046). Witness Haldi does not  
9           specifically identify the type of mail prepared by Carol Wright<sup>2/</sup> but states that its "mail consists  
10          of both letter mail and nonletter mail primarily sent at the Standard (A) Mail ECR High-Density  
11          rate" (Tr. 27/15043). He also states that the Carol Wright mail reflects a "highly targeted  
12          geographic and demographic distribution..." (Tr. 27/15048).

13          Witness Haldi develops his rate proposal in Appendix A and Appendix C of his testimony.<sup>3/</sup>  
14          His rate proposal is summarized in Table 6 of his testimony (Tr. 27/15087).

15          A comparison of the USPS' proposed rates for ECR mail with Witness Haldi's proposal is  
16          shown in Table 1 below. The USPS' proposed rates are shown in Column (2) of Table 1.  
17          Witness Haldi's proposed rates are shown in Column (3) of Table 1. The difference between

---

<sup>1/</sup> Val-Pak refers to Val-Pak Direct Marketing Systems, Inc. and Val-Pak Dealers' Association, Inc.

<sup>2/</sup> Carol Wright refers to Carol Wright Promotions, Inc.

<sup>3/</sup> Appendix B to Witness Haldi's testimony develops the margin for ECR mail under the USPS' proposed rates. Appendix D of his testimony discusses the relationship of weight and cost. Neither of these appendices directly affect his proposed rates.

1 the USPS' proposal and Witness Haldi's proposal is shown in Column (4) of Table 1. Those  
2 items where the two proposals differ are noted in bold print.

3  
4

Table 1  
**Comparison of USPS' and Witness Haldi's Rate Proposals**

Item (1)	R97-1 Proposed Rates (cents)		
	USPS <sup>1/</sup> (2)	Haldi <sup>2/</sup> (3)	Difference <sup>3/</sup> (4)
<b>LETTERS</b>			
1. Base Rate - Per Piece	<b>16.4¢</b>	<b>16.7¢</b>	<b>0.3¢</b>
2. Discount For Sortation - Per Piece			
a. Automation	0.7	0.7	0.0
b. High-Density	<b>2.1</b>	<b>2.5</b>	<b>0.4</b>
c. Saturation	<b>3.0</b>	<b>3.8</b>	<b>0.8</b>
3. Discount For Destination Entry - Per Piece <sup>4/</sup>			
a. BMC	1.5	1.5	0.0
b. SFC	1.8	1.8	0.0
c. DDU	2.3	2.3	0.0
<b>NONLETTERS</b>			
4. Base Rate - Per Piece (Piece Rated)	<b>16.4¢</b>	<b>16.7¢</b>	<b>0.3¢</b>
5. Base Rate - Pound Rated			
a. Per Piece	<b>5.5</b>	<b>5.8</b>	<b>0.3</b>
b. Per Pound	53.0	53.0	0.0
6. Discount For Sortation - Per Piece			
a. High-Density	<b>1.1</b>	<b>1.7</b>	<b>0.6</b>
b. Saturation	<b>2.3</b>	<b>2.9</b>	<b>0.6</b>
7. Discount For Destination Entry - Per Pound			
a. BMC	7.2	7.2	0.0
b. SCF	8.8	8.8	0.0
c. DDU	11.0	11.0	0.0
<sup>1/</sup> Witness Moller, page 31. <sup>2/</sup> Witness Haldi, Table 6 (Tr. 25/15087). <sup>3/</sup> Column (3) minus Column (2). <sup>4/</sup> The per piece discount is also applicable to nonletters mailed at the per piece rates.			

5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28  
29  
30  
31  
32  
33

1        Witness Haldi suggests that the USPS' proposal should be modified by measuring the  
2        sortation discounts for high-density and saturation mail in the ECR subclass. Specifically, for  
3        high-density letters, Witness Haldi proposes a discount of 2.5 cents per piece which is 0.4 cents  
4        per piece greater than the USPS' proposal of 2.1 cents per piece (Table 1, Line 2b). For  
5        saturation letters, Witness Haldi proposes a discount of 3.8 cents per piece which is 0.8 cents  
6        per piece greater than the USPS' proposal of 3.0 cents per piece (Table 1, Line 2c). Finally,  
7        Witness Haldi proposes that the per piece discount for nonletters equal 1.7 cents per piece for  
8        high-density mail and 2.9 cents per piece for saturation mail, which is 0.6 cents per piece  
9        greater than the USPS' proposal of 1.1 cents per piece and 2.3 cents per piece, respectively  
10       (Table 1, Line 6).

11       According to Witness Haldi, his proposed rates "have been designed to provide the same  
12       revenues and contribution to institutional costs as the rates proposed by [USPS'] Witness  
13       Moeller..." (Tr. 27/15086). Stated differently, Witness Haldi's proposal is, overall, revenue  
14       neutral with the USPS' proposal.

15       In order to accomplish this neutrality, Witness Haldi increased the USPS' proposed base rate  
16       from 16.4 cents per piece to 16.7 cents per piece for both letter and nonletter mail (Table 1,  
17       Line 1 and Line 4). For pound-rated nonletters, the per piece component of the USPS proposed  
18       rate is increased by 0.3 cents per piece from 5.5 cents per piece to 5.8 cents per piece (Table 1,  
19       Line 5a)<sup>4/</sup>

---

<sup>4/</sup> The per piece increase conforms to the USPS' proposal which results in mail weighing 3.3 ounces paying the same amount on a per piece basis or on a per piece/per pound basis.

1           As part of Witness Haldi's rate design, he has not modified the USPS' proposed discounts  
2           for destination entry (Table 1, line 3 and line 7) or the automation discount for letters (Table 1,  
3           line 2a). Finally, Witness Haldi's rate proposal accepts the USPS' proposed pound rate for  
4           pound-rated nonletters. In this proceeding, the USPS has proposed a rate of \$0.53 per pound  
5           for pound-rated nonletters. Witness Haldi states that he examined the proposal submitted by  
6           USPS' Witness Moeller and considered the "recommended pound rate to be conservative,"  
7           (TR 27/15172).

1 **IV. IDENTIFICATION OF "BOTTOM-UP" COSTS**

2 Witness Haldi differentiates between rates developed using costs derived from a "top down"  
3 approach and a "bottom-up" approach. "Top down" costs are computed, according to Witness  
4 Haldi, when the USPS "determines a base cost for a rate subclass, and then computes costs  
5 avoided, or costs saved, and deducts the avoided costs from the base cost to arrive at the  
6 estimated net cost for individual rate categories or rate cells"<sup>5/</sup>.

7 Witness Haldi refers to "bottom-up" costs as costs determined when the USPS "computes  
8 the amount of volume-variable costs incurred, and adds costs incurred for different functions and  
9 activities, such as sorting and transportation, to arrive at the estimated costs for individual rate  
10 categories or rate cells."<sup>6/</sup> Based on Witness Haldi's claim that data is now available for ECR  
11 rates to be calculated using a "bottom-up" approach, Witness Haldi states that his testimony has  
12 the following three purposes:

13 "(1) to develop bottom-up costs for Standard (A) ECR mail; (2) to use those  
14 bottom-up costs to examine the Postal Service's proposed rate design; and (3) to  
15 propose alternative rates for Standard (A) ECR Mail that are designed within the  
16 context and economic logic of bottom-up costs." (Tr. 27/15042)

17 Witness Haldi asserts that the USPS' "reliance on a top down rate design methodology  
18 rather than a bottom up" methodology has resulted in contribution levels for saturation mail that  
19 are high and disproportionate as compared to other ECR mail (Tr. 27/15067). As discussed in  
20 the following sections of my testimony, Witness Haldi has not followed his theory of calculating

---

<sup>5/</sup> Tr. 27/15049. (emphasis and footnote omitted)

<sup>6/</sup> Tr. 27/15049. (emphasis omitted)

1 rates from a "bottom-up" approach. In order for Witness Haldi's proposal to be consistent with  
2 a "bottom-up" approach for calculating rates, the rates for each rate cell would have to be based  
3 on "bottom-up" costs.<sup>27</sup> Aside from the fact that he has not accurately calculated the volume-  
4 variable costs for each rate cell, Witness Haldi's rate design for ECR mail deviates from the  
5 "bottom-up" approach in several significant aspects:

- 6 1. For letter rates, only the rates proposed for destination entry at the BMC are based on  
7 Witness Haldi's underlying "bottom-up" costs. The other rate cells (no destination  
8 entry, SCF and DDU) are derived utilizing the USPS' proposed rate discounts which  
9 reflect costs avoided. Therefore, of the 16 rate cells for letters, only 4 reflect Witness  
10 Haldi's calculation of "bottom-up" costs;
- 11 2. If Witness Haldi followed his "bottom-up" approach for each of the 16 letter rate cells,  
12 Part C of Table C-2 in his testimony (Initial Target Rates) shows that the letter rates  
13 would vary significantly from his proposed rates. For example, his Initial Target Rate  
14 for basic letter mail without any destination entry would equal 15.8 cents per piece  
15 which is 0.6 cents per piece less than the USPS' proposed rate of 16.4 cents per piece.  
16 Conversely, Witness Haldi's Initial Target Rate for saturation mail entered at the DDU  
17 equals 11.5 cents per piece which exceeds the USPS' proposed rate of 11.1 cents per  
18 piece by 0.4 cents per piece.
- 19 3. For the 12 nonletter rate cells in Witness Haldi's proposal, none are based on "bottom-  
20 up" costs. The base rate for nonletters is set at the letter rate for basic, no destination  
21 entry. The destination entry discounts in Witness Haldi's proposal equal the USPS'  
22 proposed discounts (i.e., a deduction reflecting costs avoided). The sortation discount  
23 proposed by Witness Haldi reflects a 60 percent passthrough of his calculation of the  
24 costs avoided; and,
- 25 4. Witness Haldi does not adjust either the pound rate for nonletters proposed by the USPS  
26 of \$0.53 per pound or the pound rate for dropshipped mail, although his calculation of  
27 "bottom-up" costs assume an arbitrary amount for costs associated with weight.

---

<sup>27</sup> For purposes of the testimony, the rate cells for ECR mail reflect the shape of mail (letter and nonletter), dropshipping entry point (no destination entry, BMC, SCF and DDU) and level of sortation (basic, letter automation, high-density and saturation). This matrix equals 16 rate cells for letters and 12 rate cells for nonletters.

- 1 In summary, the failure of Witness Haldi to apply the logic of "bottom-up" costs in his rate
- 2 proposal invalidates his results.

1

**V. WITNESS HALDI'S RATE PROCEDURES**

2

3

4

5

6

7

The rates proposed by Witness Haldi for ECR mail are developed in Appendix A and Appendix C to his testimony.<sup>8/</sup> The goal of these appendices is to restate the USPS' base rates and sortation discounts, following Witness Haldi's theory of the "bottom-up" approach, so that the total revenues for letters and nonletters remain the same as developed by the USPS' Witness Moeller. My summary of Witness Haldi's procedure and a general critique of his methodology are discussed under the following topics:

8

A. Witness Haldi's Procedures

9

B. General Critique

10

**A. WITNESS HALDI'S PROCEDURES**

11

12

13

14

15

Exhibit\_(MOAA-RT-1A) summarizes Witness Haldi's procedures that he uses to develop his proposed rates for letters. Because the procedures followed by Witness Haldi for nonletters are based on the inputs derived from his analysis of letters and arbitrary assumptions regarding the cost per piece related to weight, I have not developed an exhibit summarizing his procedures for nonletters. The steps followed by Witness Haldi are summarized below.

16

17

Step 1. The aggregate revenues for letters and nonletters are developed from the USPS' volumes, rates and discounts.

18

19

Step 2. The aggregate costs were developed for letters and nonletters based on Test Year After Rates ("TYAR") volumes and Test Year unit costs. The total costs for

---

<sup>8/</sup> Appendix B to Witness Haldi's testimony summarizes the margins and mark-up ratios for the USPS' proposed rates and does not impact his rate design.



1 ECR mail matches the USPS' Cost and Revenue Analysis ("CRA") volume  
2 variable costs utilized by Witness Moeller.

3 Step 3. Based on the USPS' unit costs per pound for destination entry and the TYAR  
4 pounds developed from USPS data<sup>9/</sup>, the aggregate costs for dropshipping are  
5 developed for each rate cell (sortation category and destination entry). These  
6 costs are converted to unit costs based on Witness Haldi's calculation of the  
7 average weight per piece.

8 Letter Rates

9 Step 4. The unit costs for each rate cell are developed utilizing the USPS' mail  
10 processing and delivery costs and the transportation/other costs are developed in  
11 Step 3 above.

12 Step 5. The aggregate costs for each rate cell are computed by multiplying the TYAR  
13 volumes by the unit costs in Step 4 above. Because the calculated aggregate  
14 costs of \$463.2 million do not match Witness Haldi's calculation of the aggregate  
15 cost for letters of \$491.0 million (Step 4 above), he calculates a cost "true-up"  
16 of 0.32 cents per piece.

17 Step 6. The revised volume variable costs are computed as the base unit costs (Step 4)  
18 plus the cost "true-up" of 0.32 cents per piece (Step 5). The USPS' contingency  
19 factor of 1 percent is utilized to calculate the final costs for each rate cell.

20 Step 7. Rates are calculated for each rate cell based on a combination of rates reflecting  
21 a fixed margin of 8.20 cents per piece (90 percent weighting) and rates reflecting  
22 a fixed mark-up percentage of 2.4405 (10 percent weighting).

23 Step 8. Witness Haldi's constructed rates for mail at the BMC destination entry are  
24 summarized in the following tabulation.

	<u>Sortation</u>	<u>Cents Per Piece</u>
25	a. Basic	15.5
26	b. Automation	14.8
27	c. High-Density	13.0
28	d. Saturation	11.8
29		

30 The constructed rates for the other rate cells are not used. This fact was  
31 confirmed by Witness Haldi in response to interrogatories (Tr. 27/15183).

---

<sup>9/</sup> The pounds for letters and piece rated nonletters are based on 1996 statistics. The pounds for pound-rated nonletters are based on Witness Moeller's aggregate data.

- 1 Step 9. The rates for no destination entry, SCF and DDU were based on Witness  
2 Moeller's destination entry discounts, thus creating an Initial Target Rate for  
3 each rate cell. The difference between the no destination entry rate and BMC  
4 rate equals plus 1.5 cents per piece. The difference between the rates for BMC  
5 and SCF equals a reduction of 0.3 cents per piece. The difference between the  
6 rates for BMC and DDU equals a reduction of 1.8 cents per piece.
- 7 Step 10. The Initial Target Rates (Step 9) were multiplied by the TYAR volume for each  
8 rate cell to determine estimated revenues. Because the Initial Target Rates  
9 produce, in aggregate, more letter revenues than the USPS' proposal (Step 1),  
10 a revenue "true-up" of 0.33 cents per piece was developed.
- 11 Step 11. The Initial Target Rates for each rate cell (Step 9) are reduced by the revenue  
12 "true-up" (Step 10) and equal the final rate for each rate cell as summarized in  
13 Table 2 below.

14  
15  
16

<u>Sortation</u>	<u>No Destination Entry</u>	<u>BMC</u>	<u>SCF</u>	<u>DDU</u>
(1)	(2)	(3)	(4)	(5)
a. Basic	16.7c	15.2c	14.9c	14.4c
b. Automation	16.0	14.5	14.2	13.7
c. High-Density	14.2	12.7	12.4	11.9
d. Saturation <sup>1/</sup>	12.9	11.4	11.1	10.6

<sup>1/</sup>Because of rounding, the revenue "true-up" for saturation mail equals 0.4 cents per piece.

25

### Nonletter Rates

- 26 Step 12. For nonletters, Witness Haldi's rate design utilizes the same basic rate as letters  
27 of 16.7 cents per piece (Table 2, Column(2), line a).
- 28 Step 13. The discount for sortation (high-density and nonletter saturation) is based on  
29 Witness Haldi's assumption of a passthrough of 60 percent of the cost savings  
30 that he develops for piece rated nonletters with no destination entry  
31 (Tr. 27/15184). The sortation cost savings developed by Witness Haldi are  
32 based on the unit costs for mail processing and delivery costs included in Step 2

1 above along with an adjustment of 2.33 cents per piece determined from the  
2 average weight for piece rated nonletters.

3 Step 14. The per pound rate (53.0 cents per pound) and the per pound discount for  
4 destination entry are based on the USPS' proposal submitted by Witness Moeller.

5 Step 15. Witness Haldi's proposed per piece rate for pound rated pieces (5.8 cents per  
6 piece) is based on his proposed basic rate (Step 12) and the per pound rate  
7 (Step 14).<sup>10/</sup>

## 8 **B. GENERAL CRITIQUE**

9 Rates based on Witness Haldi's theory of "bottom-up" costs begin with volume variable  
10 costs and add the costs for specific functions and activities. The procedures summarized above  
11 do not reflect the "bottom-up" approach in the following seven (7) ways:

- 12 1. Witness Haldi derives his rates based on numerous assumptions which are unsupported.  
13 His separation of costs between letters and nonletters as well as his determination of  
14 weight related costs are based on faulty or unsupported logic. In addition, his analysis  
15 contains numerous input or mathematical errors. My specific critique of each of the  
16 tables in his Appendix A and Appendix C is contained in my Exhibit MOAA-RT-1B.
- 17 2. In Step 5 above, Witness Haldi adds a cost "true-up" per piece amount which is not  
18 reflective of any activities or function, but rather a correction factor for each rate cell;
- 19 3. In developing Initial Target Rates in Step 7, Witness Haldi bases 90 percent of the rate  
20 on a fixed margin which does not reflect any adjustment for a specific function or  
21 activity.
- 22 4. The adjustment to recognize destination entry (Steps 8 and 14) is not based on the cost  
23 activities and functions developed by Witness Haldi, but rather the analysis of  
24 dropshipping savings calculated by Witness Moeller. Witness Moeller's destination  
25 entry cost savings do not identify the difference in costs between letters and nonletters;

---

<sup>10/</sup> The per piece rate for pound rated pieces is calculated at the breakpoint of 3.3 ounces, i.e., 16.7 cents per piece less (53.0 cents per pound ÷ 16 ounces/pound x 3.3 ounces) equals 5.8 cents per piece.

- 1 5. The final rates for letters utilize a reduction to rates of 0.3 cents per piece (Step 10  
2 above) which does not reflect any specific function or activity, but rather is a correction  
3 factor for the overrecovery of revenues under Witness Haldi's Initial Target Rates;
  - 4 6. The basic rate for nonletters is not reflective of activities or cost functions but instead  
5 equals the basic rate for letters; and,
  - 6 7. The discount for nonletter sortation is based on piece rated nonletter mail reflecting an  
7 arbitrary weight adjustment of 2.33 cents per piece and an arbitrary passthrough  
8 percentage (Step 13).
-

**VI. SORTATION DISCOUNTS PROPOSED  
BY USPS AND WITNESS HALDI**

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27

As shown above, the difference between the USPS' proposed rates for ECR mail and Witness Haldi's proposal reflects the different sortation discounts. The difference in base rates (see Table 1 above, Lines 1, 4 and 5a) results from Witness Haldi's sortation discounts and the constraint that the aggregate revenues in his analysis must equal the USPS' proposed revenues. For both the USPS and Witness Haldi, the sortation discounts shown in Table 1 above (Lines 2 and 6) are based on the cost differentials developed in their respective analyses. Table 3 below summarizes the cost analyses and the differentials in sortation as developed by the USPS' Witness Moeller and Witness Haldi.

Item (1)	Cost Per Piece (cents)		Difference From Basic (Cents Per Piece)	
	USPS <sup>1/</sup> (2)	Haldi <sup>2/</sup> (3)	USPS (4)	Haldi (5)
<b>1. Cost Per Piece - Letters</b>				
a. Basic	6.4363c	7.1281c	xxx	xxx
b. High-Density	4.2367	4.9463	2.2c	2.2c
c. Saturation	3.3297	3.8391	3.1	3.3
<b>2. Cost Per Piece - Nonletters</b>				
a. Basic	8.6042c	8.9900c	xxx	xxx
b. High-Density	5.8426	6.1588	2.8c	2.8c
c. Saturation	4.1816	4.2113	4.4	4.8
<sup>1/</sup> Moeller, workpaper 1, page 18 — reflects mail processing and delivery costs.				
<sup>2/</sup> Haldi Table A-13 (with contingency), BMC column for letters and Table A-18 (with contingency), no destination entry column as discussed at TR 27/15184.				

1           The cost differential between basic and high-density mail is the same in both the USPS' and  
2 Witness Haldi's analyses, equalling 2.2 cents per piece for letters (Table 3, line 1b) and 2.8  
3 cents per piece for nonletters (Table 3, line 2b). However, in Witness Haldi's analysis, the cost  
4 difference between basic mail and saturation mail is greater than in the USPS' analysis. For  
5 letters, Witness Haldi's cost savings equals 3.3 cents per piece versus the USPS' value of 3.1  
6 cents per piece (Table 3, line 1c). For nonletters, Witness Haldi's analysis shows a cost  
7 difference of 4.8 cents per piece versus the USPS difference of 4.4 cents per piece (Table 3,  
8 line 2c).

9           In the USPS' analysis, the sortation discount considers only mail processing and delivery  
10 costs. In addition to mail processing and delivery costs, Witness Haldi has incorrectly included  
11 transportation and other costs ("shipping costs") in his differential for sortation. Because he  
12 applied the costs on a pound basis and the fact that saturation mail in Witness Haldi's analysis  
13 weighs less than basic mail, he develops a larger cost difference due to sortation than calculated  
14 by the USPS. Table 4 below summarizes Witness Haldi's calculation of the average weight and  
15 the shipping costs for letter and nonletter mail.

1  
2  
3

Table 4  
Comparison of Average Weight and  
Shipping Costs In Witness Haldi's Analysis

Item (1)	Average Weight Per Piece - lbs <sup>1/</sup> (2)	Per Piece Shipping Costs <sup>2/</sup> (3)
4		
5		
6	1. Letters	
7	a. Basic	0.0815            0.39c
8	b. Saturation	<u>0.0566</u> <u>0.27</u>
9	c. Difference	0.0249            0.12c
10	d. Percent (L1c ÷ L1a)	31%                31%
11	2. Nonletters	
12	a. Basic	0.1039            1.43c
13	b. Saturation	<u>0.0843</u> <u>1.16</u>
14	c. Difference	0.0196            .27c
15	d. Percent (L2c ÷ L2a)	19%                19%
16		
17	<sup>1/</sup> Haldi, Table A-5 (Tr. 27/15105) - BMC for letters and no destination entry for nonletters.	
18	<sup>2/</sup> Haldi Table A-10, (Tr. 27/15110) — BMC for letters and no destination entry for nonletters.	

19            As shown in Table 4 above, the difference in shipping costs in Witness Haldi's analysis is  
20 exactly the same as the difference in the average weight per piece (31 percent for letters and 19  
21 percent for nonletters).<sup>1/</sup> As with the USPS' proposal, the difference in costs related to shipping  
22 costs should only be recognized in the destination entry discounts, not the sortation discount.

23            Finally, in addition to his inappropriate costs, Witness Haldi's rate design reflects  
24 modification of the USPS' passthrough of the cost savings related to sortation. Table 5  
25 compares the cost savings and discounts proposed by the USPS and Witness Haldi.

<sup>1/</sup> The difference between the cost savings in Table 4 and Column (5) of Table 3 is attributed to rounding and the application of the contingency factor is 1 percent.

Table 5 Summary of Cost Savings and Proposed Discounts -- Sortation				
	Item (1)	Amount (Cents Per Piece)		Percent <sup>3/</sup> (4)
		Cost Savings <sup>1/</sup> (2)	Proposed Discount <sup>2/</sup> (3)	
1	1. Letters -- High-Density			
2	a. USPS	2.2c	2.1c	95%
3	b. Haldi	2.2	2.5	114
4	2. Letters -- Saturation			
5	a. USPS	3.1	3.0	97
6	b. Haldi	3.3	3.8	115
7	3. Nonletters -- High-Density			
8	a. USPS	2.8	1.1	39
9	b. Haldi	2.8	1.7	60
10	4. Nonletters -- Saturation			
11	a. USPS	4.4	2.3	52
12	b. Haldi	4.8	2.9	60
13	<sup>1/</sup> Table 3 above.			
14	<sup>2/</sup> Table 1 above.			
15	<sup>3/</sup> Column (3) ÷ Column (2).			

22 For letters, Witness Haldi has proposed sortation discounts which are 114% to 115% of his  
 23 calculation of the cost savings while the USPS proposed discounts are 95% to 97% of the cost  
 24 savings. The passthrough percentage for Witness Haldi's proposed sortation discount for letters  
 25 (Table 5, lines 1b and 2b) exceed 100 percent because of his methodology which develops 10  
 26 percent of the rate based on a fixed mark-up ratio of 2.4405. Stated differently, Witness Haldi's



1 discounts reflect a 90 percent weighting of a cost savings per piece and a 10 percent weighting  
2 of the cost difference multiplied by 2.4405.<sup>12/</sup>

3 For nonletters, Witness Haldi's discounts are 60 percent of the cost savings while the USPS  
4 has proposed discounts equal to 39 percent of the cost savings for High-Density mail and 52  
5 percent of the cost savings for saturation. Aside from the fact that the passthrough percentage  
6 is arbitrary, Witness Haldi's procedures for nonletters bears no relationship to the procedures  
7 he has followed in developing the sortation discounts for letters.

8 In summary, Witness Haldi has offered no support for his adjustment to sortation discounts  
9 proposed by the USPS and should be rejected.

---

<sup>12/</sup> High density letters equal: [2.2 cents per piece x .90] plus [2.2 cents per piece x 2.4405 x .10]. Saturation letters equal: [3.3 cents per piece x .90] plus [3.3 cents per piece x 2.4405 x .10].

STATEMENT OF QUALIFICATIONS

My name is Roger C. Prescott, I am a Vice President and economist with the economic consulting firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke Street, Suite 200, Alexandria, Virginia 22314.

I am a graduate of the University of Maine from which I obtained a Bachelor's degree in Economics. Since June 1978 I have been employed by L. E. Peabody & Associates, Inc.

I have previously participated in various Postal Rate Commission ("PRC") proceedings. In Docket No. R90-1, Postal Rate And Fee Changes, 1990, I developed and presented evidence to the PRC which critiqued and restated the direct testimony of the United States Postal Service ("USPS") as it related to the development of the proposed rate structure on behalf of third class business mailers. I also submitted Rebuttal evidence in PRC Docket No. MC95-1, Mail Classification Schedule, 1995 Classification Reform I, regarding recommendations of intervenors in response to the USPS' proposed reclassification of Third Class Bulk Rate Regular ("TCBRR") rate structure.

The firm of L. E. Peabody & Associates, Inc., specializes in solving economic, marketing and transportation problems. As an economic consultant, I have participated in the direction and organization of economic studies and prepared reports for railroads, shippers, for shipper associations and for state governments and other public bodies dealing with transportation and related economic problems. Examples of studies which I have participated in organizing and directing include traffic, operational and cost analyses in connection with the transcontinental movement of major commodity groups. I have also been involved with analyzing multiple car

Appendix A

Page 2 of 3

movements, unit train operations, divisions of through rail rates and switching operations throughout the United States. The nature of these studies enabled me to become familiar with the operating and accounting procedures utilized by railroads in the normal course of business.

In the course of my work, I have become familiar with the various formulas employed by the Interstate Commerce Commission ("ICC") (now the Surface Transportation Board ("STB")) in the development of variable costs for common carriers with particular emphasis on the basis and use of Rail Form A and its successor, the Uniform Railroad Costing System ("URCS"). In addition, I have participated in the development and analysis of costs for various short-line railroads.

Over the course of the past sixteen years, I have participated in the development of cost of service analyses for the movement of coal over the major eastern, southern and western coal-hauling railroads. I have conducted on-site studies of switching, detention and line-haul activities relating to the handling of coal. I developed the carrier's variable cost of handling various commodities, including coal, in numerous proceedings before the ICC/STB. I have presented testimony related to the development of variable costs in ICC Docket No. 39002, Utility Fuels, Inc. v. Burlington Northern et al., ICC Docket No. 39386, The Kansas Power and Light Company v. Burlington Northern Railroad Company, et al. ("KPL"), ICC Docket No. 38783, Omaha Public Power District v. Burlington Northern Railroad Company ("OPPD"), ICC Docket No. 38025S, The Dayton Power and Light Company v. Louisville and Nashville Railroad Company ("DPL"), and ICC Docket No. 41191, West Texas Utilities Company v. Burlington Northern Railroad Company ("WTU").

As part of the variable cost evidence I have developed and presented to the ICC/STB, I have calculated line specific maintenance of way costs based on the Speed Factored Gross Ton ("SFGT") formula. In DPL and WTU, my testimony presented the evidence which calculated maintenance of way costs based on the SFGT formula.

In October 1993, I presented the history and use of the SFGT formula at a conference attended by shippers, railroads, association members and Commission staff. The conference, titled "Maintaining Railway Track-Determining Cost and Allocating Resources," examined the methodologies used to determine maintenance of way costs over freight and passenger rail lines.

I have developed and presented evidence to the ICC/STB related to maximum rates, and "Long-Cannon" factors in OPPD and KPL. I have also submitted evidence on numerous occasions in Ex Parte No. 290 (Sub-No. 2), Railroad Cost Recovery Procedures related to the proper determination of the Rail Cost Adjustment Factor.

In the two recent Western rail mergers, Finance Docket No. 32549, Burlington Northern, et al. -- Control and Merger -- Santa Fe Pacific Corporation, et al. and Finance Docket No. 32760, Union Pacific Corporation, et al. -- Control and Merger -- Southern Pacific Rail Corporation et al., I reviewed the railroads' applications including their supporting traffic, cost and operating data and provided detailed evidence supporting requests for conditions designed to maintain the competitive rail environment that existed before the proposed mergers.

## Summary Of Witness Haldi's Constructed Rates For Letters

(Cents Per Piece)

### II. Development of Proposed Rates By Rate Cell

Sortation (1)	Initial Target Rates				Revenue True-Up (6)	Final Rates			
	No Dest. Entry (2)	BMC (3)	SCF (4)	DDU (5)		No Dest. Entry (7)	BMC (8)	SCF (9)	DDU (10)
1. Adjustment For Destination Entry 1/	1.5	xxx	-0.3	-0.8	xxx	xxx	xxx	xxx	xxx
2. Basic	17.0340	15.5340	15.2340	14.7340	-0.334	16.7	15.2	14.9	14.4
3. Automation	16.3351	14.8351	14.5351	14.0351	-0.334	16.0	14.5	14.2	13.7
4. High Density	14.5379	13.0379	12.7379	12.2379	-0.334	14.2	12.7	12.4	11.9
5. Saturation	13.2712	11.7712	11.4712	10.9712	-0.334	12.9	11.4	11.1	10.6

1/ USPS proposal, Moeller, USPS-T-36, page 31.

Sources:

- Column (2): Column (3) + Column (2), Line 1.
- Column (3): Exhibit\_MOAA-RT-1A, Page 1 of 2, Column (11).
- Column (4): Column (3) + Column (4), Line 1.
- Column (5): Column (3) + Column (5), Line 1.
- Column (6): Haldi, Table C-3.
- Column (7): Column (2) - Column (6).
- Column (8): Column (3) - Column (6).
- Column (9): Column (4) - Column (6).
- Column (10): Column (5) - Column (6).

## Summary Of Witness Haldi's Constructed Rates For Letters

(Cents Per Piece)

### I. Development of Proposed Rates By Sortation Level -- BMC

Sortation (1)	Volume Variable Costs				Cost True-Up (6)	Total Costs		Constructed Rates		
	Mail Processing (2)	Delivery (3)	Shipping (4)	Total (5)		Without Contingency (7)	With Contingency (8)	Fixed Margin (9)	Mark-up Percentage (10)	Weighted (11)
1. Basic	1.9840	4.3670	0.3872	6.7382	0.3193	7.0575	7.1281	15.3271	17.3961	15.5340
2. Automation	2.3891	3.3570	0.3872	6.1333	0.3193	6.4526	6.5172	14.7162	15.9053	14.8351
3. High Density	0.3611	3.7590	0.4579	4.5780	0.3193	4.8973	4.9463	13.1453	12.0714	13.0379
4. Saturation	0.3611	2.8520	0.2687	3.4818	0.3193	3.8011	3.8391	12.0381	9.3694	11.7712

**Sources:**

Column (2) and Column (3): Haldi, Table A-1.

Column (4): Haldi, Table A-10.

Column (5): Column (2) + Column (3) + Column (4).

Column (6): Haldi, Table A-12.

Column (7): Column (5) + Column (6).

Column (8): Column (7) \* 1.01.

Column (9): Column (8) + 8.199 cents per piece (Haldi, Table C-2).

Column (10): Column (8) \* 2.4405 (Haldi, Table C-2).

Column (11): Column (9) \* 90% + Column (10) \* 10% (Haldi, Table C-2).



**APPENDIX B:**  
**ERRORS AND ASSUMPTIONS IN WITNESS HALDI'S PROCEDURES**

1     **A. TABLE A-1**

2             This table develops the average unit costs for letters and nonletters by level of sortation.  
3     First, Witness Haldi's underlying Test Year unit costs for the separation of volume variable costs  
4     rely on overall average volume for letters and flats combined for the transportation component  
5     (0.1877 cents per piece) and the other component (0.4519 cents per piece). These two  
6     components reflect approximately 10 percent of the overall unit costs. Stated differently, 10  
7     percent of Witness Haldi's costs cannot be separated between letters and nonletters.

8             Second, Witness Haldi's value for the "other" component (Table A-1, Column (4)) is not  
9     supported. When asked in interrogatories to provide the support for this value, Witness Haldi  
10    stated that he was "unable to locate the work..." and would "supplement this response after we  
11    locate it" (Tr. 27/15219). To date no support has been provided for his calculation of the  
12    "other" component for his Test Year unit costs. The lack of support for one of the underlying  
13    unit costs in his analysis renders his results meaningless. Without support for this value neither  
14    the PRC nor I can evaluate the appropriateness of his separation of costs into rate cells.

15    **B. TABLE A-2**

16             This table multiplies the unit costs from Table A-1 by the USPS' volumes to develop  
17    aggregate costs for letters and nonletters by level of sortation. Because of the errors in Table  
18    A-1, the separation of the costs between letters and nonletters cannot be validated.



**APPENDIX B:**  
**ERRORS AND ASSUMPTIONS IN WITNESS HALDI'S PROCEDURES**

1     **C. TABLE A-3 THROUGH TABLE A-5**

2             These tables develop the average weight per piece based on the 1996 Billing Determinants.

3     I agree with these calculations.

4     **D. TABLE A-6**

5             Table A-6 develops the TYAR pieces for each of Witness Haldi's rate cells. Witness  
6     Haldi's separation of total pieces for ECR pound rated mail by destination entry profile in Table  
7     A-6 is based on the USPS' separation of the pounds by destination entry profile<sup>2/</sup>. Stated  
8     differently, Witness Haldi has assumed that all pound rated nonletter mail weighs the same  
9     regardless of where the mail is entered in the mailstream. Witness Haldi's analysis reflects that  
10    all basic pound rated piece mail weighs 0.32 pounds per piece, high-density mail weighs 0.34  
11    pounds per piece, and saturation mail weighs 0.30 pounds per piece.<sup>3/</sup> Under his analysis, the  
12    weight shown above was applied to the level of sortation regardless of the destination entry  
13    location in order to determine the number of pieces.

14            Furthermore, comparison of the implicit average weights used by Witness Haldi in  
15    Table A-6 with the average weight using actual 1996 Billing Determinants (Table A-5) indicates  
16    large disparities. For example, high-density mail entered at the BMC had a 1996 average weight  
17    of 0.21 pounds per piece which reflects a 29 percent reduction from Witness Haldi's value of

---

<sup>2/</sup> The USPS' separation is shown in Witness Moeller's workpaper 1, page 20.

<sup>3/</sup> Total pounds in Table A-7 divided by total pieces in Table A-6.

**APPENDIX B:**  
**ERRORS AND ASSUMPTIONS IN WITNESS HALDI'S PROCEDURES**

1     0.34 pounds per piece. His assumption regarding pounds is false based on the same 1996 Billing  
2     Determinant data that he used elsewhere in his analysis. In summary, Witness Haldi's  
3     distribution of pounds for nonletter-pound rated mail distorts the true weight applicable to each  
4     of his rate cells, thus, the number of pieces for each rate cell derived from this average weight  
5     is also incorrect

6     **E. TABLE A-7**

7             Table A-7 develops the aggregate pounds for each rate cell. For letter mail and piece rated  
8     nonletter mail, Witness Haldi based the pounds on total pounds and pieces from the USPS' 1996  
9     Billing Determinants. However, in developing the pounds for automation letters, Witness Haldi  
10    "assumed that these [automation] letters have the same average weight as Basic Presort  
11    Letters..." (Tr. 27/15182) This assumption is false as shown in Witness Haldi's own data.  
12    Table A-5 of Witness Haldi's testimony shows that automation letters average 0.0509 pounds  
13    per piece while Basic Presort Letters have an average weight of 0.0464 pounds per piece, a  
14    difference of 10 percent. His analysis does not adjust for this difference in average weight.

15    **F. TABLE A-8**

16             In Table A-8, Witness Haldi summarizes the USPS' unit costs for shipping by point of  
17    entry. The nontransportation costs for SCF shown by Witness Haldi equals 0.72 cents per

**APPENDIX B:**  
**ERRORS AND ASSUMPTIONS IN WITNESS HALDI'S PROCEDURES**

1 pound and is not correct. The actual value from the USPS' Library Reference LR-H-111 equals  
2 0.73 cents per pound.

3 **G. TABLE A-9**

4 This table develops the aggregate shipping costs by level of sortation and destination entry.  
5 Because of the errors in the average weight for automation letters and pound rated pieces (Table  
6 A-6) and the error in Witness Haldi's unit costs for destination entry at the SCF (Table A-8),  
7 these aggregate costs are not correct.

8 **H. TABLE A-10**

9 In Table A-10, Witness Haldi develops the unit costs for shipping for each rate cell. The  
10 difference in shipping costs related to sortation are entirely due to the average weights utilized  
11 by Witness Haldi. Because of the errors noted above, these unit costs are not correct. In  
12 addition, Witness Haldi's analysis assumes that shipping costs for piece rated mail (i.e., below  
13 3.3 ounces) vary in direct proportion to weight. This assumption has not been shown to be valid  
14 and, in fact, is refuted by the data shown in Witness Haldi's Appendix D.<sup>4/</sup>

---

<sup>4/</sup> Witness Haldi's Appendix D, which is based on Library Reference LR-H-182, shows that a carrier route letter mail weighing 1 ounce costs more than letters weighing from 2 to 4 ounces.

**APPENDIX B:**  
**ERRORS AND ASSUMPTIONS IN WITNESS HALDI'S PROCEDURES**

1     **I. TABLE A-11**

2             Table A-11 summarizes Witness Haldi's total unit costs for letters by rate cell. Because of  
3     the errors in the underlying unit costs and weights, the unit costs in this table are not correct.

4     **J. TABLE A-12**

5             In order for the aggregate letter costs in Table A-2 to match his costs by rate cell, Witness  
6     Haldi's Table A-12 develops a cost "true-up" for letters of 0.32 cents per piece. However,  
7     Witness Haldi's procedures mask the wide variation in the cost "true-up" for each level of  
8     sortation. Assuming that the distribution of costs between letters and flats in Table A-2 and the  
9     unit costs in Table A-11 were correct (and in fact, are not correct), the variation within Witness  
10    Haldi's composite cost "true-up" is shown in Table 1 below:

**APPENDIX B:  
ERRORS AND ASSUMPTIONS IN WITNESS HALDI'S PROCEDURES**

1  
2  
3

Table 1 Summary of Witness Haldi's Development of Costs By Level of Sortation — Letters				
Sortation (1)	Aggregate costs (000)		Difference	
	from Table A-2 (2)	from Table A-12 (3)	Total (000) <sup>1/</sup> (4)	Cents Per Piece <sup>2/</sup> (5)
6 1. Basic	\$221,866	\$212,832	\$9,034	0.23¢
7 2. Automation	131,524	126,789	4,735	0.28
8 3. High-Density	18,705	17,323	1,382	0.35
9 4. Saturation	<u>118,910</u>	<u>106,240</u>	<u>12,671</u>	<u>0.41</u>
10 5. Total	\$491,006	\$463,184	\$27,822	0.32¢
11				
12	<sup>1/</sup> Column (2) minus Column (3).			
13	<sup>2/</sup> Column (4) ÷ letter volume by sortation level in Table A-6.			

14 Overall, the costs developed by Witness Haldi in Table A-12 are understated by \$27.8  
15 million (Table 1, Line 5 above). Witness Haldi corrects for this understatement by converting  
16 the aggregate total difference to a per piece amount which equals 0.32 cents per piece. This per  
17 piece amount is applied as the unit cost for each letter rate cell.

18 However, Witness Haldi's procedures mask the fact that his methodology overstates the cost  
19 "true up" for Basic mail (0.23 cents per piece) and for Automation mail (0.28 cents per piece)  
20 while understating the cost "true-up" for High-Density mail (0.35 cents per piece) and Saturation  
21 mail (0.41 cents per piece). If the "true-up" factor were calculated for each sortation level,

**APPENDIX B:**  
**ERRORS AND ASSUMPTIONS IN WITNESS HALDI'S PROCEDURES**

1 Witness Haldi's "bottom-up" costs for basic and automation letters would be less than he has  
2 calculated. Conversely, if the cost "true-up" were calculated by sortation level, Witness Haldi's  
3 "bottom-up" costs for high-density and saturation letters would be greater than he has calculated.

4 **K. TABLE A-13**

5 Utilizing the unit costs developed in Table A-11 and the 0.32 cent per piece cost "true-up"  
6 developed in Table A-12, Table A-13 of Witness Haldi's analysis develops the adjusted TYAR  
7 unit costs. These costs are then increased by the USPS' contingency factor of 1 percent.  
8 Because of errors in the underlying data in Table A-11 and the misapplication of the cost "true-  
9 up" in Table A-12, Witness Haldi's TYAR unit costs are incorrect.

10 **L. TABLE A-14**

11 Table A-14 begins Witness Haldi's analysis of the cost for each nonletter rate cell assuming  
12 that 2.33 cents per piece is weight related. Witness Haldi feels that the USPS has "failed to  
13 present any reliable evidence concerning which costs should be treated as pound-related and  
14 which costs should be treated as piece-related...." (Tr. 27/15055). Therefore, Witness Haldi  
15 assumes that 2.33 cents per piece should be considered weight related for all nonletters. He  
16 admits that the treatment of "2.33 cents per piece as weight-related cost is arbitrary..."  
17 (TR 27/15057). Witness Haldi's analysis of the costs associated with weight as utilized in  
18 Table A-14 (or subsequent Tables) have no bearing on his ultimate rate design for pound-rate

**APPENDIX B:**  
**ERRORS AND ASSUMPTIONS IN WITNESS HALDI'S PROCEDURES**

1 mail. Witness Haldi has accepted the per pound rate of Witness Moeller of \$0.53 per pound as  
2 "conservative" (TR 27/15172)

3 **M. TABLE A-15**

4 In Table A-15, Witness Haldi attempts to separate his assumed weight related costs of 2.33  
5 cents per piece between piece rated mail and pound rated mail. Aside from the fact that his  
6 underlying assumption regarding costs is not supported (see the discussion of Table A-14 above),  
7 Witness Haldi's table contains a mathematical error. Witness Haldi uses a divisor for total  
8 pounds of 3,909 million pounds (Table A-15, Line 2). The correct value for nonletter mail  
9 pounds following Witness Haldi's procedures, equals 3,893 million pounds as shown in Table  
10 A-7 of his statement. This causes the results in this table to be in error.

11 **N. TABLE A-16**

12 Table A-16 summarizes Witness Haldi's unit costs for nonletters. This analysis does not  
13 summarize "bottom-up" costs for two reasons. First, he assumes that the per piece portion of  
14 the costs for pound rated mail does not vary by destination entry (i.e., the costs for saturation  
15 nonletters with no dropshipping equals the costs for saturation letters dropshipped at the DDU).  
16 Second, for the pound portion of pound-rated mail, Witness Haldi assumes that costs do not vary  
17 with sortation or destination entry, (e.g., the pound portion of pound rated mail for basic

**APPENDIX B:**  
**ERRORS AND ASSUMPTIONS IN WITNESS HALDI'S PROCEDURES**

1      sortation without dropshipping is the same as the pound portion for saturation mail dropshipped  
2      at the DDU).

3      **O. TABLE A-17**

4           As with letter mail, Witness Haldi develops a "true-up" cost per piece to bring his  
5      constructed costs derived from Table A-16 in line with the costs for nonletters as developed in  
6      his Table A-2. Table A-17 reflects his development of a cost "true-up". Witness Haldi's  
7      procedures mask the difference in his costs by level of sortation as shown in Table 2 below.

Table 2					
<b>Summary of Witness Haldi's Development of Costs By Level of Sortation — Nonletters</b>					
Sortation	<u>Aggregate Costs (000)</u>		<u>Difference</u>		Cents Per Pound <sup>3/</sup>
	<u>From Table A-2</u>	<u>From Table A-17<sup>1/</sup></u>	<u>Amount (000)<sup>2/</sup></u>	<u>Amount</u>	
(1)	(2)	(3)	(4)	(5)	
1. Basic	\$945,821	\$985,418	\$(39,597)		(-)1.75
3. High-Density	70,075	67,168	2,907		1.29
4. Saturation	<u>359,870</u>	<u>302,136</u>	<u>57,734</u>		<u>4.11</u>
5. Total	\$1,375,766	\$1,354,722	\$21,044		0.54
<sup>1/</sup>	Sum of costs for piece rated nonletters, piece portion of pound rated nonletters and the pound portion of nonletters.				
<sup>2/</sup>	Column (2) minus Column (3).				
<sup>3/</sup>	Column (4) divided by number of pounds in Table A-7.				

22           Overall, the costs developed by Witness Haldi in his two tables are close, differing by only  
23      \$21 million or 0.54 cents per pound (Table 2, Line 5). However, a comparison of his initial



**APPENDIX B:**  
**ERRORS AND ASSUMPTIONS IN WITNESS HALDI'S PROCEDURES**

1 costs (Table A-2) with his constructed costs (based on the arbitrary assumption of 2.33 cents per  
2 piece related to weight) shows that his analysis underrecovers the costs for Basic nonletter mail  
3 by 1.75 cents per pound (Table 2, Line 1) and overrecovers the costs for high-density nonletter  
4 mail by 1.29 cents per pound. In addition, the cost "true-up" for nonletter saturation mail is  
5 extremely large, i.e., 4.11 cents per pound.

6       Witness Haldi's per pound "true-up" as calculated in Table A-17 is flawed because of the  
7 dramatic under and overrecovery of costs by level of sortation. Specifically, following Witness  
8 Haldi's procedures, the cost "true-up" for Basic nonletters should be a negative adjustment. In  
9 addition, the true-up for saturation mail should be approximately 8 times the value calculated  
10 by Witness Haldi. If cost "true-ups" separated by sortation are used, Witness Haldi's unit costs  
11 for basic nonletter mail would be less than he has calculated while the unit costs for high density  
12 and saturation mail would be higher than Witness Haldi calculated.

13 **P. TABLES A-18 AND A-19**

14       Tables A-18 and A-19 develop Witness Haldi's revised unit costs and restated aggregate  
15 costs for nonletters. The flaws discussed above invalidate the unit costs and aggregate costs  
16 shown these tables.

**APPENDIX B:**  
**ERRORS AND ASSUMPTIONS IN WITNESS HALDI'S PROCEDURES**

1     **Q. TABLES A-20 THROUGH A-25**

2             Tables A-20 through Table A-25 in Witness Haldi's testimony repeat the mathematical  
3     exercise he performed for nonletter mail utilizing 0.5825 cents per piece as weight related  
4     instead of the 2.33 cents per piece. First, Witness Haldi's rate proposal never relies on these  
5     tables. Second, like his prior analysis using 2.33 cents per piece, the value of 0.5825 cents per  
6     piece is arbitrary and not supported by workpapers. Therefore, the analysis in these tables have  
7     not been and should not be considered in designing rates for ECR mail.

8     **R. TABLE C-1**

9             Table C-1 summarizes Witness Haldi's calculation of the unit costs for letters by rate cell.  
10     For the reasons outlined above under my discussion of Witness Haldi's Table A-1 through Table  
11     A-13, his unit costs are incorrect and should be rejected.

12     **S. TABLE C-2**

13             Table C-2 develops Witness Haldi's Initial Target Rates for letters based on his unit costs  
14     (Table C-1) with 90 percent of the rates based on a constant margin of 8.199 cents per piece and  
15     10 percent based on a constant mark-up ratio of 2.4405. Three problems exist with these Initial  
16     Target Rates. First, as discussed in the previous sections, Witness Haldi only relies on the  
17     results for BMC mail in his rate proposal. Second, the 90%/10% allocation is arbitrary and not  
18     supported. If the distribution is changed, then the Initial Target Rates change.

**APPENDIX B:  
ERRORS AND ASSUMPTIONS IN WITNESS HALDI'S PROCEDURES**

1 Finally, Witness Haldi's constant margin and mark-up percentages are wrong because he  
2 failed to make changes after his errata was filed. Table 3 below summarizes Witness Haldi's  
3 development of the constant margin and mark-up ratio for letters with the correct values.

4  
5  
6

Table 3 Comparison of Witness Haldi's Constant Margin and MarkUp Ratio For Letters — As Stated and Revised			
Item (1)	Source (2)	As Used in Haldi's Table C-2 (3)	Corrected (4)
<b><u>Constant Margin</u></b>			
1. Revenue Requirement	Haldi, C-12	\$1,210,277 <sup>1/</sup>	\$1,194,629 <sup>2/</sup>
2. Volume Variable Costs	Haldi, A-2	<u>495,916</u>	<u>495,916</u>
3. Margin	L1 - L2	\$714,361	\$698,713
4. Pieces (000)	Haldi, A-6	<u>8,712,800</u>	<u>8,712,800</u>
5. Margin Per Piece	L3 ÷ L4	8.199¢	8.019¢
<b><u>Mark-Up Ratio</u></b>			
6. Amount	L1 ÷ L2	2.4405	2.4089

7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19

<sup>1/</sup> As shown in his original testimony.  
<sup>2/</sup> As revised in errata and submitted in testimony.

20 Witness Haldi's rate proposal for letters relies on constructed rates utilizing a constant  
21 margin of 8.199 per piece and mark-up ratio of 2.4405. The correct values are a constant margin  
22 of 8.019 cents per piece and a mark-up ratio of 2.4089. Witness Haldi's failure to utilize these  
23 corrected values invalidate his results.

**APPENDIX B:**  
**ERRORS AND ASSUMPTIONS IN WITNESS HALDI'S PROCEDURES**

1     **T. TABLE C-3**

2             Table C-3 adjusts Witness Haldi's letter rates so that his proposal is revenue neutral with  
3     the USPS' proposal. The adjustment errors are discussed in previous sections to my testimony.

4     **U. TABLES C-4 THROUGH C-11**

5             Tables C-4 through C-11 summarize the various statistics for nonletter mail and develop the  
6     aggregate revenue based on Witness Haldi's proposed rates for nonletters. Because of the errors  
7     discussed earlier in this section, his calculations are in error.

8     **V. TABLE C-12**

9             Table C-12 summarizes the USPS' revenues separately for letters and nonletters. I agree  
10    with Witness Haldi's calculations.

11    **V. SUMMARY OF CRITIQUE OF**  
12    **WITNESS HALDI'S APPENDIX A**  
13    **AND APPENDIX C**

14             As shown in this exhibit to my testimony, Witness Haldi's development of ECR rates is  
15    based on numerous faulty (or unsupported) assumptions and mathematical errors which invalidate  
16    his results. Because of the interrelationship of these errors, it is impossible to restate his results  
17    based on a theory of "bottom-up" costs for setting rates.

1 CHAIRMAN GLEIMAN: Only one participant, Val-Pak  
2 Marketing -- excuse me, Val-Pak Direct Marketing Systems,  
3 Inc., Val-Pak Dealers Association, Inc., and Carol Wright  
4 Promotions, Inc., filed a request for oral cross-examination  
5 of the witness.

6 Does anyone else wish to cross-examine this  
7 witness?

8 If not, Mr. Olson, you can begin when you're  
9 ready.

10 CROSS-EXAMINATION

11 BY MR. OLSON:

12 Q Mr. Prescott, William Olson, representing Val-Pak  
13 and Carol Wright.

14 And I want to ask you to begin by turning to  
15 Appendix B of your testimony.

16 A Yes, I have it.

17 Q Okay. And the purpose of your testimony is to  
18 rebut the testimony of Dr. Haldi on behalf of Val-Pak, Carol  
19 Wright, ~~VP~~CW-T-1; correct?

20 A Yes, it is.

21 Q And this is where you set out the errors and  
22 assumptions in Witness Haldi's procedures in his what -- in  
23 his presentation of ECR rates; correct?

24 A In this appendix and in my text; yes.

25 Q Okay. Well, what does the appendix -- the

1 appendix says errors and assumptions, and then it says it  
2 has theoretical errors, mathematical errors, faulty  
3 assumptions -- aren't most of those in the appendix, or do  
4 you have some division between what's in the text and what's  
5 in the appendix?

6 A Well, I would describe the text as being an  
7 overview of the theory and my explanation of the steps  
8 followed by Dr. Haldi, and Appendix B is intended to  
9 highlight some of the specific problems that occur in his  
10 procedures.

11 Q The mathematical errors and the faulty  
12 assumptions.

13 A Yes.

14 Q Okay. And in your testimony on page 1 you start  
15 by saying at line 11: "While the correction of mathematical  
16 errors apparently would have little impact on the rates  
17 proposed by Witness Haldi, I have identified all errors that  
18 I have found in order to provide as complete a record as  
19 possible." Correct?

20 A Yes.

21 Q Do you have an idea as to what the impact would be  
22 of the correction of all of the errors that you have found  
23 in terms of an order of magnitude of the effect on rates?

24 A The mathematical errors referenced in that  
25 sentence?

1 Q Yes.

2 A There were three specific mathematical errors that  
3 I identified, and those were in table A-8, A-15, and table  
4 C-2. And if you were to make those corrections only, it  
5 would have the impact of approximately a tenth of a cent on  
6 the rate structure.

7 Q Okay. And just for clarity, where do you discuss  
8 the errors in A-8 in your appendix?

9 A The errors in Table A-8 would be discussed in  
10 pages 4 and 5 of my Exhibit 1-B or the Appendix B.

11 Q And then E-15 is page 9?

12 A That's correct.

13 Q And the C-2 problems are on page 12?

14 A The C-2 mathematical error is discussed on pages  
15 12 and 13.

16 Q Okay. Those are mathematical errors.

17 Now you also say there are faulty assumptions and  
18 theoretical errors. Have you attempted to quantify the  
19 degree of error from the theoretical errors and the faulty  
20 assumptions?

21 A I have not restated the faulty assumptions or  
22 provided my own assumptions, no.

23 Q So you don't know whether that would have little  
24 impact on the rates proposed by Dr. Haldi or great impact on  
25 the rates proposed by Dr. Haldi?

1           A     Well, it would depend on how you would change  
2 those assumptions. For example, his assumption in Table  
3 C-2, which has a weighting of 90 percent and 10 percent, if  
4 you changed that weighting to 50/50, for example, assumed  
5 that instead, you would get quite different results.

6           Q     Actually you would get very much higher basic  
7 rates, would you not, and much lower saturation rates?

8           A     I believe that to be correct, yes.

9           Q     Okay. Let me say then as you discuss these errors  
10 and assumptions, mathematical errors, faulty assumptions,  
11 that you discuss them table by table and then you, wherever  
12 a number is rolled from one table into the next table, you  
13 then say it's an error in that table because of the prior  
14 analysis, correct?

15                     That's the approach you took?

16           A     As a general statement I would say yes.

17           Q     Okay. So it is not just identified in the table  
18 where the error is made according to your testimony, but  
19 then wherever it rolls forward into a subsequent table you  
20 have tried to point that out also, correct?

21           A     That's correct. Dr. Haldi's structure to his  
22 calculations are each table will build on a prior table.

23           Q     Right.

24           A     Right.

25           Q     Let me ask you to take a look at your page 2 and



1 your analysis of Table A-1, and there your criticism as I  
2 understand it is that Dr. Haldi in Table A-1 relies on  
3 overall average volume for letters and flats combined, for  
4 transportation, and "other" -- correct?

5 A What line would you be referring to?

6 Q From your testimony, you mean?

7 A Yes.

8 Q 4 and 5, page 2.t

9 MR. TODD: Page 2 of the Appendix, counsel?

10 MR. OLSON: Yes. Everything will deal with the  
11 appendix.

12 THE WITNESS: Yes, I see that. Yes.

13 BY MR. OLSON:

14 Q Okay, and so do you have Dr. Haldi's Table A-8  
15 there -- A-1 on page A-8? Do you happen to have his  
16 testimony?

17 A Yes, I have that.

18 Q Okay. So what you are criticizing, are you not,  
19 is that in the transportation column for example he uses  
20 .1877 for automation, basic, high density and saturation,  
21 correct?

22 A For both letters and nonletters, yes.

23 Q Exactly -- irrespective of whether it is a letter  
24 or nonletter and irrespective of condition of sortation,  
25 correct?

1 A That's correct.

2 Q Do you understand what the purpose of Table A-1 in  
3 Dr. Haldi's analysis was?

4 Do you understand Table A-1 and A-2 to be the  
5 development of a benchmark from which later analysis would  
6 be derived, but that was not the totality of the analysis?

7 A That is not the totality of the analysis.

8 Q Okay, so for example, what Table A-1 and A-2 does,  
9 correct me if I'm wrong, is attempt to extract from the  
10 Postal Service's case unit costs for mail processing,  
11 delivery, transportation and other and then multiply it by  
12 test year after rates volumes, correct?

13 A Yes.

14 Q Okay, and then he comes up with test year --  
15 excuse me, Dr. Haldi compares that to CRA costs derived from  
16 Witness Patelunas at the end of Table A-2, correct?

17 A He compares it to the CRA costs in total. In  
18 Table A-2 he also develops the costs separately between  
19 letters and nonletters.

20 Q Okay.

21 A And that is the point at which the costs are no  
22 longer valid because of the assumptions that he has made in  
23 Table A-1.

24 Q Okay, but when he goes -- when he runs his numbers  
25 and compares it to CRA costs, do you have a problem with his

1 analysis and how far it is away from CRA costs?

2 Have you looked to see how close this benchmark  
3 got him?

4 A In Table A-2, the CRA costs are quite close to the  
5 costs developed by Dr. Haldi. The problem is that in Table  
6 A-2 he is separating the total costs between letters and  
7 nonletters and the problem is in that separation, and those  
8 numbers, those aggregate costs for letters and nonletters  
9 are used later on in his analyses to develop his rates.

10 Q Okay, but when you criticize him for using the  
11 same transportation number, an average transportation number  
12 in Table A-1, you are not saying, are you, that that is  
13 where his analysis ends, but rather does he not develop  
14 shipping, unit shipping costs at a later point in his  
15 analysis?

16 A Yes, he does.

17 Q Okay. So the Postal Service did not provide --  
18 isn't it true the Postal Service did not provide information  
19 from which to be able to put in -- information from which  
20 Dr. Haldi could have drawn -- unit costs for transportation  
21 and others -- to put different numbers into this first  
22 table?

23 A The Postal Service did not provide numbers  
24 separated between letters and nonletters, that's correct.

25 Q Okay. Let me ask you to turn to the next page, to

1 page 3 and specifically Section D, where you discuss Table  
2 A-6.

3 A Okay.

4 Q You say that Witness Haldi, and I'm reading from  
5 lines five through seven here, Witness Haldi's separation of  
6 total pieces for ECR pound rated mail by destination entry  
7 profile in Table A-6 is based on the UPS' separation of the  
8 pounds by destination entry profile; correct?

9 A Yes.

10 Q There, we are talking about Witness Moeller's  
11 workpaper one, page 20; correct?

12 A Yes.

13 Q Witness Moeller in that workpaper or anywhere else  
14 in this case, I think you will confirm, did not provide  
15 piece break outs for pound rated pieces, whether they be  
16 flats -- whether they be in the standard A regular or ECR  
17 sub-class, he didn't provide a piece break out for pound  
18 rated pieces, correct, by point of entry, BMC, SCF or DDU?

19 A Witness Moeller did not; that's correct.

20 Q Therefore, those numbers had to developed;  
21 correct?

22 A Well, I don't know if they had to be developed.  
23 Dr. Haldi developed them.

24 Q The way that he developed them was using the  
25 percentages that appear in columns three, four and five of

1 that workpaper; correct?

2 A Yes.

3 Q He multiplied the percentage that was drop shipped  
4 to BMC's, SCF's and DDU's as against total pieces and put  
5 those numbers into columns six, seven and eight, in essence,  
6 where there are blanks; correct?

7 A Yes.

8 Q And the problem you have with that I take it is  
9 that -- could you state the problem you have with that?

10 A The problem with distributing pieces for pound  
11 rated non-letters based on the distribution of the pounds is  
12 that it assumes that all pieces have the same weight, the  
13 same average weight.

14 Q Same average weight; correct.

15 A The data available shows that's not true.

16 Q Is there any data available for test year? There  
17 obviously isn't. You are talking about base year 1996 data;  
18 correct?

19 A Yes. That would be the same data that Dr. Haldi  
20 relied on in developing his weight for letters and piece  
21 rated non-letters.

22 Q Let's get to that in a second. Let's just deal  
23 with this. Do you know of another way to develop the  
24 numbers of pieces for pound rated pieces, other than to use  
25 the approach Dr. Haldi used, which does make the assumption

1 that you stated, that the pieces have an average -- the same  
2 average weight?

3 A Yes.

4 Q What's the other way?

5 A There are a number of other ways. An easy way, I  
6 think, would be to assume the same type of distribution that  
7 occurred in base year 1996.

8 Q If you use the distribution in base year 1996 as  
9 between BMC entry, SCF entry and DDU entry, have you ever  
10 tried to do that, do you know any way to be able to  
11 aggregate to the numbers that appear in Witness Moeller's  
12 workpaper?

13 A You could aggregate to those numbers, yes.

14 Q Have you ever tried to do that?

15 A No, I have not done it.

16 Q Do you realize that implicit in -- strike that.

17 Now this is one of your criticisms of Dr. Haldi, I  
18 take it, about a theoretical assumption I guess you could  
19 call it.

20 Would you call this an error about a theoretical  
21 assumption?

22 A Yes.

23 Q Where does Dr. Haldi use these numbers in  
24 developing rates?

25 A Are we referring to Table A-6 now?

1 Q We are referring to Table A-6 and your analysis,  
2 your criticism of it.

3 A Do you want me to go through and list the tables  
4 that rely on the values that are in A-6? I am not sure I  
5 understand the question.

6 Q Well, I am asking you is it your position that Dr.  
7 Haldi uses these numbers in developing his rates for  
8 pound-rated pieces?

9 A Not directly, no.

10 Q Okay, so he doesn't even use these numbers to  
11 develop rates, correct?

12 A No, not directly. That's correct.

13 Q In lines 14 through 16, you say, "<sup>comparison</sup>~~Comparison~~ of  
14 the implicit average weights used by Witness Haldi in Table  
15 A-6 with the average weights using actual 1996 billing  
16 determinants, (Table A-5) indicates large disparities."

17 I would ask you if you could turn to that Table  
18 A-5?

19 A Yes.

20 Q The large disparity that you point out has to do  
21 with high density where there is -- you say which has an  
22 average weight of .21 pounds.

23 Where do you get that number from?

24 A The .21 on line 17 should be .24.

25 Q In fact, shouldn't it be .2417?

1 A I was rounding to the nearest hundredths.

2 Q Okay, so that is an error?

3 A That is a typographical error, yes.

4 Q Now you are saying that the 1996 billing  
5 determinants should have been used to develop these  
6 separations, correct?

7 A I am saying that that is a way of doing it.

8 Q Okay. Take a look at pound-rated nonletters for a  
9 second on Table A-5 in Dr. Haldi's testimony and tell me for  
10 saturation mail, for example, what systematic variation do  
11 you see of average weight depending on point of entry?

12 A I don't see one.

13 Q And in fact those numbers are fairly close, aren't  
14 they, for saturation -- .28, .29, .31 and .28.

15 A Excuse me, I was comparing saturation to high  
16 density. Could we go back?

17 Q Sure. Let me ask you if you see any kind of  
18 systematic variation among the average weight of the  
19 pound-rated nonletters for the saturation tier.

20 A The range is from .28 pounds to .32 pounds.

21 Q Okay. Any systematic variation?

22 A Maybe I am having a problem with the word  
23 systematic.

24 Q Well, as you get -- as you drop into the system  
25 closer to the customer, does it become heavier, typically a



1 heavier weight piece or a lighter weight piece?

2 A No.

3 Q It just varies randomly, correct?

4 A I don't have a basis to say that that's a random  
5 variation.

6 Q You don't have an explanation for the variation  
7 though, correct?

8 A Well, yes, I have an explanation. It's based on  
9 the Postal Service's pounds and pieces and you divide one by  
10 the other and you get --

11 Q Sure. It's what happened -- it's what happened to  
12 have happened in Fiscal '96, correct?

13 A It's actual data.

14 Q Actual data as to what happened to have happened  
15 that year?

16 A Yes.

17 Q And there happens to be more density -- excuse me  
18 -- more variation, I guess, in the high density,  
19 specifically the number you pulled out to use, which you now  
20 corrected to be .24, there seems to be more variation in  
21 high density, correct, than there is in basic or saturation?

22 A The variation in high density is between .24 and  
23 .33.

24 Q Correct. That's much greater than it is for basic  
25 or saturation; correct?

1           A     I don't know that it's much greater.  It's  
2 different.

3           Q     It's greater, right?

4           A     It's greater, yes.

5           Q     Do you know how much of total volume is high  
6 density within ECR?

7           A     The 1996 billing determinants would show that high  
8 density is 287 million pieces out of 6.6 billion pieces.

9           Q     A fairly small percentage compared to certainly  
10 saturation and basic; correct?

11          A     It's smaller; yes.

12          Q     You said before that there might be other ways to  
13 make the allocation that you criticized Dr. Haldi for using,  
14 the percentage of pounds and applying those to volume, you  
15 said there might be other ways, one you said was to use the  
16 fiscal 1996 billing determinants.  Anything else you can  
17 think of?

18          A     You could do a time series.  You could test the  
19 values over time.  You could do a regression.  You could  
20 take the test year pieces and adjust them based on the test  
21 year pounds but recognizing variation in weight.

22          Q     Do you know if you can do any of those with the  
23 information that's been provided so far in this case by the  
24 Postal Service?

25          A     I don't know.

1 Q Have you tried to do any of those?

2 A No.

3 Q Let me ask you to look at your testimony at page  
4 four, your discussion of table A-7. There you criticize Dr.  
5 Haldi, I think, for -- I'll start at line nine. You say  
6 "However, in developing the pounds for automation letters,  
7 witness Haldi (assumed that these [automation] letters have the  
8 same average weight as <sup>Basic Presort Letters'</sup> ~~basic presort letters~~." Then you say  
9 that assumption is false; correct?

10 A Yes.

11 Q Would you take a look at his table A-3, which is  
12 1996 billing determinant data, and for automation, does the  
13 Postal Service provide a break out of automation letters by  
14 BMC, SCF or DDU?

15 A There is no break out in table A-3.

16 Q In fact, there is no break out as part of the  
17 record in this case; correct?

18 A I'm not sure.

19 Q Do you know why there was no break out provided?  
20 I'll ask you to assume there was none for the purpose of the  
21 question. Do you know why automation might not have a break  
22 out where the others do?

23 A No.

24 Q Are you familiar with the implementation date of  
25 the rates in Docket No. MC95-1, the rate class case?

1 A Yes.

2 Q And the fact that these automation ECR rates went  
3 into effect during the course of fiscal 1996?

4 A Yes.

5 Q In fact, we have probably a quarter's worth of  
6 data for those automation letters?

7 A I don't know.

8 Q Otherwise, those letters -- where do those letters  
9 appear for the other three-quarters of the year in that  
10 chart?

11 A I'm not sure.

12 Q If I were to suggest they are in the basic  
13 category and in fact, I believe that is a response to an  
14 interrogatory, which I'll reference for the record, which I  
15 think is USPS-ValPak-Carol Wright-T1-18 and 19, and I don't  
16 have a page reference. I can correct that if necessary.  
17 That's what my notes indicate here.

18 Automation was a subset of basic letters for most  
19 of the year in the 1996 billing determinants. Would you  
20 accept that subject to check?

21 A Yes.

22 Q If that's so, if automation was in fact a subset  
23 of basic, is it irrational to assume that they might have  
24 the same average weight, that might be the best proxy that's  
25 available to determine the average weight of automation

1 pieces?

2 A It still wouldn't explain the variation in the  
3 average weight for the automation letters that are shown.

4 Q Do you think it's a good proxy or a reasonable  
5 proxy?

6 A No.

7 Q It's because of your numbers in table A-5?

8 A Yes.

9 Q There, the numbers are for the pieces that have no  
10 destination entry; correct? Or they are put in that column  
11 anyway for no destination entry? Do you see that?

12 A In table A-5?

13 Q Yes.

14 A Yes.

15 Q Do you see that the Postal Service did not provide  
16 average weight in the billing determinants for letters,  
17 based on point of entry? I guess they are all just under no  
18 destination entry. We just talked about how in table A-3,  
19 they did not provide BMC entry, SCF entry or DDU entry break  
20 out; correct?

21 A Yes.

22 Q You can't tell what the -- they are all lumped  
23 under no destination entry, irrespective of point of entry;  
24 correct?

25 A The only place that automation letters appear is

1 under no destination entry; that's correct.

2 Q Let me ask you to look at the bottom of page 4  
3 where you talk about table A-8.

4 A Yes.

5 Q And there you say the -- line 17, and going to the  
6 next page -- the transportation cost for SCF shown by  
7 Witness Haldi equals 0.72 cents per pound and is not  
8 correct. The actual value from USPS Library Reference  
9 LRH-111 equals 0.73 cents per pound. Correct?

10 A Yes.

11 Q Okay. Where did you get that number from the  
12 library reference?

13 A Appendix C, table 1, revised November 20, 1997.

14 Q Okay. Let me ask you if you can look at page 2 of  
15 the library reference for a moment.

16 A This would be Library Reference 111?

17 Q Yes.

18 A I don't have the entirety of that library  
19 reference with me.

20 Q Okay. Well, let me just read you one sentence for  
21 the library reference. Actually, let me read from page 6.  
22 The nontransportation cost avoidances is what we're talking  
23 about. It says the cost avoidances are 2.71 cents for DDU,  
24 1.99 cents for DSCF, and 1.35 cents for DBMC.

25 Based on those numbers, what would be the

1 nontransportation costs for SCF? Would it not be the DSCF  
2 2.71 minus the DDU 1.99?

3 A The 1.99 was revised.

4 Q To 2.0 or to 1.98?

5 A Yes.

6 Q Okay. Do you have the date of that?

7 A Appendix C, table 1, revised November 20, 1997.

8 Q Okay. That's what your criticism is then, the  
9 failure to recognize the revision?

10 A Yes.

11 Q By the penny.

12 A Yes.

13 Q And you do realize that the number you cite, you  
14 do have that page from Appendix C that you cited; correct?

15 A Yes.

16 Q The bottom of table 7?

17 A The page that I have doesn't have a table 7 on it.  
18 I'm looking at Appendix C, table 1.

19 Q Right. Appendix C, table 7 has a number carried  
20 out to more decimal points. It's .007264. Dr. Haldi used  
21 .72. You used .73. Correct?

22 A Yes.

23 Q Let me ask you to turn to your analysis there of  
24 table A-10.

25 You say at the beginning of line 11: In addition

1 Witness Haldi's analysis assumes that shipping costs for  
2 piece-rated mail, i.e., below 3.3 ounces, varies in direct  
3 proportion to weight.

4 Are you familiar with the way in which Library  
5 Reference 111 determines drop ship savings for Standard A  
6 mail?

7 A Generally, yes.

8 Q Okay. Is it on a piece -- per-piece or a  
9 per-pound basis?

10 A It's on a per-pound basis.

11 Q Okay. Every single drop ship savings is on a  
12 per-pound basis; correct? In that library reference?

13 A I don't know if every single one is. Generally --  
14 the answers are expressed on a per-pound basis. The Postal  
15 Service in developing their discounts for piece-rated mail  
16 develops the discount based on 3.3 ounces.

17 Q And you say that the assumption has not been shown  
18 to be valid. Can you explain that to me?

19 A Dr. Haldi has assumed that the destination entry  
20 cost savings are linear with changes in weight, when in fact  
21 it's not been shown that those changes are linear, and the  
22 Postal Service doesn't apply it that way.

23 Q Do you have a problem with Library Reference 111  
24 in the way they develop their drop ship savings?

25 A No.



1 Q But those are purely on a pound basis, are they  
2 not?

3 A Yes.

4 Q Okay. So they're directly -- in direct proportion  
5 to weight, are they not?

6 A There's no savings developed on a per piece basis,  
7 so there's no -- the issue of the cost savings being  
8 proportional to changes in weight is not addressed in that  
9 library reference.

10 Q You say that this is refuted by the data shown in  
11 Witness Haldi's Appendix D. Could you turn to his Appendix  
12 D?

13 A Yes.

14 Q Can you tell me what you're referencing? I guess  
15 it's the footnote 4 on that page, where you say that a --  
16 Dr. Haldi's Appendix D -- that says a carrier route letter  
17 weighing one ounce costs more than letters weighing two to  
18 four ounces. Is that what you're referring to.

19 A Yes.

20 Q That would be in Table D3?

21 A Yes.

22 Q Okay. And so, you say that this assumption about  
23 shipping costs varying in direct proportion to weight is  
24 refuted by this table, correct, in Dr. Haldi's own  
25 testimony.

1 A Yes.

2 Q Okay. Did you read Dr. Haldi's description of  
3 these tables, D1 through 3?

4 A Yes, I did.

5 Q Okay. And on page <sup>D-9</sup>~~D9~~, do you see that Dr. Haldi  
6 discusses Table 3, which is -- Tables 1 and 2 were provided,  
7 Table 3 he calculated, and he says inspection of Table 3  
8 shows that, "for carrier route mail, the results are  
9 obviously absurd?" Do you see that?

10 A Yes.

11 Q And so you're saying that he's inconsistent and  
12 that his assumption has been proved to be false by data that  
13 he presents in his testimony which he describes as obviously  
14 absurd?

15 A Well, the statement's equally valid to Tables ~~D1~~ <sup>D-1</sup>  
16 and ~~D2~~ <sup>D-2</sup> in his appendix.

17 Q But D1 and D2 are provided by the Postal Service,  
18 and it's D3 that shows that all the data are "obviously  
19 absurd." Isn't that correct?

20 A I'm not sure that Dr. Haldi was claiming that all  
21 the data in Table <sup>D-3</sup>~~D3~~ is absurd. If you look at the data in  
22 those three tables, they are uniform in that, for carrier  
23 route mail, the cost for a one-ounce piece is greater than a  
24 cost for a two-ounce, three-ounce, or four-ounce piece.

25 Q Okay. Well, take a look at his analysis at the

1 end of page <sup>D-9</sup>~~D9~~. He says serious weight cannot be given to  
2 data for flats when the residual produces results such as  
3 these. The data for flats are in Table <sup>D-2</sup>~~D2~~, correct?

4 A Yes.

5 Q Okay. So, certainly, at least Table D2 and D3 he  
6 said were absurd and could not be given serious weight,  
7 correct?

8 A Yes.

9 Q Let me ask you to turn to page 8, where you  
10 discuss Table <sup>A-14</sup>~~A14~~, and there, beginning on line 14, you say  
11 Witness Haldi assumes that 2.33 cents per piece should be  
12 considered weight-related for all non-letters. Is that an  
13 accurate statement of what you believe Dr. Haldi does?

14 A Yes.

15 Q So, you think he is of the view that 2.33 cents  
16 per piece should be considered weight-related.

17 A In purposes -- for purposes of the calculations  
18 that he's made in his appendices, yes.

19 Q Okay. And what were the purposes of those  
20 calculations that he made in his appendices?

21 A Well, this gets into the inputs into the rate  
22 design versus the calculations that he's made.

23 When he developed his aggregate cost true-ups and  
24 his tests of the distribution of the costs, he assumed a  
25 weight piece of 2.33 cents.

1           In his actual rate design for non-letters, it  
2 never appears.

3           Q     Absolutely. He did not use 2.33, correct? But  
4 rather --

5           A     But he has. He uses that number in many of his  
6 tables, and because my exercise here in this appendix was to  
7 critique the issues and the problems with each of the  
8 tables, I needed to address the 2.33 cents.

9           Q     Okay. Well, take a look at Table ~~A-14~~<sup>A-14</sup> very  
10 quickly, if you could, in his testimony. Do you see that he  
11 describes the 2.33 cents as case one?

12          A     Yes.

13          Q     And case one finishes with table A-19 and then it  
14 goes to case two, and at case two, a very different  
15 assumption is made, of .5825 cents per piece treated as  
16 weight related costs?

17          A     The case two analysis is never brought forward to  
18 his Appendix C, though, just the case one analysis.

19          Q     You criticize him on page 12 for having assumed, I  
20 guess, or you say for conducting a mathematical exercise  
21 regarding this .5825 cents, and it was just a number, and  
22 you said it's arbitrary and not supported by the workpapers.

23                I would just ask you, if you didn't get the drift  
24 of what Dr. Haldi was doing, saying that since no one knew  
25 what the weight cost relationship was, he would take two

1 extreme cases and assume that it was somewhere in between,  
2 and that one of the cases was 2.33 cents per piece, that's  
3 case one, and case two was 0.5825 per piece and that was  
4 case two, and then he compared the two, and isn't that what  
5 he was doing with those two numbers rather than vouching for  
6 those numbers?

7 A Well, when he went to this Appendix C to develop  
8 or finish his analysis, for example, table C-8 is based on  
9 the 2.33 cents per piece. There is no comparable table to  
10 C-8 based on the .5825. I would assume that he's giving  
11 more credibility to the 2.33, since he's using that in the  
12 later steps in his analysis.

13 Q In your own testimony, on the last line of this  
14 page, you say Witness Haldi's analysis of the costs  
15 associated with rate as utilized in Table A-14 or subsequent  
16 tables, have no bearing on the ultimate rate design for  
17 pound rate mail; correct?

18 A They have no bearing on the rates that he shows in  
19 his table C-10. It has a bearing on the costs that he shows  
20 in his table C-9, his costs in his table C-8, those two  
21 tables.

22 Q But it has no bearing on his proposed rates;  
23 correct?

24 A Yes.

25 Q And that he accepted Witness Moeller's .53 pounds

1 -- excuse me -- .53 cents per pound -- 53 cents a pound as  
2 the pound rate; correct?

3 A Yes.

4 Q Do you have any difference of opinion with the  
5 concept that there are -- I don't mean to have that long a  
6 pause in the question. Just strike what I've said and let  
7 me start over again.

8 Do you have a problem with Dr. Haldi's analysis  
9 that we need to know more about the effect of weight on cost  
10 with respect to non-letters?

11 A I've not addressed that in my testimony.

12 Q Do you believe there is a cost component of weight  
13 for non-letters, that cost varies with weight?

14 A In some regard, yes.

15 Q Do you have an opinion as to whether the proper  
16 weight cost relationship lies within or without the  
17 parameters of his case one and case two? The 58 cents and  
18 the --

19 A I don't have a basis to say that it's within those  
20 parameters or outside of those parameters.

21 Q Take a look, please, at your testimony on page  
22 nine regarding A-16, table A-16. There you say at line 16,  
23 for the pound portion of pound rated mail, Witness Haldi  
24 assumes that costs do not vary with sortation or destination  
25 entry; is that correct?

1 A Yes.

2 Q Do you have <sup>A-16</sup>~~A16~~ before you?

3 A Yes.

4 Q Okay. The e.g. you give for that proposition is  
5 that the pound rated portion -- excuse me, the pound portion  
6 of pound rated mail for basic sortation without drop  
7 shipping is the same as another rate cell, correct? What is  
8 the pound portion of pound rated mail for basic sortation  
9 without drop shipping, according to the chart?

10 A For basic mail it is .257.

11 Q Then you compare that to the pound portion for  
12 saturation mail drop shipped to the DDU. And what is that  
13 number, from Table <sup>A-16</sup>~~A16~~?

14 A The DDU number for saturation is .1191.

15 Q Okay. So the first number that you use there, the  
16 pound portion of the pound rated mail for basic sortation  
17 without drop shipping is 25.7 cents, and you say that is the  
18 same as the pound portion for saturation mail drop shipped  
19 to the DDU, which you said is 11.91 cents.

20 A I think the statement -- my statement in the text  
21 is not very clear. The point that I was trying to make in  
22 that statement was if you are in Table A16, you see two  
23 things. First, that for pound rated mail, the per pound  
24 amount is the same regardless of sortation. In other words,  
25 basic equals high density equals saturation.

1           The second thought that I was trying to get across  
2 here was that for the piece portion of pound rated mail, the  
3 values are the same across all -- regardless of destination  
4 entry. So that if you are, and this is one section up on  
5 Table A16, if you are basic mail, the assumption is that the  
6 cost is 5.90 cents for no destination entry but it also 5.90  
7 cents for destination entry at the DDU.

8           Q     And isn't it correct that Dr. Haldi has been  
9 critical of the Postal Service for failure to develop these  
10 weight cost relationships any quicker than they have -- than  
11 they have done so, and that he is attempting to further the  
12 analysis?

13          A     Well, Dr. Haldi stated the purpose of his  
14 testimony was to develop bottom up costs.

15          Q     And with respect to weight, he notes serious  
16 deficiencies in the available data, does he not? Isn't that  
17 what Appendix D is about?

18          A     His Appendix D discusses deficiencies in the data  
19 related to weight and cost.

20          Q     The entire topic of the section, isn't it?

21          A     Yes, it is.

22          Q     Okay. Well, so just to clarify, let me just make  
23 sure, you are not contending, are you, that the first  
24 number, 25.7 cents, is the same as 11.91 cents?

25          A     No, I not.



1 Q So this is an error?

2 A Well, the statement is not very articulate.

3 Q Well, isn't it just in error? Just wrong?

4 A Well, yes.

5 Q Let me ask you to turn to page 12, and there you  
6 talk about the 90 percent margin, 10 percent markup that Dr.  
7 Haldi uses in his recommended rates, do you recall that?

8 A Yes.

9 Q Okay. You first say on line 16 that Witness Haldi  
10 only relies on the results of BMC mail in his rate proposal.  
11 In other words, you are being -- you are criticizing him, I  
12 take it, that he didn't develop a separate analysis for SCF  
13 and DDU and no destination entry, correct?

14 A Separate analysis meaning rates, yes. His rates  
15 for the other destination entry are based on the Postal  
16 Service's discounts.

17 Q Right. Have you attempted to do the analysis for  
18 SCF, DDU, no destination entry and compare it to the way  
19 that it comes out with Dr. Haldi's analysis using BMC?

20 A No.

21 Q Okay. Secondly, you say the 90-10 allocation is  
22 arbitrary and not supported. Does that mean that you don't  
23 believe it is supported in his testimony?

24 A It appears in his testimony. There's no rationale  
25 for the 90 percent/10 percent split versus any other split.

1 Q Okay. Let me ask you to turn to page 40 of Dr.  
2 Haldi's testimony.

3 A Okay.

4 Q On page 40, Dr. Haldi starts an analysis of target  
5 margins versus target mark-ups. You have read this,  
6 correct?

7 A Yes.

8 Q Okay. And he first says, and I am reading from  
9 line 13 here, "The extent to which either of these two  
10 approaches, [margins or mark-ups] is more appropriate for any  
11 given class or subclass depends on the competitive  
12 environment for postal services, as explained below."

13 Do you have any problem with that statement?

14 A Yes.

15 Q You have a problem with it?

16 A Yes. I don't believe that either of these two  
17 approaches is appropriate from the standpoint of his  
18 analysis.

19 Q Okay. Well, first, let's go through his analysis  
20 to make sure we are clear on that and then I'll ask you  
21 that.

22 First he discussed target margin at the bottom of  
23 page 40, going on to 41, and he talks about assumptions  
24 which underlie a pricing strategy of relying on margin are  
25 when the Postal Service faces perfect or near-perfect

1 competition for sortation and shipping but has a perfect or  
2 near-perfect monopoly of the delivery function.

3 Do you see that?

4 A No.

5 Q Lines 9 through 14 on page 41.

6 A Yes.

7 Q Okay, and then when he discusses mark-up at the  
8 bottom of 41 and on to 42, he talks about how that would --  
9 and I am referring now to line 8 on page 42 -- how that  
10 would implicitly treat all postal services being subject to  
11 fairer competition.

12 Do you see that?

13 A I see the statement, yes.

14 Q Okay. Do you have any problem with his analysis  
15 there?

16 A Yes.

17 Q Okay, well, we will get to that. Then on page 43  
18 he does an assessment of the competitive environment, which  
19 according to his way of looking at it is very significant in  
20 determining whether these are mark-ups or margins, and he  
21 does an assessment of the competitive environment for  
22 delivery -- at the bottom of page 43, correct?

23 A Yes.

24 Q It goes on to 44 and then he goes into the  
25 analysis of the competitive environment for sorting and

1 shipping, correct?

2 A Yes.

3 Q Okay, and then he goes on to 46 and he leaves the  
4 issue and then he goes to page 49 where he says -- he picks  
5 up this discussion and he says, line 15, "First, initial  
6 "target rates" were derived by adding to unit costs a constant  
7 ~~mark-up~~ <sup>amount</sup> of 7.379<sup>cents</sup> plus a mark-up of 10 percent. The 10  
8 percent mark-up is a conservative recognition of the fact  
9 that the Postal Service faces competition from alternative  
10 delivery in a number of markets."

11 Is it fair to say that Dr. Haldi did not provide  
12 support for the 90-10 allocation, as you have just said?

13 A It appears in his text but there is no  
14 quantitative analysis here that says when you look at  
15 competitive positions for advertising mail that you should  
16 use 90 percent on a fixed margin and 10 percent on a  
17 mark-up.

18 His analysis that you have pointed to in this  
19 testimony doesn't have any quantitative support for a 90-10.

20 Q If the number were lower, if it were 80-20, it  
21 would result in higher basic rates, correct?

22 Anything lower than 90 would result in higher  
23 basic rates of the sort used by catalogs?

24 A Do you mean basic rates or initial target rates?

25 Q Basic rates.

1           A     I don't know because of the impact of the true-up  
2     that he uses in Table C-3.

3           Q     Okay, but if -- I guess I will do the rest of this  
4     in brief, but if -- the only question I want to ask you is  
5     isn't it true that when you move down from a 100 percent to  
6     90 percent you put at least some of the mark-up on  
7     processing and transportation and not all of it on delivery?

8                     Is that one way to look at it?

9           A     I don't think so.

10          Q     Is the -- when you move from 100 to 90 is it true  
11     that you are favoring the classes of mail that have higher  
12     unit cost by giving them less of a mark-up?

13          A     Well, let me answer that by using his table.

14                     In his Table C-2, his part A of C-2 reflects a  
15     constant mark-up of 8.19 cents. Part B of his Table C-2  
16     uses a constant percentage mark-up of -- a ratio of 2.44.

17                     He then weights Part A with Part B to get his  
18     rates.

19                     Now, within the framework of those values, if you  
20     assume that the values he's got in that table are correct,  
21     as you decrease the constant piece and increase the ratio  
22     piece, Part C of his Table C-2, the basic rate, would  
23     increase.

24                     MR. OLSON: Mr. Chairman, that's all we have.

25     Thank you.

1 CHAIRMAN GLEIMAN: Is there any followup?

2 Questions from the bench?

3 If not, that brings us to redirect.

4 Mr. Todd, would you like some time with your  
5 witness?

6 MR. TODD: Mr. Chairman, please, yes.

7 CHAIRMAN GLEIMAN: I think we'll take ten then,  
8 and make it a break.

9 [Recess.]

10 CHAIRMAN GLEIMAN: Yes, sir. Mr. Todd, did you  
11 have any redirect?

12 REDIRECT EXAMINATION

13 BY MR. TODD:

14 Q Mr. Prescott, are you ready?

15 A Yes.

16 Q Could you state what your understanding is of what  
17 Dr. Haldi was attempting to do in the testimony which is the  
18 subject of your rebuttal testimony?

19 A The purpose of Dr. Haldi's testimony was to  
20 develop what he called bottom-up costs, to look at the  
21 Postal Service's rate design and to propose a rate design  
22 which in his opinion followed the logic of bottom-up costs.

23 Q Do you believe that he was able to develop rates  
24 based upon bottom-up costing in his testimony, valid  
25 bottom-up costing in his testimony?

1 A No.

2 Q And why do you think that he failed in his  
3 attempt?

4 A The data isn't available for him to do the  
5 bottom-up cost analysis that he wanted to do and from there  
6 to develop rates based on bottom-up costs. And because of  
7 that he had to make a series of assumptions, and ultimately  
8 when he went to his rate design he utilized the Postal  
9 Service's rate design except for a modification to the  
10 sortation discounts and the discount for the base rate --  
11 excuse me, and the rates for base rates.

12 Q Thank you, Mr. Prescott.

13 MR. TODD: That's all I have, Mr. Chairman.

14 CHAIRMAN GLEIMAN: Is there any recross?

15 Mr. Olson?

16 RE CROSS-EXAMINATION

17 BY MR. OLSON:

18 Q Mr. Prescott, you say that the data isn't  
19 available to do the kind of bottom-up analysis Dr. Haldi set  
20 out to do; correct?

21 A Yes.

22 Q Are all of the data insufficiencies that you know  
23 of set out in your testimony? In other words, you're not  
24 referring to something new now that isn't already in your  
25 rebuttal testimony; correct?

1 A That's correct.

2 Q All data insufficiencies of which you are aware  
3 are in your rebuttal testimony; correct?

4 A Yes.

5 MR. OLSON: That's all I have, Mr. Chairman.

6 CHAIRMAN GLEIMAN: Any further redirect?

7 MR. TODD: No.

8 CHAIRMAN GLEIMAN: If that is the case, we want to  
9 thank you, Mr. Prescott. We appreciate your appearance here  
10 today and your contributions to our record, and if there's  
11 nothing further, you're excused, but your counsel isn't. He  
12 has to stay around for a while.

13 [Witness excused.]

14 CHAIRMAN GLEIMAN: I take it you do have another  
15 witness. Right?

16 MR. TODD: Yes, and it would be helpful, Mr.  
17 Chairman, if there could be some indication of how long the  
18 next witness is likely to take. I'm not sure who that is  
19 offhand, but --

20 CHAIRMAN GLEIMAN: Well, I'm about to --

21 MR. TODD: You're going to do that.

22 CHAIRMAN GLEIMAN: Apprise you, and then we'll all  
23 find out.

24 Our next witness is appearing on behalf of the  
25 United States Postal Service. Ms. Schenk is already under



1 oath in the proceeding. Ms. Reynolds is counsel.

2 MS. REYNOLDS: Yes, the Postal Service is calling  
3 its next witness, Leslie M. Schenk.

4 Whereupon,

5 LESLIE M. SCHENK,  
6 a witness, was called for examination by counsel for the  
7 United States Postal Service and, having been previously  
8 duly sworn, was examined and testified as follows:

9 CHAIRMAN GLEIMAN: If you could proceed to enter  
10 Witness Schenk's rebuttal testimony, and while you're on  
11 your way over there -- well, let's wait a moment before we  
12 find out from Mr. Levy. Why don't you proceed, Ms.  
13 Reynolds.

14 DIRECT EXAMINATION

15 BY MS. REYNOLDS:

16 Q All right. Dr. Schenk, I've handed you two copies  
17 of a document entitled the Rebuttal Testimony of Leslie M.  
18 Schenk on Behalf of the United States Postal Service, and  
19 designated USPS-RT-22.

20 Are you familiar with these documents?

21 A Yes, I am.

22 Q Were they prepared by you or under your direction?

23 A Yes.

24 Q And if you were to testify orally here today,  
25 would this be your testimony?

1           A     Yes, it would.

2           Q     Do you have any changes you wish to make to these  
3 documents?

4           A     Yes. There are a couple of errata to announce  
5 from the filed version. On page -- and these corrections  
6 are made in the version that we're presenting today.

7                     On page 3, line 3, it should read 0.228 billion  
8 for FY '96, not million.

9                     On page 12, line 2, the phrase in parentheses  
10 should be deleted.

11                    And then in Appendix B, Exhibit 2, on page 29, we  
12 are filing the testimony with a revised version of that  
13 exhibit. The difference between the old version and the new  
14 version is that we received three additional responses after  
15 the filing of the testimony. Those responses are included  
16 in the new version of the exhibit, but the inclusion of  
17 those responses does not change the magnitude of the  
18 estimate derived substantially, so -- and there was also one  
19 correction to one of the formulas. It was just a  
20 typographical error. So those are included in this revised  
21 version of the exhibit.

22                    MR. LEVY: May I inquire, Mr. Chairman, of the  
23 witness which lines of the table are changed?

24                    THE WITNESS: The lines would be lines 15, line  
25 19, and -- I can't find the other one here right away.

1 MR. LEVY: 244 and 249, perhaps?

2 THE WITNESS: Oh -- and 20. Oh -- and the  
3 typographical error in the formulas would be the formulas  
4 for lines 5 and 6.

5 BY MS. REYNOLDS:

6 Q That's inflation factor strata 1 and inflation  
7 factor strata 2.

8 A Yes.

9 MS. REYNOLDS: At this time, Mr. Chairman, I've  
10 got two copies of the testimony for the reporter, and we ask  
11 that they be moved into evidence. The revisions are marked  
12 in the documents that the reporter is receiving.

13 CHAIRMAN GLEIMAN: Almost afraid to ask. Are  
14 there any objections?

15 MR. LEVY: Other than the pending motion, no, Mr.  
16 Chairman.

17 CHAIRMAN GLEIMAN: Okay. Recognizing that there  
18 is a pending motion and it does raise an objection, I'm  
19 going to direct, for the moment, that the testimony and  
20 exhibits of Witness Schenk be received into evidence, and I  
21 direct that they be transcribed into the record at this  
22 point.

23 [Rebuttal Testimony and Exhibits of  
24 Leslie M. Schenk, USPS-RT-22, was  
25 received into evidence and

transcribed into the record.]

- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 10
- 11
- 12
- 13
- 14
- 15
- 16
- 17
- 18
- 19
- 20
- 21
- 22
- 23
- 24
- 25

USPS-RT-22

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

POSTAL RATE AND FEE CHANGES, 1997

Docket No. R97-1

REBUTTAL TESTIMONY OF  
LESLIE M. SCHENK  
ON BEHALF OF THE  
UNITED STATES POSTAL SERVICE

## TABLE OF CONTENTS

AUTOBIOGRAPHICAL SKETCH.....	ii
I. Purpose of Testimony.....	1
II. Analysis of the Methodology Used in the ANM Survey.....	4
A. Appropriate Statistical Survey Methodology Not Used in ANM's Survey.....	5
B. Analysis of ANM Survey Responses.....	8
III. The Limited Extent To Which Nonprofit Volumes and Costs Are Not Consistent.....	11
A. Disqualification After Acceptance.....	11
B. Disqualification During Acceptance.....	15
C. Entry at Commercial Rates.....	17
D. Effect of Disqualified Nonprofit Mail on IOCS Costs.....	18
IV. SUMMARY.....	20
Appendix A - Analysis of ANM Survey Responses.....	21
Exhibit USPS-RT23-1.....	24
Appendix B - LRCA Survey Description and Results	
Exhibit USPS-RT23-2.....	25
Appendix C - Response of the USPS To Interrogatory of the Alliance of Nonprofit Mailers (ANM/USPS-28).....	30
Appendix D - Source Code Listings.....	34

USPS-RT-22

1

**AUTOBIOGRAPHICAL SKETCH**

2

3

4

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

My name is Leslie M. Schenk. I am a Senior Economist with Christensen Associates, which is an economic research and consulting firm located in Madison, Wisconsin. I have been employed at Christensen Associates since June, 1995. During my tenure at Christensen Associates, I have worked on many research projects for the U.S. Postal Service.

In 1982 I received a B. A. from SUNY College at Buffalo, with a major in economics and a minor in mathematics. I received an M.A. in economics, and an M.A. in mathematics (with a concentration in statistics) from Indiana University in 1984 and 1986, respectively. In 1995 I received a Ph.D. in economics from Michigan State University.

From 1985 to 1986 I was a research assistant on the economic forecasting modeling project at the Indiana University Business School. There I was responsible for quarterly economic forecasts for industry clients. From 1986 to 1989 I was a demand analyst for Indiana Bell Telephone Company. Among my duties there, I helped prepare analyses for rate case filings before the Public Service Commission of Indiana. I also provided in-house statistical consultation. From 1993 to 1995 I worked as a research assistant at the Institute for Public Policy and Social Research at Michigan State University. My research there was on nonprofit organizations. From 1983 to 1993, I taught numerous economics, business statistics, and mathematics courses.

In this proceeding, R97-1, I gave direct testimony on the cost of counting, rating and billing Business Reply Mail. I also presented testimony

USPS-RT-22

- 1 on the costs of nonletter-size **Business Reply Mail** in Docket No. MC97-1.
- 2 My research for the Postal Service has also included a number of in-field
- 3 surveys to support Dockets No. MC95-1 and MC96-2.



1 I. Purpose of Testimony

2 The purpose of this testimony is to demonstrate that the hypothesis  
3 put forth by witness Haldi (ANM-T-1) in section V. of ANM-T-1,  
4 "Misreporting By The IOCS of Standard Mail (A) Entered by Nonprofit  
5 Mailers," is without foundation. In that section, Dr. Haldi hypothesizes that  
6 the unit cost attributable to nonprofit Standard (A) mail is inflated, due to a  
7 failure to calibrate or synchronize nonprofit cost and volume data. Dr. Haldi  
8 has, however, failed to prove that there is a significant discrepancy between  
9 cost and volume data for nonprofit Standard (A) mail.

10 In calculating the level of "miscalibration," Dr. Haldi relies exclusively  
11 on the results of a survey of nonprofit mailers conducted by the Alliance of  
12 Nonprofit Mailers (ANM) to make inferences about the universe of nonprofit  
13 mailers. Witness Haldi does not, however, provide evidence that the survey  
14 respondents are representative of the population of nonprofit mailers. While  
15 some of the ANM survey results do show that there are a limited number of  
16 instances when mail endorsed as nonprofit paid regular rates, these results  
17 cannot be used to make inferences on the population of nonprofit  
18 transactions because the survey results have not been shown to be  
19 representative of the population. In fact, these results are subject to bias  
20 from several sources.

21 In addition, the survey responses do not indicate how the mailings  
22 reported by respondents were entered into the Postal Service volume  
23 systems, and hence cannot be used in any way to infer that volumes and  
24 costs for nonprofit Standard (A) mail are not consistent. As such, one  
25 cannot use the estimates developed by Dr. Haldi in his testimony to conclude

USPS-RT-22

1 that "the results of the extensive modeling efforts relied upon by the  
2 Commission and the Postal Service for rate making (has) become unreliable"  
3 (Tr. 22/11811).

4 In fact, I will show that the magnitude of the impact of  
5 inconsistencies between nonprofit Standard (A) volumes and costs is  
6 minimal. As discusses in detail in Section III, there are three ways in which  
7 disqualified nonprofit mail sent at regular Standard (A) rates may have  
8 nonprofit endorsements. These three sources, and the levels of volume  
9 represented by these sources in FY96, are shown in the table below.

Source	Volume
Disqualification after acceptance (recorded in AIC 119)	Negligible impact on volumes
Reversals	6,129,920
Disqualification at acceptance	30,322,965
Total regular Standard (A) volume with nonprofit indicia	36,452,885
PFY96 Regular Standard (A) volume	59,339 million
Percentage of regular rate volumes with nonprofit indicia	0.061%

10 But, there are also circumstances under which mail sent at nonprofit  
11 rates are endorsed are regular rate Standard (A). In PFY96, reversals in the  
12 PERMIT system from regular rate to nonprofit amounted to 12.9 million  
13 pieces. Given this data and the data in the table above, we can calculate the  
14 net amount of IOCS costs that should be in regular Standard (A), but are in  
15 nonprofit Standard (A). These calculations, discussed in Section III, are  
16 summarized below.

USPS-RT-22

	IOCS Costs, FY96 (\$billion)	IOCS Costs, Adjusted to reflect endorsements (\$billion)	Cost Shift (\$billion)
Regular Std. (A)	\$1.024	\$1.0246	\$0.0006
Nonprofit Std. (A)	\$0.228	\$0.2282	\$0.0002
Net IOCS Cost Shift from Nonprofit to Regular Std. (A)			\$0.0004
Percent of Nonprofit IOCS Costs			0.18%

1           The net effect is that \$0.4 million in IOCS costs should be in regular  
2 rate, but are in nonprofit. This represents only 0.18 percent of nonprofit  
3 Standard (A) IOCS costs, which were \$0.228<sup>6</sup> billion for FY96. This  
4 contrasts with Dr. Haldi's estimate that 7.85 percent of mail processing  
5 costs have been incorrectly attributed to nonprofit mail. Therefore contrary  
6 to what is suggested by Dr. Haldi, no adjustments to nonprofit or regular  
7 Standard (A) costs are needed.

8           According to the official rules of mail preparation of the USPS, as  
9 described in the Domestic Mail Manual, mail must be endorsed to reflect  
10 appropriately the rates being paid. When a nonprofit mailer has not followed  
11 the regulations established for content of nonprofit mailings, they must pay  
12 regular bulk rates (Standard (A) or First-Class). All bulk Standard (A) mail  
13 claimed at regular rates must be endorsed as such, i.e., marked "Bulk Rate<sup>1</sup>."  
14 The fact that the mailer is not always forced to re-endorse the mail in this  
15 circumstance is an accommodation that has been extended to mailers by the

---

<sup>1</sup> Or the abbreviation "Blk. Rt.," according to the Domestic Mail Manual, Issue 49 (09-01-95), Section M302.

USPS-RT-22

1       USPS to facilitate timely service to these customers. When a mailing is  
2       disqualified for nonprofit rates after the mail has entered the mailstream or  
3       after it has been delivered, re-endorsing all mail pieces in the disqualified  
4       transactions is not feasible, nor is it feasible to identify and change the IOCS  
5       tallies that reflect this mail, if any.

6               The USPS does not dispute the fact that, in some circumstances,  
7       nonprofit mailers will pay regular Standard (A) rates for a mail piece with  
8       nonprofit indicia on it, and that, if sampled, the piece would be recorded as a  
9       nonprofit mail tally in IOCS. However, as will be demonstrated below, these  
10      instances are infrequent. In addition, as will be demonstrated here,  
11      disqualified nonprofit mailings frequently remain recorded in the volume  
12      systems as nonprofit Standard (A). In these cases, volumes are consistent  
13      with costs.

14             In the next section, an analysis of the sample methodology used in  
15      the ANM survey will demonstrate the degree to which it does not comply  
16      with standard statistical methodology, and the sources of bias that lead me  
17      to question how representative the ANM survey respondents are of the  
18      universe of nonprofit mailers. In Section III, I discuss the extent to which  
19      volumes and IOCS tallies are not consistent when a nonprofit mailing is ruled  
20      ineligible for nonprofit rates, and I show this amount to be minimal. A  
21      summary of the findings and recommendations is found in Section IV.

## 22      II.     Analysis of The Methodology Used in the ANM Survey

23             The ANM survey results are, at best, biased anecdotal instances of  
24      mailings paying regular rates but sent with nonprofit indicia in FY96. The

USPS-RT-22

1 results of the survey do not represent the population of nonprofit mailers  
2 because standard survey procedures for statistical sampling were not  
3 followed. As even witness Haldi admits, "For a fully representative survey,  
4 one would need a random sample of the entire universe of mailers that  
5 entered mail at nonprofit rates in FY1996" (Tr. 30/16410). Because the  
6 ANM survey results were not generated from a random sample of nonprofit  
7 mailers, nor developed from a survey designed using supportable statistical  
8 methodology, no inference from the survey results can be used to develop  
9 inferences on the population of nonprofit mail as a whole.

10 In addition, the ANM survey responses do not indicate how the  
11 volumes for these mailings were recorded in Postal Service databases.  
12 Therefore, the ANM survey responses cannot be relied upon to give  
13 estimates of the degree to which the volume and cost data systems for the  
14 universe of nonprofit mailers are not consistent.

15 A. Appropriate Statistical Survey Methodology Was Not Used in ANM's  
16 Survey

17 In this section, it will be shown that the ANM survey was not  
18 conducted using standard statistical survey methodology. The sample was  
19 not a random sample of nonprofit mailers, since only ANM members (or  
20 members of affiliate organizations) were sampled. It will be shown that  
21 biased estimates result because inflammatory wording was used on the  
22 survey form, and no attempt was made to control for non-response bias.  
23 The survey results were used to infer behavior of the universe of nonprofit

USPS-RT-22

1 mailers in subsequent analysis by witness Haldi, without any analysis of the  
2 representativeness of the ANM survey responses.

3 The ANM surveys were originally sent out only to ANM member  
4 organizations (USPS/ANM-T1-42). Nowhere is it shown that ANM members  
5 are representative of the population of nonprofit mailers as a whole (e.g., do  
6 most small local churches belong to ANM). If one were trying to estimate  
7 the median income in the U.S., a sample consisting of only residents of  
8 Beverly Hills, CA would not be a representative sample, and the estimate of  
9 median income from that sample would be biased.

10 For sample instrument design, the proper technique is to draft the  
11 survey form so as not to divulge the purpose behind the survey, in an effort  
12 to elicit unbiased and representative responses. The wording of the ANM  
13 survey is such that a biased response is more likely. The first paragraph of  
14 the memo to ANM members that constitutes the survey includes the  
15 following: "the ongoing postal rate case litigation before the Postal Rate  
16 Commission threatens to hit nonprofit Standard A mailers with substantial  
17 increases...could be as high as 15-18%" (Tr. 22/11833). In the second  
18 paragraph, it reads "In order to best protect your interests and the interests  
19 of your colleagues in this critical coalition..." A member of ANM receiving  
20 this survey, and not having had any mailings that were disqualified for  
21 nonprofit rates, would, quite logically, be likely to perceive that it is not in  
22 the best interests of ANM for them to report "negative" results, and so  
23 would be disinclined even to respond to the survey.

24 Mail surveys often suffer from the problem of non-response or self-  
25 selection bias. Typically when conducting a survey by mail, or, as in this

USPS-RT-22

1 case, by facsimile, multiple attempts must be made to get a response rate  
2 that is high enough to provide statistically significant results, and to reduce  
3 self-selection bias. ANM made no attempt to follow-up on non-respondents  
4 (Tr. 30/16410). The response rate (for the revised survey responses, dated  
5 February 2, 1998) was, at most, only 15 percent of all surveyed (the total  
6 number of nonprofit organizations surveyed is unknown, but considered by  
7 Dr. Haldi to be higher than the 700 who originally received surveys from  
8 ANM (Tr. 22/11,869)). A 15 percent response rate is considerably lower  
9 than what is generally considered necessary to produce statistically valid  
10 estimates.

11 Mail surveys typically produce biased results, unless certain measures  
12 are taken (such as following up on non-respondents) to ensure non-biased  
13 responses. ANM does not report any analysis done that demonstrates that  
14 the respondent group for its survey was representative of the universe of  
15 nonprofit mailers. Dr. Haldi relies on these (untested) results to make  
16 inferences on the universe of nonprofit mailers.

17 Dr. Haldi claims that, since responses came from all major geographic  
18 areas (a term that is undefined in his testimony), the survey results show  
19 that "the phenomenon of using nonprofit evidencing on Standard Mail (A) is  
20 indeed widespread" (Tr. 22/11812). There is a fallacy in Dr. Haldi's  
21 argument, since geographic dispersion of a phenomenon does not imply  
22 magnitude of that phenomenon. Airline crashes occur all over the world, yet  
23 one cannot use that fact to imply that the chances of an airplane crash are  
24 so great that one should avoid air travel.

USPS-RT-22

1           While nonprofit organizations in the U.S. may be geographically  
2 dispersed, originating nonprofit Standard (A) mail is concentrated in the  
3 Midwest and East, since many nonprofit organizations use mailing houses  
4 and large printing firms in these areas to prepare their mailings. Also, there  
5 is no *a priori* reason to believe that acceptance and accounting practices vary  
6 across facilities in the Postal Service, since both practices are governed by  
7 national rules. Therefore, Dr. Haldi's claim that the geographically  
8 representative ANM survey responses indicate that the phenomenon in  
9 question is "widespread" is unjustified.

10           Other criteria that should have been used in this case would include  
11 whether average transaction size, and type of mailing (e.g., indicia used) are  
12 similar between survey respondents and the universe of nonprofit mailers.

13           Given the data available from the ANM Survey responses, it is  
14 impossible to tell whether the respondents are representative of the  
15 population of nonprofit mailers. The survey responses provided in ANM-LR-  
16 1 do indicate that at least one-third of survey responses were received from  
17 members of the American Association of Museums; it is highly unlikely that  
18 one-third of all nonprofit Standard (A) volumes are associated with this  
19 group.

20           B.     Analysis of ANM Survey Responses.

21           In developing his estimate that 7.85 percent of all mail processing  
22 tallies are incorrectly attributed to nonprofit Standard (A) mail, Dr. Haldi uses  
23 the "conservative" estimate that at least two-thirds of mail owned by  
24 nonprofit mailers paying commercial rates had nonprofit evidencing of



USPS-RT-22

1 postage paid. This two-thirds estimate was based on the ANM survey  
2 results.

3 Not only was this two-thirds estimate developed from a non-  
4 representative sample, as described above, but some of the ANM survey  
5 responses were simply misinterpreted or recorded incorrectly. In addition,  
6 over one-third of all responses were provided on a different survey form than  
7 the one described by Dr. Haldi and attached to his testimony (compare Tr.  
8 22/11833-34 to ANM-LR-1, Forms 29 and 69-108).

9 I have performed an analysis of the survey responses provided by  
10 ANM in their library reference (ANM-LR-1); this analysis is described in  
11 Appendix A, and summarized in the table below. As shown in this table,  
12 there were 71 surveys where either a different survey form was used, or  
13 mistakes had been made in reporting the results in Exhibit ANM-T1-1.

Survey Problem	Number of Survey Responses
Used the second (less detailed) survey form	45
Survey responses not recorded correctly	26
Two responses reported on one form	22
Total	93

14 Of the 108 "responses" received by ANM, 45 are on a second (less  
15 detailed) survey form. This second survey form did not explicitly ask for  
16 information on how the disqualified nonprofit mail paying regular rates was  
17 endorsed. Given that the questions on the second survey form are worded  
18 much differently than the first, this second form really constitutes a much  
19 different survey instrument, and so the results from the two surveys should  
20 not be combined into one estimate.

USPS-RT-22

1           For 26 of the survey responses, the data recorded in Exhibit ANM-T1-  
2           1 did not match the answers provided on the survey forms (provided in  
3           ANM-LR-1). Most of these 26 survey responses indicated that the mail sent  
4           regular rates was entered "with a nonprofit permit" (question 2b), but also  
5           indicated that the indicia used on the mailpiece was for regular rate (question  
6           2c). But this clearly indicates that, for these respondents, their mail was  
7           endorsed at the rate that the mail was sent. For these 26 responses, the  
8           results reported in Exhibit ANM-T1-1 (upon which Haldi bases his analysis)  
9           erroneously show there to be the potential<sup>2</sup> for a discrepancy between the  
10          volume and cost systems, where clearly no discrepancy exists.

11           Twenty-two of the 108 "responses" are marked with two numbers on  
12          a single response form. Nothing in ANM-LR-1 indicates any reason for this;  
13          the double numbering does not appear to correspond to mailers who mailed  
14          at both commercial and nonprofit rates. Given that ANM-LR-1 was not filed  
15          until February 26, 1998, there has not been sufficient time to explore this  
16          issue further.

17           Exhibit 1 in Appendix A shows the original results of the ANM survey,  
18          as provided in Exhibit ANM-T1-1, as well as the errors found, based on my  
19          analysis of the original survey responses.

---

<sup>2</sup> Given that the ANM Survey does not obtain information on how volumes for these mailings were recorded in Postal Service data systems, the ANM Survey results cannot be used to determine whether the costs and volumes for these mailings are inconsistent.

USPS-RT-22

1           **III.     The Limited Extent To Which Nonprofit Volumes and Costs Are Not**  
2                           **Consistent**

3                           The ANM survey responses that are the basis for Dr. Haldi's estimate  
4           of the percent of mail processing tallies that are incorrectly attributed to  
5           nonprofit Standard (A) mail do not provide information on how the  
6           disqualified mailings reported were entered into the Postal Service volume  
7           systems. Therefore, the degree to which the volumes and costs for  
8           nonprofit mail are not consistent cannot be determined from the ANM survey  
9           responses.

10                          In this section, I will demonstrate that the degree to which nonprofit  
11           IOCS costs are overstated because volumes and costs are inconsistent is  
12           less than two-tenths of one percent. Therefore, the degree to which volume  
13           and costs are inconsistent is much less consequential to the development of  
14           nonprofit costs than Dr. Haldi's testimony would have the Commission  
15           believe.

16           **A.     Disqualification After Acceptance**

17                          Nonprofit mailings can be disqualified for nonprofit rates after  
18           acceptance, and even after delivery, if a determination is made that the  
19           mailing contents did not follow the official guidelines for nonprofit mailings.  
20           These determinations are made generally by postal employees or Postal  
21           Inspection Service personnel, although problems can also be brought to the  
22           attention of the Postal Service by mail recipients. These instances are  
23           infrequent in occurrence, and do not result in a discrepancy between the

USPS-RT-22

1 volume and costing data, given the official accounting practices of the Postal  
2 Service ~~(see pages 7-8 above)~~.

3 As the Postal Service provided in its response<sup>3</sup> to ANM/USPS-28,  
4 when a revenue deficiency is identified<sup>4</sup>, the official USPS accounting  
5 procedure is for the revenue deficient amount to be recorded in revenue  
6 account 41511, Revenue Postage Other (AIC 119, "Revenue Deficiency  
7 Found"), with an offset to an Accounts Receivable, general ledger account  
8 13412 (AIC 814, "Suspense"). The recording of the account receivable in  
9 AIC 814 is made at the same time the revenue deficiency is booked into AIC  
10 119, since the USPS follows a standard double entry accounting system.  
11 When payment is received for the revenue deficiency, it is debited to general  
12 ledger account 11211 (AIC 802 "Cash Received"), with a corresponding  
13 credit made to accounts receivable account 13412, AIC 814.

14 Any revenue deficiencies recorded in AIC 119 and payments  
15 subsequently debited to AIC 802 are not also recorded into a PERMIT system  
16 revenue account, since that would result in double recording of revenue.  
17 There is no shifting of volumes between nonprofit and regular rate categories  
18 when the revenue deficiency is recorded in AIC 119, since the original entry  
19 in the PERMIT system is not changed. The disqualified nonprofit mail  
20 volumes remain in the Postal Service volume and revenue systems as  
21 originally recorded in the PERMIT system (i.e., as nonprofit Standard (A)),

---

<sup>3</sup> This interrogatory response is included as Appendix C to my testimony. Initially provided as an institutional Postal Service response to a discovery request, it was prepared by me, and I am prepared to respond to questions regarding it. I hereby adopt it as part of my testimony.

USPS-RT-22

1 which is how the pieces for that mailing are endorsed. The adjustments  
2 made in AIC 119 are reflected in overall RPW revenue control for stamped  
3 and metered mail.

4 AIC 119 includes all revenue deficiencies, not just those associated  
5 with nonprofit disqualifications. Revenue deficiencies associated with  
6 transactions where nonprofit Standard (A) mail was ruled ineligible for  
7 nonprofit rates cannot be isolated without extensive examination at each  
8 postal site reporting individual transactions in AIC 119. As reported in  
9 Appendix C, the overall level of revenue in AIC 119 in FY96 was \$12.8  
10 million, which is 0.04 percent of total stamped and metered revenue in  
11 FY96. This shows that the impact of disqualified nonprofit mailings  
12 accounted for through AIC 119 on nonprofit and regular Standard (A)  
13 revenues through the BRAF adjustment is negligible.

14 Accounting for revenue deficiencies due to disqualified nonprofit  
15 mailings through AIC 119 (and its associated accounts) does not cause any  
16 change in permit imprint volumes. Permit imprint volumes account for 82  
17 percent of all nonprofit Standard (A) volumes.

18 Dr. Haldi cites 79 Revenue Investigations against nonprofit  
19 organizations, but the cases he cites were those reported to the Postal  
20 Service by the Inspection Service in FY97, not necessarily for mailings  
21 originally sent in FY96. But regardless, disqualifications as a result of  
22 Revenue Investigations will not result in changes made to nonprofit Standard

---

<sup>4</sup> As would occur in the case when a mailer sends a mailing at nonprofit rates, and it is subsequently assessed regular rates.

USPS-RT-22

1 (A) volumes, since the revenue deficiencies will be accounted for in AIC  
2 119.

3 On rare occasions, another procedure is used for accounting for  
4 disqualified nonprofit transactions. In some cases, when a nonprofit mailing  
5 is ruled ineligible soon after the transaction has already been recorded in the  
6 PERMIT system (as nonprofit mail, using Form 3602-N), the original entry  
7 will be netted out, and the same volumes (but new, higher revenues) will be  
8 recorded in PERMIT under a Form 3602-R (i.e., as regular Standard (A) rate  
9 mail). This procedure is sometimes known as a "reversal."

10 Reversals can be done for many reasons, in addition to accounting for  
11 disqualified nonprofit Standard (A) transactions. This procedure was  
12 developed, and is most commonly performed, to correct data entry errors in  
13 the PERMIT system. Reversals are also done when a customer has paid for  
14 a nonprofit transaction out of their regular rate trust account because their  
15 nonprofit trust account had insufficient funds, and then later deposits  
16 sufficient funds in the nonprofit account to cover the transaction.

17 The overall impact of reversals in the PERMIT system is minimal:  
18 using FY96 PERMIT system transaction-level data (as reported in  
19 ANM/USPS-28, see Appendix C), an estimated 6.1 million pieces were  
20 moved from nonprofit to regular rate<sup>5</sup>. This represents only 0.05 percent of  
21 all nonprofit Standard (A) volumes (12,439.6 million pieces in FY96). Given  
22 that the most common (and intended) use of the reversal procedure is to  
23 correct for data entry errors, the estimate of the percentage of nonprofit

---

<sup>5</sup> A source code listing for the analysis of reversals is provided in Appendix D.

USPS-RT-22

1 volumes that are switched to regular rate in PERMIT is considerably less than  
2 this 0.05 percent.

3 This section demonstrates that the total level of changes in volumes  
4 due to nonprofit transactions ruled ineligible for nonprofit rates after  
5 acceptance is negligible. The following section will discuss how these  
6 changes may come about.

7 B. Disqualification During Acceptance

8 Nonprofit mailings can be disqualified for nonprofit rates during mail  
9 acceptance procedures, if a determination is made that the contents of the  
10 mailings do not follow accepted guidelines for nonprofit mailings.

11 The only available means to determine the degree to which nonprofit  
12 mailings disqualified during acceptance are mailed at regular rates with  
13 nonprofit indicia are "disqualification logs," which may be maintained by  
14 acceptance units. This information, usually recorded on Form 8075, is not  
15 available in a central database. Only hardcopy forms are kept, and are not  
16 always available for years previous to the most recently completed fiscal  
17 year, as many sites discard the logs after one year.

18 In order to get some measure of the degree to which nonprofit  
19 transactions disqualified during acceptance pay regular rates but get sent  
20 with nonprofit indicia, Christensen Associates (LRCA) undertook a survey of  
21 30 acceptance sites, selected from the universe of sites with bulk permit  
22 imprint nonprofit Standard (A) revenues for FY96, as reported in the FY96  
23 Trial Balance. This survey is described in detail in Appendix B.

USPS-RT-22

1           As demonstrated by the results of the LRCA survey, reported in  
2 Appendix B, nonprofit mailings were infrequently disqualified for content  
3 reasons and mailed at regular rates, even in FY96 (in early FY96 the Postal  
4 Service issued Publication 417, which explained the restrictions on content  
5 of nonprofit mailings). By the second quarter of FY96, the sample sites  
6 contacted reported that their nonprofit mailers or mailing agents had become  
7 sufficiently familiar with the new rules, so that compliance increased  
8 dramatically<sup>6</sup>. In fact, most sites reported that Q2-Q4 FY96 were no  
9 different, in terms of the number and volumes of disqualifications, than FY97  
10 or FY98 to date.

11           When a nonprofit mailing (endorsed nonprofit) is disqualified during  
12 acceptance, and is mailed at regular rates, it is recorded using Form 3602-R.  
13 Therefore, for permit imprint mail, there would be a resulting discrepancy in  
14 these infrequent cases between volumes and costs. For stamped and  
15 metered mail, volumes were taken from the domestic probability sample in  
16 FY96. Since both volumes and costs for this mail were based on sample  
17 data, there would be no discrepancy between volumes and costs for FY96.

18           From LRCA survey results, I estimate that the volume of mail bearing  
19 nonprofit indicia that was disqualified for nonprofit rates during acceptance  
20 and paid regular rates is only 0.4 percent of all nonprofit volume, as  
21 discussed in Appendix B.

---

<sup>6</sup> Even during the first quarter of FY96, when more disqualifications were recorded, sites reported that they did not force mailers to change indicia on disqualified mailings as an accommodation to help mailers adjust to the new rules.



USPS-RT-22

1 C. Entry At Commercial Rates

2 There is only one circumstance under which mail endorsed as  
3 nonprofit is allowed to be entered by the mailer at regular rates (i.e., when  
4 not allowed just as an accommodation to the mailer). This is the case where  
5 the mail is sent pending approval or reapproval for nonprofit rates. In these  
6 circumstances, once nonprofit rates are approved, a reversal is usually  
7 recorded in the PERMIT system, and so the volumes and costs are both  
8 recorded as nonprofit, and no inconsistency exists. In this case, the original  
9 mail is sent with regular rate indicia, so costs would be underestimated for  
10 nonprofit Standard (A), since volumes are credited to nonprofit mail while the  
11 costs are credited to regular Standard (A) mail. In FY96, as reported in  
12 Appendix C, the transaction-level data shows that an estimated 12.9 million  
13 pieces were moved from regular rate to nonprofit, which represents 0.1  
14 percent<sup>7</sup> of all nonprofit Standard (A) volume.

15 There are also cases where reversals from regular rate to nonprofit are  
16 done. When a mailing is disqualified for nonprofit rates during acceptance  
17 (and is therefore entered into PERMIT using Form 3602-R) and later is ruled  
18 eligible for nonprofit rates on appeal, sites have used the option of  
19 accounting for this change through a reversal, where the original Form 3602-  
20 R is netted out, and a new Form 3602-N is recorded. In this case, there is  
21 no inconsistency between volumes and costs, since both are recorded as

---

<sup>7</sup> In fact, more than twice as many pieces were reversed from regular Standard (A) rates to nonprofit rates in FY96 (12,934,452 pieces), than were reversed from nonprofit Standard (A) rates to regular rates (6,129,920).

USPS-RT-22

1 nonprofit.

2 D. Effect of Disqualified Nonprofit Mail on IOCS Costs

3 As discussed above, there are three ways in which disqualified  
4 nonprofit mail sent at regular Standard (A) rates may have nonprofit  
5 endorsements. These three sources, and the levels of volume represented  
6 by these sources in FY96, are shown in the table below.

Source	Volume
Disqualification after acceptance (recorded in AIC 119)	Negligible impact on volumes
Reversals	6,129,920
Disqualification at acceptance	30,322,956
Total regular Standard (A) volume with nonprofit indicia	36,452,876
PFY96 Regular Standard (A) volume	59,339 million
Percentage of regular rate volumes with nonprofit indicia	0.061%

7 Therefore, the IOCS costs that should be in regular rate Standard (A),  
8 but are in nonprofit (because the mail was endorsed nonprofit) are:

$$\frac{IOCS \text{ reg. Std.}(A)(FY96)}{[1 - \% \text{ reg. Std.}(A) \text{ with NP indicia}]} - IOCS \text{ reg. Std.}(A)(FY96) =$$

$$\left[ \frac{1.024}{1 - 0.0006} \right] - 1.024 = 1.0246 - 1.024$$

\$0.0006B

9 The \$1.026 billion represents the amount of IOCS regular Standard  
10 (A) costs in FY96, if the pieces with nonprofit indicia but paying regular rates

USPS-RT-22

1 had been identified as regular bulk rate pieces in IOCS tallies (assuming all  
2 such pieces would have been sampled in IOCS).

3 But, as discussed above, there are also circumstances under which  
4 mail sent at nonprofit rates are endorsed as regular rate Standard (A). In  
5 FY96, reversals in the PERMIT system from regular rate to nonprofit  
6 amounted to 12.9 million pieces, which is 0.1 percent of PFY nonprofit  
7 Standard (A) volume. Given this, the IOCS costs that should be in nonprofit  
8 Standard (A), but are in regular rate (because the mail was endorsed regular  
9 rate) are:

$$\frac{IOCS \text{ Nonprofit Std. (A) (FY96)}}{[1 - \%NP \text{ with reg. rate indicia}]} - IOCS \text{ Nonprofit Std. (A) (FY96)} =$$

$$\left[ \frac{0.228}{1 - 0.001} \right] - 0.228 = 0.2282 - 0.228$$

\$0.0002B

10 The \$0.2282 billion represents the amount of IOCS nonprofit  
11 Standard (A) costs in FY96, if the pieces with regular bulk rate indicia but  
12 paying nonprofit rates had been identified as nonprofit pieces in IOCS tallies  
13 (assuming all such pieces would have been sampled in IOCS).

14 The net effect is that \$0.4 million in IOCS costs should be in regular  
15 rate, but are in nonprofit. This represents only 0.18 percent of nonprofit  
16 Standard (A) IOCS costs, which were \$0.228 billion for FY96. This contrasts  
17 with Dr. Haldi's estimate that 7.85 percent of mail processing costs have  
18 been incorrectly attributed to nonprofit mail. Therefore contrary to what is

USPS-RT-22

1 to what is suggested by Dr. Haldi, no adjustments to nonprofit or regular  
2 Standard (A) costs are needed.

3 IV. Summary

4 Dr. Haldi estimates that 7.85 percent of all bulk rate mail volume  
5 paying regular Standard (A) rates was endorsed as nonprofit. This estimate  
6 is based on misreported survey responses, and is subject to multiple sources  
7 of bias. Evidence from transaction-level PERMIT data, Postal Service  
8 accounting data, and acceptance logs at representative acceptance sites,  
9 show that the net effect of disqualified nonprofit mailings is that \$0.4 million  
10 in IOCS costs should be in regular rate, but are in nonprofit Standard (A).  
11 This represents only 0.18 percent of nonprofit Standard (A) IOCS costs. Dr.  
12 Haldi's 7.85 percent estimate is a gross exaggeration of the extent to which  
13 nonprofit volumes and costs may not be consistent. Because the degree to  
14 which nonprofit mail processing tallies are inconsistent with nonprofit  
15 volumes is much less significant than surmised by Dr. Haldi, his suggested  
16 adjustment to nonprofit costs is not warranted.

USPS-RT-22

**1 APPENDIX A - ANALYSIS OF ANM SURVEY RESPONSES**

**2 The survey responses filed by ANM in ANM-LR-1 clearly show that**  
**3 there were a number of instances where responses were summarized**  
**4 incorrectly. In addition, a different survey form was used for over one-third**  
**5 of the respondents. Also, there were apparently a number of cases where**  
**6 two responses were recorded on the same form. Below, we discuss our**  
**7 analysis of the ANM survey findings.**

**8 A number of responses where the mailer indicated using a nonprofit**  
**9 permit for mail entered at the Standard (A) regular rates (question 2b., on the**  
**10 ANM form) were reported in Exhibit ANM-T1-1 (revised 2-9-98) as being**  
**11 pieces entered with nonprofit Standard (A) indicia. However, question 2c**  
**12 addresses the issue of how a piece was endorsed (what postal indicia was**  
**13 used), not question 2b. Mailers can use a nonprofit permit (i.e., a nonprofit**  
**14 trust account) to pay for a regular rate mailing (which would get entered into**  
**15 the PERMIT system as regular rate), while having the piece (correctly)**  
**16 endorsed regular Standard (A) bulk rate.**

**17 For a number of responses, the answers given were unclear. For**  
**18 example, a number of mailers reporting that there were mailings entered at**  
**19 nonprofit rates that were later determined not to qualify for nonprofit rates**  
**20 (question 5 on the ANM form), also indicated that assessments were still**  
**21 under appeal. Without contacting survey respondents to clarify responses, it**  
**22 is impossible to tell if volumes reported in question 8 for these respondents**  
**23 included volumes still under appeal.**

**24 For survey responses 29, and 69-108, a different survey form was**  
**25 used than for the other responses. On the second survey form (those**

## USPS-RT-22

1           apparently sent from the American Association of Museums (AAM) to their  
2           member organizations), no direct questions were asked concerning the  
3           endorsement of the mail under investigation. Questions 3 and 4 from that  
4           form are (emphasis from original):

5                     3) During 1996, how many mailings and at what volume did you  
6                     choose to send at the COMMERCIAL Standard A (bulk) rate (i.e.,  
7                     not the nonprofit rate)?

8                     4) During 1996, how many mailings and at what volume did you  
9                     attempt to mail at the nonprofit bulk rate, but were forced by the  
10                    USPS to send at the COMMERCIAL Standard A (bulk) rate (i.e.,  
11                    not the nonprofit rate)?

12           These questions asked respondents to provide the number of mailings and  
13           number of pieces that applied. Nowhere in these questions are respondents  
14           asked to report what endorsements or indicia were on the mailings in  
15           question. It is not clear from the wording in question 4 whether the mailings  
16           reported were disqualified during acceptance or after acceptance. This  
17           distinction is important, because mailings disqualified during acceptance are  
18           accounted for differently than mailings disqualified after acceptance, and  
19           hence volumes will be recorded differently. Given how differently the  
20           questions are worded on each version of the survey, it would not be logical  
21           to combine the results from these essentially different surveys.

22                    Exhibit USPS-RT2<sup>2</sup>-1 gives the corrected survey responses. In  
23                    column 3, the reason for the correction (if any) is noted. Of the 108  
24                    "responses" received, 45 are on the less detailed (AAM) survey form, and 26  
25                    have entry errors.

USPS-RT-22

1           Twenty-two of the 108 "responses" are marked with two numbers on  
2 a single response form. Nothing in ANM-LR-1 indicates any reason for this;  
3 the double numbering does not appear to correspond to mailers who mailed  
4 at both commercial and nonprofit rates.

Exhibit USPS-RT2-1: Analysis of ANM Survey Responses

(Shading indicates revised responses or responses that could not be determined, given the information available)

Mailer	Permit used	How Shown	Correction or problem	RR Standard(A) Postage Paid Originally (on disqualified NP mail)		NP Std(A) Postage Originally Paid
				Entered with RR Std (A) Indicia	Entered with NP Std (A) Indicia	Pieces on which RR Std(A) rates were later assessed
1	NP	Indicia	? Question 9 > Question 8			15,000
2	REGULAR	Indicia		50,000		
3	NP	Indicia		22,291		
4	NP	Indicia/Meter				
5	NP	Indicia/Meter				
6	NP	Indicia	? 1 million include appeals?			1,000,000
7	NP	Indicia	Response recorded wrong		5,300,000	
8	NP	Meter	A	15,000		
9	NP	Indicia/Meter	A	45,641		6,050
10	NP	Meter	A	2,226		
11	NP	Indicia/Meter	A	25,000		
12	NP	Indicia/Meter	A (for some or all of 1,200 ?)			
13	NP	Indicia	? 500 include appeals pending?			500
14	NP	Indicia/Meter	C			
15	NP	Indicia	Both np and reg indicia used			
16	REGULAR	Indicia	Both np and reg indicia used			
17	REGULAR	Indicia		30,000		
18	REGULAR	Indicia	Combined with #19	2,100		
19	NP	Indicia	Combined with #18			560
20	REGULAR	Indicia	Both np and reg indicia used			
21	NP	Indicia				400,000
22	NP	Indicia/Meter	A	102,170		
23	NP	Indicia	Both np and reg indicia used			5,000
24	NP	Indicia	Different form (NFM), didn't ask about indicia, but implied reg. indicia	15,000		
25	REGULAR	Indicia		15,000		
26	NP	Indicia	No volumes reported as disqualified (still on appeal)			
27	NP	Indicia	7,800 originally reported is for FY97			0
28	NP	Indicia	B			
29	NA	NA	B			
30	NP	Meter	A	100,000		
31	NP	Indicia/Meter				
32	NP	Indicia	B			
33	NP	Indicia	B			
34	NP	Indicia	B			
35	NP	Indicia	Appeal pending?			65,000
36	NP	Indicia				
37	NP	Indicia	D			
38	NP	Indicia			23,578	
39	REGULAR	Meter		26,000		
40	REGULAR	Indicia/Meter		40,000		
41	REGULAR	Indicia/Meter		30,000		
42	NP	Indicia	B			620
43	NP	Indicia	Response on endorsement is vague			
44	NP	Indicia			2,900	
45	REGULAR	Indicia/Meter		20,000		
46	NP	Indicia	No volume given for Q8			
47	NP	Indicia	Both np and reg indicia used; response recorded wrong			0
48	NP	Indicia				200,000
49	NP	Indicia			35,000	
50	NP	Indicia	Response recorded incorrectly		70,000	0
51	NP	Indicia	Both np and reg indicia used			
52	REGULAR	Indicia	D	10,000		
53	NP	Indicia				2,000
54	REGULAR	Meter		3,000		
55	NP	Indicia			500,000	
56	NP	Indicia				2,200



Maller	Permit used	How Shown	Correction or problem	RR Standard(A) Postage		NP Std(A) Postage
				Entered with RR Std (A) Indicia	Entered with NP Std (A) Indicia	Originally Paid
				Pieces	Pieces	Pieces on which RR Std(A) rates were later assessed
57	NP	Indicia	B			
58	REGULAR	Indicia	Combined with #59; B			
59	NP	Indicia	Combined with #58; B			
60	NP	Indicia	Response recorded incorrectly			
61	NP	Indicia			500	30,000
62	REGULAR	Indicia		147,516		
63	NP	Indicia			200,000	
64	REGULAR	Meter	D	?		
65	NP	Indicia				600
66	NP	Meter			10,000	
67	NP	Indicia				15,000
68	NP	Indicia	B			
69	NA	NA	B			
70	NA	NA	B			
71	NA	NA	B			
72	NA	NA	B			
73	NA	NA	B			
74	NA	NA	B			
75	NA	NA	B			
76	NA	NA	B			
77	NA	NA	B			
78	NA	NA	B			
79	NA	NA	B			
80	NA	NA	B			
81	NA	NA	B			
82	NA	NA	B			
83	NA	NA	B			
84	NA	NA	B			
85	NA	NA	B			
86	NA	NA	B			
87	NA	NA	B			
88	NA	NA	B			
89	NA	NA	Combined with #90; B			
90	NA	NA	Combined with #89; B			
91	NA	NA	B			
92	NA	NA	Combined with #93; B			
93	NA	NA	Combined with #92; B			
94	NA	NA	Combined with #95; B			
95	NA	NA	Combined with #94; B			
96	NA	NA	B			
97	NA	NA	Combined with #96; B			
98	NA	NA	Combined with #97; B			
99	NA	NA	Combined with #100; B			
100	NA	NA	Combined with #99; B			
101	NA	NA	B			
102	NA	NA	B			
103	NA	NA	B			
104	NA	NA	B			
105	NA	NA	B			
106	NA	NA	B			
107	NA	NA	Combined with #106; B			
108	NA	NA	Combined with #107; B			

Legend:  
 A Indicia was regular Standard (A), not nonprofit  
 B AAM survey  
 C Responses blotted out

USPS-RT-22

**1 APPENDIX B – LRCA SURVEY DESCRIPTION AND RESULTS**

**2**           The only information available to determine the degree to which  
**3**           nonprofit mailings disqualified during acceptance are mailed with nonprofit  
**4**           indicia, but pay regular rates, are "disqualification logs" maintained by  
**5**           acceptance units. This information, usually recorded on Form 8075, is not  
**6**           available in a central database. Only hardcopy forms are used, and are not  
**7**           always available for years previous to the most recently completed fiscal  
**8**           year, since many sites discard the logs after one year. In order to determine  
**9**           the degree to which nonprofit transactions disqualified during acceptance  
**10**          pay regular rates but have nonprofit indicia, LRCA undertook a survey of  
**11**          postal sites accepting bulk nonprofit Standard (A) mail.

**12****13**          **A. Survey Methodology**

**14**           The universe of all postal sites accepting bulk nonprofit Standard (A)  
**15**          mail, as determined by those facilities with positive bulk permit imprint  
**16**          nonprofit Standard (A) mail in FY96, was divided into two strata.

**17**           From the strata with the top 20 sites (the 20 sites with the highest  
**18**          bulk permit imprint nonprofit Standard (A) revenue in FY96), we selected all  
**19**          20 sites with certainty. We selected all sites in this strata to survey,  
**20**          because, *a priori*, we expected that there will be more variance in  
**21**          experiences for the larger sites, since they will have a more variable mailer  
**22**          population (in terms of mailing sizes) than sites with less nonprofit revenue.  
**23**          That is, these sites will have very large mailers, as well as small mailers.  
**24**          Fourteen of the twenty sites in this strata responded to our survey by March

USPS-RT-22

1 6, 1998. Ten of these sites were able to provide information on acceptance  
2 activity.

3 From the second strata, containing all other sites, we selected 10  
4 sites to sample, where the sites were selected with probability proportional  
5 to size (revenue). All but one of the sites in this second strata were able to  
6 provide us information on disqualified nonprofit Standard (A) mailings in  
7 FY96. At this tenth site, all personnel now working in the acceptance unit  
8 had been there less than six months, and the FY96 logs had not been  
9 retained.

10 A source code listing for the sample selection process is provided in  
11 Appendix D.

12 A letter explaining the survey, and a list of survey questions, was  
13 faxed to each sample site's Manager of Business Mail Entry (these  
14 documents are reproduced below). The BME Manager was instructed to  
15 select someone in their facility knowledgeable about acceptance and  
16 accounting procedures for nonprofit transactions in FY96. Personnel from  
17 LRCA called the designated contact at each site, and conducted a telephone  
18 interview, with the questions previously faxed to the site as a guideline for  
19 the discussion. This survey was conducted February 25, 1998 - March 13,  
20 1998.

21 The acceptance logs for FY96 were not available at all sample sites.  
22 In these cases, survey respondents were asked to provide information on  
23 disqualified nonprofit mailings for the most recently completed accounting  
24 period (AP5), and for FY97 (if those logs were still available). The  
25 respondents were then asked to characterize FY96 activity in comparison to

USPS-RT-22

1 these other two periods. Since there was a change in content rules for  
2 nonprofit mailings that was first enforced in FY96, this period of time was  
3 memorable for the personnel we surveyed, and so they were able to provide  
4 information on acceptance activity for FY96.

5 No standard errors or confidence limits are provided for the estimates  
6 presented here, as time constraints prevented bootstrapping of standard  
7 errors before filing of testimony. However, it should be noted that the  
8 survey sites are representative of the universe of sites accepting nonprofit  
9 bulk permit imprint Standard (A) mail, given the sample design and high  
10 response rate. Respondent sites reported very similar experiences with  
11 acceptance of nonprofit mailings, lending credence to the conclusion that the  
12 results reported here represent the typical experience of acceptance units  
13 concerning nonprofit mailings.

14

#### 15 B. Survey Results

16 The most common comment of respondents concerning nonprofit  
17 mailings in FY96 was that there were more disqualifications for content  
18 violations in the first quarter of FY96, and then the disqualification rate  
19 tapered off significantly for the rest of FY96. Postal personnel credit a good  
20 working relationship with local mailers as the key to making the transition to  
21 the new rules as smooth as possible. Mailing agents (printers, mailing  
22 houses, and mail consolidators) were especially diligent about adapting to the  
23 new rules quickly, so that they could provide good service to their own  
24 customers. Mailing agents, who generally handle higher volume transactions  
25 than individual mailers, also tended to return disqualified mail to the mail

---

USPS-RT-22

1 owner, rather than send it through at regular rates. But even many smaller  
2 nonprofit mailers (e.g., local churches or scout groups) chose to rework their  
3 disqualified mailings, rather than pay the (higher) regular rates, since many of  
4 them can use volunteers to prepare mailings.

5 To determine how much nonprofit mail disqualified during acceptance  
6 paid regular rates but was endorsed nonprofit, I used the results of our  
7 survey of acceptance sites. Sites reported the volumes associated with  
8 disqualified mailings for FY96. One site reported revenue deficiencies for the  
9 disqualified mailings; the percentage of revenue deficiency to total nonprofit  
10 revenue in FY96 for this site was applied to the total nonprofit volume for  
11 this site, to calculate the volume of nonprofit mail disqualified in FY96.  
12 These volumes were rolled up in each strata to obtain an estimate of the  
13 volume of disqualified mail paying regular rates but with nonprofit indicia for  
14 the each strata. The volumes in each strata were then summed together to  
15 get the total volume of disqualified mail paying regular rates but with  
16 nonprofit indicia for the universe. As Exhibit USPS-RT22-2 shows, the  
17 volume of disqualified mail paying regular rates but with nonprofit indicia  
18 was 30.9 million pieces, which is only 0.25 percent of all nonprofit Standard  
19 (A) volume in FY96. This indicates that, even in a period when witness  
20 Haldi claims there was increased enforcement of content rules for nonprofit  
21 mail, the incidence of inconsistency between volume and cost as a result of  
22 nonprofit mailings disqualified during acceptance is negligible.

Exhibit USPS-RT2-2: LRCA Survey Results

Revised 3/20/98

Ranking	Finno	Site	Response Complete	Nonprofit Revenue	Nonprofit Pieces	% of NP disqualified	Total NP volume	Volume disqualified, paid reg. Std. (A)
Strata 1								
1			x	31,551,533	280,904,760	0.10%	280,904,760	292,500
2			x	19,147,423	172,972,413	0.00%	172,972,413	0
3			x	25,563,520	244,696,745		0	
4			x	17,214,140	171,112,655	0.00%	171,112,655	0
5			x	18,119,356	165,595,497	1.95%	165,595,497	3,234,000
6			x	16,315,849	157,808,395	0.02%	157,808,395	37,500
7			x	13,675,670	116,906,776		0	
8				15,285,455	129,600,911		0	
9			x	15,151,482	136,615,234	1.81%	136,615,234	2,476,350
10			x	13,847,738	166,005,651	0.00%	166,005,651	4,077
11			x	13,384,642	127,991,267		0	
12			x	14,636,546	130,702,743	0.41%	130,702,743	534,375
13				20,677,044	219,267,261		0	
14				13,127,299	130,397,898		0	
15				13,926,926	127,674,427		0	
16			x	10,940,879	123,434,082	0.16%	123,434,082	195,000
17			x	11,528,576	124,237,846	0.01%	124,237,846	6,500
18			x	10,677,977	111,806,349		0	
19				12,244,621	115,054,496		0	
20				12,832,677	104,490,396		0	
Strata 2								
41			x	5,548,452	47,408,699	0.76%	47,408,699	360,000
52			x	4,700,926	41,682,702	0.06%	41,682,702	25,010
54			x	9,551,672	87,304,171	0.06%	87,304,171	50,000
58			x	4,800,761	49,040,235	0.02%	49,040,235	9,000
244			x	810,527	6,913,916		6,913,916	
249			x	693,735	6,638,972		6,638,972	
462			x	193,817	1,152,840		1,152,840	0
709			x	171,026	1,297,151		0	
4220			x	12,042	-		0	0 non-PERMIT
10162			x	1,715	-	0.00%	0	0 non-PERMIT

Total response Strata 1	0.42%	1,629,389,276	6,780,302 [1]
Total response Strata 2	0.18%	240,141,535	444,010 [2]
Total revenue sites Strata 1 Respondents		168,453,521	
Total revenue sites Strata 2 Respondents		26,313,846	
Total PFY 96 revenue all strata 1		346,320,269 [3]	
Total PFY 96 revenue all strata 2		1,005,092,504 [4]	
Inflation Factor strata 1		2.06 [5]	= [3] / [1]
Inflation factor strata 2		38.20 [6]	= [4] / [2]
Inflated Disqualified strata 1		13,939,489 [7]	= [1] * [5]
Inflated Disqualified strata 2		16,959,669 [8]	= [2] * [6]
Total GFY 96 STD(A) Nonprofit Revenue		1,326,212,251 [9]	
GFY 96 Control		0.98 [10]	= [9] / ([3] + [4])
Total Estimated volume disqualified at acceptance		30,322,965 [11]	= [10] * ([7] + [8])
GFY 96 STD(A) Nonprofit Volume		12,212,159,128 [12]	
Percent of Nonprofit Volume that is disqualified at acceptance and pays regular rate (endorsed nonprofit)		0.25% [13]	= [11] / [12]

Exhibit USPS-RT22-2: LRCA Survey Results

Ranking	Finno	Site	Response	Complete	Nonprofit Revenue	Nonprofit Pieces	% of NP disqualified	Total NP volume	Volume disqualified, paid reg. Std. (A)
Strata 1	1		x	x	31,551,533	280,904,760	0.10%	280,904,760	292,500
	2		x	x	19,147,423	172,972,413	0.00%	172,972,413	0
	3		x		25,563,520	244,696,745			
	4		x	x	17,214,140	171,112,655	0.00%	171,112,655	0
	5		x	x	18,119,356	165,595,497	1.95%	165,595,497	3,234,000
	6		x	x	16,315,849	157,808,395	0.02%	157,808,395	37,500
	7		x		13,675,670	116,906,776			
	8				15,285,455	129,600,911			
	9		x	x	15,151,482	136,615,234	1.81%	136,615,234	2,476,350
	10		x	x	13,847,738	166,005,651	0.00%	166,005,651	4,077
	11		x		13,384,642	127,991,267			
	12		x	x	14,636,546	130,702,743	0.41%	130,702,743	534,375
	13				20,677,044	219,267,261			
	14				13,127,299	130,397,698			
	15		x	x	13,926,926	127,674,427	0.00%	127,674,427	3,000
	16		x	x	10,940,879	123,434,082	0.16%	123,434,082	195,000
	17		x	x	11,528,576	124,237,846	0.01%	124,237,846	6,500
	18		x		10,677,977	111,606,349			
	19		x	x	12,244,621	115,054,496	0.00%	115,054,496	3,000
	20		x		12,832,677	104,490,396			
Strata 2	41		x	x	5,548,452	47,408,699	0.76%	47,408,699	360,000
	52		x	x	4,700,926	41,682,702	0.06%	41,682,702	25,010
	54		x	x	9,551,672	87,304,171	0.06%	87,304,171	50,000
	58		x	x	4,800,761	49,040,235	0.02%	49,040,235	9,000
	244		x	x	810,527	6,913,916	0.00%	6,913,916	0
	249		x	x	693,735	6,638,972	0.00%	6,638,972	0
	462		x	x	193,817	1,152,840	0.00%	1,152,840	0
	709		x		171,026	1,297,151			
	4220		x	x	12,042	-	0.00%	0	0 non-PERMIT
	10162		x	x	1,715	-	0.00%	0	0 non-PERMIT

Total response Strata 1	0.42%	1,872,118,199	6,786,492 [1]
Total response Strata 2	0.18%	240,141,535	444,010 [2]
Total revenue sites Strata 1 Respondents		194,625,068 [1a]	
Total revenue sites Strata 2 Respondents		26,313,646 [2a]	
Total PFY 96 revenue all strata 1		346,320,269 [3]	
Total PFY 96 revenue all strata 2		1,005,092,504 [4]	
Inflation Factor strata 1		1.78 [5]	= [3] / [1a]
Inflation factor strata 2		38.20 [6]	= [4] / [2a]
Inflated Disqualified strata 1		12,076,038 [7]	= [1] * [5]
Inflated Disqualified strata 2		16,959,669 [8]	= [2] * [6]
Total GFY 96 STD(A) Nonprofit Revenue		1,326,212,251 [9]	
GFY 96 Control		0.98 [10]	= [9] / ([3] + [4])
Total Estimated volume disqualified at acceptance		28,494,263 [11]	= [10] * ([7] + [8])
GFY 96 STD(A) Nonprofit Volume		12,212,159,128 [12]	
Percent of Nonprofit Volume that is disqualified at acceptance and pays regular rate (endorsed nonprofit)	0.23% [13]		= [11] / [12]

USPS-RT-22

**APPENDIX C: RESPONSE OF THE USPS TO INTERROGATORY OF THE ALLIANCE OF NONPROFIT MAILERS (ANM/USPS-28)**

ANM/USPS-28. Assume that several mailings bearing Nonprofit Standard Mail (A) (or nonprofit third-class) indicia later gave rise to payment of back postage on grounds that each affected mailing was ineligible for nonprofit rates.

- a. When a check is received for payment of the back postage, would the payment be credited to a Standard Mail (A) (commercial) revenue account, or to a Nonprofit Standard Mail (A) revenue account? Please identify the account to which the payment would be credited, and explain why the Postal Service accounts for such payments in this way.
- b. Assume that the checks for payment of back postage were all received within the same time frame, but in different cities. Would the payment always be credited in the same manner as described in response to preceding part (a), or is it possible that in one city it would be credited one way, but in another city it would be credited differently? Please explain.
- c. If your response to preceding part (b) is that such payments are systematically credited in the same way, please:
  - i. identify the accounting regulation, rule, standard, guideline, instruction, or procedure that specifies the account to which the receipt of payment of back postage (under the circumstances specified here) should be credited, and
  - ii. produce a copy of the accounting regulation, rule, standard, guideline, instruction, or procedure.
- d. When the payment is credited to a revenue account in the manner described in response to preceding part (a), is a new or revised form 3602 filled out? If not, what record(s) is (are) filled out in conjunction with receipt of payment? Please identify the regulation, rule, standard, guideline, instruction, or procedure that specifies when a new or revised form 3602 is to be filled out, and produce a copy of the regulation, rule, standard, guideline, instruction, or procedure.
- e. Assume that the check for payment of back postage is received and credited to a revenue account (as described in your response to part (a)) in an office that is part of the PERMIT system. Please describe how the PERMIT system would pick up and reflect these additional revenues in the RPW system. For example, would the PERMIT system pick up revenues without any corresponding mail volumes? If not, how is the situation handled? Please identify the regulation, rule, standard, guideline, instruction, or procedure that specifies how the PERMIT system would pick up and reflect these additional revenues, and produce a copy of the regulation, rule, standard, guideline, instruction, or procedure.



## USPS-RT-22

- f. If a revised form 3602 is filled out, does it have the effect of removing the volume for which the payment of back postage is made from the nonprofit category and transferring it to the commercial rate category?
  
- g. Assume that a nonprofit organization has made a payment for back postage within the same year when the mail was entered and the "case" has been closed. How are the revenues and volumes for the affected mail finally recorded in the revenue accounts and the RPW system? Please identify the regulation, rule, standard, guideline, instruction, or procedure that specifies how the revenues and volumes for mail affected in this manner should be recorded and produce a copy of the regulation, rule, standard, guideline, instruction, or procedure.

USPS-RT-22

## RESPONSES:

- (a) No. According to official USPS accounting procedures, when the revenue deficiency is identified, revenue is recorded in revenue account 41511, revenue postage other (AIC 119, "Revenue Deficiency Found"), with an offset to an accounts receivable, general ledger account 13412 (AIC 814, "Suspense"). The recording of the account receivable in AIC 814 is made at the same time the revenue deficiency is booked into AIC 119. Entries are made in AIC 119 and 814 simultaneously, as part of the double entry accounting system used by the USPS.

When a check is received for postage due to revenue deficiencies, it is debited to general ledger account 11211, AIC 802 (cash received). A corresponding credit is made to the accounts receivable account 13412, AIC 814 (suspense account).

Revenues in general ledger account 41511 are used in developing revenue and volume estimates in RPW through the revenue control. This revenue account is not class specific, and so revenues in account 41511 would not be credited to either nonprofit or regular Standard (A) categories. Account 41511 goes into the overall revenue control, and so minimally affects all revenue-controlled rate categories. The overall level of revenue in AIC 119 is so small (only \$12.8 million in FY96), it impacts revenues for revenue-controlled rate categories only 0.04 percent. The revenues and volumes from the original nonprofit entry will remain as nonprofit.

- (b) Yes.
- (c) Attached is the Management Instruction titled "Collecting Revenue Deficiencies." Also attached are the pages of the F-1 Handbook ("Post Office Accounting Procedures") concerning suspense accounts.
- (d) In the case that the postage due is recorded in AIC 119 (as described in (a.)), a revised Form 3602 is not needed, although one may be filled out as a worksheet to calculate the postage due. A Form 3544 (Cash Receipt) will be filled out and provided to the mailer.
- (e) Any nonprofit-related revenue deficiencies recorded in AIC 119 (general ledger account 41511) and payments subsequently debited to AIC 802 (general ledger account 11211) will not be entered into the PERMIT system in a revenue account, since that would result in double recording of revenue. The PERMIT system revenues and volumes will remain as originally entered: there will be no shifting of volumes between nonprofit and regular rate categories. The adjustments made through AIC 119 are reflected in overall RPW revenue control for stamped and metered mail. The overall level of revenue in AIC 119 in FY96 was only \$12.8 million, but AIC 119 includes all revenue deficiencies, not just those associated with nonprofit ineligibility. We cannot isolate revenue deficiency transactions due to ineligibility for nonprofit Standard (A) rates within the time available. At most, payments for postage due on ineligible nonprofit

USPS-RT-22

transactions impact stamped and metered mail revenues by 0.04 percent (conservatively assuming all revenues in AIC 119 are due to nonprofit-related deficiencies).

- (f) No. When revenue deficiencies are recorded in AIC 119 (as in (a.)), a revised Form 3602 would not be filled out, except as a worksheet to calculate the postage due that is charged to the revenue deficiency account (as discussed in (d.)). No volume changes would be recorded in PERMIT as a result.

Revised Form 3602s are occasionally entered into the PERMIT system. These are entered to correct errors in the original entries, and are rarely used for revenue deficiencies. Official USPS accounting procedures require treatment of revenue deficiencies as described in (a). In infrequent cases where an error is caught in the original Form 3602 (locally, and shortly after mailing) or when a regular rate mailing is sent pending approval for nonprofit status, a revised Form 3602 is filled out and the data subsequently entered into the PERMIT system. As a result, permit imprint volumes would be moved from nonprofit to regular rate (or from regular rate to nonprofit, in the case where the mailer later is approved for nonprofit status).

Using FY96 PERMIT system transaction-level data, an estimated 6.1 million pieces were moved from nonprofit to regular rate. This represents only 0.05 percent of all nonprofit volumes. The transaction-level data for FY96 also show that an estimated 12.9 million pieces were moved from regular rate to nonprofit, which represents 0.02 percent of all regular rate volume.

- (g) See (e.) above.

# Management Instruction



Date Issued 6-16-89	Filing Number DM-140-89-2
Effective Date Immediately	Obsoletes MI DM-140-85-2 (7-26-85)
Originating Organization & OCC Code Rates and Classification Dept. RC210	
Title  Collecting Revenue Deficiencies	Signature & Title  <i>Frank R. Haselton</i> Frank R. Haselton Assistant Postmaster General, R&CD

## I. Purpose

To establish procedures for the uniform and expeditious handling of revenue deficiencies.

## II. Procedures

### A. Documenting the Deficiency

The postal inspector or other postal employee who discovers a revenue deficiency must document the amount and the circumstances involved in a memorandum to the postmaster. The amount of the deficiency cited in the letter will be posted immediately to AIC 119, Revenue Deficiency Found. This AIC is a receipt entry only and cannot be used on the disbursement side of the accountbook. The general ledger account number is 41511.

### B. Collection by Postmaster

1. Postmasters must take immediate action to collect amounts due. The postmaster must send a letter to the customer indicating the amount and basis of the deficiency and requiring payment 30 days from the customer's receipt of the letter. The letter must instruct the customer that a statement of intention to pay or a formal appeal contesting the deficiency must be made within 15 days of receipt of the letter.

2. The letter must also advise the customer that, in the event an appeal is not filed within 15 days, the letter will constitute the final Postal Service decision on the existence and amount of the deficiency. The letter must be delivered to the customer via certified mail, return receipt requested. If such delivery cannot be made within 30 days (if, for example, the customer refuses to sign for certified mail), a duplicate letter must be delivered as First-Class Mail. The postmaster must make a

written record of the date of delivery and the previous attempts to deliver it.

3. If no appeal is filed and the deficiency is not collected within 45 days of delivery of the letter, the postmaster must refer the case to the Field Division Controller. Copies of all letters to the customer must be sent to the General Manager, Rates and Classification Center (RCC). A second copy is sent to the Inspection Service if the revenue deficiency was discovered by a postal inspector.

4. If the revenue deficiency is paid or partial payments (see E) are received after the Field Division Controller has been notified that a revenue deficiency exists, the postmaster must promptly advise the Controller.

### C. Appeal Process

1. An appeal of a deficiency notice must be in writing and addressed to the postmaster. Postmasters must forward all appeals immediately to the General Manager, Rates and Classification Center (RCC), who will make the final Postal Service decision concerning the amount of the deficiency and advise the customer and the postmaster of the decision in writing. This notification should occur within 30 days after the receipt of any additional information or assistance requested by the General Manager. The postmaster will not initiate collection action before the RCC decision on the appeal.

2. Based upon the facts and regulations involved, the General Manager's decision will specify whether a deficiency should be assessed and, if so, its amount. A complete statement supporting the decision must be included.

Distribution Standard Distribution plus Headquarters, Headquarters Administrative Support Facilities, including Rates and Classification Centers, Regions, Management Sectional Centers, and Bulk Mail Centers	Special Instructions Organizations listed under Distribution may order additional copies from material distribution centers. Use Form 738C, MDC Supply Requisition, and specify the filing number. You may redistribute this document by photocopying it, but do not paraphrase or otherwise revise it.
---	---

**D. Customer Responsibility to Respond**

Customers must fully respond to all Postal Service correspondence concerning revenue deficiency matters within 15 days. Failure to respond within that time will be assumed as customer agreement that the assessed deficiency is correct and that the amount is due.

**E. Payment of Deficiencies**

1. The full amount due should be paid in a lump sum. When warranted, the deficiency may be settled through equal monthly payments for up to 3 years with interest computed each month on the unpaid balance. The interest rates to be applied (as set by the Secretary of the Treasury) will be published in the *Postal Bulletin* before each new calendar year.

2. An agreement to pay a deficiency by installments must be in writing and should include a provision for the acceleration of the balance due upon default in the payment of any installment. (Advice should be sought from the Field Division Controller before entering into such agreements.)

**F. Uncollected Deficiencies**

1. Postmasters must forward uncollected deficiency cases to the Field Division Controller as soon as the customer's response period has ended, or when the customer refuses to pay the amount due.

2. The Field Division Controller, with advice from the Regional Counsel, if necessary, will promptly attempt to collect outstanding amounts. If such efforts are unsuccessful, the Field Division Controller will refer the matter to the Regional Counsel for legal action.

3. If customers, in discussions with Field Division Controllers, offer to pay a partial amount in lieu of the full amount (or seek total relief), the Controller has authority to deny the request. If the Controller believes that a partial payment should be accepted, the Controller must document this recom-

mendation to the Regional Director, Finance. The Regional Director will decide whether to accept a settlement offer or to accept a request for total relief.

a. The customer must provide detailed financial records sufficient for the Regional Director, Finance, to make such determination if the basis for the requested relief is financial hardship. Postal employees will not initiate an offer to settle disputed deficiency cases for less than the full amount.

b. In making a decision, the Regional Director, Finance, may consider whether the underpayment (1) was made because of incorrect instructions given in writing by a postmaster or mail classification manager or (2) existed before a previous Postal Service review or audit of related mailer records, but was not identified at that time.

c. If the Regional Director, Finance, decides to accept a settlement offer, the Field Division Controller will establish a payment schedule and interest charges for the deficiency and will advise the customer, the postmaster, and the General Manager, RCC, of the amount due. The Field Division Controller will also advise these officials if the Regional Director, Finance, grants total relief for a postage deficiency.

4. In handling deficiency cases, Finance personnel are not to revise the established amount of the deficiency which was determined in the final Postal Service decision.

5. For uncollected deficiencies, the Regional Director, Finance, will either (a) hold the postmaster responsible for the deficiency in whole or in part or (b) relieve the postmaster of accountability for the deficiency.

6. The Postal Data Center must be informed of the necessary accounting adjustments.

## 52 Suspense Items

Suspense items are defined as stamp credits, money orders, banking shortages, travel and salary advances, external and internal audit discrepancies, revenue deficiencies, Form 1412 differences, and miscellaneous cash items. Units must report the totals in AIC 814 at the accountbook level. Records for suspense are maintained at the accountbook unit.

This section describes how to report the different types of suspense, when to use suspense for adjustment purposes, and what forms to use when reporting activity and maintaining control.

### 521 Maintaining Suspense at the Form 1412 Level

#### 521.1 Non IRT Offices

- 1> Use AIC 814 to report suspense entries in the disbursement side of the daily Form 1412 and the accountbook.
- 2> To clear suspense, report AIC 814 in the receipt side of the daily Form 1412, but make a reduction only to AIC 814 in the analysis section of the accountbook.

#### 521.2 IRT Offices

- 1> Use AICs 754-770, except for AIC 762, to report suspense items on the Form 1412. AIC 814 is a roll-up of all sub-AICs for the accountbook entry.
- 2> Use AICs 354-370 to clear suspense items of Form 1412.

*Example:* Enter a salary advance for \$100.00 as AIC 754 on the Form 1412 or the IRT. When you collect the salary advance, clear the suspense item by using AIC 354 on the Form 1412.

### 522 Controlling Suspense at the Accountbook Level

- >> Use AIC 814, the controlled account for suspense in the accountbook and statement of account (SOA) to report suspense balance.

AICs 754-770 increase AIC 814 at the accountbook level. AICs 354-370 decrease AIC 814 at the accountbook level.

### 523 Controlling Suspense Items Internally

#### 523.1 For Non-SFAP Units:

- 1> Maintain a master suspense on Form 25.
- 2> Record increases and decreases on the form to calculate the ending balance.
- 3> Compare and verify the balance to AIC 814 in the accountbook daily.

The accountbook unit uses Form 1556, *Suspense Items Support Information* (exhibit 523.1), to identify each suspense item in sufficient detail to provide an audit trail for reporting purposes. The total of all individual Forms 25 by type must equal the Form 1556 master record and AIC 814.

#### 523.2 For SFAP Units

The district accounting office (DAO) maintains the individual records for each suspense entry for offices reporting under SFAP procedures.

- >> Use the trust and suspense system (TASS) worksheet to make entries or to clear suspense items at the local Form 1412 level. Sufficient information must be noted to identify the individual or the exact reason for the suspense entry.

### 524 Maintaining Form 1556

#### 524.1 For Non-SFAP Units

- 1> Maintain a Form 1556 to list each individual suspense item outstanding on the last business day of a postal quarter (PQ).
- 2> In chronological order, fill in the original date entered to suspense, a brief description, action taken to clear, and amount.
- 3> Submit the original as support for the entry to AIC 814 on the statement of account at the end of the PQ to the DAO. Retain the duplicate as support for the office copy of the SOA.

#### 524.2 For SFAP Units

The DAO maintains the Form 1556 for all SFAP units. Within the SFAS, all suspense items are identified by unit number, AIC, description, and amount in the TASS module.

The SFAS generates a Form 1556 with all information required in date order by AIC.

### 525 Clearing Suspense Items

- >> Use the guidelines below for clearing suspense items whenever possible.

*Note:* Suspense items cannot be cleared expeditiously in every case. However, you must not ignore any item.

Type of Items	Item	Time Limit or Other Instructions/Requirement
Advances	Salary	Must be collected no later than receipt of check containing the adjustment.
	Travel	Must be collected no later than receipt of the reimbursement check.
Shortages	Stamp credit	Collect upon resolution.
	Banking	Must be cleared when the unit collects from the responsible employee, clears the amount due for a nonsufficient funds (NSF) check, sends the NSF check to CSC for collection, or provides support that the item is uncollectible (claim for loss).
Audit differences	External	The ASC issues statement of differences for these discrepancies. They should not be carried in suspense beyond 30 days unless the DAO directs it.
	Internal	These discrepancies (not to be confused with revenue deficiencies) are those discovered at the post office, usually by an inspector. They are limited to 30 days unless otherwise directed by the DAO.
Revenue deficiencies	Revenue deficiencies	Management Instruction DM-140-89-2, Revenue Deficiency, governs the length of time you may carry deficiencies.
Form 1412 differences	Item reported on Form 1908	Clear by entry to a subsequent Form 1412 by the responsible employee.
Miscellaneous	Suspense items classified as such	Should be held for no longer than 30 days before requesting assistance from the district.

526 **Applying Tolerances**

526.1 **Banking**

**Shortages**

- >> District accounting offices may clear banking shortages of \$5 with an offset to AIC 406, Unidentified Difference Short, when responsibility for the shortage cannot be determined.



## Trust, Suspense, and Audit Differences

531.1

**Overages**

- >> District accounting offices may clear banking overages of \$5 or less and offset to AIC 306, Unidentified Difference Over, when responsibility for the overage cannot be determined.

**526.2 Miscellaneous**

- >> District accounting offices may clear Form 1412 shortages of \$5 and less with an offset to AIC 406, Unidentified Difference Short, when responsibility for the shortage cannot be determined.

**527 Monitoring Suspense****527.1 District Accounting Office**

The district accounting office is responsible for monitoring all Forms 1556 from all statement of account offices within the district.

- 1> Compare the total on Form 1556 with the total in AIC 814 on the statement of account.
- 2> Review the Forms 1556 and resolve outstanding items with the individual office.
- 3> Submit semi-annual district summary suspense report to the area finance office.

**527.2 Area Finance Office**

- 1> Consolidate the district summary suspense reports.
- 2> Submit summary of suspense data to post office accounting, Headquarters.

**53 Statement of Difference**

The statement of account is audited by the Minneapolis Accounting Service Center (MNASC). When information from the SOA is matched against information obtained from internal and/or external sources, differences may arise. The various internal and external sources include stamp stock shipments, banking, debit or credit cards, money order differences, and centralized trust activity. If not already discovered by the post office, resolution will be initiated by the MNASC.

**531 Responsibilities****531.1 Minneapolis Accounting Service Center**

The MNASC is responsible for auditing the statements of account and issuing statements of differences for discrepancies:

715.5

Post Office Accounting Procedures

disks used for operation needs, such as weighing, rate information, and customer information, to ensure that there is no financial activity.

- 2> Rolls of blank PVI labels must be controlled by the supervisor. Keep unused labels in original plastic bags and shipping carton until needed, for protection and to prevent undue exposure.

**715.5 Consolidating and Closing Out the Unit**

- 1> The unit close-out person is responsible for verifying the receipt of PVI activity reports from individual clerks and the consolidated unit PVI activity report.
- 2> Each day, consolidate all clerk disks that have been "booted up" on an IRT with a PVI.
- 3> Review the unit Form 1412 "PVI Activity Report" and make the necessary adjustments to AIC 109 on the unit Form 1412 if you discover an out-of-balance condition.

**72 Mail Without Postage Affixed**

---

Mallers may be authorized to mail material without affixing postage. Procedures detailing acceptance requirements are in DMM Module P.

**721 Handling Payment**

**721.1 Accepting Payments**

Customers pay at the time they mail or through an advance deposit account. Checks accepted at bulk mail entry units (BMEUs) must have "BMEU" recorded on the front of the check. Postmasters will apply the usual criteria for accepting business checks for new permit holders and clients of permit holders.

- >> Examine checks before acceptance to be sure that the payee is either the U.S. Postal Service or the postmaster. See section 312.1.

**721.2 Recording Payments**

Non-IRT

Receipt	Disposition	
	Form 3544	Original
Duplicate		Support to Form 1412
Triplicate		Unit maintaining accounts

## IRT

Receipt	Disposition	
Form 3544	Original	Customer
	Duplicate	Unit maintaining accounts
	Unit list	Support to Form 1412

**721.3 Collecting on Nonsufficient Funds Checks**

The Postal Service may contact the check writer of returned checks or may immediately submit nonsufficient funds (NSF) checks to a collection agency after a second deposit attempt. NSF checks go to the check collection agency for collection without further collection efforts by the Postal Service. Collection efforts will be pursued only against the writer of the check, whether the permit holder or client of the permit holder.

**721.4 Additional Collection Alternatives**

If the writer of the NSF check is the permit holder, the Postal Service, after notification, may reduce the permit holder's accounts by the amount of the NSF check and applicable surcharge if the permit holder does not pay upon demand. If the amount in the permit holder's account does not cover the whole amount of the NSF check, the remainder of the amount owed is treated as a revenue deficiency. The procedures for handling revenue deficiencies are in Management Instruction DM-140-89-2, *Collecting Revenue Deficiencies*, June 16, 1989.

**722 Handling Revenue****722.1 Recording Revenue**

>> To control payments and mailings, use Forms 1412, 3083, and Individual account forms related to the specific revenue category.

Revenue Category	Form	Descriptions
Permit Imprint	Form 3609	Record of permit imprint
Periodicals	Form 3543	Record of periodical postage
Express Mail	Form 25	Express Mail corporate accounts
Postage due/business reply	Form 25	Additional postage required/business reply mail

Offices using approved automated systems such as the permit system and express mail reporting system (EMRS) will not transfer data to the Postal Service forms listed above.

**722.2 Reporting Revenue**

BMEU employees must prepare Form 3083, entering for each category the beginning balance, the total of all applicable Forms 3544 as deposits, the

USPS-RT-22

**APPENDIX D: SOURCE CODE LISTINGS****A. Source Code and Program listing for analysis of Reversals**

Program revall: Unix shell script that executes the following programs

Program - sorttmp.sm - Sorts PERMIT transactions by finance number, permit number, and transaction date.

Input file: PERMIT transaction file documented in LR-H-108 Appendix A  
output file: trans.sort - sorted transactions

Program - reverreg.f Fortran program to match reversal records to original entry and subsequent re-entry.

Input file: - trans.sort

Output files:

resolved.x - Listing of STD(A) reversed transactions which both the original and subsequent transactions could be identified.

re-entry.dat.x - Listing of STD(A) transactions where reversal could not be matched to subsequent re-entry and surrounding transactions.

rec\_tally.txt.x - STD(A) transaction statistics by finance number

rev\_tally.txt - STD(A) revenue statistics by finance number

byfin.conv.3np.x - revenue, pieces and weight of transactions reversed from STD(A) nonprofit to regular rate by finance number and permit number

byfin.conv.3rd.x - revenue, pieces and weight of transactions reversed from STD(A) regular rate to nonprofit by finance number and permit number

new.tran.np.x - listing of transactions reversed from STD(A) nonprofit to regular rate; original transaction, reversal, re-entered transaction.

new.tran.reg.x - listing of transactions reversed from STD(A) nonprofit to regular rate; original transaction, reversal, re-entered transaction.

**Excel Spreadsheets**

reversed from regular.xls - summary table of transactions reversed from STD(A) regular rate to STD(A) nonprofit.

input file - byfin.conv.3rd.x

reversed to regular.xls - summary table of transactions reversed from STD(A) nonprofit to STD(A) regular rate.

input file - byfin.conv.3rd.x

reversed stats by node - inflation and calculation of volumes reversed in permit system from one STD(A) class to the other.

USPS-RT-22

**Input files:**

rev\_tally.txt.x  
rec\_tally.txt.x

**B. Source code listing for BMEU survey**

**Program:** select\_np.f - Fortran program that randomly draws sites based on STD(A) nonprofit permit imprint revenue.

**Input file :** strata.41414 documented in LR-H-108 Appendix A  
**output file :** select\_np.out - Finance numbers of selected offices

**Program:** rollvo1\_pmt.f - Fortran program that aggregates STD(A) revenue, pieces and weight by indicia type and finance number.

**Input file :** STD(A) nonprofit PERMIT system transaction file documented in LR-H-108 Appendix A

**Output file:** npbyfinpmt.96 - STD(A) nonprofit revenue pieces and weight by indicia type and finance number.

**Excel Spreadsheets:**

npinflate.xls - summary table of nonprofit revenues and pieces.  
**Input file:** npbyfinpmt.96

disqcalcp.xls - inflation of survey results

1           CHAIRMAN GLEIMAN: I have some questions I need to  
2 ask Witness Schenk before we proceed.

3           Witness Schenk, on page 25, at lines 4 and 5 of  
4 your testimony, you describe disqualification logs  
5 maintained by acceptance units. You then describe a survey  
6 undertaken by LRCA which you present in your testimony.

7           THE WITNESS: Yes.

8           CHAIRMAN GLEIMAN: I've looked at the survey  
9 forms. I have the Library Reference H353 here. These forms  
10 reflect information provided by Postal Service employees at  
11 the sample -- the 30 samples offices. Is that correct?

12          THE WITNESS: That's correct, the sites that  
13 responded to our survey.

14          CHAIRMAN GLEIMAN: Is that number now 33?

15          THE WITNESS: That number is now 27 of the  
16 original 30. Exhibit 2 in my appendix clearly indicates  
17 that there are some sites that we have not received  
18 responses from yet.

19          CHAIRMAN GLEIMAN: You'll have to bear with me.

20          THE WITNESS: Uh-huh.

21          CHAIRMAN GLEIMAN: Now, I couldn't determine very  
22 easily from the library reference whether Postal Employees  
23 who were providing information on the possibility that mail  
24 with non-profit standard indicia paid standard A regular  
25 rates were actually taking information from Form 8075. Did

1 you ask the employees at each office whether they were using  
2 actual Form 8075 data for 1996?

3 THE WITNESS: They indicated whether those forms  
4 were available, whether they had discarded them yet, or  
5 whether they were able to obtain them from storage if they  
6 had not been discarded yet. They indicated whether they had  
7 them or not and were able to use them to give us -- to  
8 provide us that information.

9 CHAIRMAN GLEIMAN: I understand that you ask all  
10 those but questions, but my questions is, did you ask the  
11 employees at each office whether they were using actual Form  
12 8075 data for 1996?

13 THE WITNESS: Yes.

14 CHAIRMAN GLEIMAN: Did you note on the survey  
15 forms contained in the Library Reference H-35 -- did you  
16 note that on the survey forms contained in the Library  
17 Reference? And, if so, could you show me where the  
18 notations of that fact are made?

19 THE WITNESS: I don't recall if we noted that  
20 explicitly, but the information on the survey forms would  
21 indicate that. If you would bear with me for a minute, I'll  
22 find those responses. I believe there were only two sites  
23 that were able to obtain the FY '96 logs and use them to  
24 provide the information.

25 The first site would the Survey Numbered 1 in the

1 Library Reference, and what indicates that they actually did  
2 look at the disqualification -- or the acceptance logs, was  
3 that we received a list of the mailings that were sent  
4 regular rate but with nonprofit indicia, we received a list  
5 of those from the survey -- from the site themselves and  
6 that list is included in the Library Reference at the end of  
7 that Survey No. 1.

8 CHAIRMAN GLEIMAN: Do I understand you correctly  
9 that two sites actually used the data from Forms 8075 that  
10 they had in hand?

11 THE WITNESS: Yes.

12 CHAIRMAN GLEIMAN: And the others did not?

13 THE WITNESS: Yes.

14 CHAIRMAN GLEIMAN: Okay.

15 THE WITNESS: The other one would have been site  
16 No. 4.

17 CHAIRMAN GLEIMAN: Did you inquire whether Form  
18 8075s were still in existence at each of the offices, the  
19 other offices?

20 THE WITNESS: Yes. And their response would have  
21 been indicated on question No. 3 of the survey form.

22 CHAIRMAN GLEIMAN: And can you tell me how many of  
23 the offices who did not provide information from 8075s told  
24 you those forms were still in existence?

25 THE WITNESS: I don't recall offhand, I did not



1 quantify that. But it would be in question No. 3.

2 CHAIRMAN GLEIMAN: Okay. Did you ever ask Postal  
3 Service employees to go get Form 8075 before responding to  
4 the survey questions?

5 THE WITNESS: We did attempt to -- we did ask them  
6 that if they knew that they existed, to try to find them and  
7 to get the information from them. But since they were from  
8 FY '96, this is quite a number of years ago, the sites  
9 indicated that these were in storage and they -- it would  
10 take some time to find them. In fact, one of the sites that  
11 did -- both sites that found them, in took several days in  
12 order to find the boxes that had the forms in them.

13 The other sites could not spare the personnel to  
14 try to find them in the time frame that we needed to provide  
15 them for -- or get that information for rebuttal testimony.

16 CHAIRMAN GLEIMAN: Page 29 of your testimony, you  
17 list in the table 30 offices in your survey. It's the table  
18 that you have just offered us in revised form.

19 THE WITNESS: Yes.

20 CHAIRMAN GLEIMAN: Would you please identify which  
21 of those entries reflect the actual? As I understand it,  
22 it's No. 1 and No. 4?

23 THE WITNESS: It was No. 1 and No. 4 in the -- the  
24 way they are listed in the table, it would have been No. 10  
25 in strata 1 and No. 52 in strata 2.

1           CHAIRMAN GLEIMAN: Okay. Did you give  
2 instructions to any Postal employees who provided  
3 information as to how they should treat any of the notes or  
4 forms they may have used to develop the information for you?  
5 Or to put it another way, did you ask those people who had  
6 access to Form 8075 to keep those forms available?

7           THE WITNESS: The only sites that were able to  
8 obtain them in time to provide the information for rebuttal  
9 testimony were the two sites that I have already listed. I  
10 did not ask them to retain those forms nearby.

11          CHAIRMAN GLEIMAN: I have got to go back to one of  
12 my earlier questions now, and make sure I understand. I  
13 asked you earlier about whether you made an inquiry about  
14 Form 8075s and whether they were still in existence at each  
15 office.

16          THE WITNESS: Yes.

17          CHAIRMAN GLEIMAN: And you told me that that is in  
18 question -- I could find that information in question No. 3.

19          THE WITNESS: Yes.

20          CHAIRMAN GLEIMAN: We are going to take a break in  
21 a moment, and I am going to ask you to go through the  
22 Library Reference and tell me how many offices indicated  
23 that the 8075s still existed, separate and apart from the  
24 two who we have established actually used that form to  
25 provide data for you. Okay.

1           Before we take the break, though, in the interest  
2 of accommodating others, Mr. Levy, assuming for the sake of  
3 discussion that we proceed on the basis of the testimony  
4 that is in the record now, can you give me a worst case  
5 scenario on how long you might cross-examine?

6           All right. No one else has been --

7           MR. LEVY: Two hours.

8           CHAIRMAN GLEIMAN: I beg your pardon?

9           MR. LEVY: Two hours.

10          CHAIRMAN GLEIMAN: Two hours. Okay. That is an  
11 outside worst case scenario, but it could be shorter.

12          MR. LEVY: It could be shorter. It is a lawyer's  
13 worst case scenario.

14          CHAIRMAN GLEIMAN: All right. At this point we  
15 are going to take a 10 minute break and Witness Schenk,  
16 during the break, I would like you to go over the Library  
17 Reference and tell me how many question No. 3 answers  
18 indicate the continued existence of Form 8075.

19          [Recess.]

20          CHAIRMAN GLEIMAN: When last we met and before we  
21 went into shock at the prospect of two hours of cross  
22 examination by Mr. Levy and crew, I had asked you to count  
23 up question number three responses from your library  
24 reference to let me know how many other of the offices you  
25 surveyed said they actually still had 8075's.

1 THE WITNESS: Of the 27 responses we have received  
2 so far, there were 11 responses that had a "yes" to the  
3 question as to whether the FY'96 logs were available, but I  
4 want to clarify what that means.

5 This means that they have not destroyed those  
6 logs. It does not mean that they had them available on  
7 hand. These often were -- I noticed as I was going through  
8 it, we have written it clearly in some of the responses that  
9 these are logs that are kept in boxes in storage, and it may  
10 be difficult to find.

11 Like I said for one of the sites where they were  
12 able to find those logs, it took several days and many hours  
13 of a supervisor's time in finding those logs.

14 A "yes" response to that question means they  
15 haven't been destroyed. It doesn't necessarily mean they  
16 are readily available for us to look at and may take days to  
17 look --

18 CHAIRMAN GLEIMAN: I understand you. We are not  
19 dealing with -- you surveyed 30 sites.

20 THE WITNESS: Right.

21 CHAIRMAN GLEIMAN: You had 27 responses?

22 THE WITNESS: Uh-huh.

23 CHAIRMAN GLEIMAN: We have two who for sure have  
24 8075's in hand because they use them?

25 THE WITNESS: Yes.

1           CHAIRMAN GLEIMAN: We have 11 who think they have  
2 them in a box somewhere?

3           THE WITNESS: Right, and there were an additional  
4 four that said maybe. The other thing I would like to  
5 clarify is you characterized this information as data. I  
6 wanted to clarify that on the acceptance logs, they do not  
7 necessarily have listed what the volumes or even the revenue  
8 deficiencies related to these entries are. That information  
9 is kept in files for particular mailers, and getting that  
10 information would take even longer, a much longer time to  
11 get.

12           CHAIRMAN GLEIMAN: Well, I have three choices. I  
13 can rule to compel disclosure of what we know exists for  
14 sure and ask that you, "you" the Postal Service, make a  
15 concerted effort on the probables and the maybes, 11 and 4,  
16 and in the alternative, we can strike -- the problem I'm  
17 faced with is I never like to strike anything. I think it's  
18 always better to have a fuller record than not.

19           We are starrng at a mid-May delivery date for a  
20 recommended decision. I am going to leave it up to the  
21 Postal Service. Counsel, you have a choice. You, the  
22 Postal Service, have a choice.

23           Since only a limited number of forms were actually  
24 used and we know we can get two of them, and 11 more are  
25 maybe in boxes and four, we are not even sure they are in

1 boxes, you can have a week to get the forms. That is I'll  
2 compel disclosure with respect to that 13, 17 forms, with  
3 the understanding that four of those may not exist, and  
4 direct that a concerted effort be made and that a response  
5 to my ruling be provided by close of business next Thursday,  
6 or in the alternative, we will strike Witness Schenk's  
7 survey.

8 MS. REYNOLDS: Could I clarify?

9 CHAIRMAN GLEIMAN: You bet.

10 MS. REYNOLDS: If it turns out that one of these  
11 sets of forms, which may be in a box in deep storage  
12 somewhere, turn out to be indeed irretrievable, how would  
13 the Chairman like to handle that?

14 CHAIRMAN GLEIMAN: You find what you can find  
15 between now and next Thursday. We know that you should be  
16 able to find two of them. At that point, we will have what  
17 I hope would be a relatively short hearing, at which Ms.  
18 Schenk would reappear and ANM would have an opportunity to  
19 cross examine on the materials that were uncovered pursuant  
20 to the ruling in favor of the motion to compel, and if there  
21 are only two forms, then the Commission will give  
22 appropriate weight to Ms. Schenk's survey, based on where we  
23 know the data came from for sure versus where it may have  
24 come from, may it have been hidden in a box.

25 That's the best I can do. I'll give you about

1 five minutes to talk it over with your team, and the choices  
2 are come up with the forms that you can, two of them for  
3 sure, and whatever else out of that 11 plus 4 by next  
4 Thursday, close of business, or we will strike.

5 Five minutes.

6 MS. REYNOLDS: Mr. Chairman, another quick  
7 clarification?

8 CHAIRMAN GLEIMAN: You bet.

9 MS. REYNOLDS: You prefaced your comments by  
10 saying we had three options. So far, I only heard to.

11 CHAIRMAN GLEIMAN: No, I said we had three  
12 options. My option is if we have a motion to compel and you  
13 don't respond, then you'd be in violation of the lawful  
14 order and I'd ask my fellow Commissioners in joining me in  
15 issuing a C(2) order.

16 MS. REYNOLDS: Good enough.

17 [Recess.]

18 CHAIRMAN GLEIMAN: Just let me say that I didn't  
19 mean to be cavalier throwing around reference to a C(2)  
20 order, because none of us want anything like that to come to  
21 pass.

22 We know from yesterday's hearing that the Postal  
23 Service is in dire financial straits, and it's getting worse  
24 every minute, and we wouldn't want to do anything to  
25 endanger their situation, but I just wanted to clarify for

1 the record that that's, you know, a last resort, far, far  
2 out, and hopefully on a horizon that none of us ever have to  
3 come to.

4 Ms. Reynolds, you have a decision to tell me  
5 about.

6 MS. REYNOLDS: Yes, we do. We are going to take  
7 your option whereby we will make every effort to obtain the  
8 information that you're looking for by next week and recall  
9 Dr. Schenk to respond to questions on it at that time.

10 CHAIRMAN GLEIMAN: Okay. Let's just make sure we  
11 understand one another.

12 We know we're going to get two forms, or at least  
13 we think we know we're going to get two forms, and we may  
14 get a number more, and we're -- they're going to be  
15 submitted by close of business next Thursday, and we will be  
16 in touch with both the Postal Service and counsel for ANM  
17 about scheduling what hopefully will be a, relatively  
18 speaking, short hearing to allow oral cross examination on  
19 the material that is provided.

20 MS. REYNOLDS: I have a procedural question.

21 Regarding the filing of these documents, they are  
22 likely to be considerably voluminous, and I am wondering if  
23 we might waive the Commission's filing requirement whereby  
24 we are required to file 30 copies of them?

25 CHAIRMAN GLEIMAN: I believe we can do that.



1 MS. REYNOLDS: What would be an appropriate number  
2 of copies?

3 CHAIRMAN GLEIMAN: Well, I think that, if you can  
4 provide a copy to ANM, which has a seemingly deep-seated  
5 interest in these documents, and two additional copies, that  
6 would probably suffice for all of our purposes, and I  
7 suspect that the volume of the documents will depend upon  
8 the success of the search through all those boxes out there.  
9 So, we'll see what we get. Okay.

10 Now, let me ask you a question, Mr. Levy. Would  
11 you like to reassess the probable length of your cross  
12 examination today?

13 MR. LEVY: Yes, Mr. Chairman.

14 CHAIRMAN GLEIMAN: Again, this is not to put  
15 pressure on you. It's to help some others who have been  
16 sitting around and are going to have to be here late  
17 tonight.

18 MR. LEVY: My answer will depend on a question I  
19 would like to pose to you and you may not be in a position  
20 to answer, which is, for the sites in the list of 27 that  
21 don't have these disqualification logs, is the chair -- is  
22 it the chair's intention to disregard those sites? I assume  
23 the Commission probably doesn't know at this point.

24 CHAIRMAN GLEIMAN: I will tell you what I think I  
25 said earlier, when I was giving Ms. Reynolds the options and

1 some clarifications, and that is, if she chose the option  
2 that she did choose on behalf of the Postal Service, that we  
3 would await the material and we would determine the  
4 appropriate weight to give it based on what came in.

5 MR. LEVY: In that event, then I'm afraid the  
6 ruling doesn't reduce my estimate very much, because I think  
7 I need to protect my position, to ask about sites where it  
8 appears that the witness may argue that she is relying on  
9 independent judgement of local field personnel.

10 CHAIRMAN GLEIMAN: Well, it will be difficult, I  
11 think, to parse out at this point -- I'm sure that it's  
12 possible, but it might be difficult to parse out at this  
13 point which parts of the survey we're going to get a  
14 response to and which parts of the survey we're not going to  
15 get a response to, and I would respectfully suggest that we  
16 could reserve your rights and you could question on the  
17 survey in toto when we receive a response to the order to --  
18 in response to your motion to compel.

19 MR. LEVY: If I can defer questions about the  
20 survey methodology, that would cut it way down. I could  
21 probably do about half-an-hour.

22 CHAIRMAN GLEIMAN: It's not that we want to get  
23 out of here early tonight, but I think that that's a prudent  
24 course. The survey is a package, and conceivably, questions  
25 could occur to you or responses may become -- information

1 become -- may become evident to you once you see the  
2 material that's produced or not produced.

3 So, do we understand and agree that the survey  
4 --all aspects of questioning on the survey, in essence, will  
5 be reserved for that hearing that we're going to have  
6 sometime shortly after next Thursday?

7 My guess is we're looking probably at March the  
8 30th, would be a good guess, because that would give you an  
9 opportunity to review the material that came back in. I  
10 believe that's a Monday.

11 But we're not firm on that. We'll talk with the  
12 parties to make sure that everyone can --

13 MR. LEVY: Then, if the questions about the survey  
14 can be deferred until then, then my time estimate goes down  
15 to 15 to 30 minutes, because I will be asking only about the  
16 witness' criticism of Dr. Haldi's survey.

17 CHAIRMAN GLEIMAN: Well, we'll proceed on that  
18 basis, and you can begin your cross examination.

19 MR. LEVY: If I may have a moment to reorganize my  
20 notes.

21 CHAIRMAN GLEIMAN: Whenever you're ready.

22 CROSS-EXAMINATION

23 BY MR. LEVY:

24 Q Good evening, Dr. Schenk. As you know, I'm David  
25 Levy for the Alliance of Non-Profit Mailers.

1           Would you turn to page 5 of your testimony?

2           A     Yes.

3           Q     Now, on lines 10 to 11, you have the following  
4 statement. Quote, "In addition, the ANM survey responses do  
5 not indicate how the volumes for these mailings were  
6 recorded in Postal Service's databases." Do you see that?

7           A     Yes.

8           Q     How would the ANM survey respondents be in a  
9 position to know the answer to such a question?

10          A     I did not imply that the ANM survey respondents  
11 should know, and that is exactly my point is that that is  
12 the inference that Dr. Haldi was making in his analysis was  
13 that the volumes and cost data were not consistent with one  
14 another but the survey responses do not in any way show how  
15 the volumes were recorded.

16          Q     Well, how is ANM at the time we filed Dr. Haldi's  
17 testimony to indicate how the volumes for these mailings  
18 were recorded in Postal Service databases?

19          A     I'm sorry, I didn't catch your question.

20          Q     How was the Alliance of Nonprofit Mailers at the  
21 time we filed Dr. Haldi's testimony supposed to find out how  
22 the volumes for these mailings were recorded in Postal  
23 Service's databases?

24          A     I don't know, but Dr. Haldi makes inferences about  
25 how those volumes are recorded in the Postal Service

1 databases without that information, and that is one of my  
2 criticisms of his analysis.

3 Q So he shouldn't have filed his study at that  
4 point?

5 A I believe he does not have the information  
6 available to make his conclusions.

7 Q Are you aware that at the time we filed his  
8 testimony we had an outstanding request to the Postal  
9 Service for that information?

10 A Yes, I am aware of that request.

11 Q And the Postal Service's response at that time was  
12 they didn't know?

13 A I don't believe that that was -- my understanding  
14 of the Postal Service response was that the information  
15 would take a lot of time to get if it were available at all.

16 I am not sure I am characterizing that correctly,  
17 but that was my understanding of the Postal Service  
18 response, and also I believe part of that response had to do  
19 with the timing of the filing for that request.

20 Q In your testimony you attach a document that was  
21 previously filed as an interrogatory answer? Is that  
22 correct?

23 A Yes, that's correct.

24 Q And that appears starting on page 30 of your  
25 rebuttal testimony, is that correct?

1 A Yes.

2 Q That is the Postal Service's response to  
3 ANM/USPS-28, is that correct?

4 A Yes.

5 Q And that was prepared by you?

6 A Yes, it was prepared by me and my colleagues.

7 Q And that was filed after the filing date for the  
8 Intervenors' testimony, wasn't it?

9 A Yes.

10 Q Would you turn to page 8 of your rebuttal  
11 testimony?

12 A I'm there.

13 Q Starting on line 15, you state, "The survey  
14 responses provided in ANM-LR-1 do indicate that at least  
15 one-third of survey responses were received from members of  
16 the American Association of Museums. It is highly unlikely  
17 that one-third of all nonprofit Standard A volumes are  
18 associated with this group."

19 Have you seen any information in the course of  
20 preparing your testimony that museums have a higher  
21 incidence of nonprofit mail rejection than other nonprofit  
22 mailers on average?

23 A No, I have not seen any information of that sort.

24 Q Would you turn to page 9 --

25 A And I do want to clarify that my sentence in that

1 section was referring to the way that the sample was drawn  
2 and whether the sample was representative of nonprofit  
3 mailers in general, and that is what my statement was  
4 referring to.

5 Q I understand that, but an unrepresentative sample  
6 can give correct results if the different populations being  
7 surveyed -- if the sample population doesn't have traits  
8 that are significantly different from the rest of the  
9 universe. Isn't that correct?

10 A But there was no analysis in either the ANM survey  
11 responses or in Dr. Haldi's analysis that showed whether the  
12 respondents were representative of the universe or whether  
13 the nonrespondents were -- had similar or different  
14 characteristics to the respondents. And that is generally  
15 accepted methodology in survey methodologies to show that,  
16 especially with such a high nonresponse rate.

17 Q Dr. Schenk, you answered my question with the word  
18 "but." Could you first answer my question, which was, if  
19 there is not a significant difference between the sample  
20 population in its traits and the traits of the universe as a  
21 whole, then even an unrepresentative sample can produce  
22 accurate results. Isn't that correct? If.

23 A Could you restate that again? I just want to make  
24 sure that I'm understanding your question.

25 Q Yes. If hypothetically American museums

1 experience disqualification of mail tendered at nonprofit  
2 rates at the same frequency as the rest of the universe of  
3 nonprofit mail, then overweighting of museums in the sample  
4 shouldn't distort the results. Isn't that correct?

5 I'm not asking you --

6 A I believe if -- I believe given your hypothetical  
7 that that would be correct.

8 Q And then you added: but we have offered no  
9 evidence that the hypothetical is correct.

10 And my question to you is: Have you offered any  
11 evidence that the hypothetical -- that the population --  
12 that American museums experience mail rejection at a greater  
13 rate than the average nonprofit mailer? You being  
14 Christensen Associates or the Postal Service.

15 A I have no evidence to that, but also there has  
16 been presented no evidence that they are representative, and  
17 that is standard procedure in a survey like this to show  
18 that the respondents are representative when there's a high  
19 degree of nonresponse.

20 Q Representative of the universe.

21 A Of the universe.

22 Q Do you know whether any other organization or  
23 entity in the world besides the Postal Service knows who the  
24 whole universe of its nonprofit mailers are?

25 A There are a number of people who study nonprofit



1 organizations, and in fact I spent a year as I was a  
2 graduate student as a research assistant studying nonprofit  
3 organizations under a professor who studies these. So yes,  
4 there are people who know about the population of nonprofit  
5 organizations.

6 Q And those people know how much mail each nonprofit  
7 organization enters at nonprofit rates in fiscal year 1996?

8 A I do not know if anyone has studied that issue.

9 Q In fact, isn't it illegal for the Postal Service  
10 to disclose the volumes of individual mailers to the public?

11 A I'm not sure about the legality. Generally we do  
12 not provide that information in our studies to maintain  
13 confidentiality.

14 Q Would you turn to page 10 of your testimony,  
15 starting at the very first line?

16 There you state that for 26 of the survey  
17 responses the data recorded in the exhibit ANM-T1-1 do not  
18 match the answers provided in the survey forms provided in  
19 ANM-LR-1. Do you see that?

20 A Yes, I do.

21 Q Now do you know whether the data recorded in the  
22 Exhibit ANM-T1-1 includes information that was recorded  
23 directly into a computer data base or spreadsheet rather  
24 than on an intermediate basis onto the survey forms?

25 A What I'm referring to in that paragraph is the

1 fact that some of the responses were misinterpreted, not  
2 that they were recorded incorrectly in terms of data entry,  
3 but that they were misinterpreted. And that, as I explain  
4 later in that paragraph, that it was interpreted that if the  
5 mail was sent with a nonprofit permit, question 2(b), then  
6 it was assumed that it had nonprofit indicia. But in fact  
7 in question 2(c) they asked specifically for what indicia  
8 the pieces were sent at. And for these 26 survey responses,  
9 I noted that those volumes were indeed according to question  
10 2(c) sent with regular rate indicia. So there would be no  
11 discrepancy between the volumes recorded and the indicia on  
12 the piece.

13 Q I'm sorry, could you repeat the last sentence of  
14 your answer. I didn't follow that.

15 A According -- for these 26 survey responses, the  
16 volumes that were noted in the original exhibit, ANM-T1-1,  
17 indicated that these pieces were sent at regular rate with  
18 nonprofit indicia, but in fact question 2(c) indicated that  
19 they had nonprofit indicia -- or, I'm sorry, regular rate  
20 indicia on them, and therefore those pieces would have been  
21 recorded as regular rate volumes, and also if they were  
22 sampled in IOCS would have been recorded with regular rate  
23 indicia.

24 Q Now --

25 A But they were marked incorrectly in the exhibit,

1 at least I assume because question 2(b) said they were sent  
2 with a non-profit permit, which doesn't really indicate what  
3 the indicia on the piece was.

4 Q Did it occur to you that if there was an ambiguity  
5 of that sort, that Dr. Haldi or someone under his direction  
6 might have done a follow up telephone call to the people  
7 that answered the surveys?

8 A But there is nothing indicated on those survey  
9 forms that I could tell that indicated that additional  
10 information.

11 Q One wouldn't see information, additional  
12 information entered on the survey forms if the information  
13 was entered directly in the spreadsheet, would you?

14 A But the library reference was provided as evidence  
15 and I assume if you are following the evidence rules -- I  
16 could recreate the numbers in the exhibit from this library  
17 reference, and that's what I was going on.

18 Q Just as we could recreate your numbers from your  
19 library references?

20 A Yes.

21 Q Did it occur to you to see if somebody could ask  
22 Dr. Haldi through his counsel to explain the discrepancy  
23 before you filed your rebuttal testimony?

24 A I was going by -- this was provided. It was  
25 provided -- I can't remember the exact date, but it was

1 provided at the end of February. We didn't have very much  
2 time to follow up. You know, we had to spend some time  
3 getting survey responses that were missing out of it, and  
4 trying to get the information together, but since this was  
5 filed as the supporting evidence to his testimony, I assume  
6 the numbers here could be used to recreate the numbers in  
7 his exhibit.

8 Q Did you suggest to anyone on your team that Dr.  
9 Haldi be questioned about this on cross examination?

10 A I don't recall.

11 Q Line 11 on the same page, you say 22 of the 108  
12 responses are marked with two numbers on a single response  
13 form?

14 A Yes, I see that.

15 Q It goes onto say nothing in ANM-LR-1 indicates any  
16 reason for this, the double numbering does not appear to  
17 correspond to mail, who mailed it, both commercial and  
18 non-profit rates. Do you see that?

19 A Yes, I see that.

20 Q Again, did it occur to you to ask anyone to  
21 explain it?

22 A Actually, the wording of that second sentence was  
23 in response to some information that Ann Reynolds had gotten  
24 for me from your office. I was trying to determine why  
25 there were 108 responses listed, but it didn't appear to me

1 there were 108 separate survey forms. I was trying to  
2 determine that, and that was the only information that we  
3 had received from your office, and it didn't appear to me  
4 that was the case because there were other survey forms with  
5 only one number on them that had both mailed at commercial  
6 rates and non-profit rates. That didn't seem to answer the  
7 question, but as I said before, we did not receive the  
8 library reference until the end of February and there was  
9 not much time available to follow up with further questions.

10 Q Would it surprise you if the double numbering  
11 refers to mail entered at both commercial and non-profit  
12 indicia?

13 A It would surprise me, yes, because there are forms  
14 in there, as I recall, that have one number on them, that  
15 have mailed with regular rate and non-profit indicia.

16 MR. LEVY: That's all I have, Mr. Chairman, at  
17 this time.

18 Thank you, Dr. Schenk.

19 CHAIRMAN GLEIMAN: Is there any follow-up?

20 [No response.]

21 CHAIRMAN GLEIMAN: There's no follow-up. That  
22 brings us to redirect. Would you like some time with your  
23 witness?

24 MS. REYNOLDS: Just a few minutes, please.

25 CHAIRMAN GLEIMAN: Certainly.

1 [Recess.]

2 CHAIRMAN GLEIMAN: Ms. Reynolds.

3 MS. REYNOLDS: The Postal Service does not have  
4 redirect. However, given that Mr. Levy's intended  
5 cross-examination was going to be considerably longer, the  
6 Postal Service thinks that our future hearing would probably  
7 be expedited if Mr. Levy could share with us any  
8 cross-examination exhibits that he had prepared regarding  
9 Dr. Schenk's survey.

10 CHAIRMAN GLEIMAN: Mr. Levy?

11 MR. LEVY: I can tell counsel exactly what they  
12 are. The survey forms and Ms. Reynolds' letter and  
13 attachments to me dated March 13th and March 16th of this  
14 year. I believe she has possession of all of those, but I  
15 can make duplicate copies if that is desired.

16 MS. REYNOLDS: No, I think I can dredge those up.

17 CHAIRMAN GLEIMAN: They are not hidden away in  
18 boxes somewhere in some Postal facility.

19 MS. REYNOLDS: I don't assume.

20 CHAIRMAN GLEIMAN: Well, if there is no redirect,  
21 then, Ms. Schenk, we want to thank you. We appreciate your  
22 appearance today and your contributions to the record. I am  
23 sorry that we are going to have to have you come back, but

24 --

25 THE WITNESS: I will enjoy another visit to D.C.

1           CHAIRMAN GLEIMAN: We sure hope it will be  
2 enjoyable. I really do want to thank you and also your  
3 counsel for cooperating in this exercise today. It is, you  
4 know, in the furtherance of having as complete a record as  
5 we possibly can to make a decision on. And I think all of  
6 us do appreciate that you are being cooperative and helping  
7 us achieve that. So, thank you, if you have nothing  
8 further, you are excused.

9           [Witness excused.]

10           CHAIRMAN GLEIMAN: Our next witness is appearing  
11 on behalf of the Mail Order Association of America et al.  
12 Mr. Andrew is already under oath in this proceeding.  
13 Whereupon,

14                                 GARY M. ANDREW,  
15 a witness, was called for examination by counsel for the  
16 Mail Order Association of America, and also on behalf of the  
17 Advertising Mail marketing Association, and The Direct Mail  
18 Marketing Association, Inc. and, having been first duly  
19 sworn, was examined and testified as follows:

20           CHAIRMAN GLEIMAN: So, Mr. Todd, if you would  
21 introduce your witness and enter his rebuttal testimony into  
22 the record, we can, hopefully, get out of here at a  
23 reasonable hour tonight.

24                                 DIRECT EXAMINATION

25                                 BY MR. TODD:

1 Q Mr. Andrew, do you have before you a document  
2 entitled "Rebuttal Testimony of Gary M. Andrew" which has  
3 been presented on behalf of the Mail Order Association of  
4 America, the Advertising Mail Marketing Association and the  
5 Direct Mail Marketing Association, Inc., which has been  
6 identified as MOAA, et al.-RT-1?

7 A Yes, I do.

8 Q And do you adopt this testimony today as your  
9 testimony as having been prepared by you or under your  
10 direction and control?

11 A Yes.

12 MR. TODD: Mr. Chairman, I move that this  
13 testimony be admitted into evidence and transcribed into the  
14 record at this point.

15 CHAIRMAN GLEIMAN: Are there any objections?

16 [No response.]

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

21 [Rebuttal Testimony and Exhibits of  
22 Gary M. Andrew, MOAA, et al.-RT-1,  
23 was received into evidence and  
24 transcribed into the record.]

25



MOAA, et al.-RT-1

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

\_\_\_\_\_  
POSTAL RATE AND FEE CHANGES, 1997 )  
\_\_\_\_\_)

Docket No. R97-1

REBUTTAL TESTIMONY

OF

GARY M. ANDREW

Senior Consultant

L. E. Peabody & Associates, Inc.

On Behalf Of

MAIL ORDER ASSOCIATION OF AMERICA,

ADVERTISING MAIL MARKETING ASSOCIATION,

AND

THE DIRECT MAIL MARKETING ASSOCIATION, INC.

Communications with respect to this document  
may be sent to:

David C. Todd  
Patton, Boggs, L.L.P.  
2550 M Street, N.W.  
Washington, D.C. 20037  
(202) 457-6000  
Counsel for Mail Order  
Association of America

Ian D. Volner  
N. Frank Wiggins, Esquire  
Venable, Baetjer, Howard & Civiletti, L.L.P.  
Suite 1000  
Washington, D.C. 20005  
Counsel for Advertising Mail Marketing  
Association

Dana T. Ackerly II  
Covington & Burling  
1201 Pennsylvania Avenue, NW  
Washington, D.C. 20004  
Counsel for The Direct Marketing Association, Inc.

Due Date: March 9, 1998

## TABLE OF CONTENTS

	<u>Page</u>
I. PURPOSE OF TESTIMONY .....	1
II. SUMMARY AND CONCLUSIONS .....	3
III. THEORETICAL AND PRACTICAL PROBLEMS IN NAA WITNESS CHOWN'S METRIC .....	6
A. WITNESS CHOWN'S HISTORICAL AND CURRENT METHODOLOGIES .....	10
B. CLAIM OF IDENTIFIABLE INSTITUTIONAL COSTS AS A THIRD TIER COST .....	11
C. WITNESS CHOWN NEGLECTS ECONOMIES OF SCALE AND SCOPE .....	12
D. THE CHOWN METRIC IS VOLATILE WHEN COST CHANGES OCCUR .....	13
IV. CRITIQUE OF WITNESS CLIFTON'S PROPOSALS .....	24
A. CHANGES IN MIX OF MAIL CATEGORIES ARE THE PRIMARY REASON FOR DECLINING USPS' UNIT COSTS FROM 1994 TO 1996 .....	27
B. WITNESS CLIFTON'S ROLL FORWARD ADJUSTMENT IS BASED ON INCORRECT COST PROJECTIONS .....	32
C. THE BULK METERED MAIL BENCHMARK IS PREFERABLE FOR THE CALCULATION OF WORKSHARED DISCOUNTS .....	34
D. STANDARD (A) COSTS AND RATES ARE <u>NOT</u> GERMANE TO THE ESTIMATION OF FIRST-CLASS WORKSHARED COSTS AND DISCOUNTS .....	35
E. WITNESS CLIFTON'S PROPOSAL FOR CHANGES IN COST COVERAGES FAIL TO CONSIDER HIGHER LEVEL OF SERVICE AND ARE NOT NECESSARY .....	37

**TABLE OF CONTENTS**

F.	WITNESS CLIFTON'S SECOND AND THIRD OUNCE RATE PROPOSAL IS BASED ON FALSE CLAIMS OF CROSS-SUBSIDY . . . . .	39
V.	CRITIQUE OF MMA'S WITNESS BENTLEY'S PROPOSED FIRST-CLASS WORKSHARED DISCOUNTS . . . . .	44
VI.	CRITIQUE TO AAPS' WITNESS BRADSTREET'S RHETORIC . . . . .	46
A.	RATES IN A REGULATED ENVIRONMENT . . . . .	47
B.	IMPACT OF PRICING ON ALTERNATIVE MAIL . . . . .	48
C.	HISTORICAL RATE TRENDS . . . . .	50
D.	COST TRENDS . . . . .	52
E.	RAMSEY PRICING . . . . .	53

---

---

LIST OF EXHIBITS

<u>EXHIBIT NO.</u> (1)	<u>TITLE</u> (2)
MOAA, et al.-RT-1A	The R97-1 Chown Metric is a Scalar Multiple of the R90-1 Unbundling Method with Equal Mark-ups
MOAA, et al.-RT-1B	Behavior Characteristics of the Chown Metric
MOAA, et al.-RT-1C	Development of USPS' Proposed First-Class Workshared Letter Mail Discounts

---



- 1 3. the Major Mailers Association ("MMA") Witness Richard E. Bentley's proposal to  
2 reduce certain First-Class workshared discounts (MMA-T-1); and,
  - 3 4. the Association of Alternate Postal Systems ("AAPS") Witness Kenneth L. Bradstreet's  
4 comments regarding the United States Postal Services ("USPS") unfair competition to  
5 mailers (AAPS-T-1).
-

1

**II. SUMMARY AND CONCLUSIONS**

2

After reviewing the testimony of the intervenors listed above, the underlying workpapers,

3

interrogatory responses, cross examination related to the direct testimony and other sources of

4

pertinent information, I conclude the following:

5

1. NAA's Witness Chown's proposed metric should not be adopted for the following reasons:

6

7

a. Witness Chown's proposed methodology in R90-1<sup>2/</sup> reflected an unbundling approach to the distribution of institutional costs. This approach was rejected by the PRC. Her proposal in this current proceeding regarding the calculation of a metric to aid in the assignment of "identifiable" institutional costs (i.e., the "Chown Metric") does not improve upon the rejected R90-1 methodology and should, therefore, be rejected;

8

9

10

11

12

13

14

b. The Chown Metric begins with the development of a third tier of costs ("identifiable" institutional costs). This methodology is at odds with economic theory and practice in the use of costs in ratemaking;

15

16

17

c. In a multi-product firm, economies of scope and scale allow mail to share the burden of institutional costs. Witness Chown's metric approach distorts the impact of economies of scope and scale; and

18

19

20

21

d. When attributable or institutional costs change, the use of the Chown Metric in ratemaking will introduce serious inequities between subclasses and will not solve the perceived problem it attempts to address. Technically speaking, the Chown Metric is dynamically unstable.

22

23

24

25

2. Witness Clifton fails in his attempts to discredit the USPS proposal with respect to first, second and third ounce rates for workshared First-Class letter mail and has no basis for his proposed changes in coverage ratios. Specifically, Witness Clifton has erred in his analyses and conclusions in the following areas:

26

27

28

a. Witness Clifton has mischaracterized historical changes in First-Class workshared mail unit costs and has projected test year costs based upon this mischaracterized, two year time series;

---

<sup>2/</sup> PRC Docket No. R90-1, Postal Rate and Fee Changes, 1990 ("R90-1").

- 1 b. Witness Clifton has failed to adequately justify proposed adjustments to USPS'  
2 Witness Hume's model of test year delivery costs and USPS Witness Hatfield's  
3 model of test year mail processing costs;
- 4 c. Witness Clifton's rejection of the Bulk Metered Mail benchmark and use of MC95-1  
5 procedures to develop First-Class workshared discounts is a step backward in rate  
6 design and ignores both the best evidence of record and the PRC prior decision;
- 7 d. Witness Clifton's attempt to compare First-Class workshared letter rates and  
8 discounts to Standard (A) rates neglects the differences between these two classes of  
9 mail;
- 10 e. The proposal to decrease the cost coverage for First-Class workshared mail and  
11 increase the cost coverage for Standard (A) mail on the basis of efficiency and equity  
12 is not supported, furthermore, the changes in cost coverages are not and should not  
13 be required to fund First-Class workshare discounts if they are increased due to cost  
14 changes; and,
- 15 f. The allegations of First-Class subsidizing Standard (A) mail are false because of  
16 Witness Clifton's erroneous implementation of the incremental cost test for cross-  
17 subsidy.
- 18 3. MMA Witness Bentley's proposed changes to First-Class workshared discounts should  
19 be rejected because, like the analysis performed by Witness Clifton, the criticism of the  
20 USPS's studies is unfounded.
- 21 4. AAPS Witness Bradstreet's claim that the USPS' "anticompetitive, unjustifiable rate  
22 proposal" (AAPS-T-1, page 5) favors competitive mail at the expense of captive mail  
23 is unsupported for the following reasons:
- 24 a. The USPS as a "Monopoly" cannot be grouped with regulated monopolies like other  
25 utilities. The USPS is a very highly regulated entity that must operate on a  
26 breakeven basis with rates approved by the PRC;
- 27 b. Witness Bradstreet's "Rate Trend Comparison" does not support his claim that the  
28 USPS and PRC have been lowering rates for competitive mail (i.e., ECR saturation  
29 mail) at the expense of captive mail (i.e., First-Class letters and Standard (A) Basic  
30 nonletters);
- 31 c. Decreases in costs for ECR mail and the USPS' Ramsey Pricing analysis would  
32 warrant lower ECR rates.

33 The basis for these conclusions are discussed below under the following headings:



- 1        III.    Theoretical and Practical Problems in NAA Witness Chown's Metric
  - 2        IV.    Critique of Witness Clifton's Proposals
  - 3        V.     Critique of MMA's Witness Bentley's Proposed First-Class Workshared Discounts
  - 4        VI.    Critique of AAPS' Witness Bradstreet's Rhetoric
-

1  
2

**III. THEORETICAL AND PRACTICAL  
PROBLEMS IN NAA WITNESS CHOWN'S METRIC**

3           On behalf of the Newspaper Association of America, Sharon L. Chown proposes an  
4 elaborate mechanism to serve as a starting point in the distribution of institutional costs. Starting  
5 with attributable costs calculated through the Postal Service's accounting mechanisms, Witness  
6 Chown redistributes these costs through each of five functional cost pools by applying an index  
7 that either increases or decreases attributable costs in each of the five function categories.

8           The Chown Metric is computed and used as follows.

9           For each function:

- 10           1. Determine the percentage of all identifiable institutional costs that are associated with  
11           a cost function;
- 12           2. Determine the percentage of all attributable costs that are associated with a cost  
13           function;
- 14           3. Compute a "weighting factor" that is the ratio of (1) and (2), that is,  
15           % of total identifiable institutional costs  $\div$  % of total attributed costs;<sup>2/</sup> and,
- 16           4. Multiply each attributed cost in the cost function by the weighting factor, resulting  
17           in weighted attributable costs.

18           Next, for each subclass:

- 19           1. Add up the weighted attributable costs for all functions (The result is the Chown  
20           Metric).
- 21           2. Use the resulting values (one for each subclass) as the basis to mark-up to cover all  
22           institutional costs.

---

<sup>2/</sup> The weighting factors (or indices) created by this ratio can cause Witness Chown's "weighted" attributable costs to be significantly different from traditionally calculated attributable costs. For example, for Witness Chown's "Delivery" function, the weighting factor is 210.03% (function-associated institutional costs representing 60.83% of total institutional costs deemed by Witness Chown function-specific divided by the 28.96% total attributable cost associated with Witness Chown's delivery function).

1           3. After the mark-ups are determined, the distribution of institutional costs based on  
2           those mark-ups are added to the actual attributable cost to determine the revenue  
3           requirement.

4           Witness Chown summarizes her view regarding the necessity for re-aligning attributable  
5           costs as follows:

6           As this table [Table 3, Tr. 25/13270] shows, the proportion of institutional costs  
7           identified with any particular function is very different than the proportion of  
8           attributable costs associated with providing that function. For example, 50  
9           percent of all attributable costs are associated with mail processing. However,  
10          mail processing does not account for 50 percent of the institutional costs. It  
11          accounts for only 28 percent of those institutional costs that can be identified  
12          with a particular function (Tr. 25/13394-95).

13                               \*   \*   \*

14                               \*   \*   \*

15           By weighting the attributable costs I give greater weight to the attributable costs  
16           of delivery, so if you are a subclass that only uses delivery, you are going to  
17           have a higher weighted attributable cost. Therefore, you will be assigned a  
18           greater proportion of institutional costs, all other things being equal. That's the  
19           problem I'm trying to correct here, is this by an unweighted cost giving greater  
20           — what happens with nonweighted cost, if it gives greater weight to those  
21           functions that are already very attributed. (Tr. 25/13396).

22                               \*   \*   \*

23          Witness Chown suggests that her redistributed attributable costs, though plainly deviating  
24          from volume variable (or marginal) costs, are sensible starting points for pricing decisions  
25          because the redistributed attributable costs approximate incremental costs:

26          Second, I agree that economic efficiency requires a trade-off between costs and  
27          benefits at the margin and that marginal costs provide relevant information for  
28          making this tradeoff. However, it is also necessary to have relevant information  
29          on incremental costs. As Dr. Panzar points out:

30                               \*   \*   \*

31          “If the monopolist’s prices are set below per unit incremental costs, firms with  
32          superior productive techniques would be inefficiently deterred from entering the  
33          market.” (USPS-T-11, page 10, lines 24-5 and page 11, line 1)

34

---

1           Therefore, it is necessary to have information on both marginal costs and  
2           incremental costs when setting rate levels and determining the rate structures.  
3           (Tr. 25/13325).

4           Witness Chown's use of institutional costs to recalculate attributable costs for the purpose of  
5           determining institutional cost contributions is apparently based at least in part on her belief that  
6           functions cause identifiable incremental institutional costs:

7           Q. Understood. But it's your testimony here that functions do cause  
8           institutional costs in that incremental cost sense that if you eliminate the  
9           function, you eliminate the institutional costs. Is that right?

10          A. Yes, that is correct. If I don't have a delivery function and I don't have the  
11          carrier walking the street, his institutional costs, as well as his attributable  
12          costs, would be eliminated. (Tr. 25/13398-99).

13          This approach is plainly wrong from two perspectives. First, one cannot sensibly think  
14          about cost functions in terms of incremental cost causation in the context of Postal Service  
15          ratemaking. Witness Chown testified in the quotation above that a cost can be defined as  
16          incremental if it is eliminated when the USPS ceases to perform the function associated with that  
17          cost. However, the definition is vacuous because virtually all categories of mail use all of the  
18          cost functions identified by Witness Chown, and the elimination of any function would mean that  
19          the USPS had decided to put itself out of business, i.e., stop any function and you stop the mail.  
20          The delivery function on which Witness Chown focuses is the clearest example of this  
21          phenomenon. If the delivery function is eliminated, the USPS is eliminated.

22          Equally, it is not productive to characterize the costs of the functions identified by Witness  
23          Chown as incremental because it is not cost functions, but costs and rates for classes and  
24          subclasses of mail which are at issue. No mailer buys the delivery function; a mailer may buy  
25          the package of services that come with a first ounce First-Class stamp, or the services associated

---

1 with Standard (A) ECR Saturation mail dropshipped to the BMC. As USPS' Witness Panzar  
2 testified, incremental costs are important in measuring the absence of cross subsidies among the  
3 USPS' products. Economic definitions of cross-subsidy in a multi-product firm associate  
4 incremental costs with a product or service, not a specific account grouping. The USPS does  
5 not sell functions and, in consequence, the incremental costs of functions are entirely irrelevant  
6 to the rate proposals.

7 Witness Chown's proposal recommends moving away from conventionally computed  
8 attributable costs, which are a good proxy for marginal costs, to weighted attributable numbers  
9 that have no apparent justification in generally accepted economics of rate regulation. The  
10 USPS' attributable costs are its attributable costs and no amount of arithmetic manipulation can  
11 change that fact. Witness Chown's weighted attributable costs are not properly considered as  
12 costs related to any sub-class of mail and, consequently, cannot be the starting point for  
13 determining appropriate institutional cost contribution for any subclass.

14 The creation and use of the Chown Metric does not assist in solving the perceived problems  
15 regarding the relationship of attributable and institutional costs. In fact, the use of Witness  
16 Chown's proposal will introduce new problems in relationships between rates as shown below.  
17 My analysis of Witness Chown's proposal is presented below under the following headings:

- 18 A. Witness Chown's Historical and Current Methodologies
  - 19 B. Claim of Identifiable Institutional Costs As A Third Tier Cost
  - 20 C. Witness Chown Neglects Economics of Scale and Scope
  - 21 D. The Chown Metric is Volatile When Cost Changes Occur
-

1     **A. WITNESS CHOWN'S HISTORICAL**  
2     **AND CURRENT METHODOLOGIES**

3             In Docket No. R90-1, Witness Chown submitted testimony (ANPA-T-2) proposing the  
4     "unbundling" of institutional costs through a methodology that separately calculated each  
5     subclass' contribution to institutional costs associated with each of three functions performed by  
6     the USPS. Although there are some mechanical differences between that proposal and her  
7     testimony in this case, the two methodologies have only two mathematical differences. When  
8     the R90-1 method is applied to the attributable cost with uniform markups at the cost function  
9     level<sup>4/</sup> and the sum of these marked-up attributable costs multiplied by the ratio of the total  
10    attributable cost to the total identifiable institutional costs<sup>5/</sup>, the result will be the Chown  
11    Metric.<sup>6/</sup>

12            In other words, the Chown Metric is a restrictive form of the R90-1 methodology as proved  
13    in Exhibit \_\_MOAA, et al.-1A. Witness Chown has acknowledged that the R90-1 methodology  
14    and the Chown Metric yield precisely the same results when equal markups are applied to all  
15    subclasses of mail through each method (Tr. 25/13306). She also acknowledged that when the  
16    same set of unequal markups are used in each of the two methods, considerably different results  
17    are obtained (Tr. 25/13304). Although the Chown Metric is procedurally different and may  
18    appear to be easier to use than the R90-1 unbundling procedure, none of the fundamental  
19    problems contained in the R90-1 unbundling proposal are solved by the computation and use of  
20    the Chown Metric.

---

<sup>4/</sup> This is shown as equation b in Exhibit \_\_MOAA, et al.-1A.

<sup>5/</sup> This ratio (or scale factor) is the left hand term of equation e in Exhibit \_\_MOAA, et al.-1A.

<sup>6/</sup> This is shown as equation e in Exhibit \_\_MOAA, et al.-1A and Witness Chown confirmed this proof in her response to AMMA/NAA-T-1-4 (Tr. 25/13322).

1 **B. CLAIM OF IDENTIFIABLE INSTITUTIONAL COSTS**  
2 **AS A THIRD TIER COST**

3 Witness Chown contends that she is "not proposing to attribute any institutional costs to  
4 particular subclasses of mail."<sup>7/</sup> In effect, however, she does so. The Chown Metric clearly  
5 defines and uses a "third tier"<sup>8/</sup> of costs. The computation of the Chown Metric constitutes a  
6 division of the institutional (non-attributable) costs into two parts; namely, "identifiable"  
7 institutional costs and "system-wide" institutional costs. The practical effect of this division,  
8 plus the attributable cost tier, is to create a third cost tier.<sup>9/</sup>

9 When computing the Chown Metric, the identifiable institutional costs do not appear to be  
10 added to the attributable costs but the impact on the redistribution of the attributable costs is the  
11 same. Despite her protestations to the contrary, the approach would lead to treating institutional  
12 costs as attributable costs in the pricing of postal services. Her metric establishes "weighted"  
13 costs that are not attributable costs, nor institutional costs, nor incremental costs. In fact, the  
14 Chown Metric is a method of distributing approximately two-thirds of the institutional costs to  
15 the attributable costs of subclasses and normalizing the result<sup>10/</sup>, to form the weighted attributable  
16 costs. Witness Chown proposes the use of this weighted attributable cost as an aid to decision  
17 making in assigning all institutional costs ("identifiable" and system-wide). The distribution she  
18 creates is admittedly not based upon any causal relationship.<sup>11/</sup>

---

<sup>7/</sup> See response to NNA/NAA-T1-1 (Tr. 25/13339).

<sup>8/</sup> See PRC *Opinion and Recommended Decision*, Docket No. 84-1.

<sup>9/</sup> In the creation of this third tier, Witness Chown takes another liberty in cost allocation. She "piggybacks" additional costs onto the identifiable institutional cost without sufficient justification. This increases the institutional costs that are identifiable from \$13.6 billion (without piggyback) to \$18.3 billion with piggyback.

<sup>10/</sup> The result is normalized so that the weighted attributable costs for each subclass when, added together, equal the total attributable costs.

<sup>11/</sup> See responses to AMMA/NAA-T1-2 and 5 (Tr. 25/13317 and 13323).

1 In summary, the Chown Metric creates a third cost tier (identifiable institutional costs). The  
2 use of this third tier in the computation of the Metric involves two unsupported arbitrary  
3 allocations (without proof of causality): 1) Use of the piggyback factor to allocate certain  
4 indirect costs to the identifiable institutional costs; and, 2) allocation of the resulting identifiable  
5 institutional costs to the attributable costs. Although Witness Chown characterizes her  
6 methodology as an aid to decision-making, her application is in fact a mechanical redistribution  
7 of attributable costs. More important, however characterized or used, the entire approach is at  
8 odds with sound allocation of costs for ratemaking.

9 **C. WITNESS CHOWN NEGLECTS**  
10 **ECONOMIES OF SCALE AND SCOPE**

11 Witness Chown claims that:

12 Applying a mark-up to total attributable costs is appropriate only if (1) all  
13 mailers buy approximately the same mix of the four functions or (2) the ratio of  
14 institutional costs to attributable costs is relatively constant across all four  
15 functions.<sup>12/</sup>

16 There is no analytic proof of, or citations to economic literature verifying the validity of this  
17 assertion and it is clearly invalid when applied to an enterprise with extensive economies of scale  
18 and scope such as exist in the USPS. Economies of scale and scope can be defined as:

19 *Economies of scale* occur when average costs decline as single product output  
20 increases, a factor most commonly due to the fixed and common costs "linked  
21 to an indivisibility (i.e., an unmeasured fixed input) which generates unavoidable  
22 excess capacity. *Economies of scope* are exhibited when the total costs of  
23 producing two or more products jointly is less than producing these products  
24 separately.<sup>13/</sup>

---

<sup>12/</sup> NAA-T-2 at 4 (Tr. 25/13265). [See also Tr. 25/13269 and Tr. 25/13377].

<sup>13/</sup> Bonbright, James C., et al., *Principles of Public Utility Rates*, Arlington, VA, Public Utility Reports, Inc. 1988  
p. 31.



1           When economies of scale and scope exist in a firm, the negative consequence of unnecessary  
2 deviation from attributable costs as the basis for ratemaking is exacerbated. The economies of  
3 scope and scale allow mail to share the burden of institutional costs and benefit from the fact that  
4 the costs of producing all products is much less than the sum of producing each individual  
5 product line. In conditions of such favorable economies, the problem of products using  
6 resources with different volume variabilities is more perceived than real.

7       **D. THE CHOWN METRIC IS VOLATILE**  
8       **WHEN COST CHANGES OCCUR**

9           Any metric to be used in ratemaking must be designed to exhibit stability when the  
10 components of the metric undergo change. By stability, I mean that the metric should recognize  
11 when cost changes occur in a subclass of mail but not produce wide fluctuations in subclasses  
12 where no cost changes have occurred. The use of marginal costs as the point of departure for  
13 assignment of institutional costs does reflect a stable metric because the rates by subclass  
14 produced by use of marginal costs do not have wide unexplained fluctuations.

15          Prior to using any metric, even as an "aid" to ratemaking, it must be tested for stability  
16 when change in the system occurs. When a change occurs in the data inputs to a metric (costs),  
17 and major unreasonable changes occur in the outputs (rates), the metric is unstable. As shown  
18 below, the Chown Metric is unstable when either attributable or institutional costs change.

19          My examination of the instability in the Chown Metric utilizes the same example as  
20 presented in Tables 7 through 9 of Witness Chown's testimony. In the "Base Case", I compare  
21 the rates produced by her example using marginal costs versus the Chown Metric. In order to  
22 test the Chown Metric, I have developed three alternative cases. First, in Case 1, I show the

1 impact on rates if system-wide institutional costs are increased. Second, in Case 2, I show the  
2 impact on rates if the attributable costs for one class of mail are reduced (and no other changes  
3 are made to Witness Chown's example). Finally, Case 3 below shows the impact on rates  
4 associated with the combination of Case 1 and Case 2. The details supporting my examples are  
5 shown in Exhibit \_\_MOAA, et al.-1B. As shown below, simple, specific changes in attributable  
6 or institutional costs cause dramatic disparities in rates following the Chown Metric. The  
7 analysis of the instability in the Chown Metric is discussed in the following cases:

- 8 1. Base Case: Witness Chown's Example
- 9 2. Case 1: Additions to System-Wide Institutional Costs
- 10 3. Case 2: Impact of Worksharing
- 11 4. Case 3: Impact of Additions to Institutional Costs and Worksharing

12 **1. Base Case: Witness Chown's Example**

13 I use the same three classes of mail (A, B, and C) and two cost functions (1 and 2) as  
14 shown in Tables 7 through Table 9 of Witness Chown's testimony (Tr. 25/13276-8) and have  
15 reproduced her example in Exhibit \_\_MOAA, et al.-1B, page 1 of 4. Her example applies the  
16 uniform mark-up as demonstrated on page 1 of Exhibit \_\_MOAA, et al.-1A.

17 Table 1 below shows the results obtained by the Marginal Cost Metric<sup>14/</sup> and by the Chown  
18 Metric when uniform mark-up is used on each metric. The attributable costs are shown in  
19 Column (2) of Table 1. The rates based on the Marginal Cost Metric and the Chown Metric  
20 are shown in Column (3) and Column (5) respectively. The coverage ratio for each class of

---

<sup>14/</sup> This is simply the use of the attributable cost as the basis for mark-up.

1 mail in the example is shown in Column (4) for the Marginal Cost Metric and Column (6) for  
 2 the Chown Metric.

3  
 4  
 5  
 6  
 7

Table 1  
 Comparison of Ratemaking Dynamics:  
The Marginal Cost Metric Versus the Chown Metric  
 Using Uniform Mark-Up

Base Case Example

Item (1)	Attributable Costs (2)	<u>Marginal Cost Metric</u>		<u>Chown Metric</u>	
		Rate (3)	Coverage (4)	Rate (5)	Coverage (6)
1. Class A	\$125	\$200	160%	\$200	160%
2. Class B	75	120	160	90	120
3. Class C	<u>50</u>	<u>80</u>	<u>160</u>	<u>110</u>	<u>220</u>
4. Total	\$250	\$400	160%	\$400	160%

14  
 15 Source: Columns (2), (3), and (5): Exhibit MOAA, et al.-1B.  
 16 Column (4) = Column (3) ÷ Column (2).  
 17 Column (6) = Column (5) ÷ Column (2).

18 In Witness Chown's example, the total attributable costs equal \$250 and the total revenues  
 19 to be recouped equal \$400 or an overall coverage ratio of 160%. For the Marginal Cost Metric,  
 20 with equal mark-ups, the attributable costs for all classes are marked-up 60%, e.g., Class C  
 21 attributable costs of \$50 are assigned institutional costs of \$30 for mark-up ( $\$50 \times .60$ ). The  
 22 addition of the attributable cost to the assigned institutional costs produces the rates (or

1 revenues), e.g. \$50 plus \$30 equals \$80. However, under the Chown Metric, the weighted  
2 attributable costs vary from the actual attributable costs, as shown in the following tabulation.

3 4	<u>Item</u> (1)	<u>Attributable Costs<sup>1/</sup></u> (2)	<u>Weighted Attributable Costs<sup>2/</sup></u> (3)
5	1. Class A	\$125	\$125
6	2. Class B	75	25
7	3. Class C	<u>50</u>	<u>100</u>
8	4. Total	\$250	\$250
9	<sup>1/</sup> Table 1, Column (2)		
10	<sup>2/</sup> Exhibit MOAA, et al.-RT-1B, page 1. These costs reflect the redistribution based on assigning institutional costs following the Chown Metric methodology.		
11			
12			
13			

14 Next, under the Chown Metric, the overall mark-up of 60% is applied to the weighted  
15 attributable costs, e.g., Class C weighted attributable costs of \$100 are multiplied by 60% to  
16 determine the mark-up of \$60. The mark-up determined from the weighted average costs is then  
17 added to the attributable costs (not the weighted attributable costs) to equal the rate. For  
18 example, the mark-up amount for Class C of \$60 shown above is added to the attributable costs  
19 of \$50 (Table 1, Line 3, Column (2)) to determine the rate of \$110 under the Chown Metric.  
20 (Table 1, Line 3, Column (5)). Witness Chown's example is consistent with her intent to give  
21 higher mark-ups to users of functions with low volume variability (Witness Chown's high  
22 identifiable institutional costs).

1       **2. Case 1: Additions to**  
 2       **System-Wide Institutional Costs**

3             To test the behavior of the Chown Metric, I have altered her example<sup>15/</sup>, assuming that \$100  
 4     is added to the system-wide institutional costs. (Note, there were no system-wide institutional  
 5     costs in Table 7 of Witness Chown's example). No other changes have been introduced into the  
 6     system. The details of the changes to Witness Chown's example reflecting the additional  
 7     institutional costs are shown on page 2 of Exhibit MOAA, et al.-1B. Table 2 below  
 8     summarizes the results of this one change.

9   Table 2  
 10    **Comparison of Ratemaking Dynamics:**  
 11    **The Marginal Cost Metric Versus The Chown Metric**  
 12    **Using Uniform Mark-Up**

13     **Case 1: Add \$100 to the**  
 14     **System-Wide Institutional Costs**

15                    Item	Attributable	Marginal Cost Metric		Chown Metric	
16                    (1)	Costs	Rate	Coverage	Rate	Coverage
	(2)	(3)	(4)	(5)	(6)
17     1. Class A	\$125	\$250	200%	\$250	200%
18     2. Class B	75	150	200	100	133
19     3. Class C	<u>50</u>	<u>100</u>	<u>200</u>	<u>150</u>	<u>300</u>
20     4. Total	\$250	\$500	200%	\$500	200%

21  
 22     Source: Columns (2), (3), (5): Exhibit MOAA, et al.-1B, page 2 of 4.  
 23                    Column (4) = Column (3) ÷ Column (2).  
 24                    Column (6) = Column (5) ÷ Column (2).

25             As shown in Table 2 above, the attributable costs of \$250 (Column (2)) have remained the  
 26     same as in Witness Chown's original example. However, because total costs have increased by

<sup>15/</sup> The changes introduced in these examples are large to test for extreme behavior. However, when smaller changes were tested, the inconsistencies maintained the same relationships.

1 \$100 from \$400 to \$500, the rates following the Marginal Cost Metric (Column (3)) and the  
 2 coverage ratios have increased (Column (4)). The change to the institutional costs increase the  
 3 coverage ratio, under the Marginal Cost Metric, from 160 percent (Table 1, Column (4)) to 200  
 4 percent (Table 2, Column (4)).

5 Under the Chown Metric, rates are also increased if institutional costs increase. However,  
 6 using the Chown Metric, the increase in institutional costs creates a disproportionate increase  
 7 in rates between the classes of mail as summarized in Table 3 below:

8  
9

Item (1)	Marginal Cost Metric			Chown Metric		
	Rates		Percent Change	Rates		Percent Change <sup>4/</sup>
	Base <sup>1/</sup> (2)	Case 1 <sup>2/</sup> (3)		Base <sup>1/</sup> (5)	Case 1 <sup>2/</sup> (6)	
1. Class A	\$200	\$250	25%	\$200	\$250	25%
2. Class B	120	150	25%	90	100	11%
3. Class C	80	100	25%	110	150	36%
4. Total	\$400	\$500	25%	\$400	\$500	25%

10  
11  
12  
13  
14  
15  
16  
17 <sup>1/</sup> Table 1 above.  
18 <sup>2/</sup> Table 2 above.  
19 <sup>3/</sup> Column (4) = Column (3) ÷ Column (2).  
20 <sup>4/</sup> Column (7) = Column (6) ÷ Column (5).

21 Under the Marginal Cost Metric, the percent change in rates is uniform across all classes  
 22 of mail (Table 3, Column (4)). However, following the Chown Metric, the increase in rates  
 23 varies between 11 percent and 36 percent (Table 3, Column (7)). In summary, this simple  
 24 change in input to Witness Chown's example indicates that the change in system-wide  
 25 institutional costs, which by definition are not "identifiable" with any function or subclass,  
 26 causes significantly different changes in the rates of the three classes under the Chown Metric.

1           **3. Case 2: Impact of Worksharing**

2           The next test of the Chown Metric for dynamic stability is shown in Table 4 below and  
 3 assesses the impact on the Chown Metric due to cost savings from worksharing. The details  
 4 supporting this example are shown in Exhibit \_\_MOAA, et al.-1B, page 3 of 4. This example  
 5 assumes that the costs in Class A are reduced by \$25 due to worksharing, i.e., the value of 100  
 6 in Table 4, Line 1, Column (2) is \$25 less than the Table 1, Line 1, Column (2) value of \$125.  
 7 The costs for Class B, Class C and all institutional costs remain the same as the base case  
 8 (Table 1 above).

9  
 10  
 11  
 12  
 13  
 14  
 15  
 16  
 17  
 18  
 19  
 20  
 21  
 22  
 23

Table 4 Comparison of Ratemaking Dynamics: <u>The Marginal Cost Metric Versus The Chown Metric</u> Using Uniform Mark-Up						
<u>Case 2: Worksharing Costs Reduce Class A by \$25</u>						
<u>Item</u> (1)	<u>Attributable</u> <u>Costs</u> (2)	<u>Marginal Cost Metric</u>		<u>Chown Metric</u>		
		<u>Rate</u> (3)	<u>Coverage</u> (4)	<u>Rate</u> (5)	<u>Coverage</u> (6)	
1. Class A	\$100	\$167	167%	\$155	155%	
2. Class B	75	125	167	90	120	
3. Class C	<u>50</u>	<u>83</u>	<u>167</u>	<u>130</u>	<u>260</u>	
4. Total	\$225	\$375	167%	\$375	200%	
Source: Columns (2), (3), (5): Exhibit __MOAA, et al.-1B, page 3 of 4. Column (4) = Column (3) ÷ Column (2). Column (6) = Column (5) ÷ Column (2).						

24           As shown in Table 4 above, the attributable costs are \$225, reduced \$25 from Witness  
 25 Chown's original example. The change to the attributable costs increases the coverage ratio,  
 26 under the Marginal Cost Metric, from 160 percent (Table 1, Column (4)) to 167 percent.

1 Under the Chown Metric, rates are changed if attributable costs decrease. The rates for  
 2 Class A are decreased but the rates for Class C increase. (Class B rates remain constant).  
 3 However, following the Chown Metric, the decrease in attributable costs again creates a  
 4 disproportionate change in rates for the classes of mail as summarized in Table 5 below:

5  
6

7 8 9 10 11 12	Item (1)	Marginal Cost Metric			Chown Metric		
		Rates		Percent Change	Rates		Percent Change <sup>4/</sup>
		Base <sup>1/</sup> (2)	Case 2 <sup>2/</sup> (3)		Base <sup>1/</sup> (5)	Case 2 <sup>2/</sup> (6)	
	1. Class A	\$200	\$167	-17%	\$200	\$155	-23%
	2. Class B	120	125	4	90	90	0
	3. Class C	<u>80</u>	<u>83</u>	<u>4</u>	<u>110</u>	<u>130</u>	<u>18</u>
	4. Total	\$400	\$375	-6%	\$400	\$375	-6%
13	<sup>1/</sup> Table 1 above.						
14	<sup>2/</sup> Table 4 above.						
15	<sup>3/</sup> Column (4) = Column (3) ÷ Column (2).						
16	<sup>4/</sup> Column (7) = Column (6) ÷ Column (5).						

18 Under the Marginal Cost Metric, the rate for Class A with the worksharing decreases 17%  
 19 (Table 5, Line 1, Column (4)) while the rates for Classes B and C exhibit a uniform increase  
 20 of 4%. (Table 5, Column (4), Lines 2 and 3). However, following the Chown Metric, the  
 21 change in rates varies from a negative 23% for Class A to a positive 18 percent for Class C  
 22 (Table 5, Column (7)). The Chown Metric produces very disturbing results with a larger  
 23 decrease in the rate and coverage for the worksharing Class A. While Class B's rate is  
 24 unchanged, the Class C mailers are assessed an 18% rate increase to cover the worksharing  
 25 introduced by Class A.





1 Under the Chown Metric, rates are also increased if costs are decreased due to worksharing  
 2 and institutional costs increase (Table 6, Column (5)). These changes increase the coverage  
 3 ratios for each class over her base case example.

4 However, following the Chown Metric, the changes create a disproportionate increase between  
 5 rates for the classes of mail as summarized in Table 7 below:

6  
7

**Table 7**  
**Summary of Impact on Rates When Attributable and Institutional Costs Change**

8 9 10 11 12 13 14	Item (1)	Marginal Cost Metric			Chown Metric		
		Rates		Percent Change	Rates		Percent Change <sup>4/</sup>
		Base <sup>1/</sup> (2)	Case 3 <sup>2/</sup> (3)		Base <sup>1/</sup> (5)	Case 3 <sup>2/</sup> (6)	
15	1. Class A	\$200	\$211	6%	\$200	\$192	-4%
16	2. Class B	120	158	32	90	100	11
17	3. Class C	<u>80</u>	<u>106</u>	<u>32</u>	<u>110</u>	<u>183</u>	<u>67</u>
18	4. Total	\$400	\$475	19%	\$400	\$475	19%

15 <sup>1/</sup> Table 1 above.  
 16 <sup>2/</sup> Table 6 above.  
 17 <sup>3/</sup> Column (4) = Column (3) ÷ Column (2).  
 18 <sup>4/</sup> Column (7) = Column (6) ÷ Column (5).

19 The Marginal Cost Metric increases the rates for Class A (the class responsible for the  
 20 worksharing savings) increase by 6% while the rates for Classes B and C increase by 32%.  
 21 Again, the Chown Metric produces volatile results. The rates for Class A decrease by 4%, the  
 22 rates for Class B increase by 11% and the rates for Class C receive a 67% increase (Table 7,  
 23 Column (7)).

1           As demonstrated by the results of simple system cost changes on rates, the dynamic  
2 behavior of the Chown Metric is unacceptable.<sup>16/</sup> The marginal cost metric, in addition to being  
3 theoretically superior, has the practical benefit of responding to changes in a reasonable,  
4 predictable manner.

---

<sup>16/</sup> The underlying problem in the Chown Metric involves non-linearity (ratio of ratios) which contain interaction effects causing a loss of independence between subclasses and volatile reaction to change. This can be proved using the partial derivatives of the metric; however, the above numerical example demonstrates these characteristics.

---

1 **IV. CRITIQUE OF WITNESS CLIFTON'S PROPOSALS**

2 In this proceeding, Witness Clifton's testimony proposes<sup>17/</sup> reductions in the rates for First-  
3 Class workshared mail from the rates proposed by Witness Fronk (USPS-T-32). Witness  
4 Clifton's testimony proposes four distinct adjustments to the USPS' models that calculate First-  
5 Class workshared discounts. Witness Clifton proposes a test year reduction in First-Class  
6 workshared letter mail processing costs<sup>18/</sup>, a test year reduction in First-Class workshared letter  
7 delivery costs and a test year increase in the benchmark used to determine cost savings for  
8 workshared discounts. The location of these adjustments, in the context of the USPS model, can  
9 be seen in the flow chart which is attached as Exhibit MOAA, et al.-RT-1C. The fourth  
10 adjustment made by Witness Clifton, a reduction in the cost coverage for First-Class workshared  
11 letter mail, is based upon subjective considerations of efficiency and equity. Each of these four  
12 adjustments increases the level of First-Class workshared discounts above the levels proposed  
13 by the USPS.

14 Witness Clifton's testimony (on behalf of ABA/NAA) argues for a decrease in the rates  
15 proposed by the USPS for First-Class workshared letters — second and third ounces. He bases  
16 his reduction on a misuse of incremental costs in his discussion of cross-subsidy. Witness  
17 Clifton opines that there is an "apparent" cross-subsidy of Standard (A) by First-Class  
18 workshared mail but fails to provide economic tests for cross-subsidy.

---

<sup>17/</sup> Witness Clifton combines all the proposals in his Technical Appendix D; (Tr. 24/12596-12622) therefore, I have combined my rebuttal to his testimony into one section.

<sup>18/</sup> This reduction manifests itself as a reduced roll forward factor in USPS Witness Hatfield's model.

1 The impact of these adjustments on First-Class workshared rates proposed by the USPS is  
2 shown in Table 8 below.

3 **Table 8**

4 **Comparison of First-Class Workshared Letter Rates -- (Cents Per Piece)**

5 <u>Mail Class</u>	6 <u>Proposal</u>		7 <u>Difference</u>
	8 <u>USPS</u>	9 <u>Clifton</u>	
10 (1)	11 (2)	12 (3)	13 (4)
14 1. Retail Presort	15 31.0c	16 30.0c	17 (1.0)c
2. Basic Automation	27.5	26.1	(1.4)
3. 3-Digit	26.5	24.4	(2.1)
4. 5-Digit	24.9	22.8	(2.1)
5. Carrier Route	24.6	22.5	(2.1)
6. Second and Third Ounce	23.0	12.0	(11.0)

Source:  
Column (2): Direct Testimony of David Frank, USPS-T-32, page 4 (revised 10/1/97)  
Column (3): Tr. 24/12506 and Tr. 24/10829.  
Column (4): Column (3) minus Column (2).

18 Witness Clifton's proposal (Table 8, lines 1-5) reduces the USPS' proposed First-Class  
19 workshared letter rates between 1.0 to 2.1 cents per piece. Witness Clifton's reduces the USPS'  
20 proposed First-Class workshared second and third ounce charges by 11.0 cents per piece  
21 (Table 8, line 6). In addition to the rate changes in workshared letters, Witness Clifton proposes  
22 a reduction for presort business cards between 1.0 cent to 1.6 cents from the USPS proposed  
23 rates.<sup>19/</sup>

24 Witness Clifton's testimony proposes to lower the First-Class cost coverage ratios, and fund  
25 the shortfall in First-Class revenues that will result from all his proposals, by increasing the cost

<sup>19/</sup> See response to USPS interrogatory at Tr. 24/12666 and Tr. 24/12599.

1 coverage ratio of Standard (A) Commercial Mail. These changes in coverage ratios are not  
 2 proper and unnecessary to gain rate relief desired by Witness Clifton if, indeed, workshared  
 3 costs are found to be overstated by the USPS. The effects of Witness Clifton's proposals at the  
 4 aggregate level can be demonstrated by a comparison of revenue and volume changes between  
 5 his proposal and the USPS' proposal as shown in Table 9 below:

6  
7

Item (1)	Proposal		Difference <sup>1/</sup> (4)
	USPS (2)	Clifton (3)	
1. First-Class Workshared Mail			
a. Revenues	\$11,466	\$11,166	(\$300)
b. Volume	41,033	43,883	2,850
2. Standard (A) Commercial Mail			
a. Revenues	\$12,326	\$12,901	\$575
b. Volumes	66,314	64,428	(1,886)

1/ Column (3) minus Column (2)  
 Source:  
 Revenues: Tr. 24/12604  
 Volumes: Tr. 24/12602

18  
19  
20  
21         Witness Clifton's proposals in R97-1 result in a reduction in revenue requirement of \$300  
 22 million and an increase in volume of 2,850 million pieces for First-Class workshared mail. In  
 23 addition, these proposals result in an increase in revenue requirement of \$575 million and a  
 24 decrease in volume of 1,886 million pieces for Standard (A) commercial mail.

25         It should be noted that although Witness Clifton reduces First-Class coverage by 2.14  
 26 percentage points,<sup>20/</sup> all of the more than three hundred million dollars in benefits from this

<sup>20/</sup> Tr. 24/12598

1 reduction is received by First-Class business mailers and none by single piece First-Class  
 2 mailers. Witness Clifton's proposals reduce First-Class revenues by a total of 1.1 billion  
 3 dollars.<sup>21/</sup>

4 Witness Clifton's testimony in this proceeding is both confusing and misleading. When the  
 5 procedures and assumptions upon which his testimony is based are isolated and critiqued,  
 6 Witness Clifton's proposal is shown to be flawed. My critique of Witness Clifton is presented  
 7 below under the following headings:

- 8 A. Changes in Mix of Mail Categories are the Primary Reason for Declining USPS' Unit  
 9 Costs from 1994 to 1996;
- 10 B. Witness Clifton's Roll Forward Adjustment is Based on Incorrect Cost Projections;
- 11 C. The Bulk Metered Mail Benchmark is Preferable for the Calculation of Workshared  
 12 Discounts;
- 13 D. Standard (A) Costs and Rates Are Not Germane to the Estimation of First-Class  
 14 Workshared Costs and Discounts;
- 15 E. Witness Clifton's Changes in Cost Coverages Fail to Consider Higher Level of Service  
 16 and Are Not Necessary; and
- 17 F. Witness Clifton's Second and Third Ounce Rate Proposal is Based on False Claims of  
 18 Cross-Subsidy.

19 **A. CHANGES IN MIX OF MAIL CATEGORIES**  
 20 **ARE THE PRIMARY REASON FOR**  
 21 **DECLINING USPS' UNIT COSTS FROM 1994 TO 1996**

22 At the outset of his direct testimony<sup>22/</sup>, Witness Clifton highlights a comparison of the recent  
 23 performance of total unit cost data for First-Class mail presort letters and parcels taken from the

---

<sup>21/</sup> Tr. 24/12604

<sup>22/</sup> Tr. 24/12468.

1 USPS' audited Cost and Revenue Analysis ("CRA"). In Table 1 of his ABA/EEI/NAPM  
2 testimony he shows that the average unit attributable costs for presort letters and parcels  
3 (workshared mail) decreased from 11.9 cents per piece in 1994 to 10.6 cents per piece in 1996.  
4 This, he claims, represents a 10.9% decrease in the average unit costs of all workshared First-  
5 Class mail over a two year period. Later in his testimony, at Table 7, Witness Clifton highlights  
6 the recent performance of mail processing labor unit attributable costs for First-Class presort  
7 letters and parcels. In this comparison Witness Clifton claims that mail processing labor unit  
8 attributable costs decreased from 2.9 cents per piece in 1994 to 2.5 cents per piece in 1996.  
9 This represents a 13.8% decrease in these average unit costs over a two year period.

10 Witness Clifton justifies many of his subsequent adjustments to the USPS costing models  
11 on the basis that average unit costs as measured by the CRA have decreased between 10.9% and  
12 13.8%. Witness Clifton assumes, in making many of his adjustments, that the dynamics  
13 causing the decrease in these unit costs will continue into the future and will result in reduced  
14 unit costs in the test year in this proceeding (1998).

15 The decrease in unit costs shown in the CRA data reflects changes due to multiple causes.  
16 For example, the explanation of the decrease in CRA unit cost over the 1994 through 1996 time  
17 period must consider the significant shift of mail volume within First-Class presort letters and  
18 parcels from nonautomation mail to automation mail. As noted by Witness Clifton there has  
19 been a shift in workshared First-Class volume mix from higher cost nonautomation mail to lower  
20 cost automation mail.<sup>23/</sup> This is shown in Table 10 below:

---

<sup>23/</sup> Tr. 24/12654.



1  
2  
3  
4  
5  
6  
7  
8  
9  
10

Period (1)	Distribution By Year		
	Nonautomation (2)	Automation (3)	Total (4)
1. 1994	41.4%	58.6%	100%
2. 1996	<u>28.7%</u>	<u>71.3%</u>	<u>100%</u>
3. Change <sup>1/</sup>	(12.7%)	12.7%	xxx

Source: Tr. 24/12482.  
<sup>1/</sup> Line 2 minus Line 1.

11 The volume of nonautomation First-Class workshared mail declined 12.7 percentage points  
12 from 41.4% in 1994 to 28.7% in 1996. From 1994 to 1996, the volume of automation First-  
13 Class workshared mail increased 12.7 percentage points from 58.6% to 71.3%. A shift in  
14 volume within workshared mail of this magnitude from a higher cost rate category of mail to  
15 a lower cost rate category of mail would cause a reduction in overall unit costs in the CRA.<sup>24/</sup>

16 Table 11 below is a hypothetical example that demonstrates the impact of volume mix on  
17 overall unit costs.

<sup>24/</sup> USPS-29C page 1 shows the mail processing and delivery costs of First-Class automation to be lower than nonautomation.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18

Line Description (1)	Rate Category		Weighted Average Costs (4)
	Nonautomation (2)	Automation (3)	
1. 1994			
a. 1994 Costs (Cents/Piece)	\$0.120	\$0.060	xxx
b. Share (Percent)	<u>75%</u>	<u>25%</u>	<u>xxx</u>
c. Weighted Costs	\$0.090	\$0.015	\$0.105
2. 1996			
a. 1996 Costs (Cents/Piece) <sup>1/</sup>	\$0.132	\$0.066	xxx
b. Share (Percent)	<u>40%</u>	<u>60%</u>	<u>xxx</u>
c. Weighted Costs	\$0.053	\$0.040	\$0.093
3. Percent Change (L2c ÷ L1c)	xxx	xxx	(-)11.4%

19 In the above Table 11 example the weighted average unit cost decreases 11.4% (line 3) over  
20 the period from 1994 to 1996 even though unit costs for each rate category (line 2a) increase  
21 10.0% over the same time period. In other words, in the context of Table 3 above,  
22 Witness Clifton argues that because the average costs have decreased by 11.4%, there is no  
23 justification for raising the rates (or reducing the discounts) of either rate category.

24 Although the volume mix phenomenon is a significant component of the historical reduction  
25 in CRA calculated average unit costs for subclasses with workshared mail, it is not logical to  
26 simply assume that the volume mix changes will continue into the future. In his response to  
27 USPS' interrogatories, Witness Clifton concedes that while mail processing labor unit  
28 attributable costs fell by 12.0% over the 1994-1996 time period, the unit costs fell only 1.1%

1 for the FY95-FY96 time period.<sup>25/</sup> Because only a given amount of mail can qualify for  
2 migration to the less expensive automated categories, future shifts in volume to the lower cost  
3 automation categories may well occur in much smaller increments, if at all.

4       Witness Clifton's use of only two years of change in historical data (1994 to 1996) to project  
5 unit costs into the future is also suspect. He claims that 1992 through 1996 "is not a sufficient  
6 volume history" to make use of data on bulk metered mail for a test of the benchmark,<sup>26/</sup> yet he  
7 uses 1994 through 1996 data to project unit costs. He neither models the dynamics of the  
8 migration between rate categories nor the costs of these individual rate categories in his forecast.  
9 My review of the historical unit cost changes for First-Class presort letters and parcels as set  
10 forth in Table 12 below shows that the 1994 to 1996 time period chosen by Witness Clifton  
11 represents the largest percentage decrease in unit attributable costs over a two year period in this  
12 mail category since 1988.

---

<sup>25/</sup> Tr. 24/12654

<sup>26/</sup> Tr. 24/12488.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16

Table 12  
Change in Costs for  
First-Class Presort Letters and Parcels

<u>Year</u>	<u>Cost</u> <u>(cents/piece)</u>	<u>Percent Change per Period</u>	
		<u>One Year</u>	<u>Two Year</u>
(1)	(2)	(3)	(4)
1988	9.8	xxx	xxx
1989	10.2	4.1%	xxx
1990	10.5	2.9%	7.1%
1991	11.2	6.7%	9.8%
1992	11.6	3.6%	10.5%
1993	11.5	-0.9%	2.7%
1994	11.9	3.5%	2.6%
1995	11.0	-7.6%	-4.3%
1996	10.6	-3.6%	-10.9%

Source: USPS Cost and Revenue Analysis, Fiscal Years 1988-96

17           Given that this two year period represents the largest percentage decrease in unit attributable  
18 costs since 1988 and the recent dynamic migrations shown by Witness Clifton in his Table 8,  
19 it is improper to assume that this rate of decline will continue into the test year.

20   **B. WITNESS CLIFTON'S ROLL FORWARD**  
21   **ADJUSTMENT IS BASED ON**  
22   **INCORRECT COST PROJECTIONS**

23           The methodology relied upon in this docket by USPS' Witness Hatfield to calculate test year  
24 mail processing costs was previously accepted by the PRC in docket MC95-1 and represents test  
25 year mail processing costs for First-Class workshared letters. Witness Clifton's multiple  
26 criticisms of USPS' Witness Hatfield's model of test year mail processing costs for First-Class  
27 workshared letters result in numerous "qualitative" factors that he relied upon to support his  
28 proposed adjustments to the Hatfield model. The primary target of the various criticisms of the  
29 USPS model is the roll forward factor. In my opinion, Witness Clifton has focused on the

1 USPS' roll forward factor because it is the major driver in the calculations of test year mail  
2 processing costs and ultimately of First-Class workshared letter discounts. The importance of  
3 the roll forward factor to the Hatfield model is shown in Exhibit \_\_MOAA, et al.-RT-1C which  
4 contains a flow chart of the USPS' model.

5 Witness Clifton's recalculation of the USPS' roll forward factor is, in the final analysis,  
6 arbitrary and based upon faulty logic. Contrary to Witness Clifton's suggestions at  
7 Tr. 24/12480, the Hatfield model already incorporates the impact of volume mix changes into  
8 the roll forward factor. As one justification for his recalculated roll forward factor, Witness  
9 Clifton suggests that historical aggregate unit cost changes are largely driven by volume mix  
10 changes from nonautomation to automation mail. Without concrete data on continued migration,  
11 Witness Clifton cannot project historic decreases in mail processing costs into the test year costs  
12 and he cannot justify any changes to the roll forward factor developed by the USPS.

13 Witness Clifton's restatement of the USPS' model contains a roll forward factor of .9737  
14 versus the USPS' value of 1.1280. Clifton calls this a "modest" decline in the roll forward  
15 factor.<sup>27/</sup> However, Witness Clifton's proposed roll forward factor is 13.7% less than the roll  
16 forward factor proposed by the USPS  $[(0.9737-1.1280) \div 1.1280]$ .

17 Witness Clifton's calculation of the roll forward factor is based upon qualitative, judgmental  
18 considerations made by Witness Clifton.<sup>28/</sup> In addition, Witness Clifton's roll forward factor  
19 relies on the continuation of historic decreases in CRA unit cost changes and volume mix

---

<sup>27/</sup> Tr. 24/12483

<sup>28/</sup> Tr. 24/12638-12648 and 12653-12655

1 changes experienced in the 1994 to 1996 time period. As I have explained earlier, these changes  
2 are due largely to mix dynamics that are not likely to continue into the test year.

3 **C. THE BULK METERED MAIL**  
4 **BENCHMARK IS PREFERABLE FOR**  
5 **THE CALCULATION OF WORKSHARED DISCOUNTS**

6 Witness Clifton's adjustments to the cost models of USPS' Witness Hume and USPS'  
7 Witness Hatfield result in adjusted First-Class workshared unit mail processing and delivery  
8 costs in the test year that are much lower than the costs developed by the USPS.<sup>29/</sup> In order to  
9 determine the appropriate levels of workshared discounts, Witness Clifton's test year costs are  
10 compared to his calculation of a test year benchmark cost. He also suggests that the benchmark  
11 itself be increased to maximize the differential between rate category costs and the benchmark,  
12 thereby increasing the workshared discounts that are proposed in his testimony.

13 The PRC supported the use of the bulk metered mail benchmark in its MC95-1 decision:

14 The cost differential shown on this record between First-Class single-piece and  
15 the First-Class automation categories is likely to be significantly larger than the  
16 actual costs avoided, because the benchmark includes the costs of both stamped  
17 mail and bulk metered mail. For reasons discussed in the Commission's  
18 Opinion in Docket No. R90-1, the single-piece mail most likely to convert to the  
19 automation categories is limited to the bulk metered mail component. That  
20 component has significantly more homogeneous, and lower, cost characteristics  
21 than single-piece mail overall. (MC95-1, Decision, para. [4302], p. IV-136)

22 The cost of the bulk metered benchmark was not provided in MC95-1. For this reason, the  
23 PRC relied upon a modified procedure that used the First-Class single piece benchmark.  
24 However, the USPS has since developed the cost of the bulk metered component of single-piece

---

<sup>29/</sup> Tr. 24/12496.

1 mail. This benchmark is used by USPS' Witness Fronk to determine cost based discounts for  
2 workshared letters in this proceeding.

3 With the exception of the discount for retail presort mail which is maintained at its current  
4 level, Witness Clifton's workshared discounts are based on the use of the single piece  
5 benchmark. The workshared discount for basic automation mail is calculated as 78%<sup>30/</sup> of the  
6 cost differential between the single piece benchmark and the basic automation mail rate category.  
7 The remaining workshared discounts are based upon the cost savings calculated by Witness  
8 Clifton between specific rate categories<sup>31/</sup>. Witness Clifton's proposed basic automation  
9 discount, based on the MC95-1 methodology, is over 2 cents greater than the basic automation  
10 discount justified by the USPS' model.

11 Use of the single piece benchmark and the MC95-1 methodology is a step backward in rate  
12 design and should be rejected by the PRC. The bulk metered benchmark as developed by the  
13 USPS in this proceeding is the best evidence on record and should be used to determine  
14 workshared discounts.

15 **D. STANDARD (A) COSTS AND RATES ARE NOT**  
16 **GERMANE TO THE ESTIMATION OF**  
17 **FIRST-CLASS WORKSHARED COSTS AND DISCOUNTS**

18 In an effort to link the costs and rates of specific subclasses of Standard (A) mail with  
19 various rate categories of First-Class workshared mail, Witness Clifton is proposing that the  
20 ratemaking process be governed by relative similarities, historical dynamics and other subjective  
21 characterizations. Witness Clifton's analysis relies upon the apparent similarities in various unit

---

<sup>30/</sup> Tr. 24/12497-12498.

<sup>31/</sup> Tr. 24/12497.

1 cost characteristics between these mailstreams to reach the conclusion that the mailstreams are  
2 similar. This is not true.

3 First-Class mail letters have a higher value of service than Standard (A) letters. This higher  
4 value of service can be demonstrated by the specific characteristics noted below that apply to  
5 First-Class mail and not Standard A mail:<sup>32/</sup>

- 6 a. First-Class long distance mailings are transported by air;
- 7 b. First-Class mail is accorded expeditious handling and high delivery priority;
- 8 c. First-Class mail is sealed against inspection;
- 9 d. First-Class mail benefits from free forwarding and return to sender; and,
- 10 e. First-Class mail benefits from dead letter operations which direct undeliverable mail into  
11 proper hands.

12 Each of these specific characteristics point to the unique and distinct nature of First-Class  
13 mail as well as the inherent value of the service provided by USPS. Postal rates for specific  
14 mail classes are based upon cost and value of service for that specific mail class and discounts  
15 should be based upon the specific costs avoided by workshared activities related to that specific  
16 mail class. Comparisons of specific costs and discounts across mail classes are not relevant or  
17 useful in the ratemaking process unless the differences in value of service are properly  
18 considered.

19 In making faulty comparisons between First-Class worksharing discounts for specific rate  
20 categories with Standard (A) regular rates, Witness Clifton concludes that there "is a gross

---

<sup>32/</sup> Witness Foster USPS-T-11, in R94-1, at 33.



1 inequity between First-Class workshared and Standard (A) in the proposed 'give backs' that is  
2 not cost justified by the Commission in its proposed rates.<sup>33/</sup> USPS' Witness Fronk explains  
3 in his testimony that the "somewhat smaller discounts reflect the use in this docket of a  
4 benchmark that better isolates the cost savings from automation." (USPS-T-32, page 27) USPS  
5 Witness Fronk goes on to explain that "to avoid rate shock and to maintain incentives to  
6 automate" he did not shrink the discounts for First-Class automated mail by the full difference  
7 justified on a cost basis alone (USPS-T-32, page 27).

8 **E. WITNESS CLIFTON'S PROPOSAL FOR**  
9 **CHANGES IN COST COVERAGES FAIL**  
10 **TO CONSIDER HIGHER LEVEL OF SERVICE**  
11 **AND ARE NOT NECESSARY**

12 Witness Clifton's also attacks the USPS' proposal as related to the level of cost coverage  
13 for First-Class workshared mail. Witness Clifton characterizes the USPS' cost coverage of  
14 283% for First-Class workshared mail as "inexplicably high" and resulting in "economically  
15 inefficient and inequitably high rates."<sup>34/</sup> By definition, cost coverage for a given subclass of  
16 mail is the ratio of revenue to volume variable cost for that subclass of mail. Increases in cost  
17 coverages, therefore, can be explained by either an increase in revenues, a decrease in costs, or  
18 a combination of both. Based upon the unit cost changes caused by the historical volume mix  
19 shift in First-Class mail to lower cost worksharing rate categories that I discussed earlier in my  
20 testimony, given the methodologies adopted by the PRC lead to increasing cost coverages. In  
21 the past, the PRC has determined that reductions in costs due to worksharing should not

---

<sup>33/</sup> Tr. 24/12496

<sup>34/</sup> Tr. 24/12499

1 necessarily result in reductions to the contribution to institutional costs. In MC95-1 the PRC  
2 illustrated its approach to worksharing in the following example:

3 If two pieces of mail with attributable costs of 10 cents each are charged a rate  
4 of 15 cents, both pieces make a unit contribution to institutional costs of 5 cents  
5 and have an implicit cost coverage of 150 percent. If one of those pieces is  
6 barcoded, thereby allowing the Service to avoid 5 cents of attributable costs, and  
7 that piece is given a 5-cent worksharing discount, its new implicit cost coverage  
8 is 200.<sup>17/</sup> In this example, because 100 percent of the cost savings is passed on  
9 to the mailer, both pieces will continue to contribute 5 cents toward institutional  
10 costs. Presumably the worksharing piece is better off, because its total costs  
11 decline (otherwise the mailer would not go to the trouble of worksharing) and  
12 neither the Postal Service nor other mailers are worse off.

13 In this example, the implicit cost coverage of the workshare piece is higher than  
14 the implicit cost coverage of the piece which does not workshare. In fact, as a  
15 matter of arithmetic, in every situation in which some mail allows the Postal  
16 Service to avoid costs, the implicit cost coverage for that mail will be higher  
17 than the implicit coverage for otherwise similar mail. The Commission believes  
18 that this is just. (MC95-1, paragraph 3070-3071, 111-27 and 111-28)

19  
20 
$$\begin{array}{rcl} \text{<sup>17/</sup> Cost} & (10-5) & = & 5 \\ \text{Revenue} & (15-5) & = & 10 \\ \text{Cost Coverage} & = & \frac{\text{Revenue}}{\text{Cost}} = \frac{10}{5} = & 200 \text{ percent} \end{array}$$

21 The fact that the cost coverage for First-Class workshared mail is higher than the cost  
22 coverage for other First-Class mail is an indication of the effect of decreases in costs caused by  
23 the volume mix phenomenon. This increase in cost coverage for First-Class workshared mail  
24 is not an issue of equity and efficiency as suggested by Witness Clifton, rather it is a matter of  
25 arithmetic.

26 The USPS in this docket has proposed cost coverages across all mail subclasses.  
27 Throughout the ratemaking process the USPS has considered many economic and subjective

1 factors and their impact on various mail classes. The USPS has not focused exclusively on  
2 First-Class workshared rates as Witness Clifton has in his proposal.

3 The cost coverages proposed by Witness Clifton to remedy his perceived economic  
4 efficiency and social welfare losses were set arbitrarily. Witness Clifton has not provided  
5 credible quantitative support for his 270% cost coverage figure for First-Class workshared mail.

6 In order to fund the revenue losses incurred by Witness Clifton's proposed rates for First-  
7 Class workshared mail, Witness Clifton unnecessarily increases the cost coverage for  
8 Standard (A) mail. This increase in cost coverage for Standard (A) mail completely ignores  
9 competitive implications and the differences in value of service discussed above. Furthermore,  
10 if the PRC finds the USPS' estimates of First-Class workshared costs are overstated as Witness  
11 Clifton alleges, then First-Class revenue requirements can be reduced accordingly. The  
12 equitable cure for workshared mailers is to reduce their rates (increase discounts) to reflect the  
13 new cost estimates while, simultaneously meeting the reduced First-Class revenue requirements.  
14 There is no need or justification to reach into other subclasses for additional funds to meet  
15 revenue requirements by changing coverages in other subclasses.

16 **F. WITNESS CLIFTON'S SECOND AND**  
17 **THIRD OUNCE RATE PROPOSAL IS**  
18 **BASED ON FALSE CLAIMS OF CROSS-SUBSIDY**

19 In his direct testimony and in responses to interrogatories and cross-examination, Witness  
20 Clifton claims that there exists a cross-subsidy of Standard (A) Commercial mail by First-Class  
21 workshared second and third ounce letter mail. The arguments supporting his proposed decrease  
22 in rates for the second and third ounce and the funding for the resulting First-Class revenue  
23 shortfall are predicated upon this false claim of cross-subsidy. However, Witness Clifton makes

1 no attempt to analytically prove the existence of cross-subsidy. Furthermore, Witness Clifton  
2 obfuscates the concept of the incremental cost test for cross-subsidy by applying the test to part  
3 of a product and not the entire product. Below, I use Witness Clifton's definition of cross-  
4 subsidy and show that subclasses of Standard (A) mail were free of subsidy in 1996 and are  
5 estimated to be free of subsidy in 1998. I also demonstrate the error in his use of incremental  
6 costs and revenues.

7 a. **Past and Proposed Revenues**  
8 **Are Free of Cross-Subsidy**

9 In response to ADVO/ABA/NAA-T1-4<sup>35/</sup> Witness Clifton produced a recognized definition  
10 of cross-subsidy. Using his definition, a product is receiving a cross-subsidy "when the average  
11 incremental revenue contributed by the product of a firm is insufficient to cover its average-  
12 incremental cost..."<sup>36/</sup> USPS' Witness Takis (USPS-T-41) follows the theoretical foundation laid  
13 by Professor Panzar (USPS-T-11) and calculates the requisite incremental costs for this test for  
14 the Base Year 1996 and the Test Year 1998. USPS' Witness Alexandrovich and USPS' Witness  
15 Patelunas provide the corresponding incremental revenues for 1996 and 1998, respectively.  
16 These data are shown for Standard (A) subclasses as Column (3) and Column (6), respectively  
17 in Table 13 below. I use the ratio of revenue to cost to test cross-subsidy. If this ratio minus  
18 one (expressed as a percent) is positive, it indicates the amount of error that can be tolerated in  
19 the ratio and still be assured that no cross-subsidy exists. If the ratio is greater or equal to one,  
20 then incremental revenues are greater than incremental costs and there is no cross-subsidy.

---

<sup>35/</sup> Tr. 21/10920

<sup>36/</sup> Witness Clifton's quote is sourced to Baumol, William J. and J. Gregory Sidak, *Toward Competition in Local Telephony*, Cambridge, MA: The MIT Press, 1994 page 62. The remainder of the quote simply guarantees that firm is covering all costs with earned revenue.

1  
2  
3

Table 13  
Costs and Revenues of Standard (A) Subclasses  
(Cents Per Piece)

<u>Subclass</u> (1)	1996			1998		
	<u>Volume</u> <u>Variable</u> <u>Cost</u>	<u>Incremental</u> <u>Cost</u>	<u>Revenue</u>	<u>Volume</u> <u>Variable</u> <u>Cost</u>	<u>Incremental</u> <u>Cost</u>	<u>Revenue</u>
	(2)	(3)	(4)	(5)	(6)	(7)
<b>Standard (A)</b>						
Regular ECR	\$6.2	\$6.5	\$14.7	\$6.6	\$6.9	\$14.9
Regular Other	13.8	14.1	21.0	13.8	14.1	21.2
Sources: Columns 2,4: USPS-5C, pages 18-19.						
Columns 5,7: USPS-15J, pages 18-19.						
Column 3: Column (2) x [Respective entry from Column (3) of USPS-41 B (Revised 10/09/97)].						
Column 6: Respective entry from Column (8) of USPS-41B [Revised 10/09/97 (Rounded)].						

4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14

15           Based on the data shown in Table 13, Table 14 below shows the values of the test for each  
16 subclass of Standard (A) mail for 1996 (Column (2)) and 1998 (Column (3)).

17  
18  
19

Table 14  
Incremental Cost Test for Cross Subsidy  
[No Cross-Subsidy if Test is Greater Than or Equal to One]

<u>Subclass</u> (1)	1996 Test ( <u>actual</u> ) (2)	1998 Test ( <u>estimated</u> ) (3)
Regular ECR	2.26	2.16
Regular Other	1.49	1.50
Sources: Column (2) = Table 13, Column (4) ÷ Column (3). Column (3) = Table 13, Column (7) ÷ Column (6).		

20  
21  
22  
23  
24  
25  
26

1           The Standard (A) subclasses in Table 13 pass the test for being free from subsidy with a  
2 tolerance for at least 49% error. For Regular ECR mail there could be error in the revenue and  
3 cost estimates cumulating to 100% in the estimate of the ratio and still there would be no cross  
4 subsidy. Therefore, no factual foundation exists for Witness Clifton's charge of "apparent"  
5 cross-subsidy of Standard (A) mail subclasses.

6                   **b. Error in Witness Clifton's Use**  
7                   **of Incremental Costs and Revenues**

8           Witness Clifton's analysis of workshared First-Class rates for second and third ounces  
9 claims to rely on incremental costs.<sup>37/</sup> He treats the cost or revenue of one additional ounce in  
10 a one ounce letter as "incremental" cost or revenue. In a generic sense this appears to be  
11 acceptable, but technically, with respect to the test for cross-subsidy, this terminology is very  
12 misleading. According to the definition of cross-subsidy the "incremental" cost and  
13 "incremental" revenue must be associated with a product. The second ounce for a First-Class  
14 piece of mail is not a product, it is a part of the total product. Stated differently, a USPS  
15 customer cannot send a second ounce without including the total first ounce. The example in  
16 Table 15 illustrates the difference.

---

<sup>37/</sup> No clear distinction is made by Witness Clifton between incremental cost and marginal cost. For the incremental cost test, the average incremental cost is the total costs that would be avoided if the product were not produced at all divided by the current or projected production volume.

1  
2

Table 15  
**Incremental Cost for Subsidy Test Versus Clifton Incremental**

3  
4  
5

Average Incremental (1)	Product		Clifton Incremental (4)
	1 Ounce Letter (2)	2 Ounce Letter (3)	
<b>Standard (A): Uniform Price Below The Breakpoint</b>			
1. Cost	2.0c	3.0c	1.0c
2. Revenue	<u>6.0</u>	<u>6.0</u>	<u>0.0</u>
3. Test for Subsidy (L2 ÷ L1)	3.0	2.0	0.0
<b>First-Class</b>			
4. Cost	2.0c	3.0c	1.0c
5. Revenue	<u>4.0</u>	<u>6.0</u>	<u>2.0</u>
6. Test for Subsidy (L5 ÷ L4)	2.0	2.0	1.0

6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17

Source: Product cost and produced revenue data are a hypothetical example.  
Column (4) = Column (3) - Column (2) (except for Lines 3 and 6).

18           The uniform price below the breakpoint that is used in Standard (A) mail will always fail  
19 the test implicitly used by Witness Clifton. When properly applied to a product, the one ounce  
20 and the two ounce letters both pass the test for no subsidy with scores of 2 and 3, respectively.  
21 However, using the Clifton incremental approach that is not associated with any product, the  
22 "second ounce" shows cross-subsidy. This is incorrect. The incremental costs and revenues  
23 must be associated with a product to make the concept of a cross subsidy operational.

1  
2

**V. CRITIQUE OF MMA'S WITNESS BENTLEY'S  
PROPOSED FIRST-CLASS WORKSHARED DISCOUNTS**

3  
4  
5  
6  
7

Witness Bentley, like Witness Clifton, has proposed increases in discounts for First-Class automation letters above those set forth by the USPS in this proceeding.<sup>38/</sup> As a preamble to his analysis supporting discounts he has proposed in this proceeding, he quotes extensively from prior PRC opinions regarding the necessity that discount levels reflect savings that are "solidly grounded in costs."<sup>39/</sup>

8  
9  
10  
11  
12

Rather than relying upon the methodology for developing test year mail processing unit costs as set forth by the USPS in this proceeding, Witness Bentley relies upon the methodology for developing test year mail processing unit costs as adopted by the PRC in MC95-1. The MC95-1 methodology produces discounts that are greater than those proposed by the USPS in this proceeding.

13  
14  
15  
16

As I noted in my rebuttal testimony concerning Witness Clifton's proposals, the methodology used by Witness Hatfield in this proceeding is an improvement on the methodology accepted by the PRC in MC95-1 and, as such, is the best cost evidence on record and should be used to determine workshared discounts in this proceeding. (See Section IV.C, above)

17  
18  
19

Witness Bentley argues that there are many reasons to justify increased discounts.<sup>40/</sup> The reasons listed by Witness Bentley are similar to the subjective arguments set forth by Witness Clifton in his direct testimony. Although Witness Bentley does not quantify these subjective

---

<sup>38/</sup> Although Witness Bentley's preference is to maintain the 32 cent stamp, his proposal is for reductions in "rates for Automation and 2-ounce letters".

<sup>39/</sup> Tr. 21/11167

<sup>40/</sup> Tr. 21/11169-73



1 arguments as Witness Clifton has, Witness Bentley's proposed discounts should be rejected by  
2 the PRC for the same general reasons noted in my rebuttal to Witness Clifton in the previous  
3 section of my testimony.

---

1                    **VI. CRITIQUE TO AAPS' WITNESS BRADSTREET'S RHETORIC**

2                    Witness Bradstreet, on behalf of AAPS, asserts that the USPS is a monopoly which has once  
3 again submitted "an anticompetitive, unjustifiable rate proposal".<sup>41/</sup> He argues that the USPS  
4 takes advantage of its unique monopoly position by exploiting its "monopoly customers for  
5 competitive purposes",<sup>42/</sup> favoring what he considers the competitive mail over the "captive"  
6 mail.

7                    Witness Bradstreet claims AAPS volumes are the "competitive" mail that has been targeted,  
8 suffering significant competitive harm from the USPS. Yet he makes no attempt to quantify,  
9 evaluate or analyze his claims or offer any information regarding the effects the USPS' past or  
10 proposed rates have had on his industry. In response to interrogatories, Witness Bradstreet says  
11 he does not have volume, revenue or profit data of AAPS members and cannot provide  
12 information on the rates AAPS members charge.<sup>43/</sup> AAPS also cannot identify the volumes or  
13 weight of the different types of mail they deliver.<sup>44/</sup> Therefore, Witness Bradstreet is reduced  
14 to "nontechnical" testimony. For his rhetorical argument, Witness Bradstreet relies on his  
15 perception of the USPS as a monopoly, his interpretation of the criteria in the Postal  
16 Reorganization Act's (the "Act"), and what he considers incorrect and inadequate costing  
17 procedures by the USPS to suggest that rates for ECR mail should be increased. In Witness  
18 Bradstreet's view, such an increase would enable the AAPS to better compete with the USPS.

---

<sup>41/</sup> AAPS-T-1, page 5.

<sup>42/</sup> AAPS-T-1, page 47.

<sup>43/</sup> Interrogatory response MOAA/AAPS-T1-10 (Tr. 23/12038).

<sup>44/</sup> Interrogatory responses MOAA/AAPS-T1-2, 5 and 10 (Tr. 23/12030, 12033, 12038).

1 is incorrect. Second, the USPS is highly regulated. The testimony submitted in this proceeding  
2 (including Witness Bradstreet's testimony) is part of a lengthy process that serves to enforce the  
3 intent of the Postal Reorganization Act.

4 **B. IMPACT OF PRICING ON ALTERNATIVE MAIL**

5 Witness Bradstreet suggests that the USPS' customers are not the only ones that should be  
6 protected from rate increases. He states postal ratemaking should consider the Act's criteria:  
7 "the effect of rate increases upon the general public, business mail users, and enterprises in the  
8 private sector of the economy engaged in the delivery of mail matter other than letters".<sup>50/</sup> He  
9 feels rate changes for competitive classes of mail that are so low (or negative) as to hurt  
10 competitors are to be avoided. Yet, in his responses to interrogatories he says it is not his  
11 testimony that competitors' lost business due to USPS rate changes that violate the Act. He also  
12 believes the USPS is not required to raise rates when competitors do, and is not responsible for  
13 ensuring competitors can charge more although "that would be nice."<sup>51/</sup> Witness Bradstreet  
14 provides no information on how the proposed rate schedule will be injurious to competitors,  
15 particularly the alternative delivery systems.

---

<sup>50/</sup> AAPS-T-1, page 21.

<sup>51/</sup> R97-1, Interrogatory Response VP-CW/AAPS-T1-2 (Tr. 23/12060).

1           Witness Bradstreet further questions the USPS' consideration of Criteria 3 and 5 of the Act  
2 in its development of postal rates. The Act states:

3                   (3) the requirement that each class of mail or type of mail service bear the direct  
4 and indirect postal costs attributable to that class or type plus that portion of all  
5 other costs of the Postal Service reasonably assignable to such class or type.

6                   (5) the available alternative means of sending and receiving letters and other  
7 mail matter at reasonable costs.

8           USPS Witness O'Hara's testimony states that the cost coverages for Standard (A)  
9 Commercial Regular and ECR are 155% and 228% respectively, obviously covering their own  
10 costs and contributing to institutional costs.<sup>52/</sup> (See Section IV. G. (above) on cross subsidy.)  
11 Yet, Witness Bradstreet again offers no analysis of "reasonable costs" or the quantification of  
12 coverages; he does not advocate an alternative rate proposal.

13           Witness Bradstreet also believes the USPS is an overzealous competitor that does not like  
14 regulation and "has done everything it can think of to escape PRC review".<sup>53/</sup> He states that the  
15 USPS has specifically targeted saturation mail for special treatment since the late 1970's and that  
16 "ECR saturation and high density mail are the only significant part of the Standard Mail  
17 mailstream open to competition".<sup>54/</sup> There plainly are other types of mail in Standard (A) ECR  
18 open to competition.

19           Witness Bradstreet dismisses the USPS' efforts in "improving service and keeping costs  
20 low" claiming they simply "lower rates for competitive mail and increase rates for mail that has

---

<sup>52/</sup> R97-1, USPS-T-30, pages 32, 34

<sup>53/</sup> AAPS-T-1, page 8.

<sup>54/</sup> AAPS-T-1, page 9.

1 no competitive options."<sup>55/</sup> To the contrary, the USPS' efforts to reduce costs has a direct effect  
2 on keeping the rates of the "captive" market low. Improvements in operational efficiency along  
3 with other economies of scale and scope cause lower rates in a competitive environment. Lower  
4 rates for these services will bring increased volumes which result in even lower average unit  
5 costs for all mail.

6 **C. HISTORICAL RATE TRENDS**

7 In his Table A, "A Rate Trend Comparison Saturation Flats vs. Monopoly Mail," Witness  
8 Bradstreet attempts to show that lowering rates for competitive mail has been the USPS' and  
9 PRC's practice since 1978 by looking at the percent changes in rates for Third  
10 Class/Standard (A) Saturation flats ("competitive mail") and the "monopoly mail," First-Class  
11 letters and Third Class/Standard (A) Basic flats. As shown in Table 16, Column (5) below,  
12 Witness Bradstreet's trends show that the rates for First-Class letters and Third/Standard (A)  
13 Basic nonletters have increased 113% and 264%, respectively, over the last twenty years  
14 compared to the Third/Standard (A) ECR-Saturation flat rate increase of 36%. Besides his lack  
15 of sources or support to his calculations, his summary and conclusions are biased and flawed.

---

<sup>55/</sup> AAPS-T-1, page 15.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13

<u>Rate Class/Category</u> (1)	<u>Rate Trend Comparison</u> (Cents Per Piece)			<u>Percent Change</u>	
	<u>1978</u>	<u>1991</u>	<u>1996</u>	<u>78 to 96</u>	<u>91 to 96</u>
	(2)	(3)	(4)	(5)	(6)
1. First-Class Letters	15.0	29.0	32.0	113%	10%
2. Third Class/Standard Basic Nonletter	8.4	23.3 <sup>1/</sup>	30.6	264%	31%
3. Third Class/Standard:					
a. ECR Nonletters <sup>2/</sup>	8.4	12.7	13.7	63%	8%
b. ECR Saturation - DDU	8.4	10.5	11.4	36%	9%

<sup>1/</sup> Witness Bradstreet shows a rate of 22.3 cents per piece.  
<sup>2/</sup> Rates do not include any destination discounts resulting from worksharing.  
Source: R97-1, Library Reference H-87, "Volume, Revenue, Rate, Fee, and Transaction"

14 First, Witness Bradstreet includes the maximum worksharing discounts related to sortation  
15 and destination entry cost savings in his current ECR-Saturation rate. As shown in Table 16,  
16 Line 3a, the rates for ECR-Saturation without the worksharing discounts have increased 63%  
17 since 1978, more comparable to First-Class letters.

18 As shown in Table 16, Column (6) above, Witness Bradstreet compares the two "monopoly"  
19 mail rate categories to the ECR-Saturation mail that did not exist in 1978. Although Third  
20 Class/Standard Basic nonletters have increased 31% over this same time period, Witness  
21 Bradstreet failed to point out that this group of mail only accounts for 1.3%<sup>56/</sup> of all Standard (A)  
22 Commercial volumes and that they chose not to take advantage of the worksharing discounts  
23 available to them such as shifting to automation or 3/5 digit preparation. The only legitimate  
24 comparison must use the 1991 rates from when ECR-Saturation was first instituted. Since then,

<sup>56/</sup> 847 million pieces of nondropshipped Regular Basic nonletter piece rated mail divided by 66,314 million pieces of Standard (A) mail. USPS-T-36, workpaper 1, page 20.

1 ECR-Saturation rates have increased nearly the same as First-Class letters, 9% and 10%  
 2 respectively. Therefore, Witness Bradstreet's comparisons of rate trends that apply base rates  
 3 to subclasses that did not exist is biased.

4 **D. COST TRENDS**

5 Although Witness Bradstreet chose rates with worksharing discounts, he failed to recognize  
 6 the cost trends and worksharing cost savings behind those rates. Since the CRA does not  
 7 differentiate between letters and nonletters, the changes in the attributable costs per piece for  
 8 First-Class and Third-Class Standard (A) for the 1978 to 1996 time period is summarized in  
 9 Table 12 below.

10

Table 12

11

**Percent Change in Attributable Costs from 1978 to 1996**

12

	<u>Percent Change (1)</u>
First-Class	+52%
Third Class Bulk Rate Regular <sup>2/</sup>	-10%

13

14

15

<sup>1/</sup> Average cost per piece from USPS Cost Revenue Analysis, 1978 & 1996;  
 unadjusted for mix changes

16

17

<sup>2/</sup> Reflects all Third Class because saturation did not exist in 1978 .

18

As shown in Table 12 above, First-Class costs per piece have increased 52%, while the

19

average costs for Third Class/Standard (A) ECR has decreased 10%. This demonstrates that

1 rates can be decreased for Third Class/Standard (A) mail to address competition and still provide  
2 the same (or greater) level of contribution.

3 In summary, Witness Bradstreet's "Rate Trend Comparison" does not support his claim that  
4 rates have been lowered for competitive mail at the expense of monopoly mail. He did not  
5 address the costs the rates were based on and chose to compare rates that include worksharing  
6 discounts for different types of mail that did not exist in 1978.

7 **E. RAMSEY PRICING**

8 As pointed out by Witness Bradstreet, the USPS' rates are designed to cover the direct and  
9 indirect costs of the USPS. Aside from Witness Bradstreet's alleged monopolistic motives for  
10 First-Class and competitive motives for Third Class, his testimony questions the USPS'  
11 ratemaking based on the USPS' use of Ramsey Pricing.

12 Witness Bradstreet believes that the USPS' objective in using Ramsey Pricing is to put the  
13 alternative delivery industry out of business. He also argues that "sponsoring Ramsey Pricing  
14 in a postal context is tantamount to ignoring Congress and tossing nearly the entire ratemaking  
15 criteria section out of the Postal Reorganization Act".<sup>57/</sup> Witness Bradstreet's testimony and  
16 interrogatory responses acknowledge that no USPS witness proposed rates based on Ramsey  
17 Pricing.<sup>58/</sup> In addition, as confirmed by Witness Bradstreet<sup>59/</sup>, the Ramsey Pricing data submitted

---

<sup>57/</sup> AAPS-T-1, page 29.

<sup>58/</sup> AAPS-T-1, page 29.

<sup>59/</sup> R97-1 Interrogatory Response USPS/AAPS-T1-10a (Tr. 23/12049).



1 in this proceeding suggest that if rates for the ECR subclass were based on Ramsey Pricing, then  
2 the ECR rates would decrease by 50 percent.

---

**The R97-1 Chown Metric is a Scaler Multiple of the  
R90-1 Unbundling Method with Equal Markups<sup>1/</sup>**

The following is a general statement of the system of cost functions, subclasses (or products), volume variable costs, and institutional costs of the Postal Service:

$I_j$	=	Institutional costs "identifiable" with cost function $j$
$I$	=	$\sum_{j=1}^m I_j$ = The total of all "identifiable" institutional costs
$V_{ij}$	=	The total volume variable costs in cost function $j$ that have been shown to vary with a change in volume of subclass $i$
$V_j$	=	$\sum_{i=1}^n V_{ij}$ = The total of all volume variable costs for all classes served by cost function $j$
$V..$	=	$\sum_{j=1}^m V_j$ = Total volume variable cost in the system
$j$	=	Name (index) of the cost function ( $j = 1, 2, \dots, m$ )
$m$	=	The total number of cost functions
$i$	=	Name (index) of the subclass ( $i = 1, 2, \dots, n$ )
$n$	=	The total number of subclasses

- A. The R90-1 Unbundling Method with equal markups for the recovery of "identifiable" institutional costs at the cost function level yields a markup of the volume variable cost of the  $i$ th subclass and the  $j$ th cost function equal to:

$$I_j * \frac{V_{ij}}{V_j} \quad \text{(equation a)}$$

---

<sup>1/</sup>Items A through E of this exhibit were confirmed by witness Chown in her response to AMMA/NAA-T1-4 (Tr. 25/13322).

- B. The total of these distributed "identifiable" institutional costs for all cost functions used by the  $i$ th subclass is equal to:

$$\sum_{j=1}^m [I_j * V_{ij}/V_j] \quad (\text{equation b})$$

- C. The weighting factor for the Chown metric in R97-1 for the  $j$ th cost function is equal to:

$$\frac{I_j}{V_j} * \frac{V_{..}}{I} \quad (\text{equation c})$$

- D. The R97-1 weighting factor for the  $j$ th cost function, when used to weight the volume variable cost of the  $i$ th subclass, is equal to:

$$\frac{I_j * V_{ij}}{V_j} * \frac{V_{..}}{I} \quad (\text{equation d})$$

- E. The total of the R97-1 weighted volume variable costs for the  $i$ th subclass is equal to the Chown metric:

$$\left(\frac{V_{..}}{I}\right) * \sum_{j=1}^m [I_j * V_{ij}/V_j] \quad (\text{equation e})$$

- F. The term  $(V_{..}/I)$  in equation e is a constant (scaler) equal to the ratio of the total volume variable costs of the system to the total identifiable institutional costs of the system. This term forces the sum of the weighted volume variable costs to equal the total system volume variable costs:<sup>2</sup>

$$\begin{aligned} & \sum_{i=1}^n \left\{ \left(\frac{V_{..}}{I}\right) * \sum_{j=1}^m [I_j * V_{ij}/V_j] \right\} \\ &= \left(\frac{V_{..}}{I}\right) * \sum_{j=1}^m [I_j * \left(\sum_{i=1}^n V_{ij}\right)/V_j] \\ &= V_{..} \end{aligned} \quad (\text{equation f})$$

---

<sup>2</sup>This fact was also confirmed by witness Chown on cross examination (Tr. 25/13404).

- G. The Chown metric of R97-1 is a constant (scaler) multiple of the result obtained by applying the R90-1 Unbundling Method where equal markups are required to recover each cost function's identifiable institutional costs and summed across all cost functions; i.e.:

$$(\text{equation } e) = \left(\frac{V..}{I.}\right) * (\text{equation } b)$$

### Behavior Characteristics of the Chown Metric

Base Case: From NAA-T-1

	Function			System Wide	Total Institutional				
	1.	2.	Totals						
1. Institutional Costs	30	120	150	0	150	Using Marginal Cost Metric			
2. Percent of Total	20.00%	80.00%	100.00%	Markup %=	60%				
	Attributable Costs					Markup	Rate	Percent Base Rate	Cost Coverage
3. Class A	75	50	125	→		75.00	200.00	100.0%	1.60
4. Class B	75	0	75	→		45.00	120.00	100.0%	1.60
5. Class C	0	50	50	→		30.00	80.00	100.0%	1.60
6. Function Total	150	100	250						
7. Percent of Total	60.00%	40.00%	100.00%						
8. Weighting Factors (L 2/L 7)	0.333	2.000				Using Chown Metric			
	Weighted Attributable Costs					Markup	Rate	Percent Base Rate	Cost Coverage
9. Class A	25.00	100.00	125.00	→		75.00	200.00	100.0%	1.60
10. Class B	25.00	0.00	25.00	→		15.00	90.00	100.0%	1.20
11. Class C	0.00	100.00	100.00	→		60.00	110.00	100.0%	2.20

Source: NAA-T-1 Tables 4, 6, 7, and 8.

### Behavior Characteristics of the Chown Metric

#### Case 1: Increase System-Wide Institutional Cost by \$100

	Function			System Wide	Total Institutional				
	1.	2.	Totals						
1. Institutional Costs	30	120	150	100	250	Using Marginal Cost Metric			
2. Percent of Total	20.00%	80.00%	100.00%	Markup %=	100.0%				
	Attributable Costs					Markup	Rate	Percent Base Rate	Cost Coverage
3. Class A	75	50	125			125.00	250.00	125.0%	2.00
4. Class B	75	0	75			75.00	150.00	125.0%	2.00
5. Class C	0	50	50			50.00	100.00	125.0%	2.00
6. Function Total	150	100	250						
7. Percent of Total	60.00%	40.00%	100.00%						
8. Weighting Factors (L 2/L 7)	0.333	2.000				Using Chown Metric			
	Weighted Attributable Costs					Markup	Rate	Percent Base Rate	Cost Coverage
9. Class A	25.00	100.00	125.00			125.00	250.00	125.0%	2.00
10. Class B	25.00	0.00	25.00			25.00	100.00	111.1%	1.33
11. Class C	0.00	100.00	100.00			100.00	150.00	136.4%	3.00

Source: NAA-T-1 Tables 4, 6, 7, and 8; with changes as noted (above).

### Behavior Characteristics of the Chown Metric

#### Case 2: Class A Workshares Function 2, Saving \$25

	Function			System Wide	Total Institutional				
	1.	2.	Totals			Marginal Cost Metric			
1. Institutional Costs	30	120	150	0	150				
2. Percent of Total	20.00%	80.00%	100.00%	Markup %=	67%				
	Attributable Costs					Markup	Rate	Percent Base Rate	Cost Coverage
3. Class A	75	25	100	→		66.67	166.67	83.3%	1.67
4. Class B	75	0	75	→		50.00	125.00	104.2%	1.67
5. Class C	0	50	50	→		33.33	83.33	104.2%	1.67
6. Function Total	150	75	225						
7. Percent of Total	66.67%	33.33%	100.00%						
8. Weighting Factors (L 2/L 7)	0.300	2.400				Using Chown Metric			
	Weighted Attributable Costs					Markup	Rate	Percent Base Rate	Cost Coverage
9. Class A	22.50	60.00	82.50	→		55.00	155.00	77.5%	1.55
10. Class B	22.50	0.00	22.50	→		15.00	90.00	100.0%	1.20
11. Class C	0.00	120.00	120.00	→		80.00	130.00	118.2%	2.60

Source: NAA-T-1 Tables 4, 6, 7, and 8; with changes as noted (above).

### Behavior Characteristics of the Chown Metric

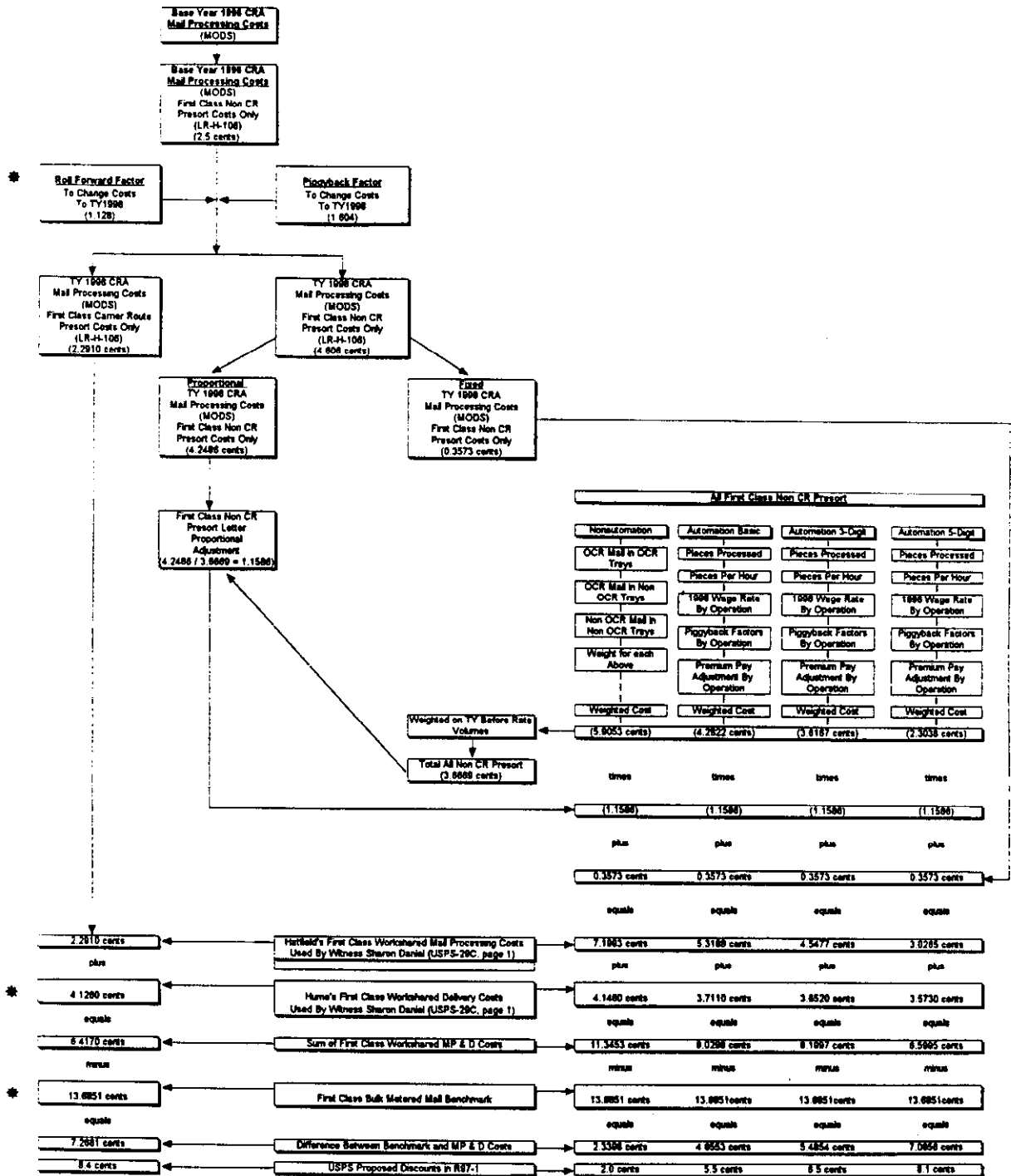
Case 3: Class A Workshares Function 2, Saving \$25; and Increase System-Wide Institutional Cost by \$100

	Function			System Wide	Total Institutional				
	1.	2.	Totals						
1. Institutional Costs	30	120	150	100	250	Using Marginal Cost Metric			
2. Percent of Total	20.00%	80.00%	100.00%	Markup % =		111%			
	Attributable Costs					Markup	Rate	Percent of Base	Cost Coverage
3. Class A	75	25	100			111.11	211	106%	2.11
4. Class B	75	0	75			83.33	158	132%	2.11
5. Class C	0	50	50			55.56	106	132%	2.11
6. Function Total	150	75	225						
7. Percent of Total	66.67%	33.33%	100.00%						
8. Weighting Factors (L 2/L 7)	0.300	2.400				Using Chown Metric			
	Weighted Attributable Costs					Markup	Rate	Percent of Base	Cost Coverage
9. Class A	22.50	60.00	82.50			91.67	192	96%	1.92
10. Class B	22.50	0.00	22.50			25.00	100	111%	1.33
11. Class C	0.00	120.00	120.00			133.33	183	167%	3.67

Source: NAA-T-1 Tables 4, 6, 7, and 8; with changes as noted (above).

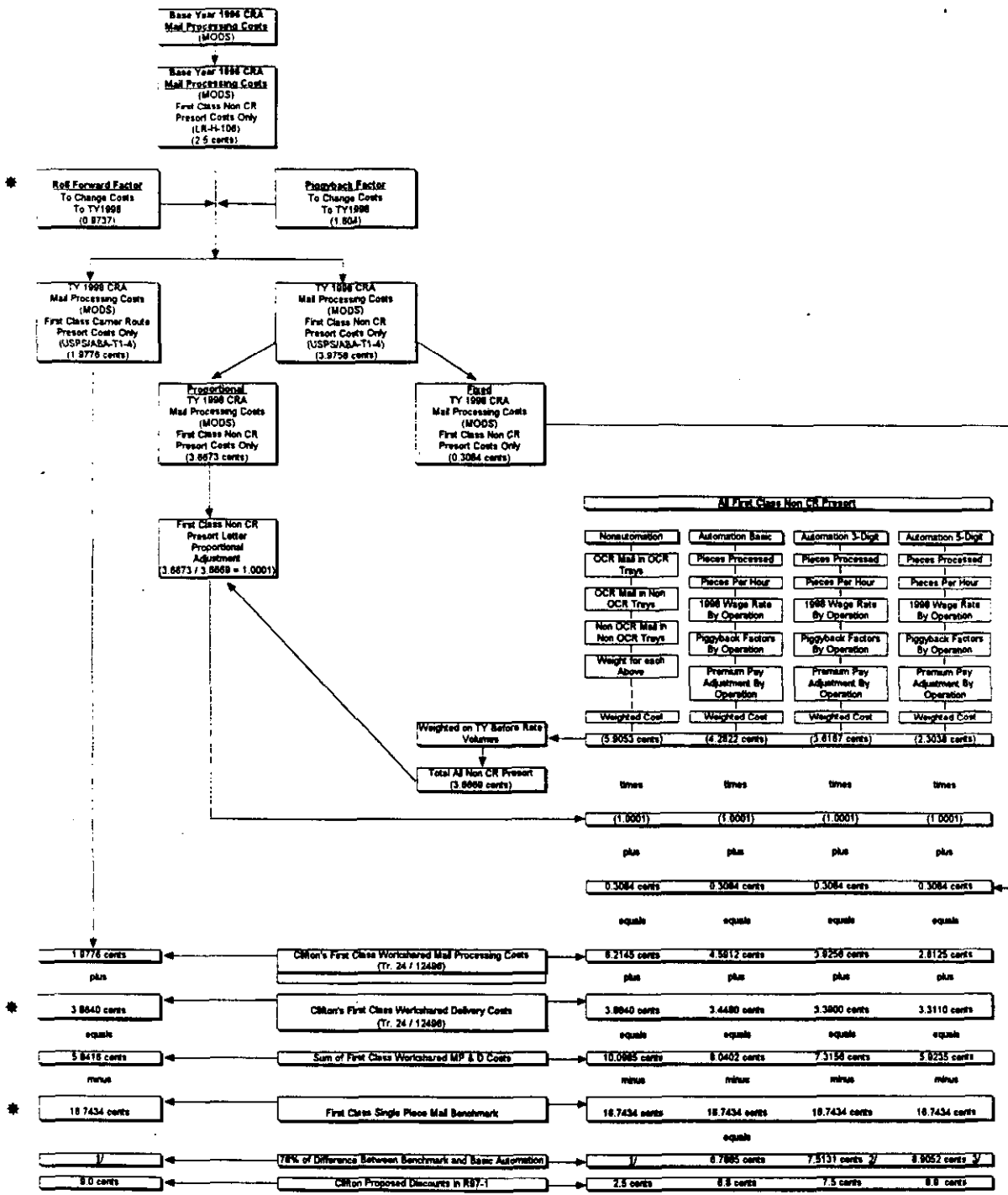


**DEVELOPMENT OF USPS' PROPOSED FIRST CLASS WORKSHARED LETTER MAIL DISCOUNTS**



\* Denotes area where Witness Clifton has proposed adjustments to the USPS' Witness Hatfield /Hume models.

**DEVELOPMENT OF USPS' PROPOSED FIRST CLASS WORKSHARED LETTER MAIL DISCOUNTS**  
(With Witness Clifton's Proposed Changes)



\* Denotes Witness Clifton's proposed adjustment to the USPS' Witness Hatfield /Hume models.  
 1/ Not applicable to the calculation of Witness Clifton's discount levels.  
 2/ Automation Basic discount plus cost savings between Automation Basic and Automation 3-Digit.  
 3/ Automation Basic discount plus cost savings between Automation Basic and Automation 5-Digit.

1 CHAIRMAN GLEIMAN: Three participants have  
2 requested oral cross-examination and we have not been able  
3 to wear them out today, so here they are, the American  
4 Bankers Association, Edison Electric Institute, and the  
5 National Association of Presort Mailers, Major Mailers  
6 Association and the Newspaper Association of America.

7 Does any party -- is any other party still  
8 standing? Does any party wish to cross-examine?

9 [No response.]

10 CHAIRMAN GLEIMAN: If not, then counsel for the  
11 Bankers Association, et al. can proceed when ready.

12 MR. CORCORAN: Thank you, Mr. Chairman.

13 CROSS-EXAMINATION

14 BY MR. CORCORAN:

15 Q Dr. Andrew, I am Brian Corcoran. I represent EEI  
16 in this proceeding.

17 A Good evening.

18 Q I would like to begin with a few, I guess what I  
19 would call matters of language with your testimony. Could  
20 you turn to page 25, please?

21 A Yes.

22 Q At lines 22 to 23 you indicate that Dr. Clifton  
23 proposes a reduction for presort business cards between 1  
24 and 1.6 cents. Do you see that?

25 A Yes.

1 Q Those lines?

2 A Yes, sir.

3 Q And as support for that, you cite Dr. Clifton's  
4 answer to a USPS Interrogatory 20. Did you review that  
5 Interrogatory?

6 A Yes.

7 Q Is it true that, in response to that  
8 Interrogatory, Dr. Clifton specifically states, quote, "The  
9 rates for First Class work-shared cards have been kept at  
10 their current rates instead of being set at the rates in the  
11 USPS proposal. I am not adopting this as part of my formal  
12 proposal." Wasn't that his testimony?

13 A That was his testimony, but in his final  
14 statements of accounts in Technical Appendix D, he included  
15 these reductions, implicitly?

16 Q It wasn't abundantly clear to you that, when he  
17 said I am not adopting this as part of my formal testimony,  
18 that he was using it simply to complete his technical  
19 appendices, and they were for illustrative purposes only?

20 A Well, that's how he got his whole system to  
21 balance from terms of the revenue -- meet the revenue  
22 requirements, so I assume they are in there implicitly.  
23 They being the reduction from the USPS proposed rates, or  
24 stating another way, keeping the -- maintaining the same  
25 rates as they are today.

1 Q Well, that's fine.

2 Let me move to one other area briefly. Is it  
3 correct that the current bench-mark used to set discounts  
4 for first class work-shared mail is the first class single  
5 piece rate?

6 A Today?

7 Q The current bench-mark, correct.

8 A The bench-mark that's used in this case or the  
9 bench-mark that was used in '95?

10 Q I'll repeat the question. Is it correct that the  
11 current bench-mark used to set discounts for first class  
12 work-shared mail is the first class single piece rate?

13 A I don't know what you mean by "current."

14 Q It's the one that the discount -- the current  
15 discounts are based upon.

16 A Okay. That's all I needed to know. The one that,  
17 today's date, is based on the single piece, but it was used  
18 as a proxy because the bench-mark or the data necessary to  
19 do the bulk rate metered mail that was proposed was not  
20 available in '95, but it is available today.

21 Q Excuse me. Was the answer to your question -- and  
22 your explanation is fine -- was the answer to the question,  
23 yes, that's the current bench-mark?

24 A That's correct, with modifications.

25 Q And is it correct that Dr. Clifton uses the

1 current bench-mark for purposes of setting discounts for  
2 first-class work-shared mail in his testimony?

3 A It is true.

4 Q At page 24, line 7 of your testimony, you've  
5 chosen to characterize Dr. Clifton's use of the current  
6 bench-mark as representing an increase in the bench-mark  
7 used to determine cost savings for work-shared discounts.  
8 Do you see that language?

9 A State the line, please?

10 Q I believe it's line 7 on page 24.

11 A Yes.

12 Q It's correct, therefore, to state, is it not, that  
13 Dr. Clifton has not proposed to increase the bench-mark.

14 A Over the existing or over what the USPS has  
15 proposed?

16 Q He's using the current bench-mark as you  
17 previously testified. Isn't that right?

18 A That's correct.

19 Q And it's correct to state, therefore, that Dr.  
20 Clifton has not proposed to increase the bench-mark. Isn't  
21 that correct?

22 A That's correct.

23 Q Are you an economist?

24 A I consider myself an economist. I don't have a  
25 Ph.D. in economics, but I've taken all the courses

1 necessary. My Ph.D. is in operations research.

2 Q I see. At page 24 of your testimony, you  
3 criticize Dr. Clifton's reduction in cost coverage for first  
4 class work-shared mail as being based upon considerations of  
5 efficiency and equity. Do you see that?

6 A On 24?

7 Q Correct. Line 11, specifically.

8 A Got it.

9 Q Is it correct that a Ramsey price is more  
10 economically efficient than a price set in excess of a  
11 Ramsey price?

12 A Yes.

13 Q Is it correct that an improvement in efficiency  
14 occurs when the departure from Ramsey price is lessened?

15 A Yes.

16 Q Is it correct in this case the Postal Service has  
17 proposed rates for work-shared first class yielding cost  
18 coverage of 283 percent?

19 A Say again?

20 Q Is it correct that, in this case, the Postal  
21 Service's proposed rates for work-shared first class mail  
22 yield a cost coverage of 283 percent?

23 A That is correct.

24 Q Is it correct that had the Postal Service set  
25 rates for work-shared first class mail based upon Ramsey

1 pricing, the cost coverage would have been 245 percent?

2 A I'd have to look that up. I don't know -- don't  
3 have it at my fingertips.

4 Q Did you read Witness Bernstein's testimony?

5 A A long time ago, yes.

6 Q Isn't it true that his testimony would result in  
7 that 245 percent or don't you recall?

8 A I said I'd have to check.

9 Q Okay. Well, let's assume for purposes of my next  
10 question that's the case.

11 A Subject to check.

12 Q Thank you.

13 Therefore, since Dr. Clifton has proposed to  
14 reduce the cost coverage for first class work-shared mail,  
15 the result must be, under Ramsey pricing, more efficient  
16 than the Postal Service's, correct?

17 A With respect to Ramsey pricing, yes.

18 Q Is it also correct that economists deem Ramsey  
19 pricing criteria to be objective and not subjective?

20 A Yes.

21 [Whereupon, at 6:00 p.m., the hearing continued in  
22 evening session.]

23

24

25



## EVENING SESSION

[6:00 p.m.]

BY MR. CORCORAN:

Q So much for language. Let's move to your mail mix. This is Section A of your testimony. That begins on page 27, I believe. Is it your testimony that changes in mail mix are the principal reason for decline in unit costs for first class work shared mail?

A One of the principal reasons, yes.

Q Doesn't your testimony at 27, the heading, say the primary reason?

A Yes.

Q Now, in effort to demonstrate your conclusion that mail mix is the primary reason for decline in unit costs, you include several tables in your testimony, including table 10, which is on page 29 of your testimony, and which shows the percentage shares of non-automation and automation work shared first class mail for the years 1994 to 1996; correct?

A Yes.

Q It's your testimony, I take it, that a shift of this magnitude, the 12.7 percent, would cause a reduction in overall unit costs in the CRA; is that correct?

A It can; yes.

Q Excuse me. Look at your testimony on lines 13 to

1 15. I've paraphrased it, but that's specifically what you  
2 say there, isn't it, a shift in volume within work shared  
3 mail of this magnitude, i.e., 12.7 percentage points, from a  
4 higher cost rate category to a lower cost category would  
5 cause a reduction in overall unit costs? That's your  
6 testimony; correct?

7 A Yes.

8 Q To demonstrate your contention, if you would turn  
9 to page 30, please, of your testimony, to demonstrate your  
10 contention, you developed table 11, in which you show a  
11 hypothetical example where a decrease in average costs for  
12 presort first class mail is consistent with increases in  
13 unit costs for each rate category, due to volume mix shifts  
14 from higher cost non-automation to lower cost automation;  
15 correct?

16 A Yes.

17 Q As a somewhat preliminary matter, does your  
18 testimony provide data showing the unit costs for rate  
19 categories within work shared first class mail for the  
20 period 1994 through 1996?

21 A Not in this table.

22 Q As to the -- you don't have any data in here, do  
23 you, specifically with respect to unit costs for rate  
24 categories within first class mail for the period 1994 to  
25 1996, do you?

1 A No, I do not.

2 Q Now, as to the hypothetical, and you do label this  
3 as a hypothetical example, the unit costs for non-automation  
4 and automation work shared first class mail are made up,  
5 aren't they?

6 A Yes, the costs.

7 Q Yes, exactly. In addition, the relationship  
8 between the unit costs of non-automation to automation,  
9 i.e., with non-automation being 100 percent higher, is made  
10 up; correct?

11 A Yes.

12 Q In fact, they bear no relationship to the historic  
13 cost relationship between the two types of mail; is that  
14 correct?

15 A That's correct.

16 Q Similarly, the percentage shares that you show --  
17 excuse me. I've lost myself. Similarly, the percentage  
18 share of the mail stream represented by non-automation and  
19 automation is made up; correct?

20 A Yes.

21 Q Further, as you demonstrated on table 10 where you  
22 did use the actual percentage shares, the percentage of  
23 shares you employ in table 11 represent a complete departure  
24 from the actual results for the time period; correct?

25 A Yes.

1 MR. CORCORAN: I have a cross examination exhibit  
2 I would like to show you.

3 [Cross-Examination Exhibit No.  
4 ABA/EEI/NAPM-XE-1 was marked for  
5 identification.]

6 BY MR. CORCORAN:

7 Q Do you have what I have labelled ABA/EEI/NAPM  
8 Cross-Examination Exhibit 1 before you?

9 A Yes.

10 Q Let me just identify the source of the data. For  
11 1994, do you see that we have -- it's an attempt to  
12 replicate your Table 11. That cost of nonautomation and  
13 automation, do you see that? -- 4.8 cents for automation?

14 A Yes, sir.

15 Q Do you see that? That comes from Witness Smith's  
16 testimony in MC-95-1 and represents the cost of automation  
17 for 3-Digit mail and we have rounded for the 4.7 cents to  
18 4.8 and the nonautomation share represents the difference,  
19 as you can see in the footnote, between a 3-Digit automation  
20 share and nonautomation mail, as provided by Witness Smith  
21 in that case and that difference is calculated to be 47  
22 percent.

23 So this --

24 A Say again?

25 Q The difference between automation and

1 nonautomation is 47 percent. That is how I derived the 7.1  
2 cents. Okay?

3 A All right.

4 Q Are you with me? All right, and the share, as  
5 noted in the Footnote 2, is the share of nonautomation and  
6 automation mail in 1994 -- 42 percent for nonautomation and  
7 58 percent for automation as compared to what you have used  
8 in Table 11, 75 percent and 25 percent, respectively. Okay?

9 A Yes.

10 Q Now is it correct that under this example, given  
11 more realistic unit cost figures, and a more realistic  
12 spread between the two categories, and using actual mail mix  
13 changes that the mail mix change, assuming no change in  
14 costs, causes the average unit cost to decrease by 5.2  
15 percent?

16 A That is exactly what we were trying to show in  
17 Table 11 but we wanted to stay away from any real numbers so  
18 we wouldn't have any arguments about details.

19 Q Wait a minute. Table 11 shows an increase, a 10  
20 percent increase in costs, does it not? That is not what  
21 my --

22 A Say again?

23 Q Your Table 11 -- does that have a --

24 A Sure --

25 Q -- a 10 percent increase in costs?

1 A It has a 10 percent increase in costs --

2 Q Yes, sir.

3 A -- and it has an 11.4 decrease in cost on a  
4 average basis.

5 Q Right.

6 A The actual costs of each individual rate category,  
7 those costs were going up by 10 percent, but because of the  
8 mix change the overall average made a decrease and that is  
9 what we were trying to show.

10 Q That's fine, but in -- we will get to that  
11 assumption about the increase momentarily, but bear with me  
12 on Cross-Examination Exhibit 1.

13 That table, given more realistic cost figures, a  
14 more realistic spread between the two rate categories, and  
15 assuming -- and actual mail mix, and assuming no change in  
16 costs causes the average unit cost to decrease by 5.2  
17 percent, isn't that what this table shows?

18 A Yes.

19 Q And isn't it correct that Dr. Clifton's analyses  
20 demonstrate mail processing costs for work-shared First  
21 Class mail declined in excess of 5.2 percent over the period  
22 1994 to 1996? Correct?

23 A Yes.

24 MR. CORCORAN: We have another cross examination  
25 exhibit for you.

1 [Cross-Examination Exhibit No.  
2 ABA/EEI/NAPM-XE-2 was marked for  
3 identification.]

4 BY MR. CORCORAN:

5 Q Do you have it in front of you, Dr. Andrew?

6 A Exhibit 2.

7 Q Yes, sir, marked ABA/EEI/NAPM Cross-Examination  
8 Exhibit 2, and it's the same table, essentially, as number  
9 1, except that we've increased the costs by 10 percent in  
10 1996. Do you see that?

11 A Yes.

12 Q Now, under these conditions and contrary to the  
13 conclusion you draw from your Table 11 that volume exchanges  
14 would cause average unit cost to decrease, here we see  
15 average unit costs actually increase by 4.3 percent,  
16 correct?

17 A Given the conditions you have here, that is  
18 correct.

19 Q Right. And in his testimony -- well, you've  
20 already answered that.

21 Now, given our Cross-Examination Exhibit 1, which  
22 shows that actual volume mix shift accounts for a  
23 5.2-percent decline in average costs, what, in your view,  
24 accounts for the balance of the decline in unit costs that  
25 are included in Dr. Clifton's analyses -- i.e., the

1 difference between the 5.2 percent and his decline of  
2 approximately 13 percent?

3 A It could be a number of factors.

4 One, it could be a difference in the change of the  
5 costs by rate category going from '94 to '96. It could be a  
6 -- that's a relative change between the two.

7 Q Isn't that your mail mix argument?

8 A No. I'm talking about the cost -- the unit cost  
9 of the category, not the mixes of the category, but the unit  
10 costs of the category. So, your 7.1 and 4.8 -- those may  
11 not change uniformly through time.

12 So, there could be a change in the level of those  
13 costs relative to one another, and there could be a change  
14 in the base -- in other words, they move up together or they  
15 -- so, there's two things operating -- the relative  
16 difference between the actual costs of the non-automated  
17 versus the automated and the relative level or base of the  
18 two, and given whatever happens in there, you can get all  
19 sorts of numbers down on the right-hand side at the bottom.

20 I also want to know on the 7.1 -- if we're going  
21 to -- are you going to ask anymore questions on this, sir?

22 Q Perhaps.

23 A I need to know the source of your 10-percent  
24 increase. Since we're using actuals --

25 Q That's easy. I just attempted to have replicated



1 your Table 11, and when you use more realistic numbers, when  
2 you use actual volume shifts, when you use costs that are --  
3 where the spread is more comparable to the actuals, you get  
4 a result that is completely at odds with your Table 11.

5 A It's not at odds at all, because in the first  
6 case, where there's no change, you're having a decrease  
7 that's strictly a function of mix, and that's what the whole  
8 exercise in 11 was to show.

9 Q Right. You claim that it's solely volume mix that  
10 causes the costs to go down.

11 A No, I didn't say that.

12 Q That's your -- that's what you started out in your  
13 heading to this testimony, that changes in mail mix  
14 categories are the primary reason for declining unit costs.

15 A Primary, but they're --

16 Q Nowhere in your -- excuse me -- nowhere in your  
17 testimony do you say that there may be some other factors  
18 such as the items you just were elaborating on.

19 A Okay.

20 Q True?

21 A I haven't read my testimony today. I thought I  
22 had, but if I didn't, I didn't.

23 Q And isn't it possible that -- besides the mail  
24 mix, isn't it possible that attributable costs were actually  
25 dropping and that's the difference between the 5.2 that we

1 show in Exhibit 1 and Dr. Clifton's results, which show  
2 minus -- negative 13 percent? It's because the costs are  
3 dropping. It's not mail mix. The mail mix is 5.2 percent,  
4 correct?

5 A The mail mix, with your numbers, give a  
6 5.2-percent decrease.

7 Q And if the results that Dr. Clifton shows is, for  
8 example, 13 percent, the difference would have to be, at  
9 least in part, dropping attributable costs, correct?

10 A Not necessarily.

11 Q In part, they wouldn't have to be, even?

12 A No. I can construct you an example, if you would  
13 like me to -- I won't do it on the stand --

14 Q Well, thank you.

15 A -- but I'll give it to you.

16 Q And I would note you didn't do it in your  
17 testimony. You just said mail mix was the primary reason.

18 MR. TODD: I would like an opportunity for the  
19 witness to complete his answer, Mr. Chairman.

20 THE WITNESS: I would be glad to make a  
21 counter-example or an example that would show the situation  
22 where this will go farther negative and the costs will at  
23 least stay the same or they certainly won't decrease.

24 BY MR. CORCORAN:

25 Q Well, let's move on.

1 A I take it that's a negative on the offer.

2 Q Even if it wasn't 6:30, it would be a negative.

3 Now, you also criticize -- and I'll find it here  
4 -- at page 31 -- and I believe it's lines 4 and 5. In this  
5 section A of your testimony, you characterize Dr. Clifton's  
6 use of only two years of change in historical -- i.e., CRA  
7 data -- from '94 to '96 as suspect. Do you see that on  
8 lines 4 and 5?

9 A Yes.

10 Q And by this, is it your testimony that Dr. Clifton  
11 should have considered a longer historical period?

12 A He definitely should have done that and/or modeled  
13 -- done a model of this system he was working with.

14 Q Now, given your criticism of the historical time  
15 period used by -- excuse me, I'll start again. Isn't your  
16 criticism of the historical time period used by Dr. Clifton  
17 irrelevant given your contention that the change in mail mix  
18 is the principal reason for the declining unit costs for  
19 First Class work-shared letter mail?

20 A Not at all, because the change in mail mix may not  
21 continue, and that is another reason for the criticism of  
22 using only the two year without a modeling of the migration  
23 from higher cost to lower cost categories.

24 Q Well, I was going to get to this later, but to  
25 keep it in one spot in the transcript, because it will be

1 riveting reading, I know, isn't it the case that -- and I'll  
2 get to it momentarily -- isn't it the case that Witness  
3 Tolley projects a decline of 13.1 percent of non-automation  
4 share before rates from a 28.76 percent in the base year?

5 A I don't remember those numbers. If you will give  
6 me the citation, I have --

7 Q That's fine. If you don't remember, that's fine.

8 A Okay.

9 Q His testimony will speak for itself. And you  
10 also, is it correct that Witness Thress -- Thress --  
11 whatever -- projects an interim year, i.e., '97, decline in  
12 non-automation share before rates of 14.9 percent?

13 A I will have to take that subject to check.

14 Q See, what I don't understand then, Doctor, you  
15 just said -- don't those -- if those two are accurate,  
16 that's projecting a decline into the interim year and into  
17 the test year, correct? So the decline is, by the Postal  
18 Service, is projected to continue, correct?

19 A Not at the level in the test year that has been in  
20 the past.

21 Q You mean the 12.7? It declined 12.7 percentage  
22 points.

23 A Would you cite that for me in --

24 Q Well, that was your testimony on page 10, your  
25 Table 10.

1 A Say again?

2 Q You show on Table 10 a decline, those are actual  
3 mail mix shifts. It's a percentage change, percentage point  
4 change of 12.7 percent, correct?

5 A That's correct. But you are talking about going  
6 into the test year after rates.

7 Q Right. And just bear with me, if the numbers I  
8 quoted were correct, and Witness Tolley projects a decline  
9 to 13.10 percent from the base year of 28.7 percent, that's  
10 a larger decline that you show in Table 10, correct, in  
11 terms of percentage points?

12 A In the interim year.

13 Q No, sir. Assume with me that I have read Tolley  
14 correctly. Then he projects a decline to 13.1 percent from  
15 the base year, which you have got right here, of 28.7.  
16 That's a decline in percentage point terms greater than what  
17 you show in Table 10, correct?

18 A Would you please give me the citation from which  
19 you are reading? And then I can follow it with you, sir,  
20 because I have the documents here.

21 Q You'll have to take it subject to check, I don't  
22 have a page number for Tolley. So assuming that I am right,  
23 the projection --

24 A Well, I have it, it's in -- it's reproduced in  
25 Table 8 of Witness Clifton's, on page 10 -- I'm sorry, page

1 19.

2 Q Nineteen.

3 A Now if you care to go ahead, I'll follow with you.

4 Q My question was, and I thought this would be easy  
5 to keep it all in one spot, but the question is, if Witness  
6 Tolley projects a decline in the nonautomation share for the  
7 test year to 13.1 percent, that's a decline that's greater  
8 than in terms of percentage points, given that the base year  
9 is 28.7, it's a decline that's greater than the 12.7 percent  
10 you show in your table 10. Correct?

11 A That is correct, but you've got to look at the  
12 progression that's taking place. In '97, the interim year,  
13 the total is 14.9 percent, so that's a reduction of 13.8.  
14 And then from 14.9 in '97 it goes to 13 even in '98, or a  
15 1.9-percent decrease. So we've got a definite leveling off  
16 which one would expect because there's only so much shift  
17 that can take place in these migrations. We've experienced  
18 that in Standard A mail over the years. And you've  
19 experienced it in your own --

20 Q Sure.

21 A Systems.

22 Q But your table 11 -- excuse me, your table 10 --  
23 shows the decline for two years.

24 A That's correct.

25 Q And from the base year to the test year is a

1 decline greater than you show in table 10. I think you've  
2 agreed. Is my math correct?

3 A Yes. Yes.

4 Q Okay. Let's go back. I didn't mean to --

5 A But the dynamic is the importance here, because  
6 the dynamic changes through time.

7 Q Let's go back to the -- where I left off, which  
8 was your criticism of Dr. Clifton concerning the time period  
9 he used, and your testimony was that your criticism is not  
10 irrelevant -- notwithstanding your reliance that the  
11 principal cause for the decline in unit costs is first -- is  
12 the mail mix shift. Just setting the table here just to set  
13 us back.

14 MR. CORCORAN: Let me show you or provide to you  
15 another exhibit.

16 [Cross-Examination Exhibit No.  
17 ABA/EEI/NAPM-XE-3 was marked for  
18 identification.]

19 BY MR. CORCORAN:

20 Q Preliminarily, Dr. Andrew, if you would turn to  
21 page 32.

22 A Yes.

23 Q Is the purpose of this table -- and I guess I said  
24 Table 32, I apologize -- page 32, Table 12 -- is the purpose  
25 of this table to demonstrate that Dr. Clifton's use of the

1 CRA data from the period '94 to '96 was too short a period  
2 to be representative?

3 A That and the fact that it's the most negative --  
4 largest decrease of the whole period. In fact, it's the  
5 only decrease in the whole period.

6 Q And -- well, that's not quite true, is it?  
7 Doesn't '93 go down slightly for a one-year period?

8 A Yes, on the one-year period, you're right.

9 Q Now, your Table 12 shows the cost per piece and  
10 percentage change for one year and two years for work-shared  
11 first class mail, correct?

12 A Yes.

13 Q And now we can go to what I've labeled ABA/EEI  
14 Cross-Examination Exhibit 3, and it was handy that you  
15 pointed to Dr. Clifton's Table 8, because as you note, we've  
16 attempted to replicate your Table 12 for the years 1988  
17 through '96.

18 The non-automation share, column two, comes from  
19 Dr. Clifton's Table 8. The percentage change is just the  
20 calculation of the difference between the years, and the  
21 automation share also comes from Dr. Clifton's Table 8, and  
22 again, the percentage point change is simply the difference  
23 in the year, and the costs in item -- excuse me -- row 6 are  
24 yours, from your Table 12, as is the percent change. Do you  
25 see that?



1 A Yes.

2 Q Now, given your testimony about the -- that mail  
3 mix would cause -- caused the decrease, let me direct your  
4 attention, for example, to 1992. You see the automation  
5 share from the period from '91 to '92, okay? You see that  
6 the automation share in '92 is 62.3 percent, correct?

7 A Yes.

8 Q And that's a drop from '92 of 16.2 percentage  
9 points, correct?

10 A No.

11 Q What is it?

12 A You said it was a drop from '92? Drop from '91.

13 Q Thank you. I mis-spoke, and I apologize.

14 A Yes, from '91 to '92, the change is 16.2 percent.

15 Q And the automation share went up by an equal  
16 amount.

17 A Correct.

18 Q And the unit cost you show went up by 3.6 percent,  
19 correct?

20 A That's correct.

21 Q And in fact, Dr. Clifton -- excuse me -- Dr.  
22 Andrew, in year 1989, there's a volume shift; in 1990,  
23 there's a volume shift; in 1991, there's a volume shift; and  
24 in each of those years, the costs go up, correct?

25 A That's correct, and in each of those years we had

1 higher rates of inflation that we do currently. So, your  
2 base -- when I talked about what could change -- what can  
3 change the average cost of the piece within that work-shared  
4 mail, it can be the general level of cost, as well.

5 Q When you refer to inflation, are you referring to  
6 postal costs specifically or just your general sense of how  
7 inflation was at the time?

8 A Well, the one I looked at was transportation, I  
9 think. I just looked at it to see what was happening back  
10 there, and most costs in that period were more than they are  
11 today, in terms of the indices.

12 Q I see. And did you look at that after I sent you  
13 this cross-examination exhibit yesterday?

14 A Yes, but I looked at it specifically again just to  
15 make sure.

16 Q Sure. And if -- could --

17 A By the way, I didn't get this till this morning,  
18 but that's okay.

19 Q Well, I knew we wouldn't be up till --

20 Is it possible that the decline that's shown, say,  
21 in '96, the decline in cost there, due to inflation being  
22 reduced?

23 A It could.

24 Q And also, you notice those costs go down in '95  
25 and '96. Classification reform was implemented in '95,

1 perhaps? Do you know?

2 A Ninety-six.

3 Q I see. Were mailers taking steps in '95 in  
4 anticipation of the classification reform?

5 A I do not know.

6 Q If they were, would that have influenced costs  
7 during that period?

8 A I do not know. It could have, I suppose.

9 Q Okay. Classification reform was in effect in '96.  
10 Could that cause these costs to be reduced?

11 A You just asked that question, didn't you?

12 Q In '96, not '95. You said -- I thought you told  
13 me that classification reform became effective in '96.

14 A Yes.

15 Q Could that be a contributing factor to the reduced  
16 costs shown in the last column here?

17 A I do not know. I haven't analyzed those changes.

18 Q Okay, that's fine.

19 Turning to a different topic, do you understand  
20 that Dr. Clifton's negative 3.6 roll-forward factor applies  
21 to mail processing costs for First Class work-shared mail?

22 A Yes.

23 Q Do you agree that Dr. Clifton's volume forecasts  
24 reflect the regression methodology and equations developed  
25 by Witnesses Thress and Tolley?

1 A Would you repeat the question, please?

2 Q Do you agree that Dr. Clifton's volume forecasts  
3 reflect the regression methodology and equations developed  
4 by USPS Witnesses Thress and Tolley?

5 A Yes. They purport to do that.

6 I have not checked them in great detail, however,  
7 because we were never able to obtain a machine-readable form  
8 other than the hard-wired copy with the numbers in it of Dr.  
9 Clifton's workpapers.

10 Q Did you request from counsel any assistance?

11 A Yes.

12 Q Which -- I don't mean yours. I mean me or Mr.  
13 Warden, who is at my right.

14 A It was my understanding that there had been two or  
15 three iterations of it and we finally gave up and did it by  
16 hand, what we could do.

17 Q Well, I will just say that it wasn't passed on to  
18 me.

19 Your Table 9, which is on page 26, shows the  
20 combined effects of Dr. Clifton's proposal concerning First  
21 Class mail, correct?

22 A Yes. All of his proposed changes that are  
23 reflected in the combination, namely Technical Appendix D as  
24 in "dog."

25 Q Right, and his Technical Appendices break out his

1 proposals separately, correct?

2 A Yes.

3 Q So for example with respect to what he has called  
4 his discount proposal, that is in Technical Appendices C-1?

5 A I believe that is correct.

6 Q Okay. Did you examine -- well, let me phrase it  
7 this way.

8 Under his discount proposal, isn't it correct that  
9 revenues for First Class work-shared mail increased by \$205  
10 million?

11 A That is what your exhibit -- potential  
12 Cross-Examination Exhibit page 2 says and we checked it and  
13 the answer is yes.

14 Q And isn't it also correct that there is no impact  
15 on Standard A commercial mail?

16 A That's right.

17 It is also true that the revenue is in imbalance  
18 inn First Class and you are -- you have used up \$152 million  
19 that you don't have.

20 Q Well, let me see if I understand your position.  
21 Your testimony addresses his combined proposals. Is it also  
22 your testimony or the position of your clients that you  
23 object to Dr. Clifton's discount proposal, which has no  
24 impact on Standard A mail?

25 A I can't speak for counsel.

1           Q     Okay -- never mind your clients. Let me limit  
2 it -- let me limit it to you and I will rephrase it.

3                     Your testimony addresses the combined effects. As  
4 we just discussed, his discount proposal has no impact, no  
5 revenue impact, on Standard A mail.

6                     Do you or is it your testimony that you object to  
7 this portion of his analyses or is it only the combined  
8 presentation?

9                     MR. TODD: May I -- Mr. Chairman, even there I  
10 suppose the witness can speak for himself. It seems to me  
11 that the question of what this testimony does is contained  
12 in the testimony. I don't believe that asking a witness in  
13 the abstract whether he objects to a certain result within a  
14 given class of mail is a proper question.

15                     I think the question should be focused on the  
16 analysis which has been done by the witness and whether that  
17 analysis -- whatever questions he may want to ask about the  
18 analysis, but getting back to the question of what is the  
19 ultimate result of this and whether he thinks it's a good  
20 idea or a bad idea I think is well beyond the scope of his  
21 testimony.

22                     CHAIRMAN GLEIMAN: Mr. Corcoran, do you want to  
23 comment before I rule?

24                     MR. CORCORAN: Okay. His testimony is -- he had  
25 Dr. Clifton's testimony in front of him. Dr. Clifton's

1 testimony consists of three proposals. He has combined all  
2 of them, I am attempting to examine one portion of that  
3 testimony. I think it is proper and the witness should  
4 answer.

5 CHAIRMAN GLEIMAN: I'm not sure that I follow.

6 MR. CORCORAN: I am examining -- he has combined,  
7 in his Table 9, and throughout his analyses, Dr. Clifton's  
8 various proposals with respect to First Class mail.

9 My client is only interested in the discounts  
10 testimony and that is what I am focusing on at the moment.  
11 The discount proposal has no impact in terms of increased  
12 revenues on standard mail. So the question to the witness  
13 was simply, do you object to that proposal?

14 MR. TODD: If I may just perhaps clarify things,  
15 or perhaps not. But, as is stated on page 1, a note to  
16 footnote 1 of the testimony of Mr. Andrew, the reason he  
17 combined this is because Dr. Clifton chose to combine it  
18 and, therefore, there wasn't any other intelligent way of  
19 putting the matter.

20 Now, if Mr. Corcoran would like to know whether  
21 the Mail Order Association of America or the other parties  
22 submitting this testimony are particularly concerned, at  
23 least insofar as this analysis goes, as to what happens  
24 within the First Class mailstream so long as it doesn't  
25 negatively affect Standard A, the answer is we really don't,

1 as a general matter. It doesn't mean that in certain areas  
2 we may not take positions pro or con particular issues.

3 But, again, Mr. Andrew's testimony is an analysis,  
4 in part, of Dr. Clifton's testimony, and it seems to me that  
5 any cross-examination concerning that analysis is proper.  
6 But going beyond to say whether he likes the end rate  
7 results or not is not proper.

8 CHAIRMAN GLEIMAN: I am afraid I am going to have  
9 to ask you to reconsider your question or rephrase your  
10 question, or withdraw your question, Mr. Corcoran.

11 MR. CORCORAN: Okay. I will deem it withdraw.

12 BY MR. CORCORAN:

13 Q Switching topics, is it your testimony that the  
14 cost characteristics of automation work-shared First Class  
15 mail and Standard A mail are not similar?

16 A The cost characteristics?

17 Q Yes.

18 A Yes, it is my testimony that they are not similar.

19 Q That they are not similar. I see. Did you bring  
20 USPS Exhibit 29(c) with you?

21 A Yes.

22 Q Could you take that out, please?

23 A I have it, sir.

24 CHAIRMAN GLEIMAN: Actually, Mr. Corcoran, I think  
25 it's best that you identify what they are on the record, so



1 that the record shows what it is you are talking about.

2 MR. CORCORAN: Sure. Thank you, Mr. Chairman.

3 BY MR. CORCORAN:

4 Q Dr. Andrew, do you have before you USPS Exhibit  
5 29(c), page one, which is first class unit cost estimates?

6 A That's page one of six?

7 Q Yes, sir.

8 A Yes, sir.

9 Q And page two, which is standard regular unit cost  
10 estimates?

11 A Yes, sir.

12 Q The columns there show mail processing and  
13 delivery costs for various types of first class mail and  
14 standard A mail; is that correct?

15 A Yes.

16 Q Would you agree that the mail processing and  
17 delivery costs, for example, for first class automation  
18 three digit and standard A automation three digit, are  
19 similar?

20 A They are within two-tenths of a cent, yes, on a  
21 base of eight.

22 Q I'm sorry. Your answer was yes, they are similar?

23 A Yes.

24 Q Are the mail prep requirements for these two types  
25 of mail similar, that is automation presort, first class

1 presort and standard A automation?

2 A I am not familiar with standard A.

3 Q Are they processed on the same machines by the  
4 Postal Service?

5 A Some of the materials are, yes.

6 Q Letter shaped mail?

7 A Yes. That's my understanding.

8 Q Except for perhaps certain air transportation, are  
9 they transported in the same vehicles?

10 A Oh, definitely not, because standard A mail is  
11 heavily drop shipped and first class mail does not drop  
12 ship.

13 Q Once they get to the destination facility, whether  
14 it's a SCF or DDU, whatever it happens to be, aren't they  
15 commingled at that point and transported together?

16 A But you are trying to make an identification that  
17 the costs are so similar between these two and they  
18 definitely are not when it comes to transportation.

19 Q But overall, the costs, as you just noted, between  
20 automation, work shared, first class, three digit and  
21 standard automation are remarkably similar; correct?

22 A For those two functions, yes, for mail processing  
23 and delivery.

24 Q Is it correct that in the Postal Service's  
25 analyses, Witness Daniel and Witness Hatfield used the same

1 productivities for standard A mail and work shared first  
2 class mail?

3 A I did not check standard -- first class.

4 Q Is it correct that standard A letter mail weighs  
5 approximately 50 percent more than first class automation  
6 work shared letters?

7 A Would you repeat that?

8 Q Is it correct that standard A letter mail weighs  
9 approximately 50 percent more than first class automation  
10 work shared letters?

11 A That's what the exhibit showed that you gave me  
12 and we checked it and the answer is yes, according to the  
13 Postal Service's information, it's actually 63 percent, but  
14 it turns out --

15 Q That's what I had, too.

16 A But it turns out that the cost is a J shaped curve  
17 in that area of weight and as you get lighter and lighter  
18 pieces, the costs have been shown to go up.

19 Q Pardon me? Could you repeat that, please?

20 A Yes. If you draw a graph and on the horizontal  
21 axis, show weight in ounces, and on the vertical axis, you  
22 show costs, unit costs of mail, as the piece gets lighter in  
23 the area of two to one to zero or 6.66, which I think is  
24 your average, the costs go up, not down.

25 Q What costs are they? What costs go up?

1 A The processing costs.

2 Q Mail processing costs?

3 A Yes.

4 Q That's not born out by the USPS Exhibit 29(c),  
5 pages one and two.

6 A You don't have weights in here.

7 Q You have the average weights that I forwarded to  
8 you. Aren't those reflected in this data by the Postal  
9 Service in 29(c)?

10 A Yes, but you have different handling  
11 characteristics of each one of them. Take and compare one  
12 to one.

13 May I confer with counsel a moment?

14 Q This could be done on redirect, perhaps. I'm  
15 willing to move on, given the hour, and if they want to do  
16 it on redirect, that's fine.

17 A I have references to Library Reference 182 on this  
18 matter.

19 CHAIRMAN GLEIMAN: Well, if Mr. Corcoran is  
20 willing to withdraw whatever question it was he was asking  
21 you --

22 MR. CORCORAN: Yes.

23 CHAIRMAN GLEIMAN: -- then we don't have to worry  
24 about that right now.

25 THE WITNESS: Thank you.

1 BY MR. CORCORAN:

2 Q You talk about, at page 36 of your testimony --  
3 and this follows up on the cost characteristics issues, and  
4 you talk about first class letters have a higher value and  
5 that's demonstrated by certain specific characteristics  
6 which you detail on lines 6 through 11 on that page,  
7 correct?

8 A Yes.

9 Q Now, in Witness Hatfield's analysis, isn't it  
10 correct that he employed a paid premium adjustment to  
11 reflect the fact that first class mail is being accorded  
12 expeditious handling and a higher delivery priority?

13 A Would you repeat that and give me a reference in  
14 --

15 Q Page 13 -- Appendix 1, page 13 of USPS-T-26.  
16 Isn't it correct that, in his analysis, he employs a paid  
17 premium adjustment that reflects first class mail being  
18 accorded expeditious handling and delivery priority?

19 A Give me your cite again, please.

20 Q It's page 13 of Appendix 1.

21 MR. CORCORAN: May I approach the witness just to  
22 show him the page?

23 THE WITNESS: I've got it.

24 MR. CORCORAN: And just for the record, we  
25 indicated in correspondence to Mr. Todd that we would -- we

1 may use this material, that's all.

2 BY MR. CORCORAN:

3 Q Do you have it?

4 A I have it.

5 Q Do I need to repeat the question?

6 A No. Just give me your reference on the page.

7 There's a lot of numbers on the page.

8 Q It's column six, premium pay adjustment.

9 A Yes.

10 Q All right.

11 Now, isn't it the case that Witness Hatfield  
12 increased unit costs by 1.1 percent to reflect that or do  
13 you know?

14 A He changed it with the premium pay, but the  
15 premium pay does not reflect all of the costs associated  
16 with that. That's a proxy.

17 Q It's a proxy for what?

18 A For the correction that your question asked.

19 Q Doesn't it relate -- the premium pay relates to  
20 expeditious handling and delivery, does it not?

21 A Yes.

22 Q Now, isn't it also true that Witness Daniel also  
23 reflected a negative premium pay adjustment with respect to  
24 standard A mail?

25 A Yes, I recall that.

1 Q And these are both cost items. That's your item  
2 -- line 7, first class mail is accorded expeditious handling  
3 and delivery?

4 A Yes.

5 Q Isn't it true, therefore, that those costs are  
6 already reflected in the attributable costs for this mail?

7 A Only part of them.

8 Q Isn't it also true that with respect to your line  
9 9, item D, First Class mail benefits from free forward and  
10 return, that that too is a cost item reflected in the  
11 attributable costs of First Class mail?

12 A Yes, but it's not in the model. I do not believe  
13 it's in the model used by Witness Daniel for First Class.

14 Q Witness Daniel didn't do the First Class, did she?

15 A No, she used somebody else's. But she made no  
16 correction in there.

17 Q Isn't it also true that the attributable costs for  
18 First Class work-shared mail reflect the benefits of  
19 dead-letter operations which you cite on line 10 of your  
20 testimony?

21 A Yes, I believe it does.

22 Q And isn't it also true that the attributable costs  
23 for First Class mail reflect what you cite at line 6, the  
24 long-distance mailings are transported by air?

25 A No.

1 Q That's not an attributable cost item?

2 A It is an attributable cost item, but if you look  
3 at how the -- I take that back. Yes, it is in the total  
4 cost.

5 Q Thank you. So isn't it true of the five items you  
6 identify here, only the sealed against inspection is a value  
7 item?

8 A No, they're all value items. Some of them have  
9 had some accounting for the additional costs, but not all.

10 Q Some have attributable costs associated with them,  
11 and some don't. Is that your testimony?

12 A And the ones that do, we have no guarantee that  
13 all the attributable costs are accounted for.

14 Q And would that be -- if they're counted as  
15 attributable costs and then they're counted as a value item,  
16 would that be in the parlance of regulatory terms a double  
17 counting of the same factors?

18 A Yes. If they both had the total.

19 Q Thank you, Dr. Andrew.

20 MR. CORCORAN: Mr. Chairman, thank you very much.

21 Can I move the transcription of the  
22 Cross-Examination Exhibits 1 through 3, please?

23 CHAIRMAN GLEIMAN: I'll direct that ABA et al.  
24 Cross-Examination Exhibits 1, 2, and 3 be transcribed into  
25 the record at this point.



1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

[Cross-Examination Exhibit Nos.  
ABA/EEI/NAPM-1 through  
ABA/EEI/NAPM-3 were transcribed  
into the record.]

ABA/EEI/NAPM Cross Exam. Exh. 1

**Actual Mail Mix Changes for 1994-1996  
Assuming No Change in Costs**

	<u>Nonauto</u>	<u>Auto</u>	<u>Weighted Ave. Costs</u>
1. <u>1994</u>			
a. Cost (cents per piece) <sup>1</sup>	7.100	4.800	
b. Share (percent) <sup>2</sup>	<u>42%</u>	<u>58%</u>	
c. Weighted costs	2.982	2.784	5.766
2. <u>1996</u>			
a. Cost (cents per piece)	7.100	4.800	
b. Share (percent)	<u>29%</u>	<u>71%</u>	
c. Weighted costs	2.059	3.408	5.467
3. Change from 1994-1996			-5.2%

---

<sup>1</sup> Smith USPS-T-10A (revised 5/17/95) in Docket No. MC95-1 shows an automation 3-digit cost of 4.7932 cents, including non-modelled costs. He shows a 3/5 digit presort model cost of 5.042 cents compared to automation 3-digit model costs of 3.4314 cents, or, stated otherwise, the nonautomation mail is approximately 47% greater. Thus, the 7.1 cents is 47% greater than Smith 3-digit automation.

<sup>2</sup> Actual percentage share; see Clifton testimony at 19, Table 8.

---

ABA/EEI/NAPM Cross Exam. Exh. 2

**Actual Mail Mix Changes for 1994-1996  
Assuming 10 Percent Change in Costs**

	<u>Nonauto</u>	<u>Auto</u>	<u>Weighted Ave.Costs</u>
1. <u>1994</u>			
a. Cost (cents per piece) <sup>1</sup>	7.100	4.800	
b. Share (percent) <sup>2</sup>	<u>42%</u>	<u>58%</u>	
c. Weighted costs	2.982	2.784	5.766
2. <u>1996</u>			
a. Cost (cents per piece)	7.810	5.280	
b. Share (percent)	<u>29%</u>	<u>71%</u>	
c. Weighted costs	2.265	3.749	6.013
3. Change from 1994-1996			4.3%

---

<sup>1</sup> Smith USPS-T-10A (revised 5/17/95) in Docket No. MC95-1 shows an automation 3-digit cost of 4.7932 cents, including non-modelled costs. He shows a 3/5 digit presort model cost of 5.042 cents compared to automation 3-digit model costs of 3.4314 cents, or, stated otherwise, the nonautomation mail is approximately 47% greater. Thus, the 7.1 cents is 47% greater than Smith 3-digit automation.

<sup>2</sup> Actual percentage share; see Clifton testimony at 19, Table 8.

**Annual Change in Costs and Mail Mix for  
First-Class Workshared Mail**

<u>Year</u>	<u>% nonauto share<sup>1</sup></u>	<u>% Pt chg nonauto<sup>2</sup></u>	<u>% auto. share<sup>3</sup></u>	<u>% Pt chg auto<sup>4</sup></u>	<u>cost cents<sup>5</sup></u>	<u>% change<sup>6</sup></u>
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1988	93.8	xxx	6.2	xxx	9.8	xxx
1989	91.8	(2.0)	8.2	2.0	10.2	4.1
1990	87.3	(4.9)	12.7	4.9	10.5	2.9
1991	78.5	(8.8)	21.5	8.8	11.2	6.7
1992	62.3	(16.2)	37.7	16.2	11.6	3.6
1993	48.2	(14.1)	51.8	14.1	11.5	(0.9)
1994	41.4	(6.8)	58.6	6.8	11.9	3.5
1995	35.5	(5.9)	64.5	5.9	11.0	(7.6)
1996	28.8	(6.8)	71.3	6.8	10.6	(3.6)

---

<sup>1</sup> Source: Clifton testimony page 19, Table 8, sum of cols. 1-3, representing non-automation volumes.

<sup>2</sup> Column shows percentage point change from prior year.

<sup>3</sup> Source: Clifton testimony page 19, Table 8, sum of cols. 4-9, representing automation volumes..

<sup>4</sup> Column shows percentage point change from prior year.

<sup>5</sup> Source: Andrew testimony page 32, Table 12.

<sup>6</sup> Source: Andrew testimony page 32, Table 12.

---

1 CHAIRMAN GLEIMAN: I think I'd like to take a  
2 ten-minute break right now.

3 [Recess.]

4 CHAIRMAN GLEIMAN: Mr. Littell?

5 CROSS-EXAMINATION

6 BY MR. LITTELL:

7 Q Mr. Andrew, are you ready?

8 A Yes, sir.

9 Q In my notice of intent to cross examine you, I  
10 asked that you bring with you all your work papers and  
11 computer runs relating to Dr. Clifton and MMA Witness  
12 Bentley's proposals on automation discounts. Do you recall  
13 that?

14 A Yes, sir.

15 Q In response to my request, didn't I meet this  
16 afternoon with you and your attorneys to look through all  
17 those back-up materials?

18 A Yes, sir, you did.

19 Q Isn't it true that those back-up materials do not  
20 include any computer runs or computations concerning Mr.  
21 Bentley's testimony or exhibits?

22 A No computer runs, and the only computations were  
23 verifications in the margins of his values, that is true.

24 Q Now, your testimony includes, in addition to the  
25 written text, three exhibits denominated as MOA --

1 MOAA-RT-1A through RT-1C. Is that right?

2 A That is correct.

3 Q Exhibit MOAA-RT-1A discusses the testimony of  
4 Witness Chown and not Mr. Bentley.

5 A That is correct.

6 Q And Exhibit MOAA-RT-1B also discusses the  
7 testimony of Witness Chown and not Mr. Bentley.

8 A That is true.

9 Q And the third and last exhibit, MOAA-RT-1C,  
10 compares proposals of Mr. Clifton and Witness Hatfield and  
11 not Mr. Bentley.

12 A That's true, but what Mr. Bentley was working on  
13 was the same thing as in -- or parts of the same material  
14 that this flow chart shows.

15 Q Thank you for that qualification.

16 Now, let's turn to your testimony rebutting MMA  
17 Witness Bentley. That testimony begins on page 44 of your  
18 rebuttal testimony and continues for three lines on page 45,  
19 correct?

20 A That is correct.

21 Q And your entire rebuttal to Mr. Bentley is four  
22 paragraphs long. That's correct, too, isn't it?

23 A That is correct.

24 Q Now, isn't the first of those four paragraphs just  
25 an introductory description of Mr. Bentley's testimony

1 without any specific criticism?

2 A Yes.

3 Q Now, please look at the second and third  
4 paragraphs of your testimony.

5 In those paragraphs, isn't your only criticism of  
6 Mr. Bentley that he used the Commission's traditional  
7 methodology that classifies mail processing labor costs as  
8 100-percent variable instead of the Service's proposed  
9 methodology?

10 A That's what the second paragraph says, yes.

11 Q And the third does, too, including your  
12 affirmation that you prefer the Service's methodology.

13 A That's correct.

14 Q All right.

15 Now, please turn to page 24 of your testimony.

16 A Yes.

17 Q There, didn't you state four criticisms of Dr.  
18 Clifton's adjustments to automation discounts with which you  
19 disagree?

20 A Yes.

21 Q Now, looking at lines 5 and 6 on that page, isn't  
22 one of your criticisms of Dr. Clifton directed at Dr.  
23 Clifton's reduction in first class work-share letter mail  
24 processing costs that manifests itself as a reduced  
25 roll-forward factor in USPS Witness Hatfield's model?

1 A That's correct.

2 Q Incidentally, did Mr. Bentley recalculate the  
3 Service's roll-forward factor?

4 A I do not believe he did.

5 Q Looking at lines 6 and 7 of that page, isn't your  
6 second criticism of Dr. Clifton that he proposes a test year  
7 reduction in First Class work-sharing letter delivery costs?

8 A Yes.

9 Q Did Mr. Bentley propose any reduction in the  
10 Service's deliver costs?

11 A I do not recall precisely.

12 MR. LITTELL: Mr. Chairman, with your permission,  
13 I would like to approach the witness and show him some pages  
14 from a transcript. And his counsel already has a copy of  
15 that.

16 CHAIRMAN GLEIMAN: Please proceed.

17 THE WITNESS: Okay.

18 BY MR. LITTELL:

19 Q Why don't we switch?

20 A Okay. Good. Thank you.

21 Q Looking at transcript page 11236 from Volume 21,  
22 didn't Mr. Bentley respond to a Postal Service Interrogatory  
23 by conceding that the only change he made in deriving his  
24 discount figures was one change from the Postal Service's  
25 presentation and that was to assume that labor costs vary



1 100 percent with volume?

2 A Yes.

3 Q So he didn't make any change, did he, in the  
4 delivery costs?

5 A Delivery costs.

6 Q Are we agreed that he did not make a change in  
7 delivery costs?

8 A Yes. That was my recollection, but I wasn't going  
9 to say it without checking.

10 Q Thank you. Now, looking at lines 7 through 8 of  
11 your rebuttal testimony on page 24, isn't your third  
12 criticism of Dr. Clifton that he proposed a test year  
13 increase in the benchmark that Witness Hatfield used to  
14 determine cost savings for work-shared discounts?

15 A Yes.

16 Q Did Mr. Bentley propose any increase or change in  
17 the benchmark that USPS Witness Hatfield used?

18 A I haven't figured that out.

19 Q Perhaps I can help you. Would you look again at  
20 the excerpts from transcript Volume 21 in this case, page  
21 11235. Do you see that the Postal Service asked Mr. Bentley  
22 whether he didn't in fact use the same bulk metered mail  
23 benchmark as did the Postal Service?

24 A But be also conditions that by saying, "For this  
25 reason, I did not specifically accept or reject the Postal

1 Service's use of the bulk metered mail as the appropriate  
2 benchmark for measuring First Class automated letter cost  
3 savings.

4 Q Yes. But wasn't the question, and I quote,  
5 "Please confirm that in developing your letter automation  
6 proposals, you used bulk metered mail as the benchmark, as  
7 did Witness Fronk, in developing the Postal Service  
8 proposal." And his answer, to begin with, was, --

9 A Confirmed.

10 Q -- quote, "Confirmed." close quote.

11 A Confirmed.

12 Q So you would agree, he used the same benchmark?

13 A Yes.

14 Q Looking at line 9 on page 24 of your rebuttal  
15 testimony, isn't your fourth criticism of Dr. Clifton based  
16 on his reduction in the cost coverage for First Class  
17 work-shared letter mail, that you say is based on subjective  
18 considerations of efficiency and equity?

19 A I'm sorry. I missed the question.

20 Q Please look --

21 A Line 9, fourth adjustment --

22 Q Yes, look at line 9 through line 11 on page 24 of  
23 your testimony, beginning with the last two words on line 9.  
24 Isn't your, quote, "fourth" criticism of Dr. Clifton based  
25 on his reduction in the cost coverage for First Class

1 work-shared letter mail which you say is based on subjective  
2 considerations of efficiency and equity?

3 A Yes.

4 Q Did Mr. Bentley derive his proposed discounts by  
5 first making a reduction of cost coverage based on  
6 subjective considerations of efficacy and equity?

7 A No, he did not.

8 MR. LITTELL: Mr. Chairman, I want to thank  
9 Witness Andrew and his counsel for being very cooperative  
10 and showing me his workpapers this afternoon and allowing me  
11 to confer with him.

12 That concludes my cross examination.

13 CHAIRMAN GLEIMAN: Mr. Baker.

14 MR. BAKER: Thank you, Mr. Chairman.

15 CROSS-EXAMINATION

16 BY MR. BAKER:

17 Q Good evening, Mr. Andrew. Let's turn to page 12  
18 of your testimony on the paragraph that appears at the top  
19 of that page. Are you there?

20 A Yes, sir.

21 Q And focusing on lines 3 and 4 where you discuss  
22 Ms. Chown's use of the piggyback factor to allocate indirect  
23 costs to identifiable institutional costs, do you see that?

24 A Yes.

25 Q Are you familiar with the concept of piggyback

1 costs?

2 A Yes.

3 Q Could you state your understanding of them,  
4 please?

5 A It's the portion of the costs that are considered  
6 volume variable that vary with the labor but they are not  
7 labor itself, so it is supervision that changes as the  
8 amount of labor required changes and similar kinds of they  
9 are costs that are attributable or volume variable, but they  
10 are not, excuse me, measured -- I shouldn't say they are not  
11 measured.

12 They are added to the labor costs or piggybacked  
13 on top of the labor costs.

14 Q They are indirect costs in other words?

15 A Yes.

16 Q Do you know --

17 A But they are not fixed costs, they are --

18 Q Do you know whether they include employee  
19 benefits?

20 A I believe they do.

21 Q Do they include a portion of costs such as space  
22 and utilities that are used to provide the functions that  
23 the employee is engaged in?

24 A I believe they do.

25 Q Okay. Let's take a look at mail processing, for

1 example, for each dollar of attributable labor cost of mail  
2 processing is it your understanding that the Postal Service  
3 also computes a piggyback factor that measures these  
4 additional indirect costs that are added to the directly  
5 attributable costs?

6 A Yes.

7 Q Okay -- and so let's assume for example that for  
8 every dollar of mail processing costs 90 cents are  
9 attributed.

10 A Yes.

11 Q For example -- and would each of those 90 cents of  
12 direct labor costs cause the Postal Service to incur these  
13 indirect supervisory and employee benefit and other costs?

14 A Well, the 90 cents wouldn't but the labor that's  
15 associated with that 90 cents would.

16 Q Now let's consider the remaining 10 cents of labor  
17 costs that are deemed institutional.

18 Does the mail processing employee get paid  
19 benefits on the basis of his or her salary -- full salary --  
20 or only based upon the portion of his efforts that are  
21 attributable?

22 A Full salary, I believe.

23 Q Okay, and does his or her supervisor supervise the  
24 mail processing employee only when the employee is  
25 performing work that can be attributed or does the

1 supervisor supervise the employee at other times as well?

2 A I don't know.

3 Q If the portion of mail processing costs that were  
4 attributable declined so that 80 cents out of every dollar  
5 is attributable instead of the 90 cents we assumed  
6 previously, but total labor costs remained the same, would  
7 the cost of the employee benefits decline?

8 A No.

9 Q Do you know whether the amount of supervisory time  
10 would decline?

11 A I don't know.

12 Q Okay. Thank you.

13 Mr. Andrew, could you please turn to your Exhibit  
14 MOAA et al. RT-1B.

15 A Page?

16 Q 1. Do you have it?

17 A Yes, sir.

18 Q At the -- let's see -- do you show here a  
19 calculation of institutional cost contributions using a  
20 marginal cost metric and assuming equal markups at the top  
21 part of that exhibit?

22 A Yes.

23 Q And setting aside the assumed equal markups, is it  
24 your testimony that the method shown in the top half of this  
25 exhibit matches the current method of assigning

1 institutional costs?

2 A Subject to your caveat that it's not equal  
3 markups, it's up to these gentlemen here to make the  
4 markups, yes. This was just an illustrative example.

5 Q I understand. Right. And under the current  
6 method the Commission would look at the attributable costs,  
7 select what it believes are reasonable markups, and apply  
8 those markups to the attributable costs. Correct?

9 A That's my understanding. Yes.

10 Q Okay. And if the Commission were to do that in  
11 this example here on the page of your exhibit, it would  
12 assign the total amount of institutional costs which are if  
13 I am correct 150?

14 A Yes, sir.

15 Q Okay. Now directing your attention to the bottom  
16 half of the exhibit, here you show how the institutional  
17 cost contributions are calculated using the Chown method as  
18 drawn from her testimony. Correct?

19 A Yes.

20 Q And in this example using weighted attributable  
21 costs once again -- well, have you applied equal markups  
22 here as well?

23 A Yes.

24 Q And under the proposed Chown method that you used  
25 here, is the sum of the weighted attributable costs equal to

1 the sum of the unweighted attributable costs?

2 A It is forced to do that by the nature of her  
3 metric.

4 Q Right.

5 A As we proved in the --

6 Q Yes. So under the --

7 A Exhibit.

8 Q Proposed Chown method the Commission would  
9 continue to assign the total amounts of institutional costs  
10 which in this example still come to 150; correct?

11 A Yes.

12 Q Okay. So in each method the Commission would  
13 decide on the markup and assign total amount of  
14 institutional costs based on its consideration of the  
15 relevant factors; correct?

16 A Starting from what point?

17 Q Well, starting from either point. Wouldn't the  
18 Commission --

19 A Okay. That's what I wanted to make sure that we  
20 understood, that one of them would be starting from true  
21 marginal cost or a proxy, namely attributable costs. The  
22 other one would be this weighted attributable costs.

23 Q Okay.

24 A That we don't know what it is.

25 Q Could you please turn to page 17 of your



1 testimony?

2 A Yes.

3 Q I have a question on table two that appears on  
4 that page. Is this a modification of one of Ms. Chown's  
5 examples?

6 A Yes. We added \$100 of system-wide institutional  
7 costs to see what impact it would have. That's the only  
8 modification.

9 Q Is this based on -- I hate to flip you back and  
10 forth -- back to Exhibit RT-1-B, is this based on page two  
11 of that exhibit?

12 A Yes.

13 Q Could we compare this, back on page 17, table 2,  
14 with table one on page 15, to see how the institutional cost  
15 contributions change as a result of the addition of the \$100  
16 of system-wide institutional costs that you have added to  
17 table two?

18 A I'm sorry. You are fading, sir.

19 Q Can I compare table two on page 17 to table one on  
20 page 15 to see how the institutional cost contributions  
21 change as a result of your adding \$100 of system-wide  
22 institutional costs?

23 A Yes.

24 Q Previously, I had distributed to your counsel a  
25 proposed cross examination exhibit by the cumbersome name of

~~X-EX 1.~~

1 NAA/MOAA et al-RT-1-~~XE-1~~. Did you receive that?

2 A Yes, I have that. Comparison of institutional  
3 cost contributions? Base case, case one?

4 Q Yes, sir.

5 [Cross-Examination Exhibit No.  
6 NAA/MOAA et al.-RT-1-XE-1 was  
7 marked for identification.]

8 MR. BAKER: Thank you, Mr. Littell, for your  
9 assistance.

10 BY MR. BAKER:

11 Q Referring you to my exhibit that was just handed  
12 to you, at the top of this page, this exhibit shows  
13 institutional cost contribution for each class of mail under  
14 the base case of your Exhibit RT-1-B, using the marginal  
15 cost method and the Chown method; correct? You might take a  
16 look at our Exhibit 1-B, page one.

17 A I'm sorry. I missed the question.

18 Q Could you turn to Exhibit 1-B, page one of four?

19 A Yes.

20 Q Where you have behavioral characteristics of the  
21 Chown metric base case.

22 A Sir, I'm sorry. I cannot -- I'm a little bit hard  
23 of hearing.

24 Q I apologize.

25 A I'm sorry.

1 Q Looking at Exhibit RT-1-B, page one, which is the  
2 base case, and my question is whether you are able to verify  
3 that the mark up or institutional cost contribution figures  
4 on my cross examination exhibit correspond with those  
5 provided on your Exhibit 1-B, page one?

6 A Yes, they do.

7 Q Is one difference that my exhibit uses percentages  
8 and yours uses cost coverages?

9 A Yes. Well, yours uses percentage of the --

10 Q I stand corrected.

11 A -- of the marginal costs or the attributable  
12 costs.

13 Q I have shown on my cross examination exhibit the  
14 percentage of institutional costs born by each sub-class of  
15 mail under both the marginal cost method and the Chown  
16 method; correct?

17 A Yes.

18 Q Again, assuming equal <sup>markups</sup> ~~mark-up's~~?

19 A Yes.

20 Q Now, on the bottom half of the cross examination  
21 exhibit labeled case one, it shows the institutional cost  
22 contributions assuming an additional \$100 of system-wide  
23 institutional costs; correct?

24 A Yes.

25 Q And do these figures correspond with those

1 provided in your Exhibit 1B, page 2?

2 A Yes, they do.

3 Q And, again, have I shown on my cross-examination  
4 exhibit, the percentage of institutional cost contributions  
5 borne by each subclass of mail under each method?

6 A Yes, except your Chown method, the percentage  
7 totals 100, not zero.

8 Q I accept that correction. Now, I notice that  
9 under each method, each -- on my cross-examination exhibit,  
10 each subclass pays the same percentage of the institutional  
11 costs both before and after the additional \$100 of  
12 institutional costs, is that correct?

13 A That is correct.

14 Q So does this exhibit show that the use of either  
15 method, with equal markups, results in no change in the  
16 share of institutional costs borne by each subclass of mail,  
17 is that correct?

18 A That is correct. With the assumptions that this  
19 example has.

20 Q Now, if we compare my cross-examination back to  
21 your Table 2 on page 17, on Table 2 has your -- does Table 2  
22 show a change in the markups or coverages of the classes of  
23 mail after the system-wide increase of \$100 of system-wide  
24 institutional costs?

25 A Yes.

1 Q Okay. And those markups, those cost coverages  
2 differ, correct?

3 A That is correct.

4 Q Okay. Is it one of the points of Ms. Chown's  
5 testimony that markups based on unweighted attributable  
6 costs may be misleading, at least in her opinion?

7 A I think that's one of the things she is concerned  
8 about, yes.

9 Q Now, I would like to move to a slightly different  
10 example that I have worked up in my next cross-examination  
11 exhibit which has the similarly awkward label, NAA/MOAA et  
12 al.-RT-1-X-XE2.

13 A Is that page 1 of 2, or page --

14 Q It's a two page exhibit.

15 A Okay.

16 MR. BAKER: I need to make sure Mr. Todd has his.

17 [Cross-Examination Exhibit No.  
18 NAA/MOAA et al.-RT-1-XE-2 was  
19 marked for identification.]

20 BY MR. BAKER:

21 Q Do you have that before you, Mr. Andrew?

22 A Yes, sir.

23 Q Okay. This is a two page exhibit in which the  
24 second page attempts to show how some of the numbers on the  
25 first page were derived. Were you able to follow that?

1 A Yes, sir.

2 Q Okay. Now, is this a variation of your Case 1  
3 from RT-Exhibit 1B, page 1, with the difference that the  
4 increased \$100 of institutional costs are directly related  
5 to the provision of function 2?

6 A Yes.

7 Q And so this is a bit different from your Case 1?

8 A Yes.

9 Q Have you reviewed the figures in this Exhibit 2  
10 and the related page in which we derive these results using  
11 the Chown method?

12 A Yes.

13 Q Are the figures calculated correctly?

14 A I believe so.

15 Q And referring to page 1 of that exhibit, Exhibit  
16 2, I notice that under the marginal cost --

17 A Would you hold --

18 Q Page 1.

19 A No, would you hold just a minute?

20 Q Oh, excuse me.

21 A I'm ready, sir. Thank you.

22 Q And I notice that on page 1 of Exhibit 2 under the  
23 marginal cost method the rates for each subclass rise by 25  
24 percent compared to the base case when the additional \$100  
25 of institutional costs were incurred associated with

1 Function 2, is that correct?

2 A Yes.

3 Q And I notice that under Ms. Chown's method the  
4 rates for Class A rise 25 percent and the rates for Class C  
5 rise by 45.5 percent but the rates for Class B remain  
6 unchanged, is that correct?

7 A That's correct.

8 Q Now is the reason why the rates for Class B remain  
9 unchanged under Ms. Chown's method that the institutional  
10 costs we have added are related to the provision of Function  
11 2 only and Class B does not use Function 2?

12 A Mathematically that is what happens, yes.

13 Q Referring you to the marginal cost side of this  
14 exhibit, do you believe it is equitable for Class B to pay  
15 25 percent more to cover an increase in cost for a function  
16 that the class does not use?

17 A Yes. When you have economies of scale and scope,  
18 yes.

19 Q Do you regard this as an area where you and Ms.  
20 Chown will simply disagree?

21 A Yes.

22 Q And I will not be able to talk you out of your  
23 position tonight?

24 A I doubt it. It's early in the evening though.

25 [Laughter.]

1 BY MR. BAKER:

2 Q All right. Could you turn now to page 20 of your  
3 testimony and look at Table 5?

4 A Yes?

5 Q This changes the hypothetical analysis that we  
6 have been following because here you show the effect of a  
7 reduction of attributable costs, correct?

8 A Yes.

9 Q Okay, and that reduction occurs because our Class  
10 A engages in work-sharing in Function 2, correct?

11 A That's correct.

12 Q And are we still using an assumption of equal  
13 mark-ups?

14 A Yes, we are.

15 Q And just as an aside, can we agree that that is as  
16 an unreasonable assumption now as it was all along?

17 A Yes, but it's something to look at. I have done  
18 these with varying rates but it gets messy, so --

19 Q Okay, and I notice that under your marginal cost  
20 method on the left side of Table 5 the rates for Class B  
21 increased by 4 percent because Class A has changed its use  
22 of Function 2, is that correct?

23 A That is correct.

24 Q Now in this hypothetical example, Class B is the  
25 class that does not use any of Function 2, correct?



1 A That's correct.

2 Q Why should the rates for Class B be affected in  
3 any way by the use Class A makes of Function 2?

4 A Because it was changing the overall institutional  
5 cost of the system.

6 Q How are we changing the institutional costs of the  
7 system?

8 A Because there -- well, I should say we are  
9 changing the base on which they're distributed. We are  
10 reducing the amount of attributable cost in the system.

11 Q Right. The change from this example -- the  
12 difference between this table and the ones we have discussed  
13 previously is this one we have reduced attributable costs in  
14 the system?

15 A That's right.

16 Q And as a consequence of this reduction of  
17 attributable costs, Class B sees a rate increase, is that  
18 correct?

19 A Yes.

20 Q In a sense is class B being made to pay a share of  
21 the institutional costs associated with function 2 that  
22 class A is no longer paying?

23 A Yes.

24 Q Okay. And under Ms. Chown's method on the right  
25 side of table 5 of your page 20, I see that if class A

1 reduces its use of function 2, the rates for class B are not  
2 affected. Is that correct?

3 A That's correct.

4 Q And that's because -- again because class B does  
5 not use function 2. Correct?

6 A That's correct. But you also have a major  
7 increase in class C, and even a more drastic decrease in  
8 class A, which was what she was trying to improve upon.

9 Q Well, now, class C, after this reduction in  
10 attributable costs, isn't it true that class C will be the  
11 heaviest user of function 2?

12 A Yes.

13 Q Now we've walked through a comparison of the Chown  
14 metric and the marginal cost metric in a number of examples.  
15 And I notice that you -- well, on page 23 of your testimony  
16 you conclude that the marginal cost metric responds to  
17 changes in a reasonable and predictable manner. Is that  
18 correct?

19 A Yes.

20 Q And you contend that the Chown approach does not?

21 A It does not.

22 Q For each of the changes we have discussed, do you  
23 think one could have predicted the results that have been  
24 achieved using the Chown method?

25 A Not the major variations that have occurred; no.

1 Q You don't think so? Well, that may be another  
2 area where you and she will have to agree to disagree?

3 A I think so.

4 Q Okay.

5 A Because through time it would be very difficult to  
6 track these as changes occur in the base attributable costs  
7 and the institutional costs.

8 Q All right. Could you turn now, shifting topics,  
9 to page 37 of your testimony, where you have some testimony  
10 regarding Dr. Clifton.

11 And just quickly I'd like to refer your attention  
12 to lines 15 and 16.

13 MR. BAKER: Actually, Mr. Chairman, I suppose  
14 before I do that I should move into the record my  
15 cross-examination exhibits.

16 CHAIRMAN GLEIMAN: Do you want them transcribed?

17 MR. BAKER: Yes, sir.

18 CHAIRMAN GLEIMAN: Are you going to provide copies  
19 to the reporter?

20 MR. BAKER: I believe -- has Mr. Littell done  
21 that?

22 CHAIRMAN GLEIMAN: Can I ask you a question with  
23 respect to Cross-Examination Exhibit No. 1?

24 MR. BAKER: Yes.

25 CHAIRMAN GLEIMAN: My recollection is that the

1 witness pointed out that there may have been an error in the  
2 last --

3 MR. BAKER: Yes.

4 CHAIRMAN GLEIMAN: Number on the bottom right-hand  
5 side. Did you correct that, or we'll just assume that it's  
6 corrected in the transcript?

7 MR. BAKER: It has been corrected in the  
8 transcript, but I would be happy to mark it if --

9 CHAIRMAN GLEIMAN: I think that that would make  
10 the record clearer.

11 And with that change on Cross-Examination Exhibit  
12 No. 1, then we'll have Cross-Examination Exhibit No. 1 and  
13 Cross-Examination Exhibit No. 2 transcribed into the record  
14 at this point.

15 MR. BAKER: Thank you.

16 CHAIRMAN GLEIMAN: There was no motion to  
17 introduce?

18 MR. BAKER: Oh, I'm sorry. I'd like to move them  
19 as evidence as well.

20 CHAIRMAN GLEIMAN: Without objection, transcribed  
21 and entered into evidence.

22 [Cross-Examination Exhibit Nos.  
23 NAA/MOAA et al.-RT-1-XE-1 and  
24 NAA/MOAA et al.-RT-1-XE-2 were  
25 received into evidence and

transcribed into the record.]

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

## Cross Examination Exhibit NAA/MOAA et al-RT-1 X-EX 1

**COMPARISON OF INSTITUTIONAL COST CONTRIBUTIONS**  
**Marginal Cost Method versus Chown Method**

<b>Base Case</b>	<b>Marginal Cost Method Institutional Costs</b>		<b>Chown Method Institutional Costs</b>	
	<b>Total</b>	<b>Percent</b>	<b>Total</b>	<b>Percent</b>
Class A	75	50.0%	75	50.0%
Class B	45	30.0%	15	10.0%
Class C	30	20.0%	60	40.0%
<b>Total</b>	<b>150</b>	<b>100.0%</b>	<b>150</b>	<b>100.0%</b>

<b>Case 1</b>	<b>Marginal Cost Method Institutional Costs</b>		<b>Chown Method Institutional Costs</b>	
	<b>Total</b>	<b>Percent</b>	<b>Total</b>	<b>Percent</b>
Class A	125	50.0%	125	50.0%
Class B	75	30.0%	25	10.0%
Class C	50	20.0%	100	40.0%
<b>Total</b>	<b>250</b>	<b>100.0%</b>	<b>250</b>	<b>100.0%</b>

## Cross Examination Exhibit NAA/MOAA et al-RT-1 X-EX 2 Page 1 of 1

**CASE 1B: SUMMARY OF IMPACT ON RATES WHEN INSTITUTIONAL COSTS CHANGE**  
**(Assumes an additional \$100 of identifiable institutional costs, associated with Function 2)**

	Marginal Cost Method			Chown Method		
	Base	Case 1B	Percent Change	Base	Case 1B	Percent Change
Class A	200	250	25.0%	200	250	25.0%
Class B	120	150	25.0%	90	90	0.0%
Class C	80	100	25.0%	110	160	45.5%
Total	400	500	25.0%	400	500	25.0%

**CASE 1B: DETAILED CALCULATIONS FOR CHOWN METHOD**

Chown Method with \$100 of additional institutional costs associated with Function 2

	Function		Total
	1	2	
Institutional Costs	30	220	250
Percent of Total	12.0%	88.0%	100.0%

	Attributable Costs		Total
	1	2	
Class A	75	50	125
Class B	75	0	75
Class C	0	50	50
Function Total	150	100	250
Percent of Total	60.0%	40.0%	100.0%

Weighting Factors	0.2	2.2
-------------------	-----	-----

	Weighted Attributable Costs			Institutional Cost Assignment (assuming equal markup)		Rate
	1	2	Total	%	Amount	
Class A	15	110	125	100.0%	125	250
Class B	15	0	15	100.0%	15	90
Class C	0	110	110	100.0%	110	160
Function Total	30	220	250	100.0%	250	500



1 MR. BAKER: My apologies, Mr. Chairman.

2 Back to page 37 of the witness' testimony.

3 BY MR. BAKER:

4 Q You state there by definition cost coverage for a  
5 given subclass of mail is the ratio of revenue to volume  
6 variable cost. That's not exactly correct the way the  
7 Commission has done it, is it?

8 A Well, are you quibbling with volume variable  
9 costs?

10 Q Yes. They use --

11 A It's attributable cost, yes, right.

12 Q Which is not under the Commission's practice  
13 necessarily the same as volume variable.

14 A Not exactly.

15 Q Okay. To the next page, page 38, and beginning in  
16 this section but in the text at line 21 you are discussing  
17 the arithmetic phenomenon that cost coverages for mail  
18 increase as work-sharing increases. And I want to draw your  
19 attention to the sentence beginning on page 23, where you  
20 state that this increase in cost coverage for First Class  
21 work-shared mail is not an issue of equity and efficiency as  
22 suggested by Witness Clifton. Rather, it's a matter of  
23 arithmetic.

24 A Where are you?

25 Q Page 38, line 23. I'm sorry.

1 Do you see that sentence?

2 A Yes.

3 Q Okay. Now Dr. Clifton's testimony contended that  
4 the second and third ounces of work-shared First Class mail,  
5 that the current extra ounce charge works out to a markup  
6 of -- or cost coverage of approximately 920. Do you recall  
7 that part of his testimony?

8 A Yes. That was using his cost.

9 Q His analysis.

10 A His analysis of cost.

11 Q Yes. That is -- do you have an opinion of whether  
12 when a cost coverage approach is 920 there, an equity issue  
13 may arise?

14 A Generally, the cost coverages are not used except  
15 at the class or sub-class level.

16 Q You would say there is no equity issue there?

17 A I don't have an opinion.

18 Q Do you think that when a cost coverage approach is  
19 920 in the context in which Dr. Clifton discussed it, any  
20 efficiency issue arises?

21 A Not necessarily. It depends on the conditions.  
22 Remember, that 920 comes out of using his costs and the  
23 current rates.

24 Q Is there any percentage point or cost coverage  
25 level at which you would begin to be concerned that an

1 equity or efficiency issue does arise?

2 A Yes, it would be contextual though.

3 Q Contextual. Can you give me a number?

4 A No, not without the context.

5 Q It's your testimony that in the context in which  
6 Dr. Clifton calculates the 920, that there is not an equity  
7 or efficiency issue; is that correct?

8 A I can't agree with the 920 because of his  
9 calculation of costs.

10 Q If his 920 were correctly calculated, would you  
11 think there was an equity or efficiency issue?

12 A I would be concerned if I was him, yes.

13 Q Would you be concerned if you were you?

14 A Yes.

15 Q Turn to page 42 of your testimony. At the section  
16 beginning under the caption subheading B, you are  
17 criticizing here Dr. Clifton's use of the term "incremental  
18 costs and revenues" in the context of the proposal; correct?

19 A Yes, sir.

20 Q I will agree with you that the second ounce of a  
21 piece of first class mail is indeed part of a two ounce  
22 piece of mail, and it's not a separate thing. However, the  
23 second ounce does pay a separate charge, 23 cents, that is  
24 above that paid for an one ounce piece. Can one think of  
25 that 23 cents charge as an incremental charge or a marginal

1 charge?

2 A No, sir.

3 Q You would not?

4 A No, sir.

5 Q If I increased the weight of a mailing from first  
6 class letter from one ounce to two ounce and I go to the  
7 Post Office and discover that I must add a 23 cents stamp, I  
8 have not incurred an incremental charge?

9 A You now have a two ounce letter instead of an one  
10 ounce letter. These incremental charges are product --  
11 incremental costs are product related. You have to consider  
12 the entire product. The method of Clifton's computing  
13 incremental costs, as I've shown on table 15 on page 43,  
14 when he's making a comparison with standard A, will never  
15 ever pass the cross subsidy test because he's got it loaded,  
16 because in the case of standard A mail, the incremental  
17 revenue, if you like, of that second ounce, we don't charge  
18 any more. The first ounce picks up the entire cost. No  
19 matter how much difference between revenue and costs there  
20 are in standard A, it would always show a subsidy, the way  
21 he has used to calculate it.

22 Q You are now talking about subsidy. I was asking  
23 still back on whether the charge for the second ounce is an  
24 incremental revenue or not.

25 Is an one ounce letter a different product from a

1 two ounce letter?

2 A Yes.

3 Q Will you accept, subject to check, that a first  
4 class carrier route automation one ounce letter today in the  
5 current rates is charged 23 cents a piece?

6 A Yes, subject to check.

7 Q And can you confirm that the second, the extra  
8 ounce rate for that piece would be 23 cents, or would you  
9 need to take that subject to check?

10 A No, that's accepted.

11 Q That you know. Okay. So this is an instance  
12 where the rate of <sup>a</sup>piece doubles with its weight, correct?

13 A Yes.

14 Q So when the First Class letter that we just  
15 discussed moves from its one ounce to -- it got heavier, it  
16 became a two ounce piece, it paid an extra ounce of 23  
17 cents. That's an incremental revenue, if you will, when you  
18 go from the once to the two ounce. Is that correct?

19 A No.

20 Q No? There is not an incremental revenue if you go  
21 --

22 A It's a different product.

23 Q It's a different product you say. Is there, at  
24 least in theory, a marginal or cost difference between the  
25 one ounce piece and the two ounce piece?

1 A There is a cost difference, in theory.

2 Q Now, a Standard A mailer can not mail a second  
3 ounce without mailing the first ounce as well, correct?

4 A Correct.

5 Q Okay. And is it your testimony that the one ounce  
6 Standard A piece and the two ounce Standard A piece are  
7 different products?

8 A Yes.

9 Q And because of the difference in the rate  
10 schedules between First Class and Standard mail, when the  
11 First Class mailer moves to a two ounce piece, he pays an  
12 extra 23 cents, but while the Standard A moves to a two  
13 ounce piece, he will continue to pay the same rate as he  
14 pays for the one ounce piece, is that correct?

15 A That is correct.

16 Q Could you --

17 MR. BAKER: I have one more line of questions and  
18 then I am done, Mr. Chairman.

19 BY MR. BAKER:

20 Q Dr. -- or Mr. Andrew, could you turn to page, back  
21 to page 40?

22 A Yes.

23 Q And here you will educate me. Because on line 17,  
24 you use a ratio of revenue to cost to test cross-subsidy.  
25 Do you see that?

1 A Yes. yes.

2 Q Why do you use the ratio rather than simply the  
3 difference between revenue and cost?

4 A Because it gives me an idea statistically of how  
5 much error I can have in the data that is going into this  
6 thing and still be free of subsidy?

7 Q And then can you tell me why the ratio minus one,  
8 expressed as a percent, is positive, indicates that the  
9 amount can be tolerated. Is that a statistical concept?

10 A Yes, it's a statistical concept.

11 MR. BAKER: Mr. Chairman, that concludes my  
12 questions.

13 CHAIRMAN GLEIMAN: Is there any follow-up?

14 MR. COOPER: Yes, Mr. Chairman, I have a few  
15 questions.

16 CHAIRMAN GLEIMAN: Mr. Cooper.

17 CROSS-EXAMINATION

18 BY MR. COOPER:

19 Q Would you refer to Mr. Baker's Cross-Examination  
20 Exhibit Number 2? I'll skip the lengthy title. It's the  
21 two page exhibit.

22 A Yes, sir.

23 Q Now would you agree with me that in this example  
24 Class B does not cause the cost, the additional cost  
25 associated with Function 2?

1 A Yes, I would agree.

2 Q Would you also agree with me that Class A doesn't  
3 cause the additional cost associated with Function 2?

4 A Yes.

5 Q And similarly, Class C does not cause them?

6 A Yes.

7 Q I think you mentioned along the way that you were  
8 not troubled by the fact that under the marginal cost method  
9 each of these three classes bears some of the burden of  
10 these additional institutional costs, is that correct?

11 A That is correct.

12 Q And you mentioned that the presence of economies  
13 of scope was one reason why you weren't troubled by that  
14 outcome, is that right?

15 A Yes, and scale also.

16 Q With respect to the economies of scope, are you  
17 saying that Class B benefits from the presence of Classes A  
18 and C?

19 A Yes.

20 Q How does it benefit?

21 A Well, as a practical matter, it benefits from the  
22 overall organization and the functions that it does share --  
23 the functions that are shared.

24 Now this is a toy example when you look at the  
25 entire spectrum of the Postal Service. You have a lot of



1 economies of scope with products, with the multiproduct  
2 production.

3 Q And you also mentioned economies of scale a few  
4 moments ago.

5 A Yes.

6 Q How did the economies of scale enter into this?

7 A Because of the more overall activity.

8 Q Does Class B benefit from the economies of scale?

9 A Yes.

10 Q How does it benefit?

11 A If there were less units of A and C, for example,  
12 it's likely that one or more of the functions could not  
13 afford to have as much automation. That would be an  
14 example.

15 Q So you are saying that the unit costs of Class B  
16 are affected by the economies of scale?

17 A Yes.

18 MR. COOPER: I have no further questions.

19 CHAIRMAN GLEIMAN: Mr. Baker?

20 FURTHER CROSS-EXAMINATION

21 BY MR. BAKER:

22 Q Were you in the exchange with counsel for the  
23 Postal Service or -- when you referred to the unit costs of  
24 B, were you referring to attributable costs or total -- you  
25 know, basically the price of B?

1 A Would you restate it?

2 Q Yes. Where you just referred to unit costs of B.  
3 Is that attributable cost?

4 A Yes, attributable cost.

5 MR. BAKER: I think I will stop here, Mr.  
6 Chairman.

7 CHAIRMAN GLEIMAN: Is there any further follow-up?  
8 There are no questions from the bench.

9 That brings us to redirect. Mr. Todd, would you  
10 like an opportunity to consult with your witness?

11 MR. TODD: Yes, please, Mr. Chairman.

12 CHAIRMAN GLEIMAN: All right. Ten minutes?

13 MR. TODD: That should be ample -- or at least  
14 sufficient.

15 [Recess.]

16 CHAIRMAN GLEIMAN: Yes, sir.

17 MR. TODD: Mr. Chairman, and not just because only  
18 you of the Commissioners have come back, we have no  
19 redirect.

20 CHAIRMAN GLEIMAN: I hadn't noticed. That's what  
21 happens when you control the buzzer. They never know when  
22 it's going to happen.

23 If that is the case then, Mr. Andrew, that wraps  
24 it up for you tonight. We appreciate your appearance here  
25 today and your contributions both the first time around and

1 this time for our record, and if there's nothing further,  
2 you're excused.

3 THE WITNESS: Thank you.

4 [Witness excused.]

5 CHAIRMAN GLEIMAN: Our last and very patient  
6 witness, appearing on behalf of CTC Distribution Services,  
7 Mr. Clark, is already under oath in this proceeding, and,  
8 Mr. Olson, if you want to introduce your witness and enter  
9 his rebuttal testimony, we can hopefully move right along.

10 I notice that after counsel finishes with their  
11 last witness of the day they seem to move out of the room  
12 faster than they move in. I don't understand that.

13 Mr. Olson, whenever you and your witness are  
14 ready.

15 MR. OLSON: Mr. Chairman, we would call John Clark  
16 to the stand, and I guess we can proceed.  
17 Whereupon,

18 JOHN L. CLARK,  
19 a witness, was called for examination by counsel for CTC  
20 Distribution Services, L.L.C. and, having been previously  
21 duly sworn, was examined and testified as follows:

22 DIRECT EXAMINATION

23 BY MR. OLSON:

24 Q Mr. Clark, I'd like to present you two copies of  
25 what has been entitled the Rebuttal Testimony of John L.

1 Clark on Behalf of CTC Distribution Services, LLC,  
2 designated CTC-RT-1, and ask you if you can review those and  
3 tell us whether they were prepared by you or under your  
4 supervision.

5 A They were prepared under my supervision.

6 Q And do you have any changes to that testimony?

7 A Upon review I'd like to eliminate or delete one  
8 sentence from the testimony. It's on page 8, lines 7 and 8.  
9 UPS -- it says in quotes, UPS has offered no sound basis for  
10 questioning the cost estimates in this proceeding, end of  
11 quote. I feel that might have overstated my position with  
12 regard to cost estimates, so I'd like to delete that  
13 sentence.

14 Q And with that change, do you adopt this as your  
15 testimony?

16 A Yes, I do.

17 MR. OLSON: Mr. Chairman, we'd move the admission  
18 of this testimony into evidence.

19 CHAIRMAN GLEIMAN: Are there any objections?

20 [No response.]

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

25 [Rebuttal Testimony and Exhibits of

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

John L. Clark, CTC-RT-1, was  
received into evidence and  
transcribed into the record.]

CTC-RT-1

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

POSTAL RATE AND FEE CHANGES, 1997 )

Docket No. R97-1

Rebuttal Testimony of

JOHN L. CLARK

on Behalf of

CTC DISTRIBUTION SERVICES, L.L.C.

William J. Olson  
John S. Miles  
Alan Woll  
John F. Callender, Jr.  
WILLIAM J. OLSON, P.C.  
8180 Greensboro Dr., Suite 1070  
McLean, Virginia 22102-3823  
(703) 356-5070

Counsel for CTC Distribution  
Services, L.L.C.

March 9, 1998

## TABLE OF CONTENTS

	Page
INTRODUCTION .....	1
I. PURPOSE OF TESTIMONY .....	1
II. THE COMMISSION SHOULD RECOMMEND THE POSTAL SERVICE'S PROPOSED UNIFORM DESTINATION ENTRY DISCOUNT STANDARDS .....	2
III. THERE HAS BEEN NO SHOWING THAT THE POSTAL SERVICE'S ESTIMATES OF AVOIDED COSTS ARE PROBLEMATIC .....	4
IV. CONCLUSION .....	8

1

**INTRODUCTION**

2

*See* CTC-T-1, pp. 1-2, Tr. 20/10162-63.

3

**I. PURPOSE OF TESTIMONY**

4           This testimony is submitted to rebut certain aspects of the testimony of  
5 Parcel Shippers Association ("PSA") witness Zwiig (PSA-T-3) and of United  
6 Parcel Service ("UPS") witness Luciani (UPS-T-4) and to expose weaknesses  
7 in the respective proposals they have made regarding Parcel Post. The  
8 Commission should recognize the deficiencies in the criticisms of the Postal  
9 Service's proposals offered by these witnesses, and should recommend in full  
10 the Postal Service's proposals which relate to the entry of Parcel Post at  
11 Origin Bulk Mail Centers ("OBMCs"), Destination Bulk Mail Centers  
12 ("DBMCs"), Destination Sectional Center Facilities ("DSCFs"), and  
13 Destination Delivery Units ("DDUs").



1                   **II. THE COMMISSION SHOULD RECOMMEND THE**  
2                   **POSTAL SERVICE'S PROPOSED UNIFORM**  
3                   **DESTINATION ENTRY DISCOUNT STANDARDS**

4                   Under the current postal rate setting process, when new postal  
5                   worksharing discounts (and the appropriate corresponding rate structures)  
6                   are developed, the Postal Service first estimates costs avoided by the  
7                   worksharing, as reflected by certain identified qualification standards. The  
8                   Postal Service next determines what percentage of the avoided costs would be  
9                   appropriate to pass through to worksharing mailers, based upon a number of  
10                  factors, including its experience with similar worksharing discounts. This  
11                  process has been very successful for the Postal Service, as worksharing has  
12                  become an integral component of rate setting, and the number of  
13                  worksharing discounts available for various mail classes and subclasses has  
14                  steadily grown.

15                 The Postal Rate Commission has played an instrumental role in the  
16                 Postal Service's success, by ensuring that proposed worksharing discounts  
17                 have been in the public interest, as well as by encouraging the development  
18                 of additional discounts as their benefits to both the Postal Service and the  
19                 mailing public have become evident. Successes of the Postal Service have  
20                 exceeded its original expectations with its DBMC Parcel Post worksharing  
21                 program. In this docket, the Postal Service seeks to extend the range of its  
22                 Parcel Post discounts to include discounts for BMC presort and prebarcoding,

1 and for OBMC, DSCF and DDU entry, as well as DBMC, which have proven  
2 successful for other classes of mail.

3           Witness Zwieg has submitted testimony stating that “[v]olume levels  
4 necessary to qualify [for the new Parcel Post rate categories] should be an  
5 operational decision made jointly by mailers and postal operations people.  
6 The size and operational capabilities of a particular destination entry facility  
7 should determine the qualifying level rather than a level arbitrarily imposed  
8 by the Commission.” (PSA-T-3, p. 8, Tr. 25/13451.) This statement appears  
9 to confuse the type of provisions historically contained in the Domestic Mail  
10 Classification Schedule (DMCS) and the type of provisions contained in the  
11 Domestic Mail Manual (DMM). The Postal Service proposal and  
12 accompanying DMCS revisions appear to follow the traditional distinctions,  
13 appear to be proper, and should be adopted. CTC Distribution Services has a  
14 proven track record as a user of Parcel Post and its existing rate structure.  
15 We would have no difficulty in utilizing the Postal Service’s proposed  
16 destination entry discounts, and we believe that the expansion of the Parcel  
17 Post worksharing program is in the best interests of the Postal Service.

1                                   **III. THERE HAS BEEN NO SHOWING THAT**  
2                                   **THE POSTAL SERVICE'S ESTIMATES**  
3                                   **OF AVOIDED COSTS ARE PROBLEMATIC**

4                   The only other criticism of which I am aware concerning the Postal  
5                   Service's new Parcel Post worksharing proposals comes from UPS, the Postal  
6                   Service's competitor. This is unsurprising, not only in view of the obvious  
7                   competition Parcel Post offers to UPS, but also the practice of UPS, which we  
8                   have seen in past dockets, of strongly resisting Postal Service offerings which  
9                   UPS feels might encroach on UPS products or profit margins.

10                  In my direct testimony in this proceeding, I tried to point out why  
11                  strengthening the Postal Service's Parcel Post offerings is important for the  
12                  entire nation, as well as for the Postal Service's own operations and economic  
13                  welfare. *See* CTC-T-1, pp. 9-15, Tr. 20/10170-76. Prior to 1990, and the  
14                  advent of the Postal Service's DBMC program, UPS was effectively the "only  
15                  game in town" with respect to nationwide parcel delivery. It is still far and  
16                  away the dominant player in the parcel delivery market. The 1997 UPS  
17                  strike gave the country just a glimpse of the dangers lurking for those who  
18                  depend on a single company for an important service such as parcel delivery.

19                  Parcel delivery is a still-burgeoning industry. It is not a "zero-sum"  
20                  game, where there must, or should, be a single purveyor of nationwide  
21                  delivery service. It is in the nation's best interest for competition to flourish  
22                  in this industry. Thus, while UPS testimony criticizing the Postal Service's

1 proposed Parcel Post worksharing discounts is no surprise, I believe the  
2 testimony is deficient in not recognizing the true state of the parcel delivery  
3 industry and how the Postal Service's proposals for Parcel Post would affect  
4 beneficially the entire industry and the nation. UPS witness Luciani (UPS-  
5 T-4), for example, who criticized the Postal Service's cost avoidance  
6 estimates, could not even offer an opinion on these matters. (See Tr.  
7 26/14442-46.)

8           Witness Luciani could not say whether Parcel Post was a growing  
9 segment of the economy, whether the Postal Service's DBMC program had  
10 caused Parcel Post to grow significantly, or even whether the growth of  
11 Parcel Post since 1990 has had any adverse effect on UPS itself. Tr.  
12 26/14445-46. Witness Luciani also worked on the UPS testimony in PRC  
13 Docket No. R90-1, where UPS sponsored testimony in opposition to the very  
14 establishment of the DBMC worksharing program. It was UPS, not the  
15 Postal Service, which made poor volume forecasts in that docket regarding  
16 DBMC. Even if witness Luciani has not studied the significance of the  
17 growth of Parcel Post, these subjects formed a part of my direct testimony in  
18 this proceeding, which witness Luciani read. (Tr. 26/14440.) By witness  
19 Luciani's refusal to comment, UPS seems to be trying to avoid the issue.

20           Witness Luciani did offer an opinion on the Postal Service's cost  
21 avoidance estimates, which he said were uncertain. Based on such  
22 uncertainty, he suggests that the passthrough of avoided costs should be

1 limited to 77 percent, rather than the 98-100 percent passthroughs  
2 recommended by the Postal Service in this docket. (UPS-T-4, pp. 22-31, Tr.  
3 26/14308-14317.) I would like to point out some weaknesses in that  
4 suggestion.

5 First, witness Luciani himself admits that the passthroughs should be  
6 higher, as the Postal Service has proposed, if the Commission does not share  
7 his opinion that the Postal Service's cost avoidance estimates are uncertain.  
8 (Tr. 26/14441.) Even under the UPS's view of the matter, therefore, the  
9 Postal Service's Parcel Post worksharing program should be adopted, and the  
10 only question has to do with the amount of the destination entry discounts.  
11 After the Commission perfects the Postal Service's cost avoidance estimates  
12 to the extent possible in this docket, it should reject the mere 77 percent  
13 passthrough recommended by witness Luciani, and pass through the whole  
14 amount.

15 Second, although witness Luciani appears to have testified as an  
16 economic or financial analyst, a field in which I have not received formal  
17 education, much of what he says about the Postal Service's cost estimates is  
18 itself subject to question, even by lay people such as myself. For example, he  
19 states that the Postal Service's cost avoidance estimates are based on "perfect  
20 execution," which is impossible to attain. (UPS-T-4, p. 26, Tr. 26/14312.)  
21 Assuming that is so, could not the same be said about every cost estimate?  
22 The real mailing world in which CTC and UPS do business strives for

1 perfection, but rarely hits the mark. Perfection cannot be the standard  
2 applied by the Commission. Furthermore, witness Luciani does not quantify  
3 in any way the "imperfection" in execution that he says is bound to exist.  
4 Presumably, it would be extremely small, and I believe that witness Luciani's  
5 notion of imperfect execution should have no impact whatsoever on the  
6 Postal Service's cost avoidance estimates.

7 Furthermore, witness Luciani states that the mail processing DBMC  
8 entry savings estimated by the Postal Service are inexplicably high, but  
9 offers no contrary proof or explanation. (UPS-T-4, pp. 26-27, Tr. 26/14312-  
10 13.) Similarly, his arguments that DBMC parcels are different from other  
11 parcels and that costs of plant load clerks should be attributed to specific rate  
12 categories (UPS-T-4, pp. 27-28, Tr. 26/14313-14) are simply posited, with no  
13 proof or quantification of any kind.

14 These UPS positions should be recognized as simply arguments, with  
15 no meaningful proof for support. They are reminiscent of the UPS criticism  
16 of the Postal Service's volume estimates for the new DBMC program in  
17 Docket No. R90-1. Ultimately, the Commission rejected that criticism and  
18 accepted the Postal Service's volume forecasts as reasonable and  
19 conservative. History has revealed how conservative those estimates were.  
20 The Postal Service's volume predictions were understated, not overstated  
21 and, contrary to the UPS position in R90-1, the Postal Service's DBMC Parcel  
22 Post worksharing program has been a resounding success.



1           CHAIRMAN GLEIMAN: The only participant who has  
2 requested oral cross-examination of Witness Clark is the  
3 United Parcel Service, and there's nobody else left in the  
4 room. So I think -- except for OCA and the Postal Service,  
5 of course.

6           MR. OLSON: And the Commission.

7           CHAIRMAN GLEIMAN: I suspect we can proceed with  
8 cross-examination at this point, Mr. McKeever.

9           THE WITNESS: Before we begin I'd like to thank  
10 Mr. McKeever and the Commission for allowing me to change my  
11 date of appearance to accommodate my personal schedule. I  
12 appreciate it very much.

13          CHAIRMAN GLEIMAN: Mr. Clark, you were one of the  
14 easy ones when it came to changing schedules.

15                           CROSS-EXAMINATION

16          BY MR. MCKEEVER:

17           Q    Mr. Clark, could you turn to page 6 of your  
18 testimony, please?

19           A    Rebuttal testimony.

20           Q    Yes, your rebuttal testimony. And I'd like you to  
21 take a look at lines 15 to 20.

22           A    Okay.

23           Q    There you state that while you have not received  
24 any formal education as an economic or financial analyst,  
25 you believe that much of what UPS Witness Luciani has said



1 about the Postal Service's cost estimates is, to use your  
2 words, subject to question. Is that right?

3 A Yes.

4 Q You've given as an example there his statement  
5 that 100-percent passthroughs of estimated avoided costs  
6 assume perfect execution, which to use your words is  
7 impossible to attain. Is that right?

8 A Yes.

9 Q You then say that, assuming that is so, could not  
10 the same be said about every cost estimate? Is that  
11 correct?

12 A Yes.

13 Q So I take it that your testimony is that every  
14 cost estimate is uncertain, or do you believe that the  
15 Postal Service's avoided cost estimates are 100-percent  
16 accurate?

17 A Well, since this case began, I have received all  
18 of the testimony of all of the witnesses, I've done my best  
19 to review that, I've looked at mostly those cases that have  
20 to do with anything related to parcels and the things that  
21 I'm interested in. But this whole proceeding by its very  
22 nature is kind of a war of estimates, even tonight as we sit  
23 here listening to the various parties go back and forth  
24 interpreting the meaning of statistical data, the  
25 applications of statistical data and so forth. So it's up

1 to the Commission apparently to decide who has the greatest  
2 ability to accurately portray the reality of the situation  
3 you're dealing with.

4 I found in Luciani's testimony a number of  
5 instances that didn't comply with what I believe to be  
6 reality, and that's why I thought this rebuttal testimony  
7 would just point out a few of those.

8 Now I presume that the Commission's role in these  
9 rate hearings is to decide who has the most valid analysis  
10 in its application. Now the Postal Service has submitted,  
11 and I have read the information that they have submitted,  
12 and they really have a better track record than UPS  
13 witnesses have all the way going back to 1990.

14 I know I'm kind of getting off the track here, but  
15 I just wanted to kind of put my, you know, where I'm coming  
16 from in putting this together.

17 Q I think you did that in your rebuttal testimony,  
18 but I'd like to get down to some specifics.

19 A Okay.

20 Q Do you believe that the Postal Service's avoided  
21 cost estimates are 100-percent accurate?

22 A It seems to me they have the best chance of being  
23 accurate because they are the ones that are operating the  
24 system, and I guess I find it very difficult to believe I  
25 read for example Luciani says in his testimony that he

1 visited an ASF, he visited this place and that place, but  
2 how could his ability surpass the ability of the Postal  
3 Service to really know what their costs are?

4 Q So your basis for your testimony is that the  
5 Postal Service must know more than anybody else about it and  
6 so that therefore when it makes a cost estimate, that should  
7 be accepted?

8 A Well, the whole approach of Luciani is to create  
9 an air of uncertainty and that is the basis for him, for  
10 example, saying that we don't think you can execute this to  
11 perfection and we think that parcels that come in from DBMC  
12 are less dense, we think that transportation costs are  
13 affected by DBMC.

14 All of these things are designed to create an air  
15 of uncertainty that would cause the Rate Commission to  
16 recommend some different kind of an approach.

17 I say I believe that the Postal Service is more  
18 certain of their proposals.

19 Q Well, do you believe that there is certainty about  
20 their avoided cost estimates?

21 A I would say that if I had to -- if I were sitting  
22 in a seat up here I would be more inclined to accept their  
23 proposals than any others that I have seen.

24 Q And that is because they are the Postal Service,  
25 right?

1           Is that what you said a few minutes ago?

2           A     Well, assuming that they are not dishonest, which  
3 I think is appropriate --

4           Q     They can't make mistakes?

5           A     -- that they make an honest approach to it. They  
6 are more qualified and have a better record of performance  
7 than anybody that I have seen in this case.

8           Q     Is it your testimony that they can't make  
9 mistakes?

10          A     Absolutely not. In fact, in some of the rebuttal  
11 testimony they have come forth and said, you know, here is  
12 where we made a mistake in the past and here is how we are  
13 correcting it.

14                 Now Luciani doesn't bother to do that, by the way.  
15 I mean he made the most colossal mistake you could imagine  
16 in 1990 with Witness Hall, talking about, you know, that the  
17 DBMC is a total disaster --

18           MR. McKEEVER: Mr. Chairman, I move to strike any  
19 remarks about Mr. Luciani in R90. He was not even a witness  
20 in that case.

21           THE WITNESS: But he put into his  
22 qualifications --

23           MR. McKEEVER: It is nonresponsive, Mr. Chairman,  
24 and it is certainly inaccurate. Mr. Luciani wasn't even a  
25 witness in that case.

1 I move to strike.

2 MR. OLSON: Mr. Chairman, I think it is  
3 responsive. I think counsel asked the question and is stuck  
4 with the answer and it certainly is that Witness Luciani has  
5 testified that he assisted with --

6 CHAIRMAN GLEIMAN: Was Mr. Luciani a witness in  
7 R90?

8 MR. OLSON: He testified that he assisted the UPS  
9 in presenting and preparing their testimony.

10 MR. McKEEVER: Mr. Chairman, may I also mention  
11 that the question was is the Postal Service capable of  
12 making a mistake.

13 CHAIRMAN GLEIMAN: As everybody who has been  
14 around these proceedings knows, the Commission is generally  
15 reluctant to strike and I will deny the motion to strike in  
16 this case.

17 However, we will read the testimony and it will be  
18 given the appropriate weight in light of the facts of the  
19 R90 case.

20 Now I am going to ask the witness to -- I know he  
21 has strongly held views. All of us probably do on one  
22 subject or another, but I think it is important to try and  
23 confine your responses, to the extent practicable, to the  
24 questions that are asked by counsel who is doing the cross  
25 examining.

1           There is an opportunity under redirect if your  
2 counsel and you decide that there is other information you  
3 want to get in that follows up on cross examination, and I  
4 think that is the appropriate place for it to come.

5           THE WITNESS: I apologize.

6           CHAIRMAN GLEIMAN: There is no need for an  
7 apology. This is -- you know, this goes on in here. It's  
8 not only a war of estimates, it's a war of a lot of  
9 different natures, and, you know, we'll sort it all out and  
10 hopefully come up with something that makes sense to most  
11 people before it is all over.

12           Could you please continue, Mr. McKeever?

13           MR. McKEEVER: Thank you, Mr. Chairman.

14           BY MR. McKEEVER:

15           Q    Mr. Clark, in fact, didn't you testify that in the  
16 real world, cost estimates rarely hit the mark?

17           A    Well, an estimate by definition is an estimate.

18           Q    And they rarely hit the mark; isn't that correct?  
19 Isn't that what you stated in your testimony?

20           A    That would be a fair statement; yes.

21           Q    On page seven at lines seven to nine, you refer to  
22 Mr. Luciani's testimony, that the DBMC entry savings  
23 estimated by the Postal Service are high, and you state  
24 there that he offers no contrary proof or explanation. Do  
25 you see that? Page seven, lines seven to nine.

1 A Yes, I see it.

2 Q You cite two pages of Mr. Luciani's testimony in  
3 support of that statement. Did you read all of his  
4 testimony?

5 A Well, I know he put in a couple of supplements.  
6 He had his original and then he had his corrections that  
7 came later on.

8 Q Did you read all of his direct testimony?

9 A I think so; yeah.

10 Q Now, did you read his testimony -- matter of fact,  
11 Mr. Chairman, may I approach the witness and furnish him a  
12 copy of the transcript in which Mr. Luciani's testimony is  
13 reproduced?

14 A I think I have that.

15 Q You do have it? Okay. Thank you. Did you read  
16 his testimony -- you do not have the transcript version; is  
17 that correct or do you?

18 CHAIRMAN GLEIMAN: It appears as though the  
19 witness has the version that was submitted and not the  
20 transcript version.

21 BY MR. McKEEVER:

22 Q Did you read his testimony beginning on page seven  
23 as it was originally submitted and now appears at transcript  
24 page 14293, that the Postal Service double counted platform  
25 acceptance costs in estimating the costs avoided by DBMC?

1 Did you read that?

2 A Yes, I read it at some time.

3 Q Did you read his testimony on pages 12 to 14,  
4 which appears in the transcript at pages 14298 through  
5 14300, that the Postal Service overestimated the costs  
6 avoided by DSCF by overstating the number of parcels that on  
7 average on in a sack or in a general purpose mail container?  
8 Did you read that?

9 A Yes.

10 Q Did you read his testimony on page 15, which  
11 appears at transcript page 14301, that the Postal Service  
12 overstated DSCF avoided costs by assuming that Postal  
13 Service personnel would not assist drop shipping mailers in  
14 unloading drop shipments? Did you read that testimony?

15 A You're on page 15?

16 Q I'm on page 15, yes.

17 A Yes.

18 Q In fact, you testified when you were here  
19 previously, at transcript page 10195, that when CTC drop  
20 ships to a BMC or, in fact, to a SCF, you testified at page  
21 10194, the Postal Service employees unload the vehicle,  
22 assisted by the driver when requested, isn't that correct?

23 A Yes. I might comment, I am not sure --

24 MR. MCKEEVER: Mr. Chairman, I am going to move to  
25 strike if -- he has responded to the question. He has



1 completed an answer. An appreciable amount of time passed.  
2 And if we are going to get out of here at a reasonable hour  
3 tonight, --

4 CHAIRMAN GLEIMAN: Well, I am not all that  
5 concerned about the reasonableness of the hour, and I can be  
6 cavalier about it on everybody else's behalf. I think that  
7 we have to operate with a rule of reason here. On the one  
8 hand, I have admonished Mr. Clark about going on to speak  
9 about matters that weren't the subject of the question, and  
10 I would respectfully request that we give Mr. Clark an  
11 opportunity to give a complete answer within the confines of  
12 my earlier admonition. I think it is not unreasonable.

13 You know, this gentleman is not a professional  
14 witness. To his credit, he is probably not an economist or  
15 an econometrician or any of the other kind of people that we  
16 see coming through here. And, you know, let's just try and  
17 take a deep breath and calm down, and I think we'll -- I'll  
18 stop talking, then we will get out of here at a reasonable  
19 hour.

20 THE WITNESS: So could I make a comment on that?

21 CHAIRMAN GLEIMAN: A short one.

22 THE WITNESS: When I read this part of the  
23 testimony, I recall in the original, at the original times,  
24 at the times when the times when these were being originally  
25 proposed, in talking with Virginia Mayes, that the whole

1 assumption was that anybody that utilized Destination  
2 Sectional Center Facilities or DDUs would be required to  
3 deliver packages in the same way that they were presently  
4 being received from the Bulk Mail Centers, that was the  
5 premise of the program.

6 So when you start to bring in all of these  
7 considerations about shaking out sacks and helping with  
8 unloading and so on, we are to do no more or no less than is  
9 presently being done by a Bulk Mail Center. It is supposed  
10 to be transparent to the system who brings those packages  
11 in. And so that was, you know, part of the perspective that  
12 I had.

13 CHAIRMAN GLEIMAN: Mr. Clark, I am going to offer  
14 another comment here that might be helpful.

15 THE WITNESS: Yes.

16 CHAIRMAN GLEIMAN: And that is that, you know,  
17 discussions that took place during the developmental phase  
18 of Postal Service proposals are not a matter of record here.  
19 And, as a matter of fact, in most cases, and as a matter of  
20 fact, many of the kinds of issues that you just spoke to  
21 aren't matters before us. The Postal Service has reserved  
22 unto itself a great deal of flexibility as to how it  
23 actually goes about implementing.

24 And, consequently, it is not unreasonable for  
25 counsel to ask questions that go to different views of how

1 things are actually going to work. Because, quite frankly,  
2 it is not all locked up with every little I dotted and T  
3 crossed when the proposal comes to us from the Postal  
4 Service.

5 Now, let's -- counsel, if you want to move on now.

6 BY MR. MCKEEVER:

7 Q It is currently the case that when you bring a  
8 drop shipment to the Postal Service, the Postal Service  
9 employees unload the vehicle, assisted by the driver when  
10 requested?

11 A That is correct?

12 Q Okay. Incidentally, have you ever testified  
13 before in any proceeding?

14 A I was here in '95.

15 Q Have you ever testified in any other forum before?

16 A Regulatory?

17 Q No. Any forum, ever, any court?

18 MR. OLSON: Mr. Chairman, I think I would object  
19 to that as being irrelevant. If it is regulatory and as a  
20 witness, that is one thing. But in any time, on any matter,  
21 I would object to that.

22 CHAIRMAN GLEIMAN: Would you like to modify your  
23 question or limit to something that might relate --

24 MR. MCKEEVER: No, Mr. Chairman, I think it is  
25 relevant, the extent to which this witness has testified

1 before. I think he knows what testifying is about.

2 THE WITNESS: Well, I apologize if I have offended  
3 you.

4 MR. McKEEVER: No, you haven't offended me.

5 THE WITNESS: You can go ahead.

6 MR. McKEEVER: Mr. Clark, I do this for a living,  
7 I don't get offended by it.

8 THE WITNESS: Okay.

9 CHAIRMAN GLEIMAN: Mr. McKeever, do you --

10 MR. McKEEVER: Mr. Chairman, I'll withdraw the  
11 question.

12 CHAIRMAN GLEIMAN: Thank you.

13 BY MR. McKEEVER:

14 Q Mr. Clark, you state in your rebuttal testimony,  
15 and you indicated this earlier this evening, too, that Mr.  
16 Luciani made an argument that DBMC parcels are different  
17 from other parcels. Do you remember that?

18 A Yes.

19 Q That's in your rebuttal testimony on page 7 at  
20 lines 10 to 11, is that right?

21 A Yes.

22 Q And, again, as I said, you made reference to that  
23 really earlier tonight. In your rebuttal testimony, you say  
24 that Mr. Luciani's statement is, quote, "simply posited with  
25 no proof or quantification of any kind". Do you see that?

1 A Yes.

2 Q Did you read Postal Service Witness Hatfield's  
3 testimony on transportation costs in this case, by the way?

4 A I probably just glanced through it.

5 MR. McKEEVER: Mr. Chairman, with your permission,  
6 I'd like to supply the witness with a copy of page 14 from  
7 Mr. Hatfield's transportation testimony, USPS-T-16, I  
8 believe.

9 CHAIRMAN GLEIMAN: Please proceed.

10 BY MR. McKEEVER:

11 Q Mr. Clark, I've handed you, as I mentioned, a copy  
12 of page 14 from Postal Service Witness Hatfield's testimony  
13 which shows a cube weight relationship by rate category for  
14 parcel post for intra-BMC, inter-BMC and DBMC. Do you see  
15 that?

16 A Yes.

17 Q Do you notice the DBMC line is the one at the top?

18 A Yes.

19 Q It's different from the other two; is that  
20 correct?

21 A Yes.

22 Q Thank you. Does the Postal Service accept  
23 shipments at CTC plants or is the acceptance done at a  
24 Postal facility?

25 A At our plants.

1 Q Postal people go to your plant?

2 A DMU, yes; detached mail unit. Your question was  
3 parcels, right?

4 Q Yes.

5 A We have other types of mail as well. We have some  
6 advertising mail, some letter mail that we commingle, so to  
7 the extent that we pay the postage on that, it would be  
8 included as well.

9 Q Mr. Clark, could you turn to page four of your  
10 testimony, rebuttal testimony? There you state at lines 15  
11 to 16 that UPS "is still far and away the dominant player in  
12 the parcel delivery market." Do you see that?

13 A Yes, sir; I do.

14 Q Is it your testimony that UPS is the dominant  
15 carrier in the case of residential deliveries?

16 A Residential deliveries?

17 Q Yes. Is that your testimony?

18 A Yes, for what's defined as a parcel.

19 MR. McKEEVER: Mr. Chairman, I would like to  
20 provide the witness with a copy of the Postal Service's  
21 Household Diary Study, Fiscal Year 1996, the Executive  
22 Summary, which is a document published by the Postal  
23 Service.

24 CHAIRMAN GLEIMAN: Please approach the witness.

25 BY MR. McKEEVER:

1 Q Mr. Clark, could you turn to page 28 of that  
2 document, please?

3 A I have it.

4 Q Now that page is headed, "Packages," is that  
5 correct?

6 A Yes.

7 Q There is a Section B entitled "Overall Volume and  
8 Carrier Used" -- do you see that?

9 A Yes.

10 Q And the first sentence in that paragraph says,  
11 quote, "There was an increase in the number of packages  
12 received per household per week during 1996."

13 Do you see that?

14 A Yes.

15 Q And then the third sentence in that paragraph  
16 states, quote, "Of all packages received, 85.1 percent were  
17 delivered by the Postal Service, which represents a  
18 relatively large increase over the 1987 figure of 77.7  
19 percent."

20 Is that correct?

21 MR. OLSON: Mr. Chairman, may we have time to  
22 examine whether there is a definition of package in the  
23 document before the witness has to answer all these  
24 questions about this, which he hasn't seen?

25 MR. MCKEEVER: Mr. Chairman, the witness can take

1 as much time as he would like.

2 CHAIRMAN GLEIMAN: Yes, you can have time to  
3 examine whether there is a definition.

4 Quite frankly, I don't know whether there is a  
5 definition in the summary. We do have the entire study if  
6 you find it necessary to look through that.

7 MR. McKEEVER: And I would be happy to have the  
8 entire document here as well, Mr. Chairman.

9 THE WITNESS: My own personal experience is that  
10 this -- that this doesn't relate to the market we are  
11 talking about here at all. This would include all Third  
12 Class, books --

13 BY MR. McKEEVER:

14 Q It includes all packages.

15 A Priority mail. It's not Fourth Class Parcel Post.

16 Q I see. Your testimony is only with respect to  
17 Fourth Class Parcel Post?

18 A That's what I made clear -- yes -- in the original  
19 testimony.

20 Q Well, that is not what you say in your rebuttal  
21 testimony and I don't have your original testimony available  
22 right now but you say, "It is far and away the dominant  
23 player in the parcel delivery market."

24 Now you are only talking about some parcels, is  
25 that correct? Is that your statement?



1           A     Well, I think you are quibbling here over what we  
2 are talking about.

3                     We are talking about work-sharing discounts.  
4 That's the context of the whole rate hearing. Why bring in  
5 issues about Third Class records, books, all kinds of  
6 packages?

7           Q     Mr. Clark, you stated in your testimony that UPS  
8 is far and away the dominant player in the parcel delivery  
9 market.

10          A     That's my opinion. Yes, sir.

11          Q     And that is the reason I brought this document up.

12          A     Well, my own opinion is it's not an appropriate  
13 representation or comparison for this case.

14          Q     You don't believe that a package -- you don't  
15 believe that a package is a package?

16          A     Well, I guess we could ask another question. Does  
17 UPS compete for the delivery of Third Class packages?

18          Q     Do you know -- first of all, I ask the questions,  
19 Mr. Clark. I apologize, but that is how it works.

20          A     Well, I am just trying to get to the truth here.

21          Q     Is it your testimony that UPS will refuse to  
22 deliver a package under one pound?

23          A     No, it's not.

24          Q     Okay. They will, won't they?

25          A     They sure do.

1 Q And they will deliver books and records, is that  
2 correct?

3 A Absolutely.

4 Q They also deliver packages as part of Second Day  
5 Air, is that correct?

6 A I presume so.

7 Q They also deliver packages that could be sent by  
8 the Postal Service as First Class mail; is that correct?

9 A That could be sent as First Class?

10 Q Could be sent as First Class mail by the Postal  
11 Service; yes.

12 A I would imagine they do; yes.

13 Q Is it your -- how was this diary put together, by  
14 the way?

15 A All I can tell you, Mr. Clark, is it's an official  
16 publication of the United States Postal Service.

17 MR. MCKEEVER: Mr. Chairman, that concludes my  
18 examination. I would like to move that the executive  
19 summary of the household diary study be transcribed in the  
20 record and also admitted into evidence as an official  
21 document of the United States Postal Service.

22 CHAIRMAN GLEIMAN: Mr. Olson?

23 MR. OLSON: Mr. Chairman, I guess I would think  
24 that page 28 would be an appropriate page, since that's what  
25 we discussed, and perhaps even 29 and 30, which deal with

1 packages, but I can see no reason for including the whole  
2 document. If it's an official postal document, it can  
3 probably get in some other way besides cross-examination of  
4 this witness.

5 MR. McKEEVER: Mr. Chairman, I have no objection  
6 to moving into evidence only the cover page and the three  
7 pages mentioned by Mr. Olson.

8 MR. OLSON: I'd certainly object to it being moved  
9 into evidence. As a cross-examination exhibit I have no  
10 problem.

11 CHAIRMAN GLEIMAN: You -- I'm not quite sure I  
12 understand. You object to it moving into evidence --

13 MR. OLSON: Yes.

14 CHAIRMAN GLEIMAN: Period. You object to it  
15 moving into -- being transcribed and admitted into evidence.

16 MR. OLSON: I think it being transcribed as a  
17 cross-examination exhibit is a good idea. I would object to  
18 putting into evidence. I cannot testify as to authenticity  
19 or Mr. McKeever certainly cannot.

20 MR. McKEEVER: Mr. Chairman, that's exactly why  
21 there is an exception for public documents, so that you  
22 don't need someone to testify as to authenticity. Rule  
23 31(d) of the Commission's rules specifically indicates that  
24 a public document such as an official report -- go ahead,  
25 Mr. Chairman, I apologize.

1           CHAIRMAN GLEIMAN: Mr. McKeever and Mr. Olson, you  
2 had an exchange before about the extent to which you would  
3 limit the number of pages. I just want to make sure before  
4 I direct that certain pages be transcribed into the record  
5 and admitted into evidence that we have the right pages.  
6 Did we have an agreement on the cover page and pages 28, 29,  
7 and 30?

8           MR. McKEEVER: That's acceptable to us, Mr.  
9 Chairman. I was putting the whole document in just for the  
10 sake of having the complete document in, because of course  
11 in the case of a public document when a party offers part,  
12 anyone else is free to put it all in, and so I was  
13 attempting to put the entire executive summary in. But I'm  
14 happy to have only those three pages put in, together with  
15 the cover page.

16           CHAIRMAN GLEIMAN: You want to stick by your  
17 request that we limit it to the cover page and the three  
18 pages, Mr. Olson?

19           MR. OLSON: At this time I do. I would say that  
20 not knowing this was going to be put into the record, I'd  
21 have to review it and see if there was some reason to burden  
22 the record with more pages, and if there was, I guess I'd  
23 make an appropriate motion, but at this time I don't.

24           CHAIRMAN GLEIMAN: Well, in that case I'm going to  
25 direct that four pages, the cover page and pages No. 28, 29,

1 and 30 of the Executive Summary of the Household Diary Study  
2 for Fiscal Year 1996 -- the Executive Summary, I did say, of  
3 the United States Postal Service, which was apparently  
4 issued, it's got a date of September 1997 on it, be  
5 transcribed into the record and admitted into evidence at  
6 this point.

7 [Excerpt from the United States  
8 Postal Service Household Diary  
9 Study, Fiscal Year 1996, Executive  
10 Summary, was received into evidence  
11 and transcribed into the record.]  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

# **The Household Diary Study Fiscal Year 1996**

## **EXECUTIVE SUMMARY**

**FINANCE  
SEPTEMBER 1997**



## PACKAGES

This report section focuses on packages and includes a review by overall volume and carrier used (Postal Service, UPS, etc.), by sender (businesses, family, friends), by content of packages (tapes, books, etc.), by special services (i.e. insurance), by class packages were sent (First-Class, priority, third-class, special fourth-class), and by demographic characteristics (i.e. income, urbanicity).

### A. Coverage of Package Data

Households recorded information about all packages sent and received in a special "packages" section of the diary. Included were packages handled by the Postal Service as well as packages handled by other carriers.

### B. Overall Volume and Carrier Used

There was an increase in the number of packages received per household per week during 1996. The 0.31 packages represents an increase over the 0.26 packages received in 1987. Of all packages received, 85.1 percent were delivered by the Postal Service which represents a relatively large increase over the 1987 figure of 71.7 percent. UPS came in a distant second with just under 15 percent of the total deliveries, most of which were ground service. Other delivery services captured only small fractions of the total package deliveries.

The percentage of packages delivered by the Postal Service includes parcels delivered at all rates. The largest share of parcels was third-class bulk rate (32.8 percent) of the total, followed by First-Class Mail and priority combined (26.0 percent).

### **C. Sender and Content of Packages**

The majority of packages received from all carriers combined tended to be from businesses rather than friends or relatives. Nearly one-half (48.2 percent) of First-Class and priority package mail combined was received from businesses, and 41.9 percent from friends and relatives. Generally, more than three-fourths of packages delivered by each of the remaining mail classes were received from businesses. By content, the Postal Service delivered 92.4 percent of records, tapes or CD's received, and 94.6 percent of books, reflecting the use of special fourth-class and bound printed matter rates. UPS was preferred by many direct mailers. Its largest shares of deliveries were in the catalog order and store order categories (27.1 and 20.9 percent, respectively; still considerably less than Postal Service percentages).

### **D. Use of Special Services**

Relatively few packages that were received included special services. Insurance, at 1.4 percent of USPS deliveries, was the service most frequently seen on packages received. All other special services combined totaled 2.7 percent.



## **E. Packages Sent**

Households sent considerably fewer packages per week (0.08) than they received (0.31) reflecting the high level of packages received that had been sent by businesses rather than other households. Households sent 75.3 percent of their packages via the Postal Service. They sent 50.6 percent of packages First-Class Mail or priority, 6.5 percent special fourth-class, and 2.6 percent third-class.

## **F. Demographics**

There is some increase in the percentage of households earning over \$50,000 and under \$25,000 to use UPS to send their packages. Middle income households (\$25K to \$49.9K), however, actually showed a decrease in UPS usage during this time (17.8 percent in 1987 versus 9.5 percent in 1996). Of the six urbanicity classifications examined, only rural and small town households show an above average tendency to use UPS.

1 MR. McKEEVER: That concludes our  
2 cross-examination, Mr. Chairman. I can furnish the court  
3 reporter with two copies of those pages in just a few  
4 moments.

5 THE WITNESS: Can I make a comment here? You  
6 asked about the definition, the top of page 29.

7 CHAIRMAN GLEIMAN: We'll have a chance to do that  
8 on redirect.

9 Is there any followup?

10 There's no followup.

11 That brings us to redirect. Mr. Olson, would you  
12 like a few minutes with your witness?

13 MR. OLSON: Yes, Mr. Chairman.

14 CHAIRMAN GLEIMAN: Five, ten?

15 MR. OLSON: Five.

16 CHAIRMAN GLEIMAN: Five. Okay.

17 [Recess.]

18 CHAIRMAN GLEIMAN: Mr. Olson, you have some  
19 redirect, I take it?

20 MR. OLSON: Yes, Mr. Chairman.

21 REDIRECT EXAMINATION

22 BY MR. OLSON:

23 Q Mr. Clark, I would ask you to look at your  
24 testimony on page 7. I believe it is line 7 through 9,  
25 although I don't have it in front of me. Mr. McKeever had

1 asked you some questions with respect to your criticism of  
2 Witness Luciani about certain inexplicable changes, and I  
3 wonder if you can tell us what you meant by that testimony.

4 A Well, I was really referring to line 16, line 16  
5 through 21 on page 26, where he simply commented that the  
6 Postal Service had changed the cost of -- the magnitude of  
7 cost estimates is unexplained. In fact, I thought that they  
8 did explain that. So just because it is unexplainable  
9 doesn't mean it is -- in his opinion, unexplainable, doesn't  
10 mean it was uncertain. It doesn't create necessarily an  
11 uncertainty.

12 Q So that part of your testimony dealt with that  
13 particular point that Witness Luciani reference, right.  
14 What page of Witness Luciani's testimony is that?

15 A On page 26. And it follows, you know, the first  
16 comment that he made about imperfect execution, it's all in  
17 that area.

18 Q And, in fact, those are the pages, 26 and 27, that  
19 are cited in your testimony right after your point, correct?

20 A That is correct.

21 Q And so when Mr. McKeever walked you through  
22 Witness Luciani's criticisms of the Postal Service costing  
23 in the early part of his testimony, that was not what you  
24 were referencing, correct?

25 A That's right.

1 Q And, in fact, you did have a line that you deleted  
2 at the beginning of the testimony. Can you tell us why you  
3 deleted that?

4 A Well, I didn't -- you know, I don't -- I feel that  
5 I overstated my position as far as my qualifications. I  
6 really -- I am not qualified to war -- be at war with the  
7 cost estimates in the proceedings, I never pretended to be  
8 that.

9 Q Okay. Secondly, let me ask you to take a look at  
10 the pages of the Household Diary Study which counsel for UPS  
11 asked you some questions about, particularly 28 and 29, and  
12 ask you if you have any further thoughts about UPS being the  
13 dominant carrier with respect to residential delivery?

14 A Well, I think that the question came up as to what  
15 the definition, the appropriateness of this comparison was,  
16 and on page 29, it says the percentage of packages delivered  
17 by the Postal Service includes parcels delivered at all  
18 rates. The largest share of parcels was Third Class bulk  
19 rate, 32.8 percent of the total, following by First Class  
20 mail and priority, which was a combined 26 percent.

21 Later on, on that same page, it goes by content.  
22 The Postal Service delivered 92.4 percent of records, tapes  
23 and CDs, 94.6 percent of books, reflecting the use of  
24 special Fourth Class and Bound Printed Matter rates. UPS  
25 was a preferred -- UPS was preferred by many mailers. It's

1 largest shares of delivery were in the catalog order and  
2 store order categories, respectively, 27.1 percent, 29.9  
3 percent.

4 Q Okay. And let's go back to page 4 of your  
5 testimony, which was the quotation that I believe counsel  
6 for UPS used to set up the question. Can you tell us what  
7 you mean the phrase "parcel" on line 15 and 16 of page 4?

8 A Well, throughout my testimony, I talk about parcel  
9 post, on line five, line seven, line 11. I talk about the  
10 DBMC program on line 14. Line 15, nationwide parcel  
11 delivery. Line 16, parcel delivery market. I pretty well  
12 limited my testimony on comparisons in this case to that  
13 marketplace, and that considered books, records, tapes, CD's  
14 and all those different things.

15 MR. OLSON: Thank you, Mr. Chairman. That's all  
16 we have.

17 CHAIRMAN GLEIMAN: Recross?

18 MR. MCKEEVER: Yes, Mr. Chairman.

19 RE CROSS-EXAMINATION

20 BY MR. MCKEEVER:

21 Q In your rebuttal testimony, you didn't use the  
22 term "parcel post" when you were talking about the parcel  
23 delivery market, did you?

24 A I just cited on page four, the number of times I  
25 did use that.

1 Q In your rebuttal testimony?

2 A Yes, sir.

3 Q You said "parcel." You didn't say "parcel post."  
4 That's my recollection.

5 A Well, look on page four, line five, line seven,  
6 line 11.

7 Q But that's not where you were talking about the  
8 delivery market; is that right? When you were talking about  
9 the delivery market, you said the parcel delivery market.

10 A Imperfect syntax, I guess.

11 Q As the household diary summary sentence that you  
12 pointed out states, the packages being talked about there  
13 includes parcels delivered at all rates; is that correct?

14 A That's what it says; yes, sir.

15 Q So those figures include among packages delivered  
16 in third class, it includes parcel post packages as well; is  
17 that right?

18 A I think so; yes. It says that in section C there.

19 Q Right. In fact, the Postal Service has a  
20 significantly large -- has a significantly large share of  
21 packages carried in third class and books and records,  
22 because their rates are far cheaper than United Parcel  
23 Service's rates; isn't that the case?

24 A I would think that would be the primary driver;  
25 yes.

1 Q Did you read Mr. Jellison's testimony in this  
2 case?

3 A Yes.

4 Q He gave some figures about parcel post shipments  
5 to residences and the share delivered by UPS and the share  
6 delivered by the Postal Service; is that correct?

7 A I don't recall it specifically. I'll take your  
8 word for it.

9 MR. MCKEEVER: That's all I have, Mr. Chairman.

10 CHAIRMAN GLEIMAN: Is there any further redirect?

11 MR. OLSON: Just one, Mr. Chairman.

12 FURTHER REDIRECT EXAMINATION

13 BY MR. OLSON:

14 Q Mr. Clark, isn't it true when Mr. McKeever just  
15 identified the items that were packages sent -- received,  
16 according to the household diary study, that perhaps he  
17 should have also listed first class mail and priority mail?

18 A It's in there; yes.

19 MR. OLSON: Nothing else.

20 CHAIRMAN GLEIMAN: Mr. McKeever?

21 FURTHER RECROSS-EXAMINATION

22 BY MR. MCKEEVER:

23 Q Taking into account all those markets, the  
24 household diary study shows that the Postal Service by far  
25 delivers more packages than anyone else to residences; is

1 that correct?

2 A That's what it reports.

3 MR. McKEEVER: Thank you, Mr. Chairman.

4 CHAIRMAN GLEIMAN: Anyone else?

5 [No response.]

6 CHAIRMAN GLEIMAN: If there is nothing else, then  
7 Mr. Clark, I want to thank you. We appreciate your  
8 appearance here today and your contributions to our record,  
9 and if there is nothing further, you are excused.

10 [Witness excused.]

11 CHAIRMAN GLEIMAN: I was supposed to have a short  
12 ending sentence here saying these hearings are adjourned.  
13 They are adjourned pending Postal Service response to my  
14 ruling on ANM motion to compel, and the scheduling of the  
15 hearing on Witness Shenk's survey relating to the documents  
16 in question, that hearing is tentatively scheduled for  
17 Monday, March 30th.

18 I hope you all have a good evening and a nice  
19 weekend.

20 [Whereupon, at 8:57 p.m., the hearing was  
21 recessed, to reconvene at 9:30 a.m., Monday, March 30,  
22 1998.]

23

24

25