

DOCKET SECTION

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

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

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

**BRIEF OF
THE MAIL ORDER ASSOCIATION OF AMERICA**

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**STATEMENT OF THE CASE AND
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The Postal Service's request for increased rates and fees in this case represents the lowest average rate increase ever proposed by the Postal Service. This is especially remarkable given the fact that, during the period since the last rate increase, the Postal Service has succeeded not only in meeting all current costs of operation but has also significantly reduced its "negative equity." Thus, it can be seen that the Postal Service has, to an extraordinary extent, heeded the PRC's admonitions in Docket No. R94-1.

The issues raised by this proceeding of principal concern to MOAA are: (1) the revenue requirement (an issue which is addressed both in this brief and in a joint brief with other parties); (2) the renewed attempt by the Newspaper Association of America ("NAA"), through the testimony of Sharon Chown, to treat a large portion of institutional costs as causally based by the use of a methodology which is directly contrary to the well-established principle that marginal costs should be the starting point for the assignment of institutional costs; (3) the proper rate design for Standard Mail A; and (4) the rate level proposed by the Postal Service for Standard A

ECR, which results in an exceedingly high cost coverage, twice as high as the level that would be established using Ramsey pricing principles.

Despite Proposed Standard A ECR and Bound Printed Matter rates which are higher than they should be, MOAA supports the USPS proposal as made, with minor exceptions. MOAA recognizes and appreciates the fact that the "overall percentage rate increase requested in this proceeding is historically low, and the rate increases for individual subclasses also fall within a relatively narrow range." USPS-T-30 at 22. Therefore, MOAA believes that the Postal Service has acted in a reasonable and responsible manner and that the rates which have been proposed should, again with minor exceptions, be recommended by the PRC.

In particular, the MOAA supports USPS proposed rate design changes within Standard Mail A, which recognize that the current pound rates are far higher than can possibly be justified on a cost basis. The existing rate design, which essentially assumes that there are few, if any, piece-related costs, is clearly at odds with known cost behavior and the cost study which has been presented by the Postal Service in this proceeding. It is time, and past time, to reform Standard A and MOAA urges the PRC to recommend the changed rate design.

Another serious concern is the fact that the rates proposed for Standard A ECR diverge so substantially from the rates which would be established by the use of Ramsey pricing. The record contains fully specified Ramsey prices, developed by distinguished economists in testimony presented by the USPS and the Office of Consumer Advocate. The testimony, establishing that setting prices closer to Ramsey levels would produce greater consumer welfare, is uncontradicted. The USPS and the PRC should adopt prices closer to Ramsey levels in future proceedings.

In addition to this brief, MOAA has joined with other parties in briefing certain issues.

Those briefs are as follows:

JOINT INITIAL BRIEF OF
ADVERTISING MAIL MARKETING ASSOCIATION
DIRECT MAIL MARKETING ASSOCIATION
MAIL ORDER ASSOCIATION OF AMERICA
ADVO, INC.,
CONCERNING
CITY DELIVERY CARRIER LOAD TIME COSTS
AND
RURAL CARRIER COSTS;

JOINT BRIEF OF
ADVERTISING MAIL MARKETING ASSOCIATION
DIRECT MAIL MARKETING ASSOCIATION
MAIL ORDER ASSOCIATION OF AMERICA
ADVO, INC.,
REGARDING REVENUE REQUIREMENT;

BRIEF OF THE COALITION OF MAILERS
WHO PROVIDE COURTESY REPLY ENVELOPES.

ARGUMENT

A. REVENUE REQUIREMENT.

The Commission's decision in Docket R94-1 is an important backdrop in considering the revenue issues in this proceeding. In that decision, the Commission was harshly critical of the approach to its finances that had been followed by the Postal Service for the entire period subsequent to Postal reorganization. MOAA has joined with other parties in briefing the revenue

issue. Because of the importance of the PRC's earlier decision to this issue, MOAA provides this additional discussion.

In that decision, the Commission chided the Postal Service for having failed to file its rate request on an earlier date.

However, the Postal Service's decision not to file a request for new rates in 1993 resulted in the estimated \$1.3 billion loss in FY1994. An earlier filing could have alleviated the Postal Service's financial stress by providing a cash infusion through increased revenue.

PRC Op. R94-1 at II-27, 28.

It is reasonable to conclude that the timing of this proceeding, which has resulted in the current revenue situation, was heavily influenced by that Commission conclusion.

The Commission was particularly critical of postal deficits. The Commission concluded that in enacting the Postal Reorganization Act, "Congress did not intend for the Postal Service, 24 years later, to have cumulative net losses of more than \$9.425 billion and negative equity of more than \$6.391 billion." *Id.* at II-30. With respect to the rate cycle, the Commission concluded that merely matching costs and revenues for a particular test year failed to meet the expectation of Congress for the "Service to break-even over time." Instead, the Commission noted, the Postal Service "has had operating deficits in 17 of its 24 years." *Id.* at II-31. The Commission characterized Postal Service controller Porras' testimony as only paying "lip service to the goals of breaking even over time and restoring equity." *Id.* at II-21.

The Commission recognized that its "mandate does not include direct intervention in the financial management of the Postal Service." *Id.* at II-21. Only USPS "management can assure that the Service operates on a break-even basis and restores its equity position." *Id.* at II-34. The Commission also emphasized, however, that equity would continue to erode if "costs continue to

exceed revenues", and that as "a matter of fact, revenue must exceed costs if the RPYL is to be accomplished." *Id.* at II-33. Generally, the Commission's entire discussion of the Postal Service's revenues, chronic operating deficits, failure to restore its equity position, and the timing of rate filings represents a condemnation of management and a strong admonition to the Postal Service to drastically modify its approach to its finances, including the timing of rate increases.

The Postal Service has taken actions which respond to the concerns expressed by the Commission. The equity position of the Postal Service has been substantially restored. During the period of FY94 to FY96, the negative equity position of the Postal Service declined from \$5.961 billion to \$ 2.624 billion. USPS-T-9 at 3. Additionally, subsequent to the PRC's R94-1 decision, the Governors adopted the policy of filing for rate increases, as necessary, to ensure that the Postal Service would never again operate in the red.

These management decisions, i.e., the restoration of equity and the avoidance of any red ink in any year, clearly were a major driving force in the timing of this rate proceeding. Based upon estimates of the probable financial position of the Postal Service for the test year, a modest rate increase was requested. In the event, the estimates have turned out to be flawed, but there is no indication that the estimates were made in anything other than good faith.

More important, the Commission cannot have it both ways. As a practical matter, in an enterprise as large as the Postal Service, subject to uncertainties with respect to volumes, costs, and other economic conditions, there is no way to predict revenue needs with the precision that would be necessary to achieve a perfectly balanced position in any given year. If, as the Commission has so strongly urged, the Postal Service is to avoid "chronic deficits" it must necessarily establish a higher rate plateau. The net result might be "chronic surpluses" rather

than "chronic deficits." Given the position taken by this Commission just three and a half years ago, however, it would be truly extraordinary to deny the Postal Service rate increases that differ substantially from those requested. Quite aside from the issue of the legal authority of the Commission to adjust revenues, it is clear that accepting the OCA approach would lead the Postal Service to conclude that it is damned if it does and damned if it doesn't.

Ultimately, the Governors authority to set the implementation date for rate increases is of controlling importance. The Governors have the power to ensure that rates do not produce revenues massively in excess of financial needs. They have the exclusive, unreviewable authority to determine when to implement any given rate change. Although the Commission cannot interfere with that authority, it can advise the Governors of its view that rate increases ought not be implemented before they are actually needed.

In summary, in the R94-1 decision, the Commission severely admonished postal management about chronic deficits and the effects of those deficits upon mail users and competitors. The Governors have take the PRC's concerns to heart and have adhered, to a substantial degree, to the actions urged upon the Postal Service in that decision. The Commission should not penalize the Postal Service for taking its advice.

B. WITNESS CHOWN'S WEIGHTED ATTRIBUTABLE COSTS METRIC IS WITHOUT ECONOMIC FOUNDATION AND SHOULD BE REJECTED.

1. Introduction.

Newspaper Association of America Witness Chown, NAA-T-1, has presented what she labels a "metric" which she contends would "allow the Commission to better gauge the appropriate level of the institutional costs to be borne by each subclass of mail." TR-25/13263.

To the contrary, the Chown metric is nothing more than a gimmick to treat certain costs acknowledged to be common or institutional and therefore not "caused" by any class of mail, as attributable costs. Because institutional costs are not "caused" by any particular class of mail, the assignment of those costs to the classes of mail in order to meet the total revenue needs of the Postal Service cannot be done on a causal basis. The proper starting place for the assignment of those institutional costs is the marginal or attributable costs of each subclass of service.

Section 3626 establishes a number of criteria to be used in assigning institutional costs to the subclasses of mail i.e., the costs to be met in addition to the marginal or attributable costs of the subclass. Interpretation of the criteria, which the PRC has recognized are in some significant respects internally contradictory, has proven to be a difficult and contentious exercise. That the task is difficult is evident, but it would only be made more difficult by straying from the bedrock principle that marginal or attributable costs must be the starting point. Attempting, as Chown has done, to treat a large portion of institutional costs as the responsibility of particular types of mail on a *cost basis*, is not helpful and is totally contrary to sound postal rate-making and the statutory requirements.

Witness Chown divides the totality of Postal Service costs into four "functions" and thereafter computes a "weighting factor" consisting of the product of the total "identifiable" institutional costs divided by the total attributable costs of each function. She advocates using the weighted attributable costs as the starting point for recovering the totality of institutional costs. A clear summary of the Chown methodology is found in the testimony of MOAA et. al. Witness Gary M. Andrew, MOAA, et. al.- RT-1. Tr.36/19672-673.

Despite the patina of having offered an approach to the determination of postal rates which has real economic content, Dr. Haldi's testimony accurately characterizes weighted attributable costs as "rearranged attributable costs." Tr. 32/17285. As he concludes, the Chown methodology "has implicitly added a new rate-making criterion, or it has implicitly given heavy and unprecedented weight to her particular interpretation of one of the existing statutory criteria." (footnote omitted) *Id.* at 17289-290. Regardless of how the Chown methodology is interpreted it should not be accepted since it would require the Commission "to yield, at least partially, to her personal standards of fairness, or else it would have to revamp totally the manner in which it interprets and applies the non-cost factors of the act." *Id.* at 17291.

2. Witness Chown's Approach Does Not Identify Incremental Costs.

Witness Chown contends that it is possible and appropriate to apply incremental cost principles to the four Postal Service functions into which she has divided all costs. She further testified that she views these functions as causing incremental costs, i.e., that it is feasible and appropriate to characterize her "weighted attributable costs" as incremental costs for the purpose of determining whether any particular class of mail is meeting its incremental costs.

As explained by Witness Andrew, the theoretical underpinnings of Witness Chown's "metric" do not withstand examination. The Chown approach equates cost "functions" with incremental costs because the cost would be eliminated if the Postal Service were to cease to perform a particular function, such as delivery. This is a misapplication of incremental cost principles. Since all categories of mail use all of the cost functions identified by Witness Chown, elimination of any those functions "would simply mean that the USPS had decided to put itself out of business." Tr. 36/19674. As Witness Andrew concludes, the delivery function itself is the

clearest example of the fallacy of the Chown approach. "If the delivery function is eliminated, the USPS is eliminated." *Id.*

The Chown approach is unrelated to actual incremental costs. Instead, incremental costs are the costs associated with a particular *product* or grouping of products within any multi-product firm. The incremental test for cross-subsidization, *e.g.*, determining the incremental costs of a Standard A mail, requires the identification of costs that would be eliminated in the event that Standard A mail were to be eliminated from the Postal Service. As concluded by Witness Andrew "the USPS does not sell functions and, in consequence, the incremental costs *of functions* are entirely irrelevant to the proposals." *Id. at 19675.*

USPS Witness Takis has given the generally accepted definition of incremental cost. It "is merely the cost caused by the provision of the entire amount of a *product*." (emphasis added) USPS-T-41 at 3. Stated another way, he explains that marginal costs represent the cost of "another unit of output", incremental costs represents the "costs generated by the provision of all units of an output." *Id.* Witness Takis explains how he measured the incremental costs associated with each Postal Service product and presents his estimates of the incremental costs for each subclass and separate service for the test year on an after rates basis. Exhibit USPS-41B. Chown's target, Standard A, generates revenues far in excess of its incremental costs. USPS-T-30 at 34-35. Her particular target, ECR, generates revenues that exceed incremental costs by a wide margin. (Revenue: \$4,304 million, incremental cost: \$1,969 million). *Id. at 35.*

In sum, witness Chown's postulations serve only to confuse the entire concept of incremental costs. Her attempt to demonstrate that there is an incremental cost associated with a

"function" is contrary to any known use of the concept and provides no information which is helpful to the PRC in attempting to determine the prices which should be charged for Postal products.

3. Witness Chown's Approach Serves Only To Obfuscate, Not Clarify, Pricing Issues.

In addition to the fact that the Chown metric lacks any theoretical economic justification, its use as pricing tool should be rejected for other reasons. As stated by USPS Witness Panzar, the Chown proposal involves "combining marginal and incremental costs in such a way that the usefulness of both concepts is destroyed." Tr. 34/18446. Witness Panzar also demonstrates that the approach advocated by Chown would serve to complicate the rate treatment that should follow from work-sharing discounts. In his testimony, he distinguishes between what he identifies as "Efficient Discount Policy", i.e., limiting discounts to the unit cost saved, and what will frequently be a competing policy of efficient pricing methodology because "efficient discounts" may not produce efficient rates. Although he does not take a position on which should prevail he notes that the Chown methodology would serve to complicate the implementation of efficient discounts. *Id.* at 8457-458.

Witness Panzar addresses Witness Chown's hypothetical example in which a class of mail using a given function is assigned institutional costs which exceed the totality of the institutional costs for the sole function used by that class of mail. *Id.* at 18452-453. He explains, however, that her "dramatic example merely illustrates the need for careful incremental cost testing when unbundling occurs." *Id.* at 18456. Chown's unrealistic hypothetical, therefore, proves nothing. Witness Panzar also notes that the Chown methodology would not even provide a basis for

ensuring the establishment of subsidy free rates since mark-ups might produce rates which are cross-subsidized, even those based upon Chown's weighted attributable costs. As he states, "basing . . . mark-ups on WAC rather than volume variable costs does nothing to ensure that subsidy free rates are established." *Id.* at 18456.

4. The Chown Metric Represents A Third Tier Of Costs, A Concept Rejected By The Courts.

Witness Chown's "weighted attributable costs" represent a third cost tier. As stated by Witness Andrew "the Chown metric constitutes a division of the institutional (non-attributable) costs into two parts; namely, 'identifiable' institutional costs and 'system-wide' institutional costs." Tr. 36/19677. Witness Chown attempts to escape from this dilemma by proposing a methodology that would assign the totality of institutional costs as found by the Postal Service rather than just the institutional costs that exceed the "weighted attributable cost." It is, however, a distinction without a difference. Under her method, the weighted attributable costs are to be used in a way which effectively treats the difference between attributable and "weighted attributable costs" as "costs". As noted in Witness Dr. Haldi's testimony, the Chown methodology represents a middle tier of costs, the use of which has been rejected by the Supreme Court. The Chown approach represents "thinly disguised effort to reinstitute the type of approach rejected by the Supreme Court's decision,¹ and have the Commission take into account a middle tier of institutional costs by mechanistically linking her identifiable institutional costs with each class of mail." Tr. 32/17293.

¹ *NAGCP v. U.S. Postal Service*, 462 U.S. 810 (1983)

5. The Chown Metric Ignores Economics Of Scale And Scope.

The Chown approach ignores the fact that the Postal Service enjoys both economies of scale and scope. As stated by Witness Andrew, these "economies of scope and scale allow mail to share the burden of institutional costs and benefit from the fact that the cost of producing all products is much less than the sum of producing of each individual product line." Tr. 36/19679. As a result, "the problem of products using resources with different volume variabilities is more perceived than real." *Id.*

Witness Crowder is correct in her conclusion that the Chown approach is "designed to offset" efficient ratemaking. Tr. 34/18350. Rather than recognizing the benefits from scale and scope economies and recognizing that the use of marginal costs is required to produce economically efficient rates, her approach would "generate entirely wrong price signals" and "discourage the most price-sensitive volume." *Id.* at 18351.

Witness Crowder, also demonstrates the extent to which the approach advocated by Witness Chown is theoretically unsound and leads in exactly the opposite direction of economically efficient rates. Tr. 34/18347-354. As she states, economically efficient rates require that they be established on the basis of marginal costs, mailers work-sharing efforts and market and demand characteristics. *Id.* at 18350.

6. The Chown Metric Produces Volatile And Unpredictable Results With Cost Changes.

In addition to being theoretically unsound and unacceptable for that reason alone, Witness Andrew has demonstrated that the use of the Chown metric produces volatility and unpredictability in the face of changes in either institutional or attributable costs. Tr.36/19679-89. The use of any "metric" or tool in rate-making should "exhibit stability when

the components of the metric undergo change." *Id.* at 19679. Specifically, cost changes in one subclass of mail should "not produce wide fluctuations in subclasses where no cost changes have occurred." *Id.* Witness Andrew presents three cases demonstrating that instability occurs under the Chown metric. *Id.* at 19679-89.

In the face of a system-wide increase in institutional costs, the use of the Chown metric "causes significantly different changes in the rates of the three classes" used by Chown to illustrate the use of her metric. *Id.* at 19684. The introduction of worksharing to a particular class also produces large changes in rates for classes of mail not involved in the new worksharing as shown in Table 5 of Andrews testimony. *Id.* at 19686. Similarly bizarre results are shown to result from the combination of an increase in overall institutional costs and the introduction of worksharing in a particular class i.e., Class A. Class C, not involved in the new work-sharing, receives a 67 percent rate increase in response to this institutional cost increase and attributable cost decreases in Class A. *Id.* at 19688. In sum, as concluded by Witness Andrew, the "marginal cost metric, in addition to being theoretically superior, has the practical benefit of responding to changes in a reasonable, predictable manner." *Id.* at 19689.

7. The Chown Metric Produces Nonsensical Results

The testimony of USPS Witness Taufique, USPS-RT-21, presents practical common sense reasoning demonstrating why the approach advocated by Witness Chown should be rejected. He gives an illustration showing that a restaurant installing a counter designed primarily for the purpose of selling coffee would be ill-advised to attempt to recover the cost of the counter from the sale of items such as candy and chewing gum, for the simple reason that it

would no longer be possible to sell those products. They would be bought from a competitor.

Tr. 34/18514-515. As Taufique concludes:

The institutional cost of the delivery network is linked to the existence of the Postal Service, not the existence of a particular class of mail. Burdening a particular class of mail with this institutional cost, as produced by Witness Chown (through the use of weighted attributable costs) does not make economic or business sense, and would undermine the sensible approach to discount pricing followed to this point by the Postal Service and the Postal Rate Commission."

Id. at 18515.

Witness Taufique demonstrates the practical difficulties of Witness Chown's approach by noting its application to a particular type of mail, i.e., in county periodicals. The Chown methodology produces weighted attributable costs of over \$129 million compared to the Postal Service's attributable costs of \$82 million. The result of using the weighted attributable costs would be to produce rates which are drastically higher than current rates, and higher than the legally required markup. Tr. 34/18516-518. In the cross-examination of Witness Taufique, counsel for NAA attempted to obtain a concession that this was not really what Witness Chown had in mind. Tr. 34/18538-545. Ultimately, however, the effort failed. As correctly stated by Witness Taufique, if the weighted attributable costs are not used in the manner which Chown has recommended "there's no point" to the entire methodology. Tr. 34/18541.

8. Prior Commission Decisions Demonstrate That The Chown Approach Should Be Rejected.

If the approach advocated by Chown is to be given serious consideration, it would be appropriate for the PRC to again visit the concept of service-related costs. The Docket R80-1 decision contains a succinct summary of the rationale for an application of service-related costs.²

² Service-Related Costs, Peak Loads, and Latent capacity.

It is not MOAA's purpose to revive a debate about the use of service-related costs in this proceeding. Nevertheless, a comparison between the "Chown metric" and "service-related costs" is particularly appropriate. The most dramatic change in cost responsibility under the Chown metric would occur in the delivery function. She states that "attributable costs of ECR mail are predominately delivery costs -- a function that accounts for a large share of the institutional costs of the Postal Service." Tr. 25/13265. She goes on to complain that the current markup method of attributing the totality of institutional costs on the basis of the criteria of the Act "can result in a low institutional cost assignment for a subclass of mail that primarily uses mail functions for which few of the costs are attributed, even if the provision of these functions causes the Postal Service to incur substantial institutional costs." *Id.* In other words, the principal thrust of Witness Chown's testimony is that the current attribution and assignment methodology represents an inappropriate assignment of costs for the delivery function.

It is, however, the delivery function which is most clearly established and maintained in its current six day a week mode because of the needs of First-Class and other types of expedited mail. The premise of service-related costs is that, in the absence of the service standards required

In R77-1 the Commission adopted the concept of service-related costs as a mechanism for identifying cost-casual relationships beyond volume variability. Service-related costs were fixed (i.e., not variable with volume) "delivery costs that could be saved in the absence of the published delivery standards for the preferred classes." In other words, service-related costs were unattributable delivery costs that could be eliminated if preferential service standards were eliminated. Service-related costs were measured by first determining how the Postal Service would organize its delivery operation if there were no preferential service standards; second, estimating the cost of this reorganized delivery operation; and third, calculating the difference between the cost of the current method of operation and the cost of the hypothetically reorganized operation. This cost difference was deemed to be an acceptable estimate of the added delivery cost of providing preferential service over and above ordinary service. (footnotes omitted) PRC Op. R80-1, at 145.

by the expedited mail classes, it would be possible to reconfigure the Postal Service to provide delivery three-rather than six-days a week. The Chown methodology would increase drastically the institutional cost responsibility of ECR mail for the delivery function i.e., the very function which is most clearly structured to serve the needs of expedited ECR mail.

If the Commission were to seriously entertain the proposition that the fundamental methodology of assigning institutional costs on the basis of attributable costs is to be abandoned in favor the use of other types of "costs" premised upon various alleged uses, such as the Chown methodology, it should at the same time examine the whole of the Postal Service to determine the extent to which its configuration is a product of the needs of the various mail classes. Chown's "weighted attributable costs" have far less "causal" basis than the costs of a delivery network designed to meet the needs of First-Class mail.

9. Summary

In summary, the Chown methodology has no basis in either accepted economic theory or the practical world of attempting to establish prices under the Postal Reorganization Act. The methodology is designed to give the appearance of a disciplined approach to assigning institutional costs, when in fact it consists of calculating a third tier of costs for which there is no legal basis, and treating those costs as caused by particular classes of mail when no causal connection exists. It should be rejected in its entirety.

C. THE USPS AND PRC SHOULD GIVE GREATER CONSIDERATION TO RAMSEY PRICES.

The USPS has presented the testimony of Witness Bernstein which establishes the economic basis for, and the postal rates which would result from, the application of Ramsey

pricing. USPS-T-31. In his testimony, he poses a question: "[c]an prices be set in a way that satisfy the net revenue requirement and impose the smallest possible burden on consumers?" *Id.* at 16. His answer: "Yes, by applying the theory of Ramsey pricing." *Id.*

The economic basis for the use of Ramsey prices is well-established, and MOAA does not consider extensive argument on the economic and consumer benefits from Ramsey pricing to be necessary. Both Witnesses Bernstein and Sherman present the reasons for using Ramsey pricing for regulated enterprises, including the Postal Service. USPS-T-31 at 8-31; Tr. 26/13711-20. As long ago as 1983, Ramsey pricing was characterized as "economically accepted" *Southern Pac. Com. Co. v. AT&T Co.*, 556 F Supp. 825, 964 (D.D.C. 1983) *aff'd*, 740 F.2d 980 (D.C. Cir. 1984).³ Witness Bernstein's testimony represents a cogent and compelling basis for establishing postal prices that are closer to the Ramsey prices than is the case under the current schedule or under the rates which have been proposed by the USPS. He estimates that mailers would "collectively gain \$1,023 million dollars in the Test Year from Ramsey pricing as opposed to the price schedule based on the R94-1 mark-ups."⁴

³ See also, *ARCO Alaska, Inc. v. FERC*, 89 F.3d 878, 883 (D.C. Cir. 1996); *National Rural Telecom Ass'n v. FCC*, 988 F.2d 174, 182 (D.C. Cir. 1993); *Burlington Northern Ry. Co. v. ICC*, 985 F.2d 589, 595-96 (D.C. Cir. 1993); *Consolidated Rail Corp. v. United States*, 812 F.2d 1444, 1454 (3d Cir. 1987)

⁴ His testimony also postulates that what he characterizes as "Efficient Component Pricing" poses an apparent conflict as applied to First-Class for single-piece and workshared letters." *Id.* at 72. He reconciles the apparent conflict between Ramsey and ECP and demonstrates the additional consumer gain that would result from the "efficient pricing of single-piece and workshared letters. *Id.* at 94. The gain would be an additional \$348 to \$484 million. *Id.* at 94. See generally, *Id.* at 76-94.

In fact, there is no need to consider "worksharing" or "discounted" rates in order to establish marginal costs, as recognized by Dr. Panzar. Tr. 34/18486. Dr. Panzar recognizes that his concern about what he characterizes as "Efficient Discount Policy" i.e., confining worksharing discounts to the amount of attributable costs saved by the worksharing, in examining economically efficient or Ramsey pricing, is simply not very

Id at 3.

OCA witness Roger Sherman, OCA-T-300, demonstrates that witness Bernstein's calculation of the loss of consumer welfare resulting from USPS proposed prices has been understated. He calculates the welfare loss as \$3.159 billion. Tr. 26/13734. Although Sherman's results differs from Bernstein's because he uses long-rather than short-term elasticities, he endorses witness Bernstein's explanation of the value of Ramsey pricing without reservation. "I join him [Bernstein] in praising such prices for the their welfare effects." *Id.* at 13714. Witness Sherman's testimony shows starkly the amounts of welfare loss resulting from the rates proposed by the USPS, particularly within First-Class Mail, Express Mail, and Standard A ECR. *Id.* at 13730. He notes that Standard A ECR, "has a price almost twice as high as its constrained Ramsey counterpart." *Id.* at 23. Sherman also recognizes the significant welfare loss resulting from the USPS proposed prices for Bound Printed Matter. *Id.* at 13738.

MOAA does not contend that the Commission, in light of the criteria of the Postal Reorganization Act, can or should simply apply Ramsey pricing in a mechanistic fashion. The PRC, however, certainly should give greater attention to Ramsey pricing than has been the case in the past. The testimony of witnesses Bernstein and Sherman demonstrates the loss in consumer welfare resulting from a failure to adopt postal rates that more closely approximate Ramsey prices. Given that uncontradicted testimony, MOAA submits that it is the burden of those parties opposing the use of Ramsey pricing to demonstrate why the criteria of the Act require such a sharp departure from economically sound rates.

important. "If they [the PRC] were just interested in Ramsey-like total surplus calculations they wouldn't have to pay any great attention to the Efficient Discount Policy because the Ramsey calculation has made that trade-off automatically." *Id.* at 18483-484.

MOAA recognizes the difficulty of moving in the direction of Ramsey prices because of concerns about "fairness." Those mailers whose rate levels would increase understandably will continue to argue that Ramsey pricing should have no role in the establishment of postal rates. The issue is particularly sensitive because of the consequences for single piece First-Class mail. The PRC should recognize, however, that the overwhelming majority of the mail stream consists of business mail. Indeed, 10 percent of First-Class mail consists of advertising.

Further, the use of Ramsey pricing will benefit society as a whole. Thus it is inappropriate to look solely at the apparent "winners" and "losers" within the mail stream in setting prices. These considerations, which are essentially political, should not lead the PRC to ignore economic efficiency. The very existence of the PRC is premised in large part upon ensuring that rates are established on the basis of sound economics; not politics.

But if rates and classifications are to be established on the basis of expert considerations of the overall value of the service provided and the allocation of costs on a scientific or quasi-scientific basis, then Congress should be removed entirely from the ratemaking and classification business.

S. Rep. No. 91-912, June 3, 1970 at 11

MOAA finds it regrettable that the USPS pricing witness, Donald J. O'Hara, has so blithely dismissed Ramsey pricing in his testimony. He concedes that "the consideration of movement toward or away from Ramsey prices did not have a major effect on my conclusions." USPS-T-30 at 21. This presumably explains a Standard A ECR rate that is twice as high as it would be by using Ramsey prices. He gives three reasons for this approach: (1) the "modest" proposed levels of increase, (2) the desire to keep all subclasses close to the overall average increase and (3) a desire to "exercise restraint in reflecting the new costing information." *Id.*

MOAA finds that, to a degree these reasons are rational. The modest overall level of rate increases and the goal of keeping increases at or close to the overall average is appealing and are among the reasons leading MOAA to support the USPS proposed rates, despite the fact that they are manifestly not economically sound. In so doing, however, MOAA expresses its frustration at the slow movement, if any, in the direction of using sound economic pricing principles.

MOAA urges the PRC and the USPS to come to grips with the fundamental disparity between the rates which are currently in effect, and the rates which the USPS has recommended, and the rates which should be established under Ramsey pricing principles. A failure to move more rapidly in the direction of economically efficient rates will ultimately harm the very mailers the USPS and PRC seek to protect. Single piece First-Class rates are manifestly lower than can be justified on any economic basis. That may appear to be more fair and desirable. If, however, the overall rate schedule is allowed to diverge too greatly from economic rates, which would produce greater consumer welfare, there is the grave threat of forcing all rates higher. That occurs, as a matter of math, by deviating from Ramsey pricing. The uneconomic pricing of price sensitive mail threatens to have even more dramatic consequences in the future.

It is apparent, also, that "fairness" as a justification for maintaining the First-Class single piece rates at uneconomically low levels is more apparent than real. The maximization of consumer surplus serves to benefit all mailers. The slavish adherence to the notion that First-Class single piece rates should be maintained below economic levels on the grounds of fairness will prove to be a self-defeating approach to pricing postal services. It is time to move beyond parochial concerns and to recognize that economically efficient rates are to the benefit of all mailers and the entire society.

D. THE PROPOSED ECR AND BOUND PRINTED MATTER RATES ARE TOO HIGH AND THE STANDARD A RATES SHOULD BE ADJUSTED TO REFLECT FULL WORKSHARING COST SAVINGS.

1. The Proposed Standard Mail ECR And Bound Printed Matter Rates Are Too High.

MOAA supports the rates which have been proposed by the USPS in this proceeding, and as set forth above, believes that such rates are reasonable given the totality of circumstances. Among other things, MOAA recognizes that there is a need to be concerned about large rate increases for any particular type of mail. Nevertheless, it is abundantly clear that the rates that have been proposed by the USPS for Standard A ECR and Bulk Bound Printed Matter are excessive. Therefore, those rates, and the resulting rate relationships between the classes of mail, should not be regarded as establishing rate level relationships which will be accorded any presumption of validity in future proceedings. The consumer welfare benefit that would result from rates closer to Ramsey prices is ample justification for adopting lower prices for those two subclasses of mail.

The continuation of excessive Standard A ECR rates has grave implications for the future well-being of the USPS and in particular its ability to offer universal service at reasonable rates. It is recognized that the Postal Service faces competitive threats within First-Class mail. At least at the present time, the diversion of First-Class mail into electronic alternatives appears to be a more serious threat than it does for Standard A. This appears to be reflected by recent volume trends for Standard A and First-Class. It should also be noted, however, that electronic diversions as well as other possible diversions remains a distinct threat for Standard A. It is vitally important that Standard A and especially Standard A ECR not be priced at levels which

will force mail out of the system, either because of diversion, or simply because of rate levels precluding the continuation of a business using Standard A.

In summary, MOAA supports the USPS proposed rates, but only reluctantly because those rates are so far in excess of economical efficient rates as shown by the testimony of witnesses Bernstein and Sherman. The Commission should signal its strong concern that future prices proposed by the USPS should not differ so drastically from those which have been shown to be economically efficient.

2. Destination Entry Discounts Should Reflect 100 Percent Of Cost Savings.

USPS Witness Moeller has proposed destination entry discounts which equal only 80 percent of the cost savings. As shown by Witness Andrew, the result is "a false price signal" to the market, and would fail to meet the objective of maximizing productive efficiencies. Tr. 20/10135. *See generally* Tr. 20/10135-138.

Witness Andrew also made the necessary adjustments in "basic" piece rates in order to ensure that Standard A mail continues to meet the revenue requirement that has been established by the Postal Service. This approach is in notable contrast to the approach advocated by Witness Clifton in which revenue losses resulting from increasing the discounts for First-Class presorted mail would be dumped upon Standard A. Although, the changes proposed by Witness Andrew are relatively minor, MOAA believes that they are sound and would result in a more cost-based rate structure than that which has been proposed by the USPS.⁵

⁵ MOAA acknowledges that the changes for destinations entry proposed by Witness Andrew would serve to change, to a small degree, the relationship between the piece and pound charges proposed by the USPS. Such changes would be minimal and would move in the direction of more accurately reflecting those Postal Service costs which are related to piece handling and those Postal Services costs which are weight related.

E. THE POSTAL SERVICE'S PROPOSED RATE DESIGN FOR STANDARD A SHOULD BE ADOPTED.

1. The Postal Service Proposal.

The Postal Service has proposed a redesign of the rates for Standard A. The pound rate for nondestination entry, regular would be reduced from the current rate of 67.5 cents to 65 cents, with lower rates at the BMC and SCF levels. USPS-T-36 at 21. For Enhanced Carrier Route ("ECR"), the pound rate would be reduced from 66.3 to 53 cents for nondestination entry mail, with lower rates at the BMC, SCF and DDU levels. USPS-T-36 at 31. USPS Witness Moeller, has presented the reasons for the proposed rate design. He gives a number of reasons for the proposed changes of the pound rates.

- ◆ Under the current rate design a doubling of weight results in the doubling or near doubling of the rate. For example, for DDU saturation, pound-rated mail, the rate for one eight ounce piece is 27.6, cents, the same as the rate for *two* four ounce pieces. This is obviously illogical and contrary to all known cost behavior. It is apparent that the cost of handling two pieces of mail are considerably greater than handling a single piece of mail of the same shape and so close together in weight. The eight-ounce piece costs some greater amount than the four-ounce piece, but certainly costs do not double. This illogical result flows in large part from the premise embodied within the current rate schedule that saturation, non-letter size mail incurs no piece charges. The piece rate is "0." Even for high-density and basic, the piece charges are only 1.0 and 1.8 cents respectively. This is not a credible piece charge. USPS-T-36 at 24.

- ◆ The previous rationale that the pound rate served as a proxy for increased costs resulting from parcels, and therefore reflected the increased costs of changing shape, is no longer applicable. ECR is now a separate subclass in which parcel and flat costs are about the same. Further, there are only a negligible number of parcels within ECR. *Id.* at 24.
- ◆ If cost and otherwise justified, a surcharge for a Standard A parcels would eliminate any rationale for using weight as a proxy for shape. *Id.* at 25.
- ◆ Weight plays only a very small role in ECR costs, as shown in the Christensen Associates study USPS LR-H-182, Exhibit USPS 44B. *Id.* at 25.
- ◆ ECR traffic competes with alternatives in which weight plays little role in the establishment of rates. *Id.* at 26.⁶

In his cross examination, Witness Moeller reiterated the illogic of the current pound rate structure within ECR.

The crux of the difference between the two methods is that the Commission's method results in rates for pound-rated Saturation mail that double with weight. As described in my testimony at page 24, this outcome does not seem to be as cost-based in that it seems illogical that the Postal Service would be indifferent between delivering one eight-ounce piece, and two four-ounce pieces, yet the total postage in these two cases would be the same. Another outcome is a basic pound rate which implies that the weight is much more a cost driver than suggested by available weight/cost data. The proposed selection to the pound rate is cost-based in that it considers available cost-data. The selection of the piece rate of zero for pound-rated saturation Mail is only cost-based under circumstances where costs for pound-rated saturation mail are solely tied the weight of the piece. Tr. 6/2853.

⁶ See Tr. 6/2791 which offers further support for Witness Moeller's conclusion that weight plays little role in the rates for those carriers with whom the Postal Service competes in ECR pound rated mail.

No party has offered any economic analysis which questions the cost rationale supporting the Moeller rate design. In fact, the only witness that presented an economic analysis of the overall rate design, Witness Haldi, specifically endorsed the proposed pound rate. Tr. 27/15091. He also noted that a higher pound rate than proposed by the Postal Service would result in a "further reduction in the unit cost of non-letters below the corresponding cost of letters." Tr. 27/15172. For these reasons, he concluded that Witness Moeller's recommended pound rate is "conservative." *Id.*

2. Witness Bradstreet's Testimony Provides No Basis For A Rejection Of The Proposed Rate Design.

The only testimony that attacks the proposed pound rate is the anecdotal testimony of Kenneth Bradstreet offered by an association of competitors of the Postal Service, the Association of Alternate Postal Systems. AAPS-T-1. He describes his testimony as "not technical" and offered in his capacity as a competitor and a "layperson." Tr. 23/11980. He testified that the members of AAPS "compete with the USPS for the delivery of Standard ECR saturation or high density advertising. . ." Tr. 22/11981. He requests that the Commission "maintain the present level of rate relationships." Tr. 22/12024.

Witness Bradstreet offers no data that would support his criticisms of the USPS proposal. He was unwilling to provide any information about the weight distribution of the materials delivered by AAPS members. Tr. 23/1203. He was unwilling to give any information about the wages paid to employees of his own company to perform delivery functions. Tr. 23/12033. He claimed competitive harm from the rates proposed by the Postal Service, but did not provide any data to support that claim in the form of volumes, revenues and profits for members of AAPS.

Tr. 23/12036. He was unwilling to supply a schedule of the delivery rates actually charged by his own company, APS. Tr. 23/12037. He provided no information about the delivery rates charged by members of AAPS. *Id.* at 12038. Although he claimed that the Postal Service enjoys enormous competitive advantages, he also conceded that the Postal Service itself operates pursuant to competitive disadvantages including the fact that it cannot independently set its own rates or product lines (Tr. 23/12031), has no independent ability to establish the wages for its employees (*Id.* at 12032), and pays wages which are "substantially" in excess of those paid by his company. *Id.* at 12033. He also conceded that member of AAPS can set their rates without review by any rate authority. *Id.* at 12034.

He stated that it was not his testimony that the USPS should increase the proposed rates for Standard Mail A ECR solely on the basis of the competitive concerns expressed in his testimony. Tr. 23/12035. In fact, however, the entirety of the testimony is just that. He provided no basis for the PRC to determine whether there is any real threat of competitive harm from the rates proposed by the USPS. Nevertheless, he urges a drastic restructuring of those rates based upon a naked assertion that competitive harm will result. MOAA submits that, in the absence of any data, it is at least as likely that the members of AAPS are seeking only to preserve a substantial competitive advantage resulting from the unreasonably and unjustifiably high pound rate. This is especially true given the fact that within the private delivery industry weight plays little role in costs and the resulting rates.

In sum, Witness Bradstreet has wholly failed to carry the burden of showing that the rates proposed by the Postal Service will cause a degree of competitive harm which should lead the PRC to price ECR mail at higher than proposed levels, or to recommend pound rates higher than

proposed by the Postal Service. In Docket R90-1, the PRC rejected claims by witness Bradstreet which were strikingly similar to his current claims. The PRC, in this case, should conclude, as it did then, that the USPS competitors "characterization distorts reality." PRC Op. R90-1 at V-305. As concluded by MOAA Witness Andrew, Witness Bradstreet "provides no information on how the proposed rate schedule will be injurious to competitors, particularly the alternative delivery systems." Tr. 36/19714.

3. Witness Bradstreet's Testimony Has Been Shown To Be Without Substance By Rebuttal Witnesses.

Witness Andrew demonstrates that the attempts by Bradstreet to show that USPS has deliberately lowered rates for competitive mail is fatally flawed. Witness Bradstreet's analysis of rates since 1978 failed to take into account work-sharing discounts introduced over that period. Tr. 36/19717. Since ECR saturation mail rates were first instituted in 1991, rates have increased at essentially the same rate as increases for First-Class letters. Tr. 36/ 19717-718. Further, Witness Bradstreet ignores the enormous differential between the attributable cost behavior of First-Class and what is now Standard A during the period of 1978 to 1996. During that period, First-Class average per price costs have *increased* 52 percent. During that same period Standard A ECR costs have *decreased* 10 percent. Tr. 36/19718. Obviously, it is impossible validly to assess the rate relationships that now exist, and how the Postal Service and the Postal Rate Commission arrived at those rate relationships, in the absence of a full analysis of both costs and revenues, an analysis which shows that the rate comparisons that Bradstreet has presented are without value.

The testimony of Harry J. Buckel on behalf of the Saturation Mail Coalition, SMC-RT-1, also demonstrates that Witness Bradstreet's rate comparisons are highly distorted since they start with the year 1978. He describes that year as a "low point" for volume because of the "excessively high postal rates that failed to reflect the low cost and price sensitivity of saturation mail." Tr. 32/17242. It was also a time in which the "rate structure contained no worksharing discounts." *Id.* He also points out that the rate increases resulting from R87-1 were enormous, the result of which was a substantial loss of volume from the Postal Service to private carriers, including newspapers. *Id.* See generally Tr. 32/17241-244.

The testimony of Witness Green undercuts Bradstreet's contentions that weight costs are not sufficiently recognized in the proposed pound rate. Witness Green acknowledged that weight is not a significant factor in the delivery function for competitors of the Postal Service. As a competitor, not using the Postal Service, he has not been concerned with "weight for so long since we're in the hand delivery." Tr. 23/11973. His materials, if entered into the Postal Service, would be mailed at the pound rate (Tr. 23/11974) and the current pound rate structure for Standard A ECR is "prohibitive." ("[T]he incremental cost of putting my piece into their [shared mail] package would make it prohibitive.") *Id.* at 11970. His testimony can only be interpreted as supporting the proposition that, for delivery costs, weight is of little importance, otherwise he would have "been concerned with weight." Witness Buckel, whose company is engaged in alternative delivery operations, confirms Green's testimony. He testified that in the alternate delivery industry "rates tend to be weight-insensitive." Tr. 32/17274.

Witness Crowder, Advo-RT-1, also effectively rebuts Witness Bradstreet's contention that the ECR pound rate proposed by the Postal Service does not reflect cost behavior. See Tr.

34/18325-331. Witness Bradstreet constructed an example which he maintains demonstrates that there are more weight related costs in the delivery function than has been recognized by the Postal Service. His example was atypical, addressing a hypothetical carrier route of 600 stops averaging 60 stops per loop. The typical postal route has far fewer loops, and far fewer stops. *Id.* at 18325-326. As she shows in her testimony, "the delivery system has far more capacity to handle weight volume than assumed in Witness Bradstreet's examples." *Id.* at 18327.

She also explained that postal costs are driven primarily by factors unrelated to weight. This includes such factors as "geographic coverage, groupings of addresses, special service requirements for particular addresses, traffic patterns, parking availability, safety, terrain, and maintenance of contiguous addresses within a route." *Id.* at 18328. She also notes that the deferability of Standard A Mail allows the Postal Service to adjust its actual delivery pattern to avoid any excess affects of weight upon carrier costs. *Id.* at 18328-329.

Ultimately, Crowder demonstrates that the entire premise of Witness Bradstreet's "park and loop" testimony is inaccurate and not supported by an actual analysis of the behavior of park and loop costs. She also shows that substantial amounts of delivery costs, including rural carrier, city carrier, and non-park and loop motorized curb line routes have little or no sensitivity to weight and pieces, i.e., these costs are exclusively piece driven. *Id.* at 18330-331.

4. NAA'S Contentions That The USPS Should Ignore Competitive Realities Should Be Rejected.

The competitive realities of the Postal Service support the proposed change in the pound rate. The position of the Newspaper Association of America ("NAA") however, is that in the face of competition the Postal Service should price its services so as to be as accommodating as

possible to competitors.⁷ The NAA approach is nothing more than an invitation to the Postal Service (and the PRC) to design postal products and rates in a manner which ensures that it will be unable to compete with the private sector. Surely, this is a recipe for disaster, not only for the mailers directly involved in using Standard A, but for the entirety of the Postal Service.

The NAA contends that competitive pricing by the Postal Service is contrary to its public service roll. NAA memorandum at 20-24. To the contrary, a failure of the Postal Service to price its services in a manner which reflects cost incurrence would violate the pricing provisions of the Act, and would severely strain its ability to carry out its public service roll, particularly since the USPS is faced with competitors whose pricing is not weight sensitive. A notable feature of NAA's memorandum is its conspicuous failure to contend that the Postal Service's proposed pound rate design is out of line with industry practice. The fact is that for newspapers, and other competitors offering alternate delivery, weight has little influence upon costs, and therefore, little influence upon the rates charged to users. Tr. 6/2791. Indeed, it is this very fact that has allowed the newspapers and other alternate delivery companies an enormous price and thus competitive advantage. The only reason that the USPS has been able to retain the volume that is now within ECR is because of the fact that the Postal Service has a perceived value among recipients that is sufficient to allow some advertisers to use the Postal Service despite lower cost alternatives. If business decisions were based purely on price, the Postal Service would lose an enormous portion of its market. At the rate levels which have been proposed by the USPS, which increase rapidly as weight increases, the newspapers and the alternate delivery companies will still be able to compete effectively on price. The rate design may allow the Postal Service a

⁷ Newspaper Association of America Memorandum of Law on The Pound Rate for Standard (A) Enhanced Carrier Route Mail, March 26, 1998.

somewhat more competitive position than now exists, but it certainly will not wipe out the price advantages enjoyed by competitors.

NAA has made a great deal of noise over the 1998 USPS marketing plans, which it portrays as an insidious plot by the Postal Service to target competitors in a fashion contrary to its public service functions. Regardless of the ultimate evidentiary status afforded to the marketing plans, MOAA urges the PRC to read the document itself rather than the hysterical characterizations of that document which have been made by NAA. MOAA is gratified that the Postal Service has given systematic and thoughtful consideration to marketing and what it will need to do to ensure its future. It is this kind of approach, business-like and reflecting careful thinking about its current status and future needs, that presumably has permitted the Postal Service to achieve much improved operating results. In sum, the plan is neither insidious nor reprehensible, but merely a recognition of the kind of action needed to maintain a healthy Postal Service capable of carrying out its public service function.

It is unfortunate that the Postal Service's reaction to NAA's use of the marketing plan has tended to reinforce the contentions of NAA that there is something improper about the plan. MOAA fully understands why the Postal Service is annoyed and contends that its marketing plan, which clearly is proprietary information which should be maintained in confidence, has been leaked to NAA, representing competitors of the USPS. The USPS outrage, and presumably its concern that NAA has a mole within USPS more concerned with helping the enemies of the Postal Service than the Postal Service, is fully understandable. The efforts of the Postal Service to put this cat back in the bag, however, are futile. Now that the NAA has successfully released to the world proprietary information contained in the USPS marketing plans, any damage simply

cannot be undone. The Postal Service should recognize this reality and emphasize that the marketing plans represents responsible, not irresponsible, conduct.

In sum, the NAA position that it is inappropriate for the Postal Service to concern itself with competitive realities in establishing rates cannot be accepted. The adoption of this approach to postal pricing would serve the interests of the newspapers and other competitors of the USPS, but would surely be severely detrimental to the overall functioning of the Postal Service and the public which it serves. If the Postal Service fails to take account of competitive realities it will price itself out of the market, to the detriment of its advertising mail customers, and its ability to offer universal service at anything approaching reasonable rates.

5. The Christensen Associates Study Offers Valid Support For The Proposed Rate Design.

The testimony of Advo Witness Crowder, Advo-RT-1, provides effective rebuttal to NAA's claims that USPS exhibit 44B offers an unreliable basis for supporting the pound rate which has been proposed by the Postal Service. As she concluded, the results of her analysis demonstrate that the USPS "proposed reduction in the pound rate is not only fully justified but very conservative in relation to the low weight-related costs beyond the breakpoint. . ." Tr. 34/18316. Further, she shows that the current cost study accords with the pattern that was shown in previous cost studies. The current results show similar pattern to those found in the 1993 IOCS study, the OCA's 1989 IOCS study and the 1982-83 cost study presented by the USPS in Docket R84-1. *Id.* at 18314. Figures 1-5 of her testimony are a graphic showing of the consistency between the studies. Tr. 34/18320-324. As Witness Crowder concludes, these studies "conducted over a 15-year span" are consistent and serve to demonstrate that the "1996

weight cost study is neither 'anomalous' or 'erratic'." *Id.* at 18315. This consistency refutes the NAA position that the 1996 study, in the words of NAA, is based upon such "thin" data that it should not be relied upon for any purpose.

Not only are the studies consistent with one another, they also demonstrate that the proposed pound rate structure would recover revenues that are far in excess of the costs of heavier weight pieces. The study would support per pound rates of 18.1 cents per pound for nonworkshared mail (no destination entry) and 7.4 cents per pound for workshared mail. *Id.* at 18317. Obviously, 18.1 cents per pound is only a small fraction of the proposed rate of 53 cents per pound for nondestination mail. In sum, the testimony of Witness Crowder amply demonstrates that the criticisms of the cost study are not well taken. *Id.* at 18310-324. The cost study may not be perfect. Few studies of such difficult issues are. The fact remains, however, that, try as it might, NAA can offer no counter-evidence that suggest that the cost study is seriously flawed.

In sum, even if the cost-study represents an enormous understatement of the relationship of weight to costs for pound rated material, a proposition for which there is no support, the rates which have been proposed produce revenues so far in excess of the pound related costs shown by the study that there can be no reasonable basis for arguing that the rates are too low. Indeed all of the signposts, and all analyses of the nature of postal costs, reflect the fact that the pound rates are conservative and will produce revenues from the pound portion of the rate that are far greater than actual weight-related costs.

6. Other Criticisms Of The Proposed Pound Rate By The Newspaper Association Of America Have No Merit.

a. Introduction.

Despite the heat which is evidenced in the NAA memorandum, reflecting the desire of the NAA to preserve a faulty rate structure which fails to reflect the effects of weight on costs, the arguments advanced shed little light on the issues before the Commission.

The NAA memorandum conveys the impression that the proposed pound rate is primarily of concern to saturation mailers. That is not the case. The preponderance of Standard A ECR mail is entered at the "basic" level, i.e., 18.127 billion pieces compared to 10.208 billion and .846 billion pieces entered at the saturation and high density levels respectively. USPS Lib. Ref. H145 § G.

Additionally, from the NAA memorandum, the reader would be led to believe that the Postal Service has proposed a flat rate for all of Standard A ECR mail. NAA memorandum 11-20. That, of course, is far from reality. Under the USPS proposal, there are substantial increases in rates with increases in weight. The actual pound rates proposed by the USPS reflect an increase in price as weight increases which is far in excess of the rates that would be supported by the Christensen and previous cost studies.

b. NAA's Discussion Of Alleged Rate Design Problems Within First-Class Mail Do Not Refute The Need To Improve The Standard A Rate Design.

The NAA places principal emphasis upon its contentions that alleged flaws in the rate structure for First-Class should prevent the PRC from adopting a more logical and cost-based structure for Standard A. Memorandum at 7-10, 25-27. The argument is foolish. Testimony has

been offered which tends to show that the current rate structure for First-Class is not cost-based and reflects an inappropriate revenue burden between presorted and single piece First-Class mail, and between pieces weighing one, two or three ounces. MOAA believes that those issues deserve the attention of the Postal Service and the PRC. NAA, however, which does not have a major interest in First-Class mail, enthusiastically supports the testimony, not because it shows a flawed rate design, but solely because those witnesses propose to cure their perception of First-Class rate design problems by shifting massive amounts of the revenue burden to Standard Mail A. Such an approach is self-destructive and cannot be the answer to any rate anomalies that may exist within First-Class mail.⁸

The existence of any perceived or actual rate design problems within First-Class mail cannot logically lead to a refusal to address Standard A rate design problems. If progress can be made within any class or subclass of mail, it should be made. That further structural changes may be needed in other classes of mail is irrelevant. The NAA approach would effectively stymie any progress toward more logical and cost-based structures within any of the classes.

NAA also fails to acknowledge that the PRC has determined that the approach to rate design within First-Class mail raises issues that differ fundamentally from the rate design of

⁸ Further, the rate designs for other classes of mail are persuasive evidence that the current Standard A rate design is wholly out of line with reality. The rate schedule for Bulk Bound Printed Matter carrier route, with piece charges of 46.7 cents in the local zone and 63.7 cents for all other zones supports the reasonableness of lower Standard A rates. Thus, the rate for a one pound, local carrier route BPM piece is 49 cents and the rate for a two pound piece is 51.3 cents, representing less than a 5 percent rate increase. The relationships are similar for the other zones. For example, the rate for a one pound, zone 1 and 2, carrier route piece is 68 cents, and 72.3 cents for a two pound piece, a 6.3 percent rate increase. Unlike Standard A, therefore a doubling of the weight of a BPM piece does not even come close to doubling the rate. Instead, the rate increases by only a modest amount reflecting the additional costs incurred from increased weight. Similar relationships are shown for parcel post rates.

other classes of mail, and in particular Standard A, a class of mail used exclusively by businesses. PRC Op. MC95-1 at V-15, 16. In particular, the PRC's rejection of the reclassification of First-Class mail proposed by the USPS in MC95-1 was premised upon a conclusion that "reclassification cannot be responsibly recommended without anticipation of its probable implications for the ratemaking process." *Id.* at V-16. The PRC saw as a "foreseeable" consequence "a potentially severe upward pressure on rates" for single piece First-Class mail. *Id.* The same considerations apply to the rates for First-Class mail weighing two or three ounces, particularly if confined to presorted First-Class mail, which is the proposal supported by NAA witness Clifton. The notion that First-Class mail can be drastically restructured, with substantially lower rates for presorted First-Class mail, including the rates for two and three ounce pieces, without affecting single piece, non-presorted mail is a pipe dream.

Further, in Docket MC95-1 the PRC gave considerable importance to its recognition that there was a "near unanimous agreement" among intervenor users of Standard Mail for the rates proposed by the Service and for establishing an Enhanced Carrier Route subclass. PRC Op. MC95-1 at V-195. The PRC recognized that the objections to the Standard A USPS proposals were "from intervenors perceived primarily as competitors to the Service or mailers using classes of mail other than Standard." *Id.* at V-195. This was in striking contrast to the reaction of mail users with respect to the classification changes proposed for First-Class Mail, which engendered substantial controversy. The PRC gave substantial weight to the objections to classification changes expressed by those parties with a primary interest in First-Class single piece mail.

c. NAA'S Reliance Upon The PRC'S MC95-1 Rate Design Ignores The Faulty Nature Of That Design.

In its MC95 decision, the PRC refused to accept the rate design for ECR proposed by the USPS. It did so with a rather brief discussion which simply affirmed that it would continue to use the rate design methodology that had been proposed by the USPS in Docket R90-1 and adopted by the PRC in that proceeding. PRC Op. MC95-1 at V-254-55. The Commission explained that "the pound rate and the basic piece rate for flats are an algebraic function of the other decisions." (footnote omitted) *Id.* at V-254. The USPS approach was rejected because, *inter alia*, "the pound rate no longer depends on the other decisions" because it was selected by USPS witness Moeller. *Id.* The Commission concludes that under its "algebraic" approach "the resulting piece charge for pound rate mail . . ." is cost-based. *Id.*

The fact is, however, as is discussed by Witness Moeller in this proceeding, the approach used by the PRC necessarily assumes that there are zero piece handling costs for saturation ECR mail, and only negligible piece costs for basic and high density ECR mail. Thus, it can be seen that the PRC's conclusion that the piece charge is "cost-based" is not accurate. The rate design proposed by Moeller in this proceeding uses a far more reasonable approach and recognizes that there are piece costs associated with all ECR mail, including saturation mail, that are significantly greater than 0, 1.0 and 1.8 cents respectively.

Further, and more fundamental, under the PRC's approach in R-90, as carried forward in MC95, it is beyond argument that the pound rate which results solely from the "algebraic" function is not cost-related. The USPS approach in this proceeding uses a cost study, which is consistent with previous cost studies, which demonstrates that the effect of weight on costs for

pieces beyond the break point is far out of line with the current rate structure. The proposed design achieves a cost-based pound rate to a far greater degree than does the existing structure.

The rate design also amply reflects the effect of weight upon costs. Thus, for example, the pound rate for a piece of mail entered at the basic rate, with no destination entry, weighing six ounces, incurs a pound rate charge of 6.625 cents on top of the basic piece charge of 5.5 cents. At the DDU entry level, the rate for a basic six ounce piece of mail increases 5.30 cents as a result of the pound element, a 33 percent increase. This is despite the fact that at the DDU level there are few operations in which weight plays any significant role in the handling of mail.

Under the proposed rates, a six-ounce, nondestination entry flat would pay a rate of 25.4 cents or 6.6 cents more than the rate of 18.8 cents for a four ounce piece. This thirty-five percent increase in rate certainly covers any increase in costs for the heavier of the two pieces, which has indistinguishable handling characteristics from the lighter piece. Within the private sector, the two pieces would incur little difference in rates.

The more thorough the analysis of the effects of weight upon costs, the more it becomes apparent that the pound rate which has been proposed by the Postal Service is higher than it should be. Certainly, there can be no justification for continuing the existing pound rate. It is unsupported by any qualitative analysis or the quantitative studies of the effects of weight upon costs which have thus far been carried out. The plain fact is that mailers of Standard ECR Mail have long been paying rates that cannot be justified. It is time to end this inequity by establishing a pound rate which will more nearly reflect the actual cost effects of increasing weight.

F. PROPOSALS TO INCREASE THE COST BURDENS OF STANDARD A AND TO MAKE CERTAIN RATE DESIGN CHANGES SHOULD BE REJECTED.

1. Witness Clifton's Proposals Should Be Rejected.

Witness Clifton on behalf of a number of First-Class mailers and a representative of USPS competitors, the Newspaper Association of America, presented testimony which proposes reductions in certain First-Class presorted rates and recovering the resulting revenue loss from Standard A mail. Tr.20/10815-889. First, as shown in the testimony of Witness Andrew, many of the bases which Witness Clifton uses to make his adjustments to First-Class rates do not withstand examination. The testimony depends upon the assumption that the declining unit costs for presort letters that were experienced during the period of 1994 to 1996 will continue in a straight line basis. Witness Clifton also assumes that volume mix changes that have occurred in the 94-96 period will continue into the future, an illogical conclusion. Tr. 36/19696. Further, the use of only two years of data to project future costs is in itself suspect. *Id.* at 19697.

Witness Andrew also shows that the criticisms of the USPS roll forward model are not valid. The 13 percent decline proposed by Witness Clifton in the roll forward value is not well supported. Specifically, Clifton's contention that the cost changes that have been driven by volume changes from nonautomation mail has not been supported. Tr.46/19698-700.

Witness Clifton concluded that it is not appropriate to use the bulk metered mail benchmark which has been used by the USPS in this proceeding. Instead, he supports the use of a single piece benchmark. As concluded by Witness Andrew, however, the "bulk metered benchmark as developed by the USPS in this proceeding is the best evidence on record and should be used to determine workshared discounts." Tr. 36/19701.

Witness Clifton's most egregious errors, however, concern his contentions that the proposed rates for Standard A support his proposed changes to the rates proposed by the Postal Service for First-Class workshared mail. Tr. 36/190701-705. As concluded by Witness Andrew:

The equitable cure for workshared mailers is to reduce their rates (increase discounts) to reflect the new cost estimates, while simultaneously meeting the First-Class revenue requirements. There is no need or justification to reach into other subclasses for additional funds to meet revenue requirements by changing coverages in other subclasses. Tr. 36/19705.

The single most remarkable claim made by Clifton is that he can justify the proposed reduction for workshared First-Class mail weighing two or three ounces on the basis of a comparison to the rates within Standard A, from which he makes an absurd claim of cross-subsidy. As concluded by Witness Andrew, his argument is "predicated upon this false claim of cross-subsidy." Tr. 36/19705. In addition to the fact that Witness Clifton makes "no attempt to analytically prove the existence of cross-subsidy" he "obfuscates the concept" by attempting to apply the test to a part of a product rather than the entire product." Tr. 36/19706. Witness Andrew, relying upon the testimony sponsored by the USPS in this proceeding, conclusively demonstrates that both the regular and ECR Standard A subclasses are subsidy-free. Tr. 36/19706-708.

Finally, Witness Clifton's analysis, which treats the cost and revenues that are associated with an additional ounce in a letter as "incremental", is misleading. This is because the second ounce of a First-Class letter is not in itself a product. Rather it is a part of the total product. As stated by Witness Andrew, "a customer cannot send a second ounce without including the total first ounce." Tr. 36/19708. In sum, "incremental costs and revenues must be associated with a product to make the concept of a cross subsidy operational." Tr. 36/19709.

2. There Should Be No Adjustment In The Costs Shown For The Standard A Commercial And Non-Profit Subclasses.

Witness Haldi, on behalf of a the Alliance of Nonprofit Mailers, has testified that the cost of nonprofit mail has been overstated. Therefore, he contends, there should be an adjustment of the costs by reducing nonprofit costs and increasing the costs of the commercial subclasses. The contentions are without merit.

His position is premised principally upon the contention that mail entered originally at the nonprofit rates was thereafter assessed postage at regular rates because found to be ineligible for the nonprofit rates. Tr. 22/11808-09. He contends that "7.85 percent of all valid mail processing talleys as well as the mail processing costs arising from those talleys have been incorrectly attributed to nonprofit mail, and instead should have been attributed to commercial rate bulk mail." Tr. 22/11814. This conclusion was based upon a survey of ANM members, which has been shown by the rebuttal testimony of USPS Witness Schenk, USPS-RT-22, to be flawed and designed to produce biased results. Further, the magnitude of the supposed misallocation postulated by Witness Haldi's strains credibility.⁹

The survey upon which Haldi's testimony is based was virtually guaranteed to produce a biased result. In the initial paragraph, the survey informed recipients that the outcome of pending proceeding "threatens to hit non-profit Standard A mailers with substantial increases." *Id.* at 11894. Additionally, because of the nature of the survey, mailers who did not enter mail under the nonprofit permit which was later assessed commercial postage rates would not have responded to the surveys. *Id.* at 11895-896. Finally, the survey made no attempt to obtain

⁹ Even recognizing, as observed by Tom Stoppard, that "Credibility is an expanding concept."

information from mailers who have initially entered mail at commercial rates during the period when a application to mail at nonprofit rates was pending which was ultimately charged at nonprofit rates. A nonprofit organization whose application to be recognized as a "qualified nonprofit organization," has not yet been approved is required to enter the mail at the full commercial rate. The Postal Service records the difference between the full postage paid and the postage that would have been paid under the nonprofit rates. Thereafter, when the organization is granted nonprofit status, the difference in postage is refunded. DMM 53 E 9.2., 9.3. That type of mail would offset the opposite situation addressed by the ANM survey and Witness Haldi's testimony. *Id.* at 11897.

Also, as pointed out by USPS Witness Schenk, another reason showing that the survey is suspect and should not be relied upon was the failure to follow-up non-recipients that did not respond. As concluded by Witness Schenk, the 15 percent response rate of this survey "is considerably lower than what is generally considered necessary to produce statistically valid estimates." Tr. 36/19597. As she also shows, defending the survey on the basis of geographic dispersion does not serve to validate the results. She notes "originating nonprofit Standard (A) Mail is concentrated in the Midwest and East. . ." *Id.* at 19598. Ultimately, she concludes that "it is impossible to tell whether the respondents are representative of the population of nonprofit mailers." *Id.* Schenk also points that since two survey forms were used, with wording that differed significantly, combining the results of both survey forms is not valid. She noted that of the 108 responses, 71 were suspect on the basis of inconsistent forms or other errors in the responses. *Id.* at 19599. In sum, the survey results, which form the basis of the Haldi testimony are flawed and cannot be accepted for any purpose. *See generally Id.* at 19594-600.

3. The Adjustments To The Basic, High-Density And Saturation Rates Proposed By Witness Haldi Should Be Rejected.

Witness Haldi, on behalf of Val-Pak *et. al.* has proposed to increase the per piece rates for basic "ECR" and decrease the per piece rates for high-density and saturation ECR. Tr. 27/15087. Witness Prescott's testimony established that the Haldi proposals have no sound cost basis. A comparison of the USPS and Haldi rate proposals are shown in witness Prescott's testimony. Tr. 36/19512. The premise upon which Witness Haldi has made his rate adjustment is the contention that his rates are based upon "bottom up" costs rather than the "top down" methodology employed by the Postal Service. Tr. 27/15049 ff. It is not necessary to determine whether the approach advocated by Witness Haldi, bottom up costing, would be superior to the approach that has been used by the Postal Service. This is because of the simple fact that the cost data necessary to determine costs by a bottom up methodology is not available. As a result, Witness Haldi had to make numerous judgments which he conceded were "arbitrary" in order to perform his costing analysis.

As stated by Witness Prescott, the "proposed rates for letters and nonletters are not based upon 'bottom-up' costs because he has not relied on cost reflective of the different functions and activities for each rate cell and he has utilized arbitrary criteria in developing his rate proposal." Tr. 36/19509. Witness Prescott observes that in order to develop bottom up costs "specific data would need to be gathered in the USPS' cost system reflecting the specific function and activities of each rate cell." *Id.* In explaining why Witness Haldi failed in his attempt to arrive at bottom up costs, Witness Prescott testified:

The data isn't available for him to do the bottom-up cost analysis that he wanted to do and from there to develop rates based on bottom-up costs. And because of that he had to make a series of assumptions, and ultimately when he went to his rate design he

utilized the Postal Service's rate design except for a modification to the sortation discounts and the discount for the . . . rates for base rates. Tr. 36/19581.

G. FIRST-CLASS RATE DESIGN ISSUES CANNOT BE SOLVED BY SHIFTING COSTS TO STANDARD A.

Despite the serious analytical errors contained in the testimony of Witness Clifton, as discussed in part F.1. of this brief, MOAA recognizes that his testimony, and the testimony of Witness Bentley on behalf of the Major Mailers Association, have highlighted significant rate design problems within First-Class mail. Specifically, the overall rates for presorted First-Class mail appear to be excessive and it is exceedingly difficult to defend the rates for First-Class mail weighing two and three ounces. Neither of these issues, however, should be considered in isolation from the overall rate design issues within First-Class mail. The fundamental dilemma within First-Class mail is the failure to separately cost and price the distinct products that are a part of the class. As discussed in part E.6.b. of this brief, this results in substantial part from a concern by the PRC over the possible effects of cost-based classifications on single piece First-Class rates. The same considerations apply to the rates for mail pieces weighing two and three ounces. The overall rate levels for First-Class mail, presorted and single piece, and the rates for one, two and three ounce pieces must be considered together. Although, the rate for two and three ounce mail pieces, considered in isolation, are obviously excessive, those rates must be considered in the context of the overall rates for First-Class mail.

Unfortunately, those parties representing First-Class mail have tended to obscure rate design problems by proposing to shift the loss of revenues from rate reductions within First-Class to the other classes of mail, and more particularly, Standard A. Indeed, the fact that Witness Clifton's testimony has been sponsored in part by NAA, a representative of competitors

whose sole aim is to obtain the highest possible rates for Standard A, serves to detract from the real, and more difficult, issue. The approaches advanced in this proceeding may appear to avoid hard questions, such as those expressed by the Commission in MC-95-1, but ultimately, they will not resolve the First-Class rate design difficulties.

MOAA believes that there should be a reform in the rate schedule for First-Class mail and has a substantial interest in achieving such reform. MOAA also recognizes that achieving such reform without producing rates for "Aunt Minnie" which are deemed to be politically unacceptable or otherwise not in accord with the requirements of the Postal Reorganization Act, will be exceedingly difficult. Nevertheless, the issues raised by Witnesses Clifton and Bentley will be solved only when there is a willingness to address the overall rate structure for First-Class mail. MOAA also believes that the parties, the PRC and the Postal Service should more openly acknowledge that much of the single piece First-Class mail is in fact entered by businesses, rather than Aunt Minnie. There would appear to be few, if any reasons, to favor higher cost business mailers over lower cost business mailers in the First-Class rate design. In any event, it simply is not possible, and certainly not wise, to shift costs to Standard A, in order to alleviate a problem which is fundamentally internal to First-Class mail.

H. BOUND PRINTED MATTER.

The Postal Service has proposed a higher than average rate increase for Bound Printed Matter ("BPM") resulting in a cost coverage of 152 percent. USPS-T-30 at 38. This is in contrast with the slightly lower than average increase for Standard A Mail regular and the resulting cost coverage of 155 percent. *Id.* at 33. This is in line with the PRC's decision in

Docket No. R94-1, reiterating the position that the markup for BPM and third-class regular should be similar. PRC Op. R94-1 at V-127, 28.

MOAA accepts this proposed rate, primarily for the same reasons that it is generally supportive of the rates proposed by the Postal Service, i.e., the modest levels of increase and the recognition that within that context major changes would be difficult to effectuate. Nevertheless, the proposed rates do not accord with the fact that BPM now consists primarily of books, which should result in lower rates under criterion 8 because of the ECSI value of books. Witness O'Hara states that he is following Commission precedent in giving "some ECSI consideration in setting rate levels" for BPM. *Id.* at 39. It is obvious, however, that the "some" consideration represents a very small "sum" indeed. Additionally, the rates exceed Ramsey rate levels.

MOAA has in the past opposed various classifications changes, the net effect of which has been to permit an ever increasing volume of books to be entered as BPM. It did so because of a concern that the favorable cost characteristics of what was at one time a subclass limited to advertising media would be diluted by allowing books containing no advertising into the subclass. Unfortunately, those fears have proven to be warranted. BPM costs have increased at a rate greater than the average level of cost increases. MOAA continues to believe that this is the result of the entry of increasing volumes of materials that do not have the exceedingly favorable cost characteristics of catalogs for which MOAA members use the subclass. The advertising materials within BPM, having been penalized by the entry of higher cost books, should also receive the benefit of the ECSI value of those books.

It is apparent, as of now, that the overwhelming majority of materials mailed at the BPM rate are books. That being the case, MOAA continues to contend that criterion 8 should be given

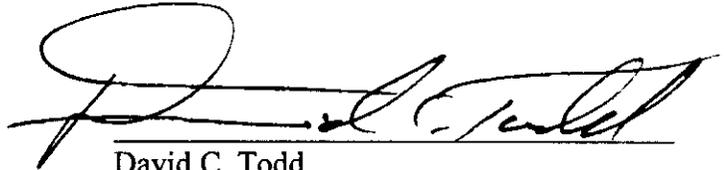
greater affect and the overall cost coverage of BPM should be substantially lower than has been proposed by the Postal Service. Compare, for example, the 107 percent cost coverage proposed for a periodicals with the 152 percent cost coverage proposed for BPM.

Accordingly, although the rates proposed are acceptable within the context of this proceeding, MOAA continues to contend that BPM rate levels are excessive and urges both the Postal Service and the Commission to examine this issue seriously in proposing and establishing BPM rates in future proceedings.

CONCLUSION

For the above reasons, the PRC, with minor exceptions, should recommend the rates proposed by the Postal Service.

Respectfully submitted,



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CERTIFICATE OF SERVICE

This is to certify that I have caused a copy of the Brief of the Mail Order Association of America to be served upon the Postal Service and all parties of record, in accordance with Section 12 of the rules of practice, this 1st day of April, 1998.

A handwritten signature in black ink, appearing to read "David C. Todd", written over a horizontal line.

David C. Todd