

ORIGINAL
WILLIAM J. OLSON, P.C.

ATTORNEYS AT LAW

8180 GREENSBORO DRIVE, SUITE 1070
MCLEAN, VIRGINIA 22102-3823

TELEPHONE (703) 356-5070

FAX (703) 356-5085

WILLIAM J. OLSON
(D.C., VA.)
JOHN S. MILES
(D.C., MD., VA., OF COUNSEL)
ALAN WOLL
(VA.)
JOHN F. CALLENDER, JR.
(FL. ONLY)
GILMAN & PANGIA
(OF COUNSEL)

RECEIVED
JUN 1 10 45 AM '98
1515 G STREET, N.W.
SUITE 600
POSTAL WASHINGTON, D.C. 20006-3604
OFFICE TELEPHONE (202) 223-9066
FAX (202) 331-8986

May 20, 1998

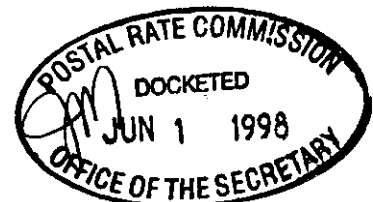
Hon. Sam Winters
Chairman, Board of Governors
U.S. Postal Service
475 L'Enfant Plaza, S.W.
Room 10300
Washington, D.C. 20260-1000

Re: Postal Rate Commission
Opinion and Recommended Decision, Docket No. R97-1
Standard A Residual Shape Surcharge

Dear Chairman Winters:

We are writing on behalf of our clients District Photo, Nashua Photo Inc. (now Images, LLC.), Mystic Color Labs, Seattle FilmWorks, Inc., and Merck Medco Managed Care, LLC. ("NDMS/Merck Medco"), all of which were intervenors in Docket No. R97-1 before the Postal Rate Commission. We also write on behalf of Skrudland Photo, Inc. which, while not an intervenor, joined with and supported the positions of NDMS and Merck Medco.

As you are aware, the Postal Rate Commission has recommended the Postal Service's requested 10-cent Standard A residual shape surcharge (hereinafter "surcharge" or "parcel surcharge"). On behalf of our clients, we request that the Governors seek reconsideration of the failure to adopt drop ship discounts associated with this recommended surcharge. The parcel surcharge, together with other increases in Standard A Regular rates would increase the amount of Standard A postage for certain weight pieces that these companies pay by as much as 54.11 percent. For the reasons set out below, it appears to us that, based on the Commission's own analysis, that the surcharge was developed is an arbitrary and capricious exercise of Commission authority in that it did not provide for destination entry discounts.



We understand that it would be unusual for the Governors to seek reconsideration of a Commission recommendation where the same classification change and associated rate had been originally requested by the Governors, but we believe that this step is appropriate in that the Postal Rate Commission recognized the postal service's inconsistent treatment of transportation costs in developing (i) destination entry discounts and (ii) the residual shape surcharge, but took no action to deal with the recognized inconsistency.

NDMS/Merck Medco witness Dr. Haldi's testimony exposed the gross inconsistency between the Postal Service's development of destination entry discounts, and its development of the residual shape surcharge:

Destination entry discounts for Standard A Mail are developed in LR-H-111. That study assumes throughout that all Standard A Mail has the same density. That assumption is acceptable when all other costs for Standard A Mail are developed by averaging together letters, flats and parcels in the customary top down approach to cost development and rate design. However, it is **completely inconsistent with the de-averaging of costs carried out by witness Crum**. Not only is it totally inconsistent, but it would also be **unfair and inequitable to parcel mailers to charge them extremely high transportation costs based on a tenuous Postal Service estimate of density, on the one hand, while denying them destination entry discounts based on the exact same Postal Service estimate, however tenuous it may be, on the other.**
[NDMS-T-3, p. 39.]

Dr. Haldi identified two options available to the Commission to resolve this blatant inconsistency:

Should the Commission decide to impose a surcharge, it can resolve the inequity discussed above in one of two ways:

- Estimate the cost of parcels using average transportation costs for letters, flats and parcels combined, consistent with the average transportation costs used to develop destination entry discounts;
or
- De-average the destination entry discounts for parcels, using the same density that is assumed when estimating bottom up transportation costs of parcels. [*Id.*, pp. 39-40.]

In their Initial Brief, NDMS/Merck-Medco reiterated the choice presented by Dr. Haldi:

Analyzing just transportation costs, if Standard A parcel transportation costs are recalculated using the average transportation cost for letters, flats and parcels combined, the average cost of parcels would be reduced by approximately 6.6 cents. *Id.*... Mail processing costs could likewise be averaged between Standard A shapes.

Alternatively, if the Commission does not recalculate Standard A parcel transportation costs using the average cost for letters, flats and parcels combined, Dr. Haldi observes that fairness would require the Commission to “recompute separate de-averaged destination entry discounts for parcels.” *Id.*, p. 41, Tr. 23/12172. In other words, **separate parcel destination entry discounts should be recommended**. As Dr. Haldi observes, “giving parcels a destination entry discount that fully reflects cost avoidance would seem both fair and desirable in allowing mailers of parcels the opportunity to offset that portion of the surcharge being imposed.” *Id.* [NDMS Initial Brief, p. 102.]

The Commission recognized the obvious flaw identified by Dr. Haldi in the Postal Service’s rate design methodology, but nevertheless chose to retain the flawed rates:

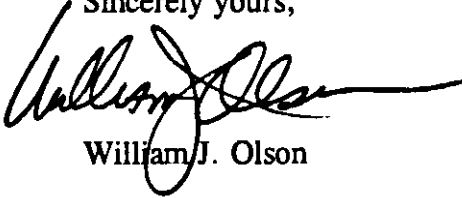
Haldi’s proposal that the shape costs should be based on average transportation cost, or, alternatively, that destination entry discounts should be deaveraged by shape must be rejected at this time because of a lack of record data with respect to destination entry cost by shape. However, **there is merit in Haldi’s proposal** and the Service’s only rebuttal is that the rate schedule would become complex. The Postal Service **should study this issue** before the next rate case, as the base rate should be **consistent** with the discount subtracted from it. Further, the Commission is not adverse to considering a rate schedule with all discounts on a shape basis, regardless of the apparent added complexity to the rate schedules in Standard A. Presort and barcode discounts are currently shape-based and Standard A is used by bulk mailers who can be expected to cope with some slight increased complexity. [*Op. & Rec. Dec.*, p. 425 (emphasis added).]

Having chosen to base the parcel surcharge on de-averaged transportation costs, the Commission could and should use the data on the record to adopt a reduced rate associated with residual pieces entered at SCFs and DDUs, reflecting the significant cost savings associated with drop shipment. *See, e.g.*, Tr. 5/8043-8044. The Commission chose to retain the admitted inconsistency by deferring any consideration of a drop ship discount to the indefinite future, which constitutes an arbitrary and capricious exercise of their authority.

For the foregoing reasons, the Governors should request the Commission to reconsider its recommended single Standard A parcel surcharge and provide for drop ship discounts for

residual pieces entered at SCFs and DDUs, developed in a manner consistent with that used to derive the surcharge.

Sincerely yours,

A handwritten signature in black ink, appearing to read "William J. Olson", with a long horizontal flourish extending to the right.

William J. Olson

cc: Docket No. R97-1 Service List