

USPS-RT-11

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

POSTAL RATE AND FEE CHANGES

Docket No. R2006-1

REBUTTAL TESTIMONY  
OF  
JAMES M. KIEFER  
ON BEHALF OF  
THE UNITED STATES POSTAL SERVICE

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1

2 **I. PURPOSE AND SCOPE OF TESTIMONY**

3

4 My testimony rebuts several arguments and proposals made by a number

5 of witnesses in this docket. These intervenor arguments and proposals concern

6 Standard Mail, Parcel Post, Bound Printed Matter, Media Mail and Library Mail.

1 **II. LIBRARY REFERENCES**

2

3 There are no library references associated with my testimony.

1 **III. STANDARD MAIL PARCEL AND NFM PRICING**

2

3 **A. Witness Horowitz's proposal to change the definition of Standard**  
4 **Mail should be rejected.**

5

6 In his testimony, witness Horowitz proposes to redefine Standard Mail by  
7 allowing parcels containing up to 16 ounces of merchandise to contain an  
8 additional two ounces of advertising inserts beyond the 16-ounce weight limit for  
9 Standard Mail.

10 Witness Horowitz claims that advertising inserts in fulfillment parcels  
11 generate new business for mailers and, through the multiplier effect, produce  
12 more mail for the Postal Service. I do not dispute that including advertising  
13 inserts along with mail order merchandise has some value to mailers. Nor do I  
14 dispute that customers, by potentially responding to these advertisements, may  
15 generate additional mail pieces. But, based on the record evidence in this case,  
16 neither the Postal Service, nor the Commission has enough information to know  
17 whether the alleged benefits will be material or trivial. Against this unknown  
18 benefit, the Commission must consider possible negative repercussions of  
19 significantly redefining the Postal Service's largest mail class.

20 Witness Horowitz's testimony did not present a thorough analysis of the  
21 implications of his proposal. In my view, his proposal raises a number of obvious  
22 concerns that must be addressed before it could be considered for  
23 recommendation:

- 24 • Witness Horowitz proposes to breach the weight limit, but only for  
25 advertising inserts. His testimony fails to address how the Postal Service  
26 is to determine that the additional weight allowed by breaching the 16

1 ounce limit is composed of advertising inserts only. For example, consider  
2 a mailer that currently mails parcels with 14 ounces of merchandise and  
3 two ounces of advertising inserts. If Mr. Horowitz's proposal were to be  
4 approved, the mailer could mail 18 ounce parcels, with 16 ounces of  
5 merchandise and two ounces of advertising inserts. In this case the mailer  
6 would be using the increased weight limit to mail additional merchandise,  
7 not advertising, and there would be no additional multiplier benefits.

- 8 • Witness Horowitz's testimony does not address the fairness of  
9 implementing his proposal for Standard Mail with respect to other classes.  
10 While the absolute weight limits for most classes (70 pounds) are unlikely  
11 to be reached or surpassed, there are many lower weight rate cells where  
12 mailers could make a "fairness" argument for treatment similar to Standard  
13 Mail. For example, consider a mailer that uses Media Mail to fulfill mail  
14 orders. The mailer commonly mails merchandise parcels that are just  
15 below two pounds apiece, for which the mailer pays the two-pound Media  
16 Mail rate. The mailer would like to also include advertising inserts for the  
17 same reasons cited by Mr. Horowitz, but that would cause the parcels to  
18 exceed the two pound limit; the parcel would then be required to pay the  
19 three-pound rate. If the Standard Mail weight limit can be breached for  
20 advertising inserts, then why not the weight step limits for Media Mail,  
21 Library Mail, Parcel Post, or Priority Mail? What would be the impact of  
22 making the weight limit on virtually all postage rate cells flexible?

- 1       • Witness Horowitz proposes breaching the weight limit only for parcels.  
2       Why are flat-shaped pieces excluded? Witness Horowitz has offered no  
3       evidence that additional advertisements are beneficial only when mailed in  
4       parcel-shaped containers. But then, if the overweight eligibility is extended  
5       to flats, the further question arises: has any evidence been presented that  
6       the supposed “benefits” of additional advertising accrue only when the  
7       additional advertising is in the form of separate sheets or pieces? Couldn’t  
8       additional net benefits (including multiplier effects) be claimed if an 18-  
9       ounce catalog were mailed instead of a 16-ounce catalog?
- 10      • What are the extra costs of this additional advertising material? Witness  
11      Horowitz implies that extra costs are minimal or none, since he claims that  
12      the size of the boxes Cosmetique would use would not increase. Even if  
13      that is Cosmetique’s intention, in the absence of an explicit limitation on  
14      box size, the Postal Service has no assurance that costs will not increase.  
15      In addition, other mailers may not have unused space in their boxes, and  
16      may increase their package sizes. There is no evidence in this case on  
17      what the additional costs would be.

18  
19      In summary, these and other related issues should be addressed on the  
20      record before the Commission recommends a redefinition of the basic  
21      boundaries of a major class of mail, such as that proposed by witness Horowitz.

22

23

1 **B. The Postal Service's proposed parcel and NFM pricing is not**  
2 **unreasonably high.**

3  
4 A number of parties who currently enter mail that would be assessed  
5 postage under the Postal Service's proposed parcel and NFM rates have offered  
6 testimony claiming that the proposed rates are too high.<sup>1</sup> I believe that my  
7 proposed pricing for parcels and NFMs is reasonable. Yet the Postal Service's  
8 principal goal in this docket is to establish separate classifications with  
9 meaningful price differentials that lead to the efficiencies that the proposals  
10 intend to induce.

11 Many of these parties' testimonies (for example, POSTCOM-T-6,  
12 POSTCOM-T-7 and MBI-T-1) also argue that the proposed pricing will have  
13 significant adverse impacts on their businesses. I am aware that I have proposed  
14 large increases for some categories of Standard Mail parcels and NFMs. I am  
15 also aware that the proposed pricing may have a major impact on some mailers.  
16 But I believe that it is important for the Commission to take into consideration that  
17 the Postal Service and its customers have long been aware of the Postal  
18 Service's concerns that Standard Mail parcels and, especially, NFMs, have not  
19 been adequately covering their costs and contributing to institutional costs. As  
20 part of the effort to have parcels and NFMs appropriately priced, the impact of  
21 rate changes on mailers was taken into account and the proposed rates reflect  
22 significant mitigation. The proposed rate design also offers more attractive  
23 presort and drop ship options to soften the impact. I recognize that the proposed  
24 rates will challenge some mailers, but the proposed rates are already mitigated

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<sup>1</sup> See, for example, the testimonies of witnesses Glick (PSA/POSTCOM-T-1), Horowitz (POSTCOM-T-6), Knight (POSTCOM-T-7), and Wilbur (MBI-T-1).

1 and, without the rate change mitigation already proposed, the impacts could have  
2 been much more significant. In the end, while the degree of rate increase is a  
3 matter of judgment, what is of primary importance is that the classifications be  
4 established with meaningful price differentials.

5         In his testimony, witness Glick (PSA/POSTCOM-T-1) points out that, on  
6 average, the Postal Service is requesting rate increases for Standard Mail  
7 parcels and NFMs above the 30 percent general rate increase limit proposed for  
8 Parcel Post.<sup>2</sup> Different circumstances apply to these two classes, however. In the  
9 case of Standard Mail parcels and NFMs, the Postal Service is proposing a  
10 reclassification of pieces that are not adequately covering their costs at present.  
11 When items are being reclassified, broader price changes should be expected  
12 than when price changes are being proposed for essentially unchanged rate  
13 categories (like those in Parcel Post). In addition, the utmost caution and care  
14 should be exercised before importing rate design elements (including percentage  
15 increase limits) from one class of mail to another. When establishing maximum  
16 rate change limits, absolutes do not exist that cover all situations. One size does  
17 not fit all mail categories.

18         While I disagree with many of the counterproposals put forth by some  
19 customers who mail Standard Mail parcels (or NFMs), I do appreciate the  
20 feedback received through intervenor testimonies and interrogatories to the  
21 Postal Service which has been helpful in highlighting potentially anomalous rate

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<sup>2</sup> Despite the imposition of the 30 percent general limit, in certain circumstances this limit was exceeded. For example, in Parcel Post Intra-BMC Zone 5, some rate cells show increases of more than 50 percent.

1 relationships. Specifically, interrogatory UPS/USPS-T36-1 pointed out a potential  
2 problem in the Standard Mail Regular parcel pricing proposals where it could  
3 appear that the Postal Service's pricing might be encouraging mailers to make  
4 otherwise machinable parcels nonmachinable to take advantage of lower rates.  
5 The rate relationship highlighted in this interrogatory is an important one and I  
6 would certainly want to emphasize that the Postal Service does not want its rates  
7 to encourage machinable parcels to become nonmachinable.

8

9 **C. Witness Glick's criticism of the Postal Service's flat-parcel cost**  
10 **difference passthrough misapplies the principles of efficient**  
11 **component-pricing, and should be rejected.**

12  
13 In his testimony (PSA/POSTCOM-T-1), witness Glick criticizes the Postal  
14 Service's pricing proposals for parcels because he claims they "pass through  
15 more than 100 percent of the cost difference between Standard Regular flats and  
16 parcels." (PSA/POSTCOM-T-1, at 3). The implication of this testimony, and of the  
17 PSA Response to NOI No. 2, to which witness Glick directs us in his testimony, is  
18 that a passthrough that exceeds 100 percent of the flat-parcel cost difference is  
19 somehow improper on its face. Again, the Postal Service realizes that the  
20 application of judgment in deciding the appropriate size of price increases  
21 mailers will be asked to pay may result in flat-parcel cost difference passthroughs  
22 that turn out to be less than 100 percent. But as a matter of policy, there is no  
23 basis to conclude that 100 percent is the upper bound.

24 Witness Glick's prescription—that the proper passthrough (absent the  
25 need for rate change mitigation) should be 100 percent—is equivalent to the

1 assertion that unit contributions should be the same for both flats and parcels. It  
2 is also equivalent to claiming that the efficient component-pricing (ECP) rule  
3 should apply to shape-based cost differences.

4 The Postal Service disagrees strongly with this view. As the Postal  
5 Service stated in its own response to NOI No. 2 (Docket No. R2006-1, Response  
6 of the United States Postal Service to Notice of Inquiry No. 2, at 4), the ECP rule  
7 is only applicable to pricing worksharing cost differences, not shape-based cost  
8 differences. Witness Sidak, one of the original developers of the ECP concept,  
9 also agrees: “ECP is not an appropriate concept to use in calculating shape-  
10 based rates in the same manner that would be used to determine worksharing  
11 discounts.” (NAA-T-1, at 11, lines 20-22). This means that passthroughs of  
12 shape-based cost differences exceeding 100 percent do not necessarily indicate  
13 economically inefficient pricing. Indeed, Valpak’s witness Mitchell argues that the  
14 letter-flat cost difference should be marked up by the full cost coverage of the  
15 subclass.<sup>3</sup> While I am not persuaded of the validity of this “Mitchell rule,” his  
16 testimony shows that the Postal Service is not the only voice arguing that shape-  
17 based cost differences deviating from 100 percent are not, in themselves,  
18 evidence of economic inefficiency or price discrimination. Indeed, as I discuss in  
19 my rebuttal of certain points of witness Panzar’s testimony, requiring equal unit  
20 contributions for all shapes of mail (the equivalent of requiring 100 percent  
21 passthrough of shape-based cost differences) can lead to nonsensical, and  
22 potentially distorting, pricing decisions.

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<sup>3</sup> Mitchell acknowledged upon cross examination that his prescription applied not solely to the letter-flat cost difference, but is also applicable to the flat-parcel cost difference as well (Transcript, pp. 9014-15).

1           Witness Glick cannot appeal to ECP or any other sound theory to support  
2 his preference for keeping the flat-parcel cost difference passthrough to 100  
3 percent or less. His critique of the Postal Service's parcel pricing should be  
4 rejected and the Postal Service's proposed parcel rates should be evaluated on  
5 their merits and not solely on their relation to flats costs.

1 **IV. PARCEL POST PRICING**

2

3 **A. Witness Luciani's claim that the Postal Service inappropriately**  
4 **marks up Parcel Post transportation cost differences is based on a**  
5 **mistaken understanding of the Postal Service's cost data.**

6

7 In his testimony, witness Luciani (UPS-T-2) criticizes the Postal Service's

8 Parcel Post rate design methodology for applying a markup factor to

9 transportation costs by rate category. The Postal Service's methodology,

10 according to witness Luciani, "marks up transportation worksharing cost

11 differences" (UPS-T-2, at 5) and he claims that this approach "is directly contrary

12 to sound Commission policy." (UPS-T-2, at 6).

13 Witness Luciani's claims and criticisms may have an immediate superficial

14 appeal, but they are wrong. They are based on a flawed understanding of the

15 Postal Service's Parcel Post transportation cost data.

16 The key to understanding witness Luciani's error is his identification of the

17 transportation cost differences between Parcel Post rate categories as

18 "worksharing cost avoidances." Although the five principal rate categories in

19 Parcel Post do reflect different levels of worksharing, these categories are not

20 themselves pure worksharing categories for transportation purposes. The Postal

21 Service estimates transportation costs for the five Parcel Post categories based

22 on actual measured transportation data for the five rate categories. These cost

23 estimates, while reasonable and reliable for Parcel Post's rate categories as the

24 categories are currently constituted, do not control for the differences in mail that

25 use these five rate categories. The rate category transportation costs provided by

26 witness Mayes reflect different mixes of mail—that is, differences in size, weight,

1 distance traveled, etc. For this reason, the differences in transportation costs  
2 between the different categories are influenced by a variety of factors and cannot  
3 simply be identified as worksharing cost avoidances.

4 Moreover, estimating transportation costs by zone introduces an additional  
5 complicating factor, at least for the Inter-BMC, DBMC and Intra-BMC rate  
6 categories. Simply put, zone designations cannot be directly compared across  
7 these Parcel Post rate categories. To make this idea more concrete, a zone 3  
8 DBMC piece is not just a zone 3 Inter-BMC piece (or even a zone 3 Intra-BMC  
9 piece) that has merely been workshared. Zone designations have different  
10 operational meanings, depending on the rate category. For all rate categories,  
11 the zone measures the direct distance between the location where the mail piece  
12 is deposited and its destination. But the zone, measured in this fashion, has  
13 different meanings for cost estimation purposes, depending on the category, as  
14 is explained below.

15 • For Inter-BMC, a zone 3 piece may have to be transported anywhere from  
16 a short distance to a fairly significant distance from the place where the  
17 piece is entered to the origin BMC. It must then be transported from the  
18 origin BMC to the destination BMC and, finally, it must be transported from  
19 the destination BMC to the piece's final destination. This final destination  
20 can range anywhere from a short distance (for example, a zones 1&2  
21 distance) up to a large distance (for example, a zone 4 distance). The  
22 actual transportation distance may be proportional to the postage zone  
23 rating of the piece or it may not.

- 1 • For DBMC, a zone 3 measures the distance traveled from the BMC to the  
2 destination locality. Here the distance traveled is generally proportional to  
3 the zone rating.
- 4 • For Intra-BMC, a zone 3 is unlikely to be proportional to the distance  
5 traveled, since a parcel will have to be transported between the entry point  
6 and the BMC, and from the BMC to the parcel's destination. The travel  
7 distance has no meaningful correlation with the zone rating, because the  
8 origin or destination may be close or far from the BMC.

9  
10 The key understanding to take away from the foregoing discussion is that  
11 a workshared piece, for example, a DBMC zone 3 piece, can avoid widely  
12 differing amounts of transportation costs. A DBMC zone 3 piece cannot simply be  
13 understood as an Inter-BMC zone 3, or an Intra-BMC zone 3 piece that has  
14 some well-defined Postal Service transportation activity avoided by the mailer.  
15 No obvious benchmark exists that can be used to calculate with satisfactory  
16 precision the avoided transportation costs for a specific category of mail, say  
17 DBMC zone 3 parcels. We know that these parcels avoid some Postal Service  
18 costs, but it would grossly overstate our knowledge to claim that the avoided  
19 transportation cost is the same as the difference in average transportation costs  
20 between DBMC zone 3 parcels and Inter-BMC zone 3 or Intra-BMC zone 3  
21 parcels (or even between the costs for DBMC zone 3 parcels and the average  
22 Inter-BMC or Intra-BMC parcel). The plain fact is that we do not have a suitable  
23 pure transportation cost benchmark for DBMC zone 3 parcels.

1           Witness Luciani’s mistake is to identify the cost differences between the  
2 average transportation costs for “workshared” and the average transportation  
3 costs for “non-workshared” parcels as solely (or even primarily) due to  
4 worksharing, and therefore as “avoided costs.” They are not. It is reasonable to  
5 conclude that there may be some avoided cost component in these cost  
6 differences, but I understand from Postal Service staff who calculate these costs,  
7 the avoided cost component cannot be reliably extracted or estimated. Nor can it  
8 even be determined that the avoided cost component is either a relatively large  
9 or relatively small component of the cost differences.

10           The Postal Service’s methodology is a reasonable way to approach the  
11 problem posed by the complex nature of Parcel Post rate categories.<sup>4</sup> Witness  
12 Luciani’s critique is based on a misunderstanding of the Postal Service’s  
13 transportation costs.

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<sup>4</sup> And, despite witness Luciani’s claims (UPS-T-2, at 4-5), the Postal Service’s approach is consistent with the approach used by the Commission in the most recent case (Docket No. R2000-1) in which the Commission published rate design workpapers for Parcel Post.

1 **V. USE OF ECP FOR NON-WORKSHARING PRICING**

2  
3 **A. Witness Panzar's assertion that Efficient Component-Pricing (ECP)**  
4 **should guide all pricing within a subclass is wrong and should be**  
5 **rejected.**  
6

7 Witness Panzar (PB-T-1) claims that all pricing within a subclass should  
8 be set consistent with the Efficient Component-Pricing (ECP) rule and therefore,  
9 all pieces within a subclass should have the same unit contributions.<sup>5</sup>

10 In making this claim, witness Panzar misapplies the ECP rule. As witness  
11 Sidak testifies, the ECP rule is appropriate for pricing worksharing cost  
12 differences, but ECP is generally not applicable to shape-based cost differences.  
13 Witness Sidak explains the reason: these characteristics (i.e. mail shapes) "do  
14 not generate costs avoided for the USPS, as does workshared mail." (NAA-T-1,  
15 at 11). Witness Panzar's approach does not limit the application of ECP (or, its  
16 equivalent, equal unit contributions) to cost differences associated only with  
17 worksharing (that is, avoided costs). By extending the ECP rule to all cost  
18 differences, he misapplies ECP.

19 Witness Panzar bases his argument for extending the ECP rule on two  
20 premises, both of which are unproven, and likely wrong. The first premise is that  
21 mailers choose the characteristics of the mail they send, such as the shape of  
22 the mail pieces, and that their choices are highly flexible and largely susceptible  
23 to influence by the relative prices set by the Postal Service.

24 Witness Panzar offers not the slightest bit of evidence to support this  
25 premise. In fact, the evidence that is available in this docket strongly suggests

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<sup>5</sup> See, for example, PB-T-1, at 45, lines 1-8; also, lines 21-22: "The basic economic argument in support of cost-based rate differentials is the same as that for avoided cost worksharing discounts." See also VP/PB-T1-10 and Transcript, p. 9258.

1 that the opposite is true: that mailers do not see their mail piece characteristics  
2 as highly flexible, and they are not willing and able to switch them, even in  
3 response to substantial changes in relative prices.<sup>6</sup>

4 The second premise on which witness Panzar's argument rests is that the  
5 demand characteristics (or, price elasticities) of all subgroups of pieces within the  
6 subclass are the same, or at least, inconsequentially different (See, for example,  
7 Transcript, p. 9260). Like the first, this second premise is wholly unsupported by  
8 witness Panzar, and is probably false. Rather than provide evidence to support  
9 this notion, he evidently simply assumes it to be true.

---

<sup>6</sup> In this docket the Postal Service is proposing significant rate increases for certain Standard Mail pieces based on their shape (parcels and NFMs). If witness Panzar's assumptions were valid, one would expect mailers to respond primarily by changing their mail piece characteristics to avoid the rate increases. Yet the evidence on the record in this case does not support Panzar's view. For example, witness Knight's testimony expects the Postal Service, rather than its customers to change: "One could suspect that the Postal Service's zeal to modify its customers' products to fit its future operations is self-defeating. A wiser choice for the Postal Service would be to adapt its operations to fit the existing and traditional specifications of its customers' products..." (POSTCOM-T-7, at 2). Elsewhere, Knight testifies that, rather than change its products in response to the price increase, his company will simply ship less: "Unless the Commission rejects or at the very least, very profoundly mitigates the rates proposed by the Postal Service, we anticipate that our annual volume of product shipments would decline drastically." (POSTCOM-T-7, at 9). Witness Horowitz echoes Knight's testimony that the response to the price change is not to change his company's mail piece characteristics (for example, to reduce the weight of its parcels or change their shape). Rather, his title to Section B proclaims, "A Decrease in the Use of the Mailstream is Our Most Logical Choice." (POSTCOM-T-6, at 7). Incidentally, on the same page, Horowitz testifies that postal price signals are not the all-powerful determinant of mail piece characteristics that Panzar seems to suggest: "In fact, it costs us more to drop enter our parcels at some West Coast bulk mail centers than we save in the drop entry discount. For operational and service reasons, however, we drop enter at all bulk mail centers." (POSTCOM-T-6, at 7). Another party does testify on the issue of changing mail piece characteristics in response to the price change proposals, but his testimony clearly undercuts Panzar's presumed mail piece characteristic flexibility: "Theoretically, we could mitigate this increase by reconfiguring our packaging to accommodate the USPS machinery and therefore make it qualify as machinable...However, the nature of our product lines makes this a very challenging if not impossible assignment." (MBI-T-1, at 1. Emphasis added). While the Postal Service suspects that mailers' claims of drastic reductions in mail volumes may be a bit overstated, these testimonies do not appear to wholeheartedly support witness Panzar's assumption that mail shape choices are highly flexible.

1           This assumption reveals a serious misunderstanding of the nature of  
2 postal subclasses. With the relatively small number of postal subclasses and the  
3 wide range of mail piece types in each, it should not be surprising at all to see  
4 significant variations in price elasticity for different subgroups within the broad  
5 subclasses, whether or not these elasticities have been separately estimated.  
6 Yet, in spite of this fact (acknowledged by witness Panzar for Parcel Post during  
7 cross examination (Transcript, pp. 9256-7)), he does not alter his testimony that  
8 all pieces of Parcel Post should bear the same absolute markup, regardless of  
9 weight, distance transported, machinability, or whether the piece was destination  
10 entered or not. (See, for example, VP/PB-T1-10).

11           At most, witness Panzar suggests that modifying his ECP rule prescription  
12 might be appropriate “in these kinds of situations” (Transcript, p. 9260) where  
13 subgroups within a subclass have demonstrably different demand elasticities.  
14 Nevertheless, he reasserts his ECP rule prescription for “the basic,  
15 homogeneous elasticity characterization of subclass demand” (Transcript, p.  
16 9260) without providing or pointing to any evidence whatsoever that  
17 “homogeneous elasticity” can actually characterize postal subclasses.

18           This points out a major flaw in witness Panzar’s reasoning. He assumes  
19 that subclasses are composed of pieces with homogeneous price elasticity and  
20 maintains that his assumption holds generally, even while acknowledging that  
21 widely different price elasticities do occur in a subclass that is relatively  
22 homogeneous in terms of shape and purpose (Parcel Post).

1 I think this example only shows that witness Panzar doesn't fully  
2 appreciate the complex nature of postal subclasses where, to take Standard Mail  
3 Regular as an example, mail pieces can range from advertising letters weighing  
4 less than one ounce to mail order fulfillment parcels that weigh almost 16  
5 ounces.

6 Witness Panzar's overextension of the ECP rule is not just a matter of  
7 theoretical concern. It has real-world consequences that may produce  
8 undesirable and perverse incentives. For example, it ignores the fact that cost  
9 estimates tend to have margins of uncertainty that increase with weight, rather  
10 than are constant at every weight. Applying witness Panzar's pricing prescription  
11 to Parcel Post would assign the same absolute per-piece markup over marginal  
12 cost for a 60 pound parcel as for a one pound parcel, regardless of the degree of  
13 uncertainty attached to their respective cost estimates. This rule would tend to  
14 discourage the carriage of large parcels and over-encourage the carriage of  
15 smaller parcels.<sup>7</sup>

16 Moreover, if the Postal Service has competitors who add a higher risk  
17 premium to heavier parcels, or who otherwise mark up their services

---

<sup>7</sup> Consider the hypothetical example where the Postal Service can carry either 100 large parcels or 10,000 small parcels in its truck. The cost for a particular run is \$1,000: \$10 for each large parcel, or \$0.010 for each small parcel. If the cost of transportation rose for unforeseen reasons from \$1,000 to \$1,050, the cost increase would amount to \$0.50 for each large parcel, or \$0.005 for each small parcel. It should be obvious that, in the face of transportation cost uncertainty, Panzar's equal unit contribution rule would give the Postal Service a strong incentive to avoid carrying larger parcels rather than smaller parcels, since \$0.50 represents a much larger fraction of any uniform per-piece contribution than \$0.005. Moreover, in the face of any significant cost uncertainty or volatility, the larger parcels run the real danger of becoming money-losers, requiring other pieces to pick up the burden of covering the larger parcels' volume variable costs, let alone any contribution to institutional cost coverage. Of course, a contingency could be added to the costs to compensate the Postal Service for the cost uncertainty, but if the contingency were applied at the subclass level (as in Postal Service pricing), Panzar's pricing rule would still distort the price signals, discouraging the carrying of large parcels and excessively encouraging the carrying of small parcels.

1 proportionally to cost (rather than on an absolute basis), heavier parcels would,  
2 ceteris paribus, be driven toward the Postal Service. This is not a stable situation.  
3 The Postal Service would find itself taking on ever-increasing quantities of  
4 potentially money-losing large parcels and proportionately fewer of the smaller,  
5 relatively more profitable parcels (which, if witness Panzar's rule were used,  
6 would be over-priced compared to the prices charged by the Postal Service's  
7 competition).<sup>8</sup>

8           Because witness Panzar's pricing rule applies ECP where no real  
9 worksharing is taking place, and because following witness Panzar's rule  
10 potentially can lead to perverse incentives for the Postal Service to avoid heavier  
11 (or more distant) mail, witness Panzar's pricing rule should not be applied.

12           Another reason that his rule is inappropriate is that he bases his  
13 prescription on two premises that he assumes to be true, but that the available  
14 evidence strongly indicates are not. Furthermore, dogmatically applying the ECP  
15 rule for non-worksharing cost differences robs the Postal Service and the  
16 Commission of the ability to use reasonable judgment to reflect information (such  
17 as shape-based demand and impact information) that is present, but not  
18 discernable in aggregate subclass price elasticities. This additional information  
19 may point to appropriate deviations from strict ECP rule application when pricing  
20 non-worksharing cost differences.

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<sup>8</sup> Although, in the foregoing discussion, products were differentiated by size, similar problems could occur if the differentiation were by distance traveled, or zone.

1 **VI. VALPAK'S STANDARD MAIL PRICING PROPOSALS**

2  
3 **A. Witness Mitchell's approach to ratemaking is excessively**  
4 **mechanistic and produces unreasonable rate change proposals.**

5  
6 Witness Mitchell proposes rates for Standard Mail that adhere to the  
7 principle that all rates below the subclass level should be based only on  
8 estimated cost differences (See USPS/VP-T1-26). Mitchell justifies this approach  
9 by appealing to the principles of economic efficiency which, he claims, require  
10 prices to be set as he proposes.

11 While I acknowledge that economic efficiency is an important goal and  
12 guide in establishing pricing at all levels, I believe that it is not the sole criterion.<sup>9</sup>  
13 Witness Mitchell's approach is too doctrinaire. It is excessively focused on just  
14 one pricing factor out of many, and produces prices that fail to acknowledge  
15 several other factors that are also important in setting rates.

- 16  
17 1. Mitchell's approach does not adequately acknowledge the importance of  
18 existing rate relationships.

19  
20 I do not believe that existing rate relationships are carved in stone and  
21 must never change. Indeed, I am sympathetic to the view, strongly advocated by  
22 Valpak in this docket, that Standard Mail flats should bear a greater share of the  
23 Standard Mail institutional cost burdens. Yet, at the same time, I understand that  
24 most Standard Mail flats are making significant positive contributions, and I am  
25 sensitive to the impacts that rapid changes in relative prices might have on the  
26 businesses of those customers who mail Standard Mail flats. Therefore, I

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<sup>9</sup> I agree with the Commission's view, stated in Docket No. R2000-1: "Economic efficiency is neither the exclusive nor even the paramount ratemaking objective under the Act." (Docket No. R2000-1, Opinion and Recommended Decision, para. 4042).

1 strongly believe that changes in relative letter-flat prices should be evolutionary,  
2 not revolutionary. Witness Mitchell's approach would jump instantly to his  
3 preferred rate relationships, heedless of the consequences his proposed pricing  
4 would have on mailers' businesses. I believe that relative letter-flat prices should  
5 adjust gradually, even after considering that the "evolution" has been delayed  
6 because of a number of unrelated factors.<sup>10</sup>

7

8 2. Mitchell's proposed pricing does not properly acknowledge the impacts it  
9 would have on mailers whose mail is otherwise covering its costs.

10

11 In his testimony, witness Mitchell concludes that the letter-flat cost  
12 difference is not fully recognized in the rates proposed by the Postal Service. In  
13 his pricing he attempts to "fix" this "problem," virtually in one step.<sup>11</sup> The upshot of  
14 Mitchell's desire to fully recognize the letter-flat cost difference in rates is to place  
15 an excessive adjustment burden on Standard Mail Regular flats. Mitchell's Chart  
16 1 shows many minimum-per-piece rated Regular flats rate cells with proposed  
17 increases exceeding 40 percent and 50 percent. Mitchell does not argue that  
18 increases of this magnitude are required to ensure that Regular flats cover their  
19 costs. Rather, his proposals are the direct result of his dogmatic pursuit of  
20 "economic correctness," without adequate concern for impacts on mailers.

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<sup>10</sup> These include the unanticipated period of rate stability caused by the recognition of the overfunding of the Postal Service's CSRS pension liability, and the across-the-board rate increase related to the Postal Service's obligation to fund an escrow.

<sup>11</sup> Mitchell's proposed pricing for Standard Mail Regular assigns a passthrough of the letter-flat cost difference of 95 percent, only slightly less than his minimum acceptable passthrough of "at least 100 percent." (VP-T-1, at 118). Mitchell here actually argues for a shape-based cost difference passthrough set at the subclass coverage. While I agree with witness Mitchell (and with witness Sidak (NAA-T-1, at 11) that there is no compelling theory to require, or even limit, setting non-worksharing cost difference passthroughs at 100 percent, I also find Mitchell's alternate passthrough-setting rule to be too rigid and doctrinaire.

1 The Postal Service's proposals, in contrast, do increase the relative letter-flat  
2 rate difference, when compared to current rates. But the Postal Service's rate  
3 proposals take into consideration the impact of rate changes on mailers. The  
4 Postal Service's proposed rates for minimum-per-piece rated Regular flats  
5 increase as much as 23.7 percent for a Mixed ADC origin-entered flat. Increases  
6 of this magnitude indicate a clear movement toward assigning flats a greater  
7 share of Standard Mail Regular's institutional costs. At the same time, the  
8 proposed rates show sensitivity to the fact that our rate increases will have an  
9 impact on flats mailers.<sup>12</sup> Witness Mitchell's proposed pricing expects flats  
10 mailers to adjust to whatever changes come out of his mechanistic application of  
11 "economically correct" pricing. His methodology produces unreasonable rate  
12 increases for flats mailers.

13  
14 3. Mitchell's pricing methodology assumes that only cost-related factors  
15 should be used in rate design below the subclass level. It fails to  
16 acknowledge the possibility of differences in product market  
17 characteristics below the subclass level that may be appropriate to  
18 consider.

19  
20 Witness Mitchell believes that a subclass' price elasticity appropriately reflects  
21 all non-cost factors, like value of service, for the subclass (See his response to  
22 USPS/VP-T1-17). Yet different product subgroups within a subclass often have  
23 different non-cost and market characteristics. If the price elasticity does capture  
24 the valuation of non-cost and market characteristics, as witness Mitchell

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<sup>12</sup> This is a significant increase and reflects, in part, the push-up effect from de-averaging the Automation basic presort rates. The ADC presorted flats benefit, in part, from the push-down effect of de-averaging. Since many mailers enter mail at several presort levels, the total impact of higher and lower rate increases tend to average out and would probably be less than the maximum increase.

1 postulates, then different product groups within subclasses would likely also have  
2 different own-price elasticities (whether or not these elasticities are separately  
3 estimated). But while witness Mitchell's logic thus suggests the likelihood that  
4 different subgroups within a subclass have different demand characteristics, his  
5 pricing methodology nonetheless insists that these demand-side differences be  
6 ignored in rate design. According to witness Mitchell, all products within a  
7 subclass should be priced differently based on costs only.<sup>13</sup>

8 I disagree. While we do not have price elasticities for most subgroups  
9 below the subclass level, I see no reason why such market information as is  
10 available (whether formally quantified or not) must be ignored in developing  
11 appropriate rates. Mitchell's mechanistic rate setting methodology is too  
12 doctrinaire and would ignore this information.

13 There is yet another way in which Mitchell's excessively mechanistic  
14 approach to ratemaking reveals itself. Mitchell's testimony clearly reveals that  
15 prospects for legislative reform of the postal ratemaking process propelled his  
16 rather extreme rate change proposals. At one point he states,

17 "It cannot be presumed that a second (or third) step, moving  
18 gradually toward preferred rate positions, will be possible in the next  
19 omnibus case or in the one after that. [footnote omitted] The most  
20 appropriate rates must be reached in one step, even if it is a large one, in  
21 order to prevent present inefficiencies and inequities from being etched  
22 into relationships that will be difficult, if not impossible, to correct. (VP-T-1,  
23 at 9-10).  
24

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<sup>13</sup> See. USPS/VP-T1-26. Mitchell's reliance on "costs only" does not preclude marking up cost differences, as he argues we should do to the letter-flat cost differential. It only seems to mean that differences in non-cost factors between products or categories have no meaningful role in setting price differences below the subclass level.

1            Yet, if legislative restructuring of Postal Service pricing were no longer  
2 imminent, an alternate pricing proposal could be had by simply changing two  
3 cells in his workpapers:

4            In fact, I have given you a spreadsheet where you can go in, and  
5 you can change the number in two cells, which anybody in the third grade  
6 should be able to do, and the new rates will come out. That's it. Two cells,  
7 and you'll have a complete set of rates with increases, and I see no  
8 reason why those wouldn't be defensible. (Transcript, p. 9022).

9  
10           In response to this assertion, one is compelled to ask: where is the  
11 careful, balanced consideration of rate change impacts and rate relationships  
12 that should be expected if the rate design were to respond to a complete change  
13 in so fundamental a driving assumption? The answer is clear: there is none.

14           Mitchell's approach to ratemaking is so mechanistic that it is immaterial  
15 whether or not Congress acts to completely restructure postal ratemaking, and  
16 rate levels are significantly changed in response. Mitchell's pricing model can  
17 shift to produce a complete set of rates for Standard Mail under either of two  
18 fundamentally different environments with no judgment required. I do not believe  
19 that rates should be simply produced by turning the crank on some big rate  
20 machine. Mitchell's approach to ratemaking is excessively mechanistic and  
21 should not be used as the basis for setting Standard Mail rates.

22

23        **B.     Mitchell's pricing proposals and methodology do not reflect a**  
24        **balanced consideration of relevant factors and so should be**  
25        **rejected.**

26

27           It is clear from reading witness Mitchell's testimony that he views his  
28 pricing proposals as primarily completing the work of Standard Mail de-averaging

1 that was begun in Docket No. MC95-1.<sup>14</sup> This is an excessively narrow lens in  
2 which to view rate changes in this docket, and it reflects an inappropriate lack of  
3 balance in ratemaking.

4 Since Docket No. MC95-1, there have been four intervening omnibus rate  
5 cases. Although one of the four (Docket No. R2005-1) did not significantly  
6 change existing rate relationships, it cannot be denied that circumstances, both  
7 within and outside Standard Mail, have changed. It is unrealistic to view Valpak's  
8 preferred changes in ECR rates and cost coverage solely within the context of  
9 de-averaging Standard Mail as witness Mitchell does. Changes in ECR's rates  
10 and cost coverages must be evaluated within the wider context of the  
11 circumstances facing the Postal Service and the Commission in Test Year 2008.  
12 Witness Mitchell has not done this. He has simply shifted the entire burden of  
13 achieving his desired ECR rates to Standard Mail Regular without regard to the  
14 wider implication of such a stance.

15 Even if one were to accept, for the sake of argument, that Standard Mail  
16 Regular were the appropriate subclass to bear the burdens of desired ECR rate  
17 reductions, Mitchell has provided no evidence showing the likely impacts of his  
18 proposed radical rate restructuring of Standard Mail on the Postal Service as a  
19 whole, and on other classes of mail, particularly on First-Class Mail. Mitchell's  
20 analysis doesn't even attempt to provide the after-rates revenue and contribution  
21 impacts of his proposals on the Standard Mail subclasses themselves. This might  
22 not be so serious if the suggested changes were minor, and the expected  
23 impacts were de minimis. But Mitchell is proposing ECR rate reductions of 8.47

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<sup>14</sup> See, for example, VP-T-1, at 8-9.

1 percent (compared to the Postal Service's proposed increase of 8.4 percent),  
2 and a Regular rate increase of 17.56 percent (compared to the Postal Service's  
3 proposed 10.8 percent increase). Mitchell offers no evidence as to what kind of  
4 impacts his rate changes would have.

5           It is clear that witness Mitchell's excessively narrow focus has led him to  
6 propose a massive restructuring of Standard Mail rates without providing any  
7 evidence of the repercussions of his proposals. Mitchell's analysis is too  
8 incomplete to rely on as the basis for so significant a rate restructuring.

1 **VII. PACKAGE SERVICES CLASSIFICATION PROPOSALS**  
2

3 **A. Witness Haldi's proposal to change the definition of Bound Printed**  
4 **Matter to allow non-printed material would increase BPM's unit costs**  
5 **and should be rejected.**  
6

7 In his testimony (AMZ-T-1), witness Haldi proposes that Bound Printed  
8 Matter (BPM) should be re-defined so that CDs, DVDs and other forms of  
9 electronic media (such as memory cards) can be mailed as BPM.<sup>15</sup> This proposal  
10 would likely lead to a migration of parcels from Media Mail, and possibly, Parcel  
11 Post, to BPM and increase the average unit costs for BPM. Neither witness  
12 Haldi's testimony nor any other part of the record provide any evidence showing  
13 what the financial impacts of this restructuring of BPM would have on BPM or on  
14 Media Mail. Furthermore, witness Haldi's defense of his proposal reveal a  
15 serious misunderstanding of the nature of BPM, its cost characteristics, and  
16 certain content exceptions that are permitted. Because of these flaws, Haldi's  
17 testimony is wholly inadequate and cannot be relied on as the basis for making  
18 such a sweeping change in the definition of an important parcel subclass.

- 19 1. Haldi's "higher average cost coverage" argument reveals a serious  
20 misunderstanding of how Postal Service parcel costs are generated.  
21

22 Witness Haldi expects his proposal to cause some pieces, currently  
23 ineligible for BPM, to migrate from Media Mail to BPM. He asserts that, since

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<sup>15</sup> Although witness Haldi initially proposed that just electronically published books and CDs, and DVDs of movies based on books, be admitted into BPM, he later stated in response to written cross examination, "The proposal contained in Appendix II of my testimony would enable all CDs and DVDs to qualify." (USPS/AMZ-T1-3c). [Emphasis added]. Appendix II is Haldi's proposed DMCS language.

1 BPM has a higher average cost coverage than Media Mail, migrating pieces will  
2 increase Postal Service contribution.<sup>16</sup>

3           Witness Haldi's assertion is demonstrably false. He first attempts to  
4 inoculate his claim from criticism by knocking down a straw-man objection.  
5 Immediately after making his assertion he assures us that "reliance on such  
6 averages can of course be deceptive, because no mailer makes decisions based  
7 on averages." (VP-T-1, at 17). Witness Haldi then segues into a discussion  
8 where he argues that Media Mail users would not "cherry pick" and that this  
9 problem therefore "does not exist." (VP-T-1, at 18).

10           There is no need to address the merits or flaws of his cherry picking  
11 argument, since it is simply a red herring, tossed in to draw attention away from  
12 the glaring flaw in his "contribution will be improved" assertion. His argument is  
13 false because the only relevant factors in determining the contribution a parcel  
14 makes to Postal Service institutional costs are the postage it pays and the costs  
15 it imposes on the Postal Service. Period. Cherry picking, mailers' "decisions,"  
16 etc., are irrelevant. Only the postage and the costs matter.

17           Since the motivation for witness Haldi's proposal is to lower postage paid,  
18 the only way a piece migrating from Media Mail to Bound Printed Matter would  
19 increase contribution would be if that mail piece were to cost less as a BPM  
20 piece than as a Media Mail piece. The Postal Service processes and delivers  
21 similarly presorted and entered bulk Media Mail and BPM in the same way, so

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<sup>16</sup> "Based purely on averages, it would appear that each piece which migrates from Media Mail to BPM would increase the contribution to overhead by \$0.03, which represents a 14 percent gain over the contribution in Media Mail." (AMZ-T-1, at 17).

1 the cost would be the same, regardless of the subclass.<sup>17</sup> If migration does not  
2 change the costs, and postage goes down, it follows unambiguously that, ceteris  
3 paribus, allowing currently non-qualifying pieces to migrate from Media Mail to  
4 BPM will reduce Postal Service contribution.

5  
6 2. Witness Haldi says that his proposal is consistent with past Commission  
7 positions to make available low-cost options when possible (AMZ-T-1, at  
8 18).  
9

10 Here the term “low cost” is intended to mean low postage. But, as shown  
11 in the previous discussion, expanding the definition of BPM will not, ceteris  
12 paribus, reduce Postal Service costs.

13 Just because migrating pieces are mailed using a subclass with lower unit  
14 costs does not mean that these pieces will be processed and delivered at lower  
15 cost. BPM has lower average unit costs than other Package Services subclasses  
16 because its composition is different: it has a high proportion of flats, which  
17 generally are cheaper to process and deliver than parcels.<sup>18</sup> Bringing more  
18 parcels into BPM would increase average unit costs, eroding the low average  
19 cost characteristics of BPM.

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<sup>17</sup> Because Media Mail (and Library Mail) do not have destination entry discounts, an argument might be made that eligibility for BPM would encourage additional drop-shipping, and so lower the cost to the Postal Service. This, of course, would only improve contribution if the Postal Service passed through less than 100 percent of its appropriately estimated destination entry avoided costs. While passthroughs may be lower than 100 percent at present, neither the Postal Service nor the Commission has expressed the view that they should remain so indefinitely.

<sup>18</sup> According to FY 2005 RPW by shape, flat-shaped pieces account for 46 percent of BPM. See also, Attachment 14 to the testimony of Postal Service witness Smith(USPS-T-13), which projects that test year mail processing costs for BPM flats will be 23.71 cents per piece, compared to 62.28 cents per piece for parcels/IPPs.

1           Witness Haldi's proposal would lead to lower postage, but not lower cost  
2 for BPM. It would erode the low-cost characteristics for BPM, eventually leading  
3 to higher rates for all BPM pieces.

4  
5           3. Witness Haldi says that BPM has a highly de-averaged, cost-based rate  
6 structure that shields mailers of low cost mail from inefficient mail.  
7

8           Witness Haldi claims that "[d]evelopment of this highly de-averaged, cost-  
9 based rate structure has helped protect those BPM mailers who submit highly-  
10 prepared and highly-efficient mail from suffering rate increases on account of  
11 less-efficient and more costly mail being averaged into the rate structure." (AMZ-  
12 T-1, at 13).

13           One might be tempted to agree with witness Haldi if one were only to give  
14 a superficial glance at the BPM rate charts. BPM does have separate rates for  
15 presorting, drop-shipping and for flats and parcels. But this ignores the fact that  
16 the BPM rate structure is in evolution and has by no means arrived at the blissful  
17 state of (near) perfect cost and rate de-averaging that witness Haldi praises.  
18 Witness Yeh (USPS-T-38) has testified that she developed the flat-parcel rate  
19 differential without having witness Smith's estimated mail processing costs by  
20 shape available to her. (See witness Yeh's Response to POIR No. 5, question  
21 2b). It is clear from witness Yeh's testimony and workpapers that her proposed  
22 flat-parcel rate differential does not fully reflect all of the combined delivery and  
23 mail processing costs differences estimated by witnesses Kelley and Smith.

24           If cost differences are not yet recognized at their appropriate levels,  
25 encouraging migration of higher cost parcels from Media Mail to BPM would be,

1 at best, premature and, at worst, potentially disastrous for BPM. Simply put,  
2 bringing pieces with cost characteristics on the high-cost side of the average into  
3 the BPM mix would definitely cause lower-cost BPM mail to suffer increased  
4 rates, precisely the outcome that witness Haldi claims would not happen because  
5 of BPM's "highly de-averaged" rate structure.

6 Finally, despite witness Haldi's claims (AMZ-T-1, at 35), the BPM rate  
7 design is not "cost-based" in one important aspect: it does not recognize the  
8 impacts of cubic volume (or "cube") on costs separately from weight. Because of  
9 the difficulties of measuring cube, the Postal Service has traditionally relied on  
10 weight as a proxy for cube in rate design. This approach makes some sense  
11 when one is dealing with mail pieces all having the same shape (i.e. all parcels,  
12 or all flats). But, in a mixed-shape subclass such as BPM, to blindly assume that  
13 BPM flats, BPM parcels, and parcels that potentially would migrate from Media  
14 Mail all have the same average densities is to run the risk of making disastrous  
15 rate design decisions. Nowhere in witness Haldi's testimony, or elsewhere in the  
16 record is there any estimate of the cost impacts of bringing in low-density CDs  
17 and DVDs into a subclass that consists largely of relatively high-density books  
18 and catalogs. This is a serious shortcoming in Haldi's testimony and renders it  
19 inadequate to use as the basis for restructuring BPM.

20  
21  
22  
23  
24  
25

4. Witness Haldi says that excluding books published in electronic format is illogical, particularly because current rules allow certain non-print items to accompany printed books and pay BPM rates. (AMZ-T-1, at 16).

1           Witness Haldi claims that his proposal would not alter the basic content  
2 requirement for BPM. (AMZ-T-1, at 24). He can make this claim because he has  
3 redefined the word “content” to refer only to what is communicated by the books,  
4 catalogs, CDs, DVDs, etc. (i.e. advertising, editorial matter, and so on) that he  
5 argues should be allowed in BPM. But, BPM’s attractive cost characteristics rely  
6 crucially on a broader notion of content, one that includes inherent physical  
7 characteristics: bound printed matter. Bound printed matter is by its very nature  
8 dense. High-density parcels and flats have favorable cost characteristics that  
9 have led to the low rates that make BPM so attractive. To allow low-density non-  
10 printed matter parcels into BPM would erode and, perhaps, eventually destroy  
11 BPM’s low cost profile. It would certainly shift recovery of the higher average  
12 costs onto high-density BPM pieces with favorable cost characteristics to the  
13 extent that BPM rates do not fully reflect the impact of density on costs.

14           Witness Haldi’s assertion that his proposal would not alter the content of  
15 BPM is untrue. His proposal would shift the content of BPM away from highly  
16 dense printed books and catalogs with favorable cost characteristics.

17           His proposal would likely lower contribution in the short run, and in the  
18 longer run would increase the rates of high-density bound printed matter already  
19 in the subclass. Witness Haldi’s proposal would bring significant undesirable  
20 impacts to BPM. Witness Haldi has done no concrete analysis of these impacts  
21 and there is nothing on the record to even demonstrate how these impacts might  
22 be reasonably estimated.

23

1 **B. Witness Angelides' proposal to change the Media Mail rate design to**  
2 **include half-pound rate increments is inconsistent and is not based**  
3 **on any record evidence of cost causation by weight. It should be**  
4 **rejected.**  
5

6 Witness Angelides (POSTCOM-T-5) proposes to change the long-  
7 standing Media Mail rate design to introduce half-pound rate steps between 1.0  
8 pounds and 5.0 pounds. Below 1.0 pound and above 5.0 pounds, the rate would  
9 change in whole pound increments. (POSTCOM-T-5, at 6).

10 Witness Angelides supports his change to the rate design by arguing that  
11 full pound rate increments at low weights "can result in dissimilar packages  
12 paying the same rate." (POSTCOM-T-5, at 5, lines 17-19). Of course, the notion  
13 that dissimilar mail pieces pay the same rate is fundamental to the notion of  
14 averaged rates. Dissimilar mail pieces pay the same rates in all mail classes  
15 offered by the Postal Service.

16 What concerns witness Angelides is apparently not just that 1.1 pound  
17 parcels differ from 2.0 pound parcels and 2.1 pound parcels differ from 3.0 pound  
18 parcels, etc., but the relative size of the difference. Witness Angelides provides a  
19 pair of tables (Tables 2 and 3) (POSTCOM-T-5, at 7) to show some variations  
20 between the weights of parcels that pay the same rates. Table 2 shows the  
21 variations in weights under the current full-pound weight step rate design. Table  
22 3 shows the variations under his proposed half-pound step rate design.

23 Witness Angelides does not provide any evidence that the weight  
24 differences shown in Tables 2 and 3 in and by themselves have a demonstrable  
25 effect either on costs or on other factors that compel them to be separately

1 recognized in the rate design. Parcels with similar, or even identical, costs can  
2 have equally dissimilar cubic volumes (cube) and, from what I understand from  
3 Postal Service staff who calculate parcels costs, differences in cube at low  
4 weights are of considerable importance in determining differences in costs.

5         Witness Angelides is also rather inconsistent in the way he applies his  
6 principle of avoiding significant relative weight variations within weight steps. For  
7 example, in Table 2, the relative weight variations for the 3.1 to 4.0 pound and  
8 4.1 to 5.0 pound rate steps are 23 percent and 18 percent. Apparently witness  
9 Angelides finds weight variations this big to be unacceptable, since he proposes  
10 to reduce them by setting up half-pound weight steps between 3.0 and 5.0  
11 pounds. But if 23 percent variation is not acceptable in a full pound weight step,  
12 why is 27 percent variation acceptable in his half-pound step between 1.0 and  
13 1.5 pounds? At what point exactly does a weight variation within a rate step  
14 become unacceptable? Witness Angelides does not explain why 45 percent or  
15 23 percent or 18 percent is unreasonable.

16         Moreover, witness Angelides does not adequately explain why he  
17 exempted the first pound from his half-pound plan. Again, this is inconsistent.  
18 Using his methodology, the variation between a 1.0 pound Media Mail piece and  
19 a 0.1 pound piece is 90 percent. Of course, one might respond that there may be  
20 no 0.1 pound pieces in Media Mail. But there certainly are likely to be pieces that  
21 weigh less than eight ounces that would fall in a 0.0 to 0.5 pound rate step. What  
22 is more, witness Angelides has not explained why his principle applies only to  
23 Media Mail. If the Commission accepts this principle for Media Mail, presumably

- 1 it should apply to other subclasses as well. Witness Angelides evidently has not
- 2 considered the implications of applying his principle throughout the postal rate
- 3 structure.