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FINAL VERSION: December 5, 2006

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

REBUTTAL TESTIMONY
OF
ALTAF H. TAUFIQUE
ON BEHALF OF
UNITED STATES POSTAL SERVICE

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AUTOBIOGRAPHICAL SKETCH

My name is Altaf H. Taufique. I serve as an Economist in the office of Pricing, which is a component of Pricing and Classification Department, within the Marketing group at the United States Postal Service headquarters. I testified earlier in this docket, presenting the First-Class Mail rate design proposals of the United States Postal Service (USPS-T-32). I incorporate by reference the autobiographical sketch reflected at page(s) ii-iii of that testimony.

1 I. Purpose And Scope Of Testimony

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3 Several intervenor witnesses in this docket, particularly American
4 Postal Workers Union witness Kathryn Kobe (APWU-T-1) and Office of the
5 Consumer Advocate witness Pamela Thompson (OCA-T-4), present alternative
6 First-Class Mail rate designs that differ from the rate design that I proposed on
7 behalf of the Postal Service in my direct testimony, USPS-T-32. In rebuttal, I
8 explain why their alternative rate designs should not be recommended by the
9 Postal Rate Commission to the Governors of the United States Postal Service.

10 II. A Variety Of Reasons Caution Against Adoption Of The APWU Rate
11 Design Proposal

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13 APWU witness Kathryn Kobe (APWU-T-1) disagrees with my First-Class
14 Mail rate design methodology and expresses concerns regarding changing the
15 policies of the Postal Service and the Commission. She also expresses concern
16 about changing the rate relationships between single-piece and presorted First-
17 Class Mail letters, and creating a template for further change. APWU-T-1 at 4.

18 Witness Kobe criticizes the Postal Service for not using bulk metered mail
19 (BMM) as a rate design benchmark and for not providing the data to compare
20 presorted mail to these benchmark pieces. APWU-T-1 at 4-7. She proceeds to
21 develop her own benchmark and her own set of initial rates for presort letters.
22 Preliminarily, based on 100 percent passthroughs, her approach would yield
23 percentage rate increases in the range of 15.5 to 18.4 percent for letters in the

1 various workshare rate categories.¹ Finding these results untenable, she
2 abandons idealism in favor of pragmatism and makes adjustments that result in
3 her presenting a different set of rates for the Commission's consideration. In the
4 following subsections, I discuss some of the implications of her rate design, from
5 both a practical and a theoretical standpoint.

6 A. Witness Kobe's Passthroughs Are Inexplicable

7 The effective passthroughs using witness Kobe's rates and avoided
8 costs are shown below in Table 1, and are based upon the cost summaries
9 provided in APWU-LR-1 (page 1) and APWU-LR-3 (page 1) and rates provided
10 in APWU-T-1, page 9.

11 TABLE 1
12 RATES, DISCOUNTS, COST AVOIDANCES, AND PASSTHROUGHS
13 PROPOSED BY APWU WITNESS KOBE

Rate Category	Rates	Discounts	Cost Avoidance	Passthrough
Single-Piece	\$0.41			
Mixed AADC	\$0.351	\$0.059	\$0.042	140.48%
AADC	\$0.340	\$0.070	\$0.054	129.41%
3-Digit	\$0.336	\$0.074	\$0.058	126.76%
5-Digit	\$0.321	\$0.089	\$0.073	121.58%

14
15 Witness Kobe's passthroughs are slightly lower using PRC-version costs,
16 but still are well above 100 percent, ranging from 119 percent for 5-Digit
17 Automation letters to 133 percent for Mixed AADC letters. These passthroughs
18 suggest that witness Kobe's initial thinking for presort automation letters may
19 have reflected the Bulk Metered Mail benchmark. But, by virtue of passthroughs

¹ The only exception would be for Nonautomation presort letters which would only be subjected to a 2.7 percent increase.

1 that are over 100 percent at each presort level, she breaks away from rigid
2 adherence to BMM. She articulates no reason for the choice of passthroughs at
3 each rate level. Under her proposal, rate increases for the finest presort levels of
4 3-Digit and 5-Digit Automation Letters would be 9.1 and 9.6 percent, respectively.
5 She subjects these rate categories to the largest increases, with the lowest
6 passthroughs. At the same time, rate categories such as Mixed AADC and
7 AADC are recipients of the highest passthroughs, with lower percentage rate
8 increases. This element of selectivity in witness Kobe's passthroughs is
9 especially troublesome in light of the fact that similar concern is not expressed for
10 the mailers of Carrier Route presort letters. Under her proposal, these pieces
11 would face a 10.7 percent rate increase, since the 5-Digit Automation rate would
12 apply.

13 B. CRA Costs Do Not Justify The Increases For Presort Mail
14 Proposed By Witness Kobe

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16 Table 2, below, presents Cost & Revenue Analysis (CRA) unit revenues
17 and costs for the last nine fiscal years.

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TABLE 2
UNIT REVENUES AND COSTS, FCM LETTERS SUBCLASS

	SINGLE-PIECE			PRESORT		
	Average	Vol. Var.	Unit*	Average	Vol. Var.	Unit*
	Revenue	Cost	Contribution	Revenue	Cost	Contribution
1997	\$ 0.396	\$ 0.218	\$ 0.178	\$ 0.268	\$ 0.098	\$ 0.171
1998	\$ 0.402	\$ 0.218	\$ 0.184	\$ 0.268	\$ 0.094	\$ 0.174
1999	\$ 0.411	\$ 0.235	\$ 0.176	\$ 0.272	\$ 0.105	\$ 0.167
2000	\$ 0.416	\$ 0.239	\$ 0.177	\$ 0.275	\$ 0.098	\$ 0.177
2001	\$ 0.421	\$ 0.243	\$ 0.178	\$ 0.280	\$ 0.101	\$ 0.179
2002	\$ 0.436	\$ 0.247	\$ 0.188	\$ 0.288	\$ 0.101	\$ 0.188
2003	\$ 0.455	\$ 0.252	\$ 0.203	\$ 0.307	\$ 0.098	\$ 0.209
2004	\$ 0.454	\$ 0.252	\$ 0.202	\$ 0.306	\$ 0.095	\$ 0.210
2005	\$ 0.453	\$ 0.264	\$ 0.189	\$ 0.305	\$ 0.101	\$ 0.203

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Note: Unit Contribution estimates may not equal the difference between Average Revenue and Vol. Var. Cost due to rounding.

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Within the First-Class Mail Letters and Sealed Parcel subclass, compound annual unit-revenue growth from FY1997 to FY2005 was 1.7 percent for single-piece and 1.6 percent for presort. Over the same time period, unit costs increased by 2.4 percent annually for single-piece, but only by 0.4 percent annually for presort. It seems unfair that Ms. Kobe reserves the highest rate increases within the First-Class Mail Letters and Sealed Parcels subclass for the finest presort mail that has one of the lowest increases in costs over the last nine years and provides the highest implicit cost coverage compared to any class of mail.

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C. The Volume Impact Of Witness Kobe's Proposal Would Be Counter-Productive

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Another shortcoming of APWU witness Kobe's proposal is that it promotes results that would run counter to the Postal Service's long-term automation goals. Her price signals, if embraced by the Commission, would encourage a reduction

1 in automation-compatible mail and a 35 percent increase in Nonautomation
2 presort mail volume.

3 D. Witness Kobe's BMM Benchmark Does Not Necessarily Reflect the
4 Average Piece Converting to Presort

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6 APWU witness Kobe (APWU-T-1) proposes continued use of the bulk
7 metered mail (BMM) benchmark for purposes of estimating avoided costs and
8 establishing rates for Presorted First-Class Mail letters. In support of her
9 proposal for continued use of the BMM benchmark, and in opposition to the
10 Postal Service's Docket No. R2006-1 rate design, she makes several
11 statements which the Postal Service does not necessarily dispute. For example, I
12 do not dispute her assertion that, under the Postal Service's proposal for "de-
13 linking" First-Class Mail presort letter rates from those for single-piece letters,
14 "clean" (lower-cost, generally) letters approximating the BMM benchmark will
15 tend to make a higher contribution to institutional costs if they are single-piece
16 rather than presorted. See, APWU-T-1 at 7, lines 2-6.

17 Quite simply, the use of a benchmark will not prevent two mail pieces that
18 are in all respects the same (other than that one is presorted and the other is not)
19 from making different contributions to the Postal Service's institutional costs. In
20 fact, given the heterogeneous nature of both presorted and non-presorted mail,
21 such differential contributions will be fairly commonplace. In some cases the
22 presorted mail piece will contribute more than the single piece, in other cases it
23 will contribute less. This is not to say that the concept of benchmarking is flawed;

1 it is only to say that a benchmark, particularly with respect to single-piece First-
2 Class Mail, cannot be developed with the precision that Ms. Kobe implies.

3 The shortcomings of witness Kobe's position can also be understood in
4 the context of mail piece heterogeneity as discussed by Pitney Bowes witness
5 Panzar (PB-T-1 at 28 to 39), as well as in his paper, *Clean Mail and Dirty Mail:
6 Efficient Worksharing Discounts with Mail Heterogeneity*.² See PB-T-1, at 36,
7 footnote 24. In fact, there is every reason to believe that many mail pieces that
8 are at the margin of presorting (or reverting from presorting) are distinct in some
9 way from the BMM benchmark. Pitney Bowes witness Panzar (PB-T-1), drawing
10 at least in part on the above-referenced scholarly paper, says that the BMM
11 benchmark is *not representative* of the average piece "just at the margin of being
12 profitable for mailers to workshare." PB-T-1 at 36. He adds that rather, it "is
13 likely to lead to discounts *too low* to result in an efficient allocation of mail
14 processing activity." PB-T-1 at 37. (Emphasis added.) As he reiterated during
15 cross-examination:

16 I think the previous benchmark was bulk metered mail. It's clear
17 that's not at the margin. That's way inside the margin....That makes it too
18 clean a benchmark to use.

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21 Tr. 26/9307.

22 In the Postal Service's view, the BMM benchmark is certainly
23 representative of *one* type of mail that is a candidate for migration from single-
24 piece to presort (or the reverse). But there are other types of single-piece mail
25 that potentially could convert to presort — including pieces lacking the uniform

² Presented at the 14th Conference on Postal Delivery Economics in Bern, Switzerland, May 31 - June 3, 2006.

1 characteristics of BMM. Theoretically, and in practice, many of these other types
2 of candidate mail, when presorted, are likely to produce greater savings for the
3 Postal Service than presorted BMM.

4 E. Practical Impediments

5 As explained above, theoretically a single BMM benchmark, or any
6 benchmark will not be reflective of all of the variety of mail pieces that can
7 convert to (or revert from) presort. In this regard, witness Panzar was more
8 forceful in describing the uncertainty, and practical uncertainty and present
9 intractability, of the situation:

10 At the margin of being workshared was a theoretical concept that came
11 out of my theoretical analysis in the paper that's been cited in my
12 testimony. I have thought long and hard about how to make that a
13 practical quantifiable measure without coming to what I think is any
14 particularly implementable or helpful solution, but this is still an area of
15 research in progress.

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17 Tr. 26/9306. Witness Panzar further responded to Chairman Omas:

18 Q: Given the data that could reasonably be made available to the
19 Commission could you explain how to identify and measure the
20 cost of the efficient benchmark mail as you've defined it?

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22 A: Well, I think the short answer is no for the reasons that I was just
23 talking about. We need a way of usefully identifying which type of
24 mail is at the margin of worksharing and that's easy to do in a
25 mathematical model, but not in practice although I hope that as I
26 talk to people more involved with the details of the costing system
27 that a shorthand approximate way for doing that will emerge, but I
28 can't give you one at the moment.

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30 Tr. 26/9308-09.

31 The Postal Service also believes that, even if a "true" benchmark could, in
32 a theoretical sense, be agreed to by a wide range of parties, practical
33 measurement problems could intrude. Mail that is at the margin of worksharing

1 is by definition not yet workshared, so how to measure cost savings if this mail
2 were to become workshared is a conundrum. In consideration of these
3 theoretical and practical obstacles, as well as of the long history of dissension on
4 the matter, the First Class Mail benchmark problem can well be considered
5 intractable.

6 F. De-linking Offers A Practical Solution For Setting First-Class
7 Mail Workshare Discounts

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9 In the face of First-Class Mail heterogeneity, the increasing maturation of
10 the market for workshare conversion of “clean” (lower cost generally) mail pieces
11 most often sent by large mailers, increasing relative diversity in the population of
12 mail that is converting or is on the margin of converting, and the longstanding
13 difficulty in agreeing upon a benchmark conversion piece, the Postal Service’s
14 de-linking proposal for First-Class Mail, relying on data from the CRA, offers a
15 viable and practical alternative to continued reliance on the bulk metered
16 benchmark. In addition to reflecting the market trend, the Postal Service's
17 approach will have a number of benefits. It is a methodology that is reproducible
18 from one rate case to the next,³ easily verifiable, and transparent. It has the
19 advantage of relying on a robust and well-established data source, the Cost and
20 Revenue Analysis (CRA). Finally, it has the potential to reduce much of the
21 dissension that has characterized worksharing discussions in the past.

22 While the Postal Service is proposing to de-link the mechanics of single-
23 piece and presort First-Class Mail rate design, we have the goal of equal unit

³ This does not mean that there must be rigid adherence to the same formula. As with all postal ratemaking, to the extent that other factors are present (such as a significant change in the mail mix), those factors can be recognized and the effects tempered.

1 contributions to institutional costs from single-piece and presort (all else equal).
2 In this respect, a strong link is maintained between single-piece and presort rates
3 and costs. This underscores the Postal Service's continued treatment of single-
4 piece and presort as separate categories within a subclass, not as separate
5 subclasses.

6 III. The OCA Additional-Ounce Rate Design Should Not Be Recommended

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8 Office of Consumer Advocate witness Thompson (OCA-T-4) proposes to
9 change the long-standing ounce increment First-Class Mail additional-ounce rate
10 structure and asks the Commission to recommend Four-Ounce Shape-Based
11 Incremental Rates. OCA-T-4 at 5-7. I urge the Commission not to recommend
12 the structure proposed by witness Thompson for two reasons.

13 First, as demonstrated in Table 3 below, the percent rate increases
14 resulting from her proposal for single-piece mail within the Letters and Sealed
15 Parcels subclass range would range from negative 62.2 percent to plus 223
16 percent, a huge range around the average increase for First-Class Mail. The
17 Postal Service was sensitive to extraordinary rate impacts in developing its
18 proposal to redesign the First-Class Mail rate structure on the basis of shape.
19 Incorporation of the rate design changes proposed by witness Thompson would
20 only subject many mailers to ever higher percentage increases than those
21 proposed by the Postal Service.

22 Second, the range of rate reductions and increases resulting from the
23 rates proposed by witness Thompson is bound to lead to significant changes in

1 mail mix, the financial and operational consequences which should be examined
 2 before such a radical redesign is seriously considered.

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TABLE 3
 PERCENT CHANGES IN RATES RESULTING FROM WITNESS
 THOMPSON'S PROPOSAL

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Letters				Flats				Parcels			
Ounce	Current Rates	OCA Proposal	Percent Change	Ounce	Current Rates	OCA Proposal	Percent Change	Ounce	Current Rates	OCA Proposal	Percent Change
1	\$ 0.39	\$ 0.42	7.7%	1	\$ 0.52	\$ 0.84	61.5%	1	\$ 0.52	\$ 1.68	223.1%
2	\$ 0.63	\$ 0.42	-33.3%	2	\$ 0.63	\$ 0.84	33.3%	2	\$ 0.63	\$ 1.68	166.7%
3	\$ 0.87	\$ 0.42	-51.7%	3	\$ 0.87	\$ 0.84	-3.4%	3	\$ 0.87	\$ 1.68	93.1%
4	\$ 1.11	\$ 0.42	-62.2%	4	\$ 1.11	\$ 0.84	-24.3%	4	\$ 1.11	\$ 1.68	51.4%
				5	\$ 1.35	\$ 1.68	24.4%	5	\$ 1.35	\$ 2.52	86.7%
				6	\$ 1.59	\$ 1.68	5.7%	6	\$ 1.59	\$ 2.52	58.5%
				7	\$ 1.83	\$ 1.68	-8.2%	7	\$ 1.83	\$ 2.52	37.7%
				8	\$ 2.07	\$ 1.68	-18.8%	8	\$ 2.07	\$ 2.52	21.7%
				9	\$ 2.31	\$ 2.52	9.1%	9	\$ 2.31	\$ 2.79	20.8%
				10	\$ 2.55	\$ 2.52	-1.2%	10	\$ 2.55	\$ 2.79	9.4%
				11	\$ 2.79	\$ 2.52	-9.7%	11	\$ 2.79	\$ 2.79	0.0%
				12	\$ 3.03	\$ 2.52	-16.8%	12	\$ 3.03	\$ 2.79	-7.9%
				13	\$ 3.27	\$ 2.52	-22.9%	13	\$ 3.27	\$ 2.79	-14.7%

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