

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

**REBUTTAL TESTIMONY
OF
ROGER C. PRESCOTT**

On Behalf Of
MAIL ORDER ASSOCIATION OF AMERICA

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LIST OF WORKPAPER EXHIBITS

<u>ITEM</u> (1)	<u>TITLE</u> (2)
MOAA-LR-1	WP-STDECR-R0621 with MOAA revisions.xls

REBUTTAL TESTIMONY

OF

ROGER C. PRESCOTT

My name is Roger C. Prescott. I am an economist and Executive Vice President of the economic consulting firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke Street, Suite 200, Alexandria, Virginia 22314 and 5901 N. Cicero Avenue, Suite 504, Chicago, Illinois 60646. I am the same Roger C. Prescott who previously submitted Direct Testimony in this proceeding on September 6, 2006 on behalf of the Mail Order Association of America (“MOAA”). My qualifications were attached as Appendix A to my Direct Testimony.

In this proceeding, the rates for Commercial Enhanced Carrier Route (“ECR”) mail at the Basic level as proposed by the United States Postal Service (“USPS”) are shown in Table 1 below:

Table 1
USPS’s Proposed Rates For Commercial ECR Mail - Basic

<u>Item</u>	<u>Amount (cents)</u>	
	<u>Letters</u>	<u>Flats</u>
(1)	(2)	(3)
1. Piece Rated Mail (Per Piece)	23.3	23.3
2. Pound Rated Mail		
a. Per Piece	10.1	10.1
b. Per Pound	64.1	64.1

Source: USPS’s Request in R2006-1, Attachment A, page 19.

1 The USPS has proposed that piece rated Commercial ECR mail, at the Basic level, pay
2 23.3 cents per piece while pound rated Commercial ECR mail at the Basic level, which weighs
3 more than 3.3 ounces, pays 10.1 cents per piece and 64.1 cents per pound. Under the USPS's
4 proposal, the ECR Basic rates for letters and flats are the same.

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I. PURPOSE OF TESTIMONY

In this proceeding, Mr. Robert W. Mitchell (VP-T-1) submitted testimony on behalf of Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. ("Valpak") responding to rates for Standard mail submitted by the USPS. Witness Mitchell states that his testimony attempts to: 1) demonstrate that the cost coverages for Standard Regular mail and Standard ECR mail should be modified; 2) support certain changes submitted by the USPS; and, 3) propose an alternative set of rates for Regular and ECR mail (Mitchell, page 3). As part of his modifications to the USPS's rate structure, Witness Mitchell suggests changes to the base rates and discounts for Regular and ECR mail which are intended to reflect the differences in the shape of the mail (i.e., letters, flats and parcels).

I have been asked by MOAA to evaluate the alternative set of rates presented by Witness Mitchell for ECR mail (item 3 above). In particular, I have been asked to evaluate the impact on rates by incorporating the letter/flat differential that Witness Mitchell proposes for ECR mail entered at the Basic rate level.

Witness Mitchell has recommended "that 100% of the cost difference [between letters and flats] be passed through into rates, at the Basic level, in ECR" (Mitchell, page 178). Witness Mitchell supports this change to the USPS's proposal because, in part, he claims that letters and flats "are for all practical purposes separate products" (Mitchell, page 178). Based on his calculation of the cost differences and his revised coverage ratios, Witness Mitchell recommends

1 the rates for Commercial ECR Basic mail shown in Table 2 below.¹ Table 2 also identifies the
2 differences between the USPS’s proposed rates and the rates proposed by Witness Mitchell.

3 Table 2
4 **Witness Mitchell’s Rates For Commercial ECR Mail - Basic**

5	6	<u>Item</u> (1)	Amount (cents)	
			<u>Letters</u> (2)	<u>Flats</u> (3)
7		<u>Witness Mitchell’s Rates 1/</u>		
8		1. Piece Rated Mail (Per Piece)	18.5	20.8
9		2. Pound Rated Mail		
10		a. Per Piece	3.3	7.6
11		b. Per Pound	64.1	64.1
12		<u>Difference from USPS Proposed Rates 2/</u>		
13		3. Piece Rated Mail (Per Piece)	-4.8	-2.5
14		4. Pound Rated Mail		
15		a. Per Piece	-6.8	-2.5
16		b. Per Pound	0.0	0.0

17 1/ Mitchell (VP-T-1), page 190.
18 2/ Lines 1 and 2 above less the values in Table 1 above.

19 As shown in Table 2 above, Witness Mitchell’s rate for piece rated mail equals 18.5 cents
20 per piece for letters and 20.8 cents per piece for flats (Table 2, line 1). For pound rated mail,
21 Witness Mitchell recommends that the per piece portion of the rates be set at 3.3 cents per piece
22 for letters and 7.6 cents per piece for flats (Table 2, line 2a). The rate per pound suggested by

¹This summary adopts Witness Mitchell’s modification of the coverage ratio for Standard Regular and ECR mail. My testimony does not critique his changes to the overall coverage ratios for the Standard mail subclasses. Witness Mitchell has also proposed rates for ECR Nonprofit mail. With the exception of the impact of his recommendation on the ECR Nonprofit pound rate, my Rebuttal Testimony does not critique his proposal for ECR Nonprofit mail.

1 Witness Mitchell equals 64.1 cents per pound (Table 2, line 2b), the same rate as proposed by
2 the USPS. When compared to the USPS rates, Witness Mitchell's rates for piece rated mail are
3 4.8 cents per piece less for letters and 2.5 cents per piece less for flats (Table 2, line 3). For
4 pound rated mail, Witness Mitchell recommends a decrease of 6.8 cents per piece for letters and
5 2.5 cents per piece for flats (Table 2, line 4a). For the weight portion of the rates for pound rated
6 mail, Witness Mitchell does not change the rate of 64.1 cents per pound proposed by the USPS
7 (Table 2, line 2b and line 4b).

8 The differences between the proposals of the USPS and Witness Mitchell derive from
9 Witness Mitchell's revision to the coverage ratio for ECR mail, the modification of the amount
10 of the discounts proposed by the USPS and his application of his calculated cost differences
11 between letters and flats related to mail processing and delivery costs. I have been requested by
12 MOAA to review the direct testimony, underlying workpapers and interrogatory responses of
13 Witness Mitchell to evaluate the rate differential proposed by Witness Mitchell for letters and
14 flats in ECR mail.² The results of my analyses are summarized under the following topics:

- 15 II. Summary and Conclusions
- 16 III. Historical Calculation of Basic Rates for ECR Mail
- 17 IV. ECR Basic Relationship to Regular 5-Digit Automation
- 18 V. Flaws in Witness Mitchell's Proposal

²Witness Mitchell also proposes a revised rate differential for ECR automation letters and parcels. While much of my critique of his rate differentials for letters and flats is, in general, equally applicable to his calculations for automation letters and parcels, this Rebuttal Testimony addresses the proposed letter/flat changes.

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II. SUMMARY AND CONCLUSIONS

Based on my review and analysis of Witness Mitchell’s proposed rates for Commercial ECR mail at the Basic level, my summary and conclusions include:

1. The adoption of Witness Mitchell’s proposed letter/flat rate differential would disrupt the relationship between the Commercial ECR Basic letter rate and the letter rates in the Standard Regular subclass for 5-digit automation mail. The application of Witness Mitchell’s proposed letter flat differential to the rates shown in USPS’s Witness Keifer’s workpapers would result in a rate for ECR Basic letters that is 0.4 cents per piece lower than the rate for Standard Regular 5-digit automation mail. This would prevent the migration of much, or all, of the mail expected to shift from ECR Basic to Standard Regular and would thwart the USPS’s goal of increasing the amount of automation mail.
2. The cost difference between letters and flats calculated by Witness Mitchell considers only the differences in mail processing and delivery costs. If the Basic rates for letters and flats are to be separated based on costs, then a thorough cost analysis, considering the impact of weight difference between letters and flats on the average costs, needs to be presented. One study relied upon by Witness Mitchell, which does not consider these weight differences, suggests that the total cost difference between ECR letters and ECR flats shows only a small differential in average costs of 0.2 cents per piece.
3. Witness Mitchell’s claim that flats show no contribution to institutional costs is misleading because his claim is based on a study of mail for one specific mailer that reflects only 0.4 percent of the total volume and combines ECR mail with Standard Regular mail. In fact, the study referenced by Witness Mitchell shows that ECR flats and ECR letters both make substantial and nearly equal contributions on a per piece basis to institutional costs.
4. Witness Mitchell’s proposed rate design is flawed because he fails to recognize that part of the cost difference is due to the variation in the average weight between letters and flats. Therefore, any differential between letters and flats must be accompanied by changes in the pound rate.
5. Witness Mitchell’s proposal would create a rate structure for ECR Nonprofit mail that results in a negative per piece rate for high density and saturation mail which weighs more than 3.3 ounces, an obviously unacceptable rate design.

1 **III. HISTORICAL CALCULATION OF BASIC RATES FOR ECR MAIL**

2 The Standard class for mail, with the Standard Regular and ECR subclasses, was
3 established in the MC95-1³ proceeding. In that proceeding, the rates at the ECR Basic level
4 included a differential between letters and flats of 0.5 cents per piece.⁴ Beginning with the R97-
5 1 proceeding,⁵ and in all of the subsequent proceedings, the PRC has accepted a rate structure
6 where letters and flats at the ECR Basic level paid the same rates.⁶ In other words, the rate
7 structure has looked like the format shown in Table 1 above.

8 Since MC95-1, Valpak, through the testimony of Witness Haldi or Witness Mitchell, has
9 advocated for a rate differential or separate rates for ECR letters and flats. For example, in
10 MC95-1, Valpak’s Witness Haldi asserted that the “cost differences between carrier route letters
11 and flats warrants separate rate treatment.”⁷ While the PRC did adopt different rate categories
12 for letters and flats within the ECR subclass, the PRC also noted that “special consideration has
13 been given to the Postal Service’s concern that lower rates for carrier route letter mail will be
14 counterproductive to the Service’s letter mail automation program.”⁸

³PRC Docket No. MC95-1, Mail Classification Schedule, 1995, Classification Reform I, Opinion and Recommended Decision dated January 26, 1996 (“MC95-1”).

⁴MC95-1 Decision, Appendix One, Rate Schedule 321.3.

⁵PRC Docket No. R97-1, Postal Rate and Fee Changes, 1997, Opinion and Recommended Decision dated May 11, 1998 (“R97-1”).

⁶I recognize that, beginning with the MC95-1 decision and all subsequent decisions, letters and flats have paid different rates for mail at the high density and saturation level.

⁷MC95-1 Decision, page V-230.

⁸MC95-1 Decision, page V-238.

1 As recognized in the PRC’s decision in R97-1, the USPS’s objective in eliminating the rate
2 differential between ECR Basic letters and Basic flats was to provide incentive for mailers to enter
3 the letter mail as Basic automation in ECR or 5-digit automation in the Standard Regular subclass
4 (R97-1 Decision, pages 448-449). No additional rationale exists today from what existed at the
5 time of the MC95-1 proceeding which supports a revision to the historically-accepted rate
6 structure where ECR Basic rates are the same for letters and flats.

7 In this current proceeding, Witness Mitchell relies on the PRC’s response to his testimony
8 in R2005-1 as support for changing the rate structure (Mitchell, pages 118-119). While I agree
9 that the PRC’s decision in R2005-1 did acknowledge Valpak’s “thoughtful discussion of why
10 the letter/flat differential should be recognized in Basic ECR rates” (R2005-1 Decision, page
11 137), the PRC’s R2005-1 Decision did not accept Valpak’s arguments and was concerned that
12 the rate structure proposed by Witness Mitchell failed to recognize that costs are affected by
13 weight as well as shape.⁹

14 Additionally, Witness Mitchell entirely ignores the fact that the rate structure of Standard
15 Mail, in which some pieces pay a uniform piece rate, and other pieces pay both a piece and pound
16 rate, complicates the transition from per piece-rated mail to piece plus pound-rated mail. Heavy
17 minimum-per-piece rated mail entered at the maximum weight allowed for the flat rate (3.3 ounces),
18 such as the mail of Valpak, pays the same rate as a mail piece of less than one ounce, i.e., the costs
19 of added weight are not reflected in the rates.

⁹In Section V below, I discuss in detail how Witness Mitchell’s proposal is flawed because, in addition to other problems, he accepted the weight component of the rates as proposed by the USPS.

1 I recognize that the rate structure of Standard Mail has long been in place and it is not my
2 purpose here to suggest that it should be reexamined. Nevertheless, it is pertinent to an evaluation
3 of the Direct Testimony of Witness Mitchell, which addresses only a single element of the Standard
4 Mail rate design with no consideration of the extent to which the issue addressed by him, is intrinsic
5 to the overall rate structure of Standard Mail.

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IV. ECR BASIC RELATIONSHIP TO REGULAR 5-DIGIT AUTOMATION

In his Direct Testimony, Witness Mitchell believes that a rate difference for letters and flats of 2.3 cents per piece should be implemented for ECR Basic rates.¹⁰ Witness Mitchell’s proposed rates, based on the Test Year Before Rates billing determinants and his revised coverage ratios, masks much of the impact of his letter/flat adjustment.

At page 42 of his Direct Testimony, Witness Mitchell asserts that ECR Basic rates for letters are kept high in order to maintain the current relationship between ECR Basic rates and the 5-digit automation rates in the Standard Regular subclass. Witness Mitchell rejects this relationship as a valid concern. While my testimony here does not attempt to critique what the relationship between ECR Basic rates and Standard Regular 5-digit automation rates should be, the impact of Witness Mitchell’s proposed rate structure should be considered and evaluated before his rates are accepted.

In the past, the PRC has followed a process of oversight regarding the rate relationships between the Standard Regular and ECR subclasses. For example, in R2000-1, the PRC stated:

“Additional objectives include creating (or maintaining) appropriate rate relationships, such as ensuring that the 5-digit automation letter rate is lower than the basic ECR letter rate, but higher than the basic ECR automation letter rate; avoiding rate anomalies; providing for more cost-based rates; and achieving results that are reasonable, in terms of an overall perspective” (R2000-1 Decision, pages 338-339).

¹⁰ Witness Mitchell calculates the mail processing and delivery costs for Basic letters at 9.317 cents per piece while his calculation of the cost for Basic flats equals 11.636 cents per piece (Mitchell, pages 178-179). The cost difference claimed by Witness Mitchell equals 2.319 cents per piece or 2.3 cents per piece rounded. As noted at page 180 of his Direct Testimony, Witness Mitchell’s costs are based on utilizing the “PRC Method” for costing. If the USPS’s costs are utilized, as developed by the USPS’s Witness Kiefer, the costs equal 9.51 cents per piece for letters and 11.09 cents per piece for flats, a difference of 1.6 cents per piece.

1 The letter/flat differential proposed by Witness Mitchell in this proceeding would defeat
2 some of the PRC's objectives.¹¹ In the current proceeding, the USPS has stated that setting Basic
3 letter/flat rates at the same level "would best support the Postal Service's goal of promoting
4 automation and sequencing of letters at plants to the extent possible."¹² Witness Mitchell no longer
5 sees any need to maintain this relationship.

6 In order to test the impact of Witness Mitchell's letter/flat differential on Test Year After
7 Rates, I have modified the ECR rate and revenue worksheet submitted by USPS's Witness Kiefer
8 (USPS-T-36) in this proceeding.¹³ For my analysis, I have accepted the ECR discounts for density
9 and dropshipping as proposed by Witness Kiefer as well as his overall revenue requirement for the
10 ECR revenue subclass. My analysis is included with my workpapers as MOAA-LR-1, in a
11 spreadsheet titled "WP-STDECR-R0621 with MOAA revisions.xls." In the spreadsheet, I made
12 several changes to the level titled "Proposed Rates."¹⁴ The Basic rate for letters (cell H25) was
13 adjusted to equal 2.3 cents less than the Basic rate for flats (cell H30). The piece rate for mail
14 weighing greater than 3.3 ounces were all set to equal the rate for origin entered mail (cells M25,
15 N25, M30, N30 and O30). The Basic rates per piece (cells D7 and E7) were adjusted until the
16 required revenues shown by Witness Kiefer (\$5.956 billion) were reached, assuming a 2.3 cent per
17 piece differential were in place. The results of my analysis are summarized in Table 3 below:

¹¹Following Witness Mitchell's "presort tree", the 2.3 cents per piece differential is incorporated into all rate categories for ECR mail.

¹²See response of Witness Kiefer to NAA/USPS-T36-1.

¹³See USPS Library Reference-L-36, spreadsheet WP-STDECR-R0621.xls.

¹⁴For purposes of this analysis, I have accepted the coverage ratio and revenue requirement for ECR mail that Witness Kiefer utilized. My Direct Testimony in this proceeding on behalf of MOAA advocates a reduction in the coverage ratio for ECR mail.

1 Table 3
 2 **Rates for Commercial ECR Mail - Basic**
 3 (TYAR Rates With Letter/Flat Differential)

Item (1)	Amount (cents)	
	Letters (2)	Flats (3)
<u>Revised TYAR Rates 1/</u>		
1. Piece Rated Mail (Per Piece)	21.5	23.8
2. Pound Rated Mail		
a. Per Piece	8.3	10.6
b. Per Pound	64.1	64.1
<u>Difference from USPS Proposed Rates 2/</u>		
3. Piece Rated Mail (Per Piece)	-1.8	0.5
4. Pound Rated Mail		
a. Per Piece	-1.8	0.5
b. Per Pound	0.0	0.0

16 1/ MOAA-LR-1, WP-STDECR-R0621 with MOAA
 17 revisions.xls, level "Proposed Rates".

18 2/ Lines 1 and 2 above less the values in Table 1 above.

19 Based on my analysis, the Basic rate for flats would be increased from 23.3 cents per piece
 20 to 23.8 cents per piece (Table 3, line 1 above) and the per piece portion of the pound rate would
 21 increase from 10.1 cents per piece to 10.6 cents per piece (Table 3, line 2a above). This reflects an
 22 increase of 0.5 cents per piece. For Basic letters, the revised rate equals 21.5 cents per piece and
 23 the piece portion of the pound rate equals 8.3 cents per piece (Table 3, column (2), lines 1 and 2a).
 24 These rates are 1.8 cents per piece less than the rates proposed by the USPS (Table 3, column (2),
 25 line 3 and 4a). Rates set at this level would produce ECR revenues of \$5.974 billion, 0.3 percent
 26 higher than the revenues calculated by Witness Kiefer.

1 The current rate for ECR flats entered at the Basic level equals 20.4 cents per piece. The
2 USPS’s proposed rate in Table 1 above equals 23.3 cents per piece, an increase of 14 percent.
3 Based on Witness Mitchell’s letter/flat rate differential, the ECR flat rate would increase to 23.8
4 cents per piece, an increase of 17 percent. Witness Mitchell’s proposal, therefore, would have a
5 substantial impact on the rates paid by ECR flats.

6 The problem with the rates created by utilizing Witness Mitchell’s letter/flat differential is
7 the resulting relationship between the ECR Basic letter rate and 5-digit automation rate for Standard
8 Regular letters, i.e., the problem addressed in the PRC’s R97-1 and R2000-1 decisions. Witness
9 Kiefer has proposed a 5-digit automation rate for Standard Regular mail of 21.9 cents per piece.
10 Under Witness Kiefer’s proposed rates, the difference between the ECR Basic letters and Standard
11 Regular 5-digit automation rates equaled 1.4 cents per piece (23.3 cents per piece less 21.9 cents
12 per piece).¹⁵ If Witness Mitchell’s proposed letter/flat rate differential is incorporated into Witness
13 Kiefer’s proposed rate structure, ECR Basic letters will pay 21.5 cents per piece, which is 0.4 cents
14 per piece less than the 5-digit automation rate.

15 In my opinion, because of the lower ECR Basic rate, the letter shaped mail paying the 5-digit
16 automation rate in Regular will migrate to ECR or, alternatively, the automation mail that the USPS
17 has assumed will migrate to Standard Regular will not migrate at all. This potential problem was
18 addressed by the USPS when it stated that the “reduction or reversal of the rate differential [between
19 Basic ECR and Standard Regular 5-digit automation letters] would diminish the incentive for
20 mailers to prepare larger trays of 5-digit presorted automation compatible letters that can be directly

¹⁵The rate differential for letters entered at the DBMC and DSCF also equaled 1.4 cents per piece.

1 delivery point sequenced at plants...[which is] less supportive of the Postal Service's letter
2 automation goal..."¹⁶

3 I would note that Witness Mitchell's proposal essentially penalizes flats for a rate problem
4 related to letters. There is no basis to assume that ECR Basic flats do not provide substantial
5 contribution to institutional costs and, in fact, as shown below, evidence exists to show that ECR
6 flats and letters provide for approximately the same level of contribution. Therefore, the rates for
7 ECR flats should not be increased above a level proposed by the USPS in this proceeding.

8 Witness Mitchell also argues that ECR flats and letters are essentially different products
9 (Mitchell, page 178).¹⁷ Under this theory, Witness Mitchell would advocate for a separate mark-up
10 or coverage ratio for ECR letters and flats. Since the establishment of the ECR subclass, the PRC
11 has always combined the letter and flat products in ECR before applying the coverage ratios. In
12 other words, the PRC develops coverage ratios for each subclass, not each rate category. In MC95-
13 1, the PRC rejected the proposition that subclass treatment, and separate markups, can be premised
14 solely on the basis of the cost differences of a particular type of mail.¹⁸ Witness Mitchell has given
15 no reason for the PRC to alter that conclusion.

¹⁶See Witness Kiefer's response to NAA/USPS-T36-13.

¹⁷See also, e.g., Tr. 25/8950.

¹⁸MC95-1 Decision, pages I-2 to I-3 and V-160.

1 **V. FLAWS IN WITNESS MITCHELL’S PROPOSAL**

2 Witness Mitchell has several flaws in his approach to adjusting the ECR rates to reflect
3 the cost differences between letters and flats. Because of these flaws, the PRC should not adopt
4 his proposal for a letter/flat rate differential. My discussion of the flaws in Witness Mitchell’s
5 proposal are addressed under the following topics:

- 6 A. Proper Use of the USPS’s Costs
- 7 B. Contribution for ECR Letters and Flats
- 8 C. Improper Rate Differential for Pound Rated Mail
- 9 D. Impact of Weight on Cost Differences
- 10 E. Anomalies in Witness Mitchell’s Nonprofit Pound Rate
- 11 F. Summary

12 Each issue is discussed below.

13 **A. PROPER USE OF THE USPS’S COSTS**

14 The analysis of mail processing and delivery costs developed by the USPS is designed
15 to calculate the cost differences and discounts related to density. The density discounts are
16 calculated separately for letters and flats, without the consideration of the difference between
17 letters and flats at any particular density level. In other words, the cost analysis for letters is the
18 basis for setting the discounts for high density letter mail and saturation letter mail while the cost
19 analysis for flats is the basis for the discounts for high density flat mail and saturation flat mail.
20 Following the USPS’s rate structure, the discount per piece is the same for piece-rated and
21 pound-rated mail. Neither cost analysis addresses the totality of the cost difference between
22 letter and flat shaped mail.

1 Witness Mitchell asserts that if the other costs in addition to mail processing and delivery
2 costs are considered, the average costs for Basic level mail equal 9.583 cents per piece for letters
3 and 12.518 cents per piece for flats (Mitchell, page 181). This calculation implies an even
4 greater cost differential between letters and flats (2.9 cents per piece) than the cost differential
5 relied upon by Witness Mitchell to calculate his letter/flat rate difference (2.3 cents per piece).
6 Witness Mitchell's analysis is misleading. The library reference relied upon by Witness Mitchell
7 (USPS-LR-L-135), shows only a small differential in average costs of 0.2 cents per piece
8 between letters and flats when all costs are considered.¹⁹ Even this calculation of the letter/flat
9 cost differential is not appropriate for the use that Witness Mitchell intends for two reasons.
10 First, the average costs reflect the average weight for letter and flat mail, i.e., the costs have not
11 been adjusted to reflect that the average flat weighs more than the average letter. Second, the
12 average costs are not solely related to mail entered at the Basic level.

13 In order to develop a rate difference at the ECR Basic level, all of the cost differences
14 between letters and flats must be analyzed. Stated differently, before a separation of the Basic
15 rates can be made, all cost components must be analyzed, not the limited components related to
16 mail processing and delivery costs. Without such an analysis, the PRC has no basis to make a
17 determination of the cost differences related solely to the shape of the mail.

18 **B. CONTRIBUTION FOR ECR LETTERS AND FLATS**

19 Included in the general observations regarding the letter-flat rate differential in his Direct
20 Testimony, Witness Mitchell refers to testimony in MC2005-3²⁰ sponsored by USPS Witness

¹⁹8.4 cents per piece for flats versus 8.2 cents per piece for letters as shown in USPS-LR-L-135, level "unit costs", cells M24 and M25.

²⁰PRC Docket No. MC2005-3, Rates and Service Changes to Implement Baseline Negotiated Service Agreement with Bookspan, ("MC2005-3").

1 Michelle K. Yorgey. Witness Mitchell states that the USPS testimony “shows no contribution from
2 flats, and considerable financial gain from flats converting to letters” (Mitchell, page 117). Witness
3 Mitchell has ignored the underlying data from the study put forth by Witness Yorgey and ignores
4 Valpak’s critique of the USPS’s testimony. Witness Mitchell’s incorrect conclusions regarding
5 MC2005-3 should have no bearing on the determination of the rate levels for ECR mail as it relates
6 to this current proceeding (R2006-1).

7 Witness Mitchell is correct to state that page 9 of Appendix A in Witness Yorgey testimony
8 shows financial gain to USPS from converting flats into letters. The details supporting this
9 conclusion are shown in the earlier pages of that Appendix A. However, Witness Mitchell fails to
10 acknowledge that the revenue and cost study addressed in MC2005-3 is specific to the mail of the
11 company addressed in that proceeding, Bookspan. Specifically, the study only calculates the impact
12 of the shift from flat shaped mail to letter shaped mail for Bookspan’s fiscal year 2004 volumes and
13 revenues. The Bookspan volume for the year analyzed (258 million pieces) equals only 0.4 percent
14 of the total USPS volume for the Standard class of mail (66,169 million pieces).²¹ The results of
15 an analysis of such a small percentage of the total volume should not be the basis for reaching any
16 conclusions regarding the contribution of flat mail in this current proceeding.

17 Witness Mitchell’s contention that USPS receives “no contribution from flats” (Mitchell,
18 page 117) is incorrect because he ignores the fact that the Bookspan study combined mail shipped
19 Standard Regular with mail shipped in ECR. Witness Mitchell ignores the contribution that ECR
20 flats make to the USPS. In the USPS’s study of Bookspan’s mail, the contribution per piece from

²¹MC2005-3, Witness Yorgey, Appendix A, page 5.

1 ECR flats is 7.1 cents per piece while the contribution per piece from ECR letters is 8.2 cents per
2 piece.²² Both shapes of mail make significant contributions to USPS's institutional costs.

3 Also, in the MC2005-3 proceeding, Valpak questioned the validity of Witness Yorgey's
4 study. Valpak argued that the national average costs used by the USPS were incorrect. For
5 example, Valpak's interrogatories to USPS Witness Yorgey filed on September 7, 2005 questioned
6 the development of the costs. The PRC noted Valpak's challenges to the costs used in the USPS
7 study. The PRC also noted in its decision in MC2005-3 that "Valpak argues that looking at
8 disaggregated data in this manner is appropriate because there are variations in unit contributions
9 between flats prepared differently."²³

10 In summary, the study relied upon by Witness Mitchell to support his claim that flats make
11 no contribution to institutional costs actually supports the opposite conclusion. According to the
12 MC2005-3 study, ECR letters and flats both make a substantial contribution to institutional costs
13 and the difference in contribution between ECR flats and letters is only 1.1 cents per piece. Witness
14 Mitchell's reliance on the MC2005-3 cost study also contradicts Valpak's position in that
15 proceeding where Valpak asserted that the cost study was flawed and inappropriate for calculating
16 the cost difference between letters and flats.

17 **C. IMPROPER RATE DIFFERENTIAL FOR POUND RATED MAIL**

18 Witness Mitchell claims that the rate differences between letter and flat shaped mail
19 should reflect the 2.3 cents per piece cost difference that he has calculated. Following his
20 methodology (including his revised coverage ratio and discounts), Witness Mitchell calculated

²²See Witness Yorgey, Appendix A, pages 5 and 6. For ECR letters, the average revenue equals 16.6 cents per piece and an average cost of 8.4 cents per piece. For ECR flats, the average revenue equals 16.9 cents per piece and an average cost of 9.8 cents per piece.

²³See PRC decision in MC2005-3 dated May 10, 2006, page 77.

1 a rate for ECR Basic flats of 20.8 cents per piece. Based on the rate differential of 2.3 cents per
2 piece, he then set the ECR Basic letter rate at 18.5 cents per piece (20.8 cents per piece less 2.3
3 cents per piece).²⁴ Because Witness Mitchell does not adjust the per pound rate for pound-rated
4 mail, Witness Mitchell calculates a per piece rate for flat shaped pound-rated mail of 7.6 cents
5 which reflects the rate designed to make the pound-rated and piece-rated flat rate equal at the
6 breakpoint of 3.3 ounces.²⁵

7 As summarized in Line 2a of Table 2 above, Witness Mitchell proposes a rate of 3.3 cents
8 per piece for ECR Basic pound-rated letter mail. This reflects a rate differential of 4.3 cents per
9 piece (7.6 cents per piece minus 3.3 cents per piece). Witness Mitchell’s calculation is in error.
10 In developing his ECR Basic rates, Witness Mitchell included rates for automation letters which
11 reflected a discount of 2.0 cents per piece. Following his methodology, the automation letter rate
12 equaled 16.5 cents per piece (18.5 cents per piece from Table 2, line 1 above less the proposed
13 discount of 2.0 cents per piece). In order to develop his piece rate for per pound rated ECR
14 Basic letters, Witness Mitchell subtracts his difference of 4.3 cents (Basic flat rate of 20.8 cents
15 per piece less the automation letter rate of 16.5 cents per piece) from his pound rate of 7.6 cents
16 per piece.²⁶ The proper calculation, following Witness Mitchell’s methodology would be to
17 subtract the cost difference of 2.3 cents per piece from the per piece rate for flats of 7.6 cents per
18 piece, resulting in a rate of 5.3 cents per piece for ECR Basic pound-rated letter mail. This error

²⁴See Witness Mitchell’s spreadsheet titled VP-RWM-Workpaper-8.xls, level “inputs”, cells V57 and AA52.

²⁵ $(64.1 \text{ cents per pound} / 16 \text{ ounces} \times 3.3 \text{ ounces} + 7.6 \text{ cents per piece}) = 20.8 \text{ cents per piece.}$

²⁶See Witness Mitchell’s spreadsheet titled VP-RWM-Workpaper-8.xls, level “Comm”, cells G50, G54 and K41.

1 in the per piece rate also flows through to Witness Mitchell’s calculation of the per piece portion
2 of the letter rates for pound rated mail at the High Density and Saturation levels.

3 **D. IMPACT OF WEIGHT ON COST DIFFERENCES**

4 Witness Mitchell is of the opinion “that the studies done to date to estimate the effects
5 of weight on the costs of Standard Mail are indicative but not terribly reliable, then no real basis
6 exists for evaluating the pound charges” (Mitchell, page 182). He also concludes that
7 “[a]djustments in the pound rates should not affect letters” (Mitchell, page 183). Based on these
8 opinions, Witness Mitchell’s proposed rate structure does not adjust the ECR rate per pound
9 proposed by the USPS in this proceeding.

10 While I agree that no study has been presented on the effects of weight on mail, this is
11 another reason why Witness Mitchell’s separation of the Basic rates for letters and flats must be
12 ignored. Contrary to Witness Mitchell’s claim, his failure to make any adjustment to the pound
13 rate does impact the rates for letters.

14 The PRC, in the R2005-1 Decision, recognized that the pound rate included the cost
15 differential between letters and flats was “likely true to some extent” (R2005-1 Decision, page
16 137). Even Valpak, which was advocating a letter/flat differential in R2005-1 as well as in this
17 proceeding, recognized that the pound rate contained some portion of the letter/flat cost
18 differential, although Valpak asserted “the differential might be quite small” (R2005-1 Decision,
19 page 136). The pertinent point for this proceeding is not the magnitude of the cost differential,
20 but simply the fact that Witness Mitchell has ignored this difference in calculating his proposed
21 rates.

22 In R97-1, the same Dr. Haldi that appears on behalf of Valpak in this proceeding was
23 critical of the USPS’s failure to consider the impact of weight when determining the cost

1 differences between flats and parcels.²⁷ The same logic applies to this proceeding where the
2 impact of weight must be considered in determining the cost differential between letters and
3 flats.

4 Witness Mitchell acknowledges that the costs that he has utilized for flats in his analysis
5 (11.636 cents per piece) reflects “flats from 0 to 16 ounces, not just for flats paying the minimum
6 -per-piece rate” (Mitchell, page 179). However, only 56.9 percent of the flat mail pays the
7 minimum per piece rate.²⁸ For letter shaped mail, the percentage of mail paying the minimum
8 per piece equals 98.4 percent.²⁹

9 The average weight of ECR letter mail equals 0.76 ounces while the average weight for
10 ECR flat mail equals 3.28 ounces. ECR flat mail weighs 332 percent more than ECR letter mail.
11 More importantly, for the 43.1 percent of the ECR flat mail that pays based on the pound rates,
12 the average weight is 5.11 ounces, 572 percent greater than the average weight of ECR letter
13 mail.³⁰ According to Witness Mitchell the underlying weight characteristics of ECR letter and
14 flat mail does not support recognition of the impact of weight on costs. I disagree. Before any
15 separation of the ECR rates to recognize the cost differences between letters and flats are
16 established, the full impact of weight on costs must be understood and recognized.

²⁷R97-1 Decision, page 406.

²⁸See Witness Mitchell’s Direct Testimony at page 182 and spreadsheet titled VP-RWM-Workpaper-8.xls, level “TYBR”, cell G241.

²⁹ See Witness Mitchell’s spreadsheet titled VP-RWM-Workpaper-8.xls, level “TYBR”, cell D241.

³⁰The average weight figures I have utilized here are the TYBR values relied upon by Witness Mitchell. See Witness Mitchell’s spreadsheet titled VP-RWM-Workpaper-8.xls, level “TYBR”, cells D244 through D248.

1 **E. ANOMALIES IN WITNESS MITCHELL’S NONPROFIT POUND RATE**

2 The rates proposed by Witness Mitchell create an anomaly for ECR Nonprofit mail. Based
3 on Witness Mitchell’s proposed rate structure, he recommends that the per piece portion of the
4 pound rate should be set at a negative value. For example, Witness Mitchell proposes that the per
5 piece rate for ECR Nonprofit mail equals (-)0.3 cents per piece for High Density mail and (-)1.2
6 cents per piece for Saturation mail (Mitchell, page 191, under “Origin Auto”). While
7 mathematically the per piece portion of the pound rate can be solved knowing the rate for mail
8 weighing less than 3.3 ounces and a given pound rate, the logic of a negative rate should be
9 questioned. The ECR rate schedule has never had a negative rate. Essentially, Witness Mitchell’s
10 approach says that for ECR Nonprofit mail weighing more than 3.3 ounces, you determine the rate
11 by taking the pound rate divided by 16 ounces, multiply that result by the weight of the piece and
12 then subtract an amount from that result. This creates a contradiction with the current procedures
13 and the procedures proposed by the USPS.

14 **F. SUMMARY**

15 The structure of the rates proposed by the USPS in this proceeding, as shown in Table
16 1 above, reflects that letter and flat mail at the Basic level pay the same rate. No reason exists
17 to change the rate structure for mail at the Basic level to reflect the impact of shape as proposed
18 by Witness Mitchell. In addition, no testimony has been presented in this proceeding to properly
19 modify the pound rate if such a letter/flat rate differential were adopted by the PRC. The
20 problems in Witness Mitchell’s analysis related to the letter/flat differential cannot be ignored.
21 Letters and flats at the ECR Basic level should pay the same rate.