

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

POSTAL RATE AND FEE CHANGES  
PURSUANT TO PUBLIC LAW 108-18

Docket No. R2005-1

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO  
PRESIDING OFFICER'S INFORMATION REQUEST NO. 3  
(QUESTIONS 3(c)-(d), 4-7)  
(May 13, 2005)

The United States Postal Service hereby provides the responses to Presiding Officer's Information Request No. 3 Questions 3(c)-(d), 4-7, issued April 29, 2005. The responses to Questions 1, 2, and 3(a)-(b) are forthcoming.

Each question is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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POIR NO. 3, QUESTION 3(c)

3. Tables 3A to 3E show the development of passthrough percentages for all Standard Mail discounts based on the Postal Service's proposed rates. Tables 3A to 3D show the avoidable mail processing and delivery costs. Table 3E shows the avoidable cross docking and transportation cost. All costs reflect the Commission's methodology used in Docket No. R2001-1, as presented by the Postal Service in the current docket.

(c) Table 3C, lines 16 and 17, column 1 shows that the mail processing unit cost for a Basic ECR letter is greater than the mail processing unit cost for a Basic ECR nonletter. Please explain the reason for this counterintuitive result.

**RESPONSE:**

There are several reasons why the mail processing unit cost of Basic ECR letters (non-automation rate) is greater than that of Basic ECR nonletters. First, Basic ECR letters are often captured at and/or backhauled to the plant for DPS processing. Delivery units work closely with plants to identify machinable ECR letter bundles and trays to incorporate these pieces into the DPS mail stream. This additional distribution step at the plant, along with accompanying allied labor activities, increases mail processing costs of ECR letters relative to nonletters, all other things being equal.

In contrast, Basic ECR nonletters are not generally incorporated into plants' distribution mail streams, with the exception of pieces from broken bundles. As such, a greater proportion of Basic ECR nonletter costs arise from manual distribution and allied labor operations than do Basic ECR letter costs, since DPS is an automated process. Because the equipment- and space-related costs are lower for manual distribution operations than for automated distribution operations, a higher effective piggyback factor is applied to letters, which amplifies unit labor cost differences.

Also, the Standard Mail rate structure for letters encourages customers to prepare mail to qualify for automation rates (either 5-Digit presort or Auto Carrier Route), versus Basic ECR, when possible. This may lead the remaining Basic ECR

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letters to have higher cost characteristics such as being physically non-machinable or lacking the necessary address elements to enable the application of a barcode. As of FY 2004, there were 2.5 billion fewer pieces of Basic ECR letters than in FY 2000, a decrease of 58 percent (compare volumes in LR-J-83 and LR-K-107). Please note that mail processing costs for Basic ECR letters have fallen, though not in proportion to the volume decline.

Finally, it is important to note that when Basic ECR automation and non-automation letters are combined, the resulting unit mail processing cost is below the Basic ECR nonletter cost. The Postal Service expects to consider alternative methods for disaggregating ECR letter costs prior to the filing of the next omnibus case.

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3. Tables 3A to 3E show the development of passthrough percentages for all Standard Mail discounts based on the Postal Service's proposed rates. Tables 3A to 3D show the avoidable mail processing and delivery costs. Table 3E shows the avoidable cross docking and transportation cost. All costs reflect the Commission's methodology used in Docket No. R2001-1, as presented by the Postal Service in the current docket.

(d) Table 3C, lines 16 and 17, column 2, shows that the delivery unit cost for Basic ECR letter is substantially larger than the delivery unit cost for a Basic ECR nonletter. Please explain the reason for this counterintuitive result.

**RESPONSE:**

First, the 6.152 cent delivery unit cost reported in Table 3C of this POIR for Basic ECR Nonletters is incorrect. 6.152 equals the unit cost for Basic ECR Flats. The delivery unit cost for Basic ECR Nonletters is 6.173 cents, as shown in cell O103 of 'Summary TY'.

The reason the corresponding 9.694-cent delivery unit cost for ECR Basic Letters is so much higher is the way that the 'Rural Crosswalk' worksheet in LR-K-101 allocates total BY 2004 Rural Carrier Cost System (RCCS) volumes across shapes. Cell C25 in 'Rural Crosswalk' reallocates 1,395,586,000 RCCS ECR flats to ECR letters, based on the 'RCCS EVAL' analysis. These 1,395,586,000 reallocated flats account for over 29% of the original RCCS ECR total. Moreover, all 1,395,586,000 flats are reallocated to ECR Basic Auto letters and ECR Basic letters. Cell C39 in 'Rural Crosswalk' shows that this reallocation causes a corresponding reallocation of \$72,417,000 in rural ECR Basic flats delivery costs to ECR letters. Furthermore, of this \$72,417,000, \$19,193,000 is allocated to ECR Basic Auto, and \$53,224,000 to ECR Basic.

To facilitate the understanding of the effect of this reallocation done in "LR-K-101.xls", 'Rural Crosswalk', the attached workbook called "LR-K-101.No,ECR.Crosswalk.xls" calculates the unit delivery costs without the Rural

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Crosswalk performed in "LR-K-101.xls". The cells that changed are shaded in each of the worksheets within the workbook "LR-K-101.No,ECR.Crosswalk.xls".

Cell B51 in the 'Rural Crosswalk' sheet of the attached file "LR-K-101-No-ECR-Crosswalk.xls" shows that without this \$72,417,000 reallocation, the letter percentage of total rural ECR volume would equal only 24.1%, instead of the 41.5% that cell B51 in the current "LR-K-101.xls" 'Rural Crosswalk' calculates for ECR Letters. In addition, the flats percentage of this total would equal 75.9%, instead of 58.5%. These 24.1% and 75.9% allocations would, in turn, cause the BY 2004 total rural ECR Basic Letters cost to fall from the \$87,820,000 that "LR-K-101.xls" calculates in cell J87 of 'Summary BY', to the \$56,139,000 that "LR-K-101-No-ECR-Crosswalk.xls" calculates in cell J87 of its 'Summary BY'. They would also cause the BY 2004 total rural ECR Basic Nonletters cost to increase from the \$158,097,000 in cell J102 of "LR-K-101.xls", 'Summary BY', to \$279,742,000 in cell J102 of the "LR-K-101-No-ECR-Crosswalk.xls", 'Summary BY'. The piggyback-inflated rural ECR Basic letters unit cost would likewise fall, from 5.324 cents currently in cell N87, to 3.403 cents; the piggyback-inflated rural ECR Basic Nonletters unit cost would also increase, from 1.465 cents currently in cell N102, to 2.592 cents. Moreover, at these new rural delivery unit costs, the total BY 2004 city **plus** rural ECR Basic Letters unit cost would fall to 6.861 cents, and the corresponding ECR Basic Nonletters unit cost would increase to 6.334 cents. Finally, since the TY 2006 ECR Letter and Nonletter total unit delivery costs maintain the same proportional relationship to one another as do the BY 2004 Letter and Nonletter unit costs, the new TY 2006 unit costs would likewise be only slightly higher for ECR Basic Letters, specifically, 7.856 cents, than for ECR Basic Nonletters, namely 7.313 cents.

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'Summary BY' in "LR-K-101-No-ECR-Crosswalk.xls" also shows why the rural ECR Basic Letters unit cost continues to still marginally exceed the rural ECR Basic Nonletters unit cost, even though the rural ECR flats that "LR-K-101.xls", 'Rural Crosswalk' moved into letters are now moved back into flats. This remaining small excess occurs because the ratio of the RCCS ECR Basic Letters over the Permit-Volume ECR Basic Letters in "LR-K-101-No-ECR-Crosswalk.xls", 'Summary BY' equals 0.855, as shown in cell S87, whereas the corresponding ratio of RCCS ECR Basic Nonletters over Permit-Volume ECR Basic Nonletters equals only 0.449, as shown in cell S102. To further illustrate this point, cells T87 and T102 show that, at 3.981 cents, the rural ECR Basic Letter cost per delivered piece – that is, per RCCS piece – **is**, as expected, substantially lower than the 5.767-cent rural ECR Basic Nonletter cost per RCCS piece.

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POIR NO. 3, QUESTION 4(a)

4. Tables 4A, 4B, and 4C depict the calculated passthroughs, using the PRC costing methodology reflected in Docket No. R2001-1, for Parcel Post, Bound Printed Matter (BPM), and Media Mail/Library Rate (Media), respectively. The passthroughs were calculated using the avoided costs found in the Postal Service's version of PRC Parcel cost models, USPS-LR-K-103.

(a) Please confirm the avoidable unit costs, discounts, and percentage passthroughs shown in Tables 4A to 4C. Please provide corrections as appropriate.

**RESPONSE:**

(a) The avoidable unit costs, discounts (and surcharges) and percentage passthroughs shown in Tables 4A to 4C are confirmed with the following exceptions and qualifications:

- The citation in note 1 of Table 4A is not correct. It should read USPS-LR-K-103.
- The DSCF (3-digit) Nonmachinable Surcharge Cost Avoided is not correct. It should be calculated as the difference between the unit cost of a DSCF 3-digit sorted NMO and the weighted average unit cost of a DSCF piece. Calculated in this way, the avoided cost is \$1.35. The passthrough then becomes 85%. Note 4 should then be adjusted accordingly.
- The BPM Costs Avoided, Proposed Discounts (and shape differential), and Calculated Passthroughs shown in Table 4B only reflect the per-piece elements of the cost and rate differentials shown in the table. The drop-shipment discounts also have per-pound components. The title to Table 4B should be modified to include "Per-Piece Elements Only."

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- BPM rates, discounts and differentials are customarily rounded to tenths of a cent. The Costs Avoided and Proposed Discounts in Table 4B are rounded to whole cents. This causes some slight discrepancies in the Calculated Passthroughs compared to the passthroughs that would have been calculated if the avoided costs and proposed discounts were both rounded to tenths of a cent before the passthrough calculation. Specifically, 58% would become 59%, 46% would become 45% and 103% would become 104%.

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POIR NO. 3, QUESTION 4(b)

4. Tables 4A, 4B, and 4C depict the calculated passthroughs, using the PRC costing methodology reflected in Docket No. R2001-1, for Parcel Post, Bound Printed Matter (BPM), and Media Mail/Library Rate (Media), respectively. The passthroughs were calculated using the avoided costs found in the Postal Service's version of PRC Parcel cost models, USPS-LR-K-103.

(b) Please provide cost avoidance calculations, using the PRC methodology reflected in Docket No. R2001-1, for Parcel Return Service (PRS) mail, and provide the calculated passthroughs for PRS.

**RESPONSE:**

A fuller explanation of the way we treated PRS should have been provided in my original testimony. The following discussion should remedy that omission.

Since PRS volumes, revenues and costs are included in the Base Year totals, PRS had to be addressed one way or another in the Postal Service's Test Year projections. The PRS experiment will expire less than three weeks into the Test Year. At present, the Postal Service is still collecting and evaluating data from the experiment and I am informed that the Postal Service has made no decision on whether to request an extension of the experiment and file for a permanent classification or not. With that background, the Postal Service faced several possible treatments for PRS:

- The Postal Service could have eliminated PRS volumes, costs and revenues from Test Year projections. But this could have unnecessarily alarmed PRS customers, who might have viewed it as demonstrating a lack of commitment to PRS on the Postal Service's part.
- The Postal Service could have assumed that PRS would continue into the Test Year at its current rates. This treatment would have effectively increased the PRS discounts significantly. In turn, this could have led the Commission and other interested parties (for example, our Package

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Services competitors) to question whether the Postal Service was intentionally using the current rate case to increase the discounts more than proportionately without offering any cost studies or other demonstrations that such increases were appropriate.

- The Postal Service could project PRS revenues into the Test Year assuming PRS rates were increased by the uniform 5.4% increase that other mail services received. In the end, this choice was the most appealing, since it represented the most neutral pricing assumption and had the least potential to send out false signals regarding the Postal Service's intentions.

As I noted previously, the PRS experiment will expire in October of 2005. The Postal Service must request a permanent classification for PRS before then to keep the experiment running. I am informed that the Postal Service is still in the data collection phase of the experiment and has not done any new cost studies. It will soon begin evaluating the information it has been collecting and expects to have sufficient analyses completed in time to determine the best course of action before the term of the experiment expires.

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4. Tables 4A, 4B, and 4C depict the calculated passthroughs, using the PRC costing methodology reflected in Docket No. R2001-1, for Parcel Post, Bound Printed Matter (BPM), and Media Mail/Library Rate (Media), respectively. The passthroughs were calculated using the avoided costs found in the Postal Service's version of PRC Parcel cost models, USPS-LR-K-103.

(c) The cost avoidance for barcoded mail in Parcel Post was used as a proxy for the cost avoidance in BPM and Media Mail. Please confirm that a separate barcode cost avoidance was not calculated for BPM or Media and explain why the Parcel Post cost avoidance is a reasonable proxy.

**RESPONSE:**

(c) Confirmed. The Parcel Post barcode cost avoidance analysis is very limited in scope and reflects the tasks required for a Primary Parcel Sorting Machine (PPSM) clerk to key the 5-digit ZIP Code for a parcel-shaped mail piece. Given that Parcel Post, Bound Printed Matter, and Media Mail parcels are all processed on the PPSM, the use of this proxy is reasonable.

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POIR NO. 3, QUESTION 5

5. Please provide the SAS output logs for MODS, NONMODS, BMC, and Other in LR-K-100.

**RESPONSE:**

LR-K-100 does not list the SAS logs separately for MODS, NONMODS, BMC and OTHER as LR-K-82 did in Docket No. R2001-1. This is because the SAS programs in LR-K-100 are executed in one data processing stream which combines the four data processing streams for MODS, NONMODS, BMC and OTHER shown in LR-K-82. The SAS logs from this one data processing stream are contained in zipped format in the SAS Logs directory of the diskette originally provided with LR-K-100. The SAS logs for MODS, NONMODS, BMC, and OTHER can be extracted from the SAS logs in LR-K-100. The order in which the programs are executed is listed in the JCL.rtf file. The SAS logs for MODS start with program MOD1POOL through programs M5ALLIED and MODSHAPE; those for nonMODS start with program NONMOD1 through programs N5ALLIED and NMDSHAPE; those for BMC start with program BMC1 through programs B5ALLIED and BMSHAPE; and those for OTHER start with program ADMWIN through the remaining programs listed in the JCL.rtf file.

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POIR NO. 3, QUESTION 6

6. Postal Service witness McCrery states, in connection with Periodicals, that the Postal Service is “aggressively exploring” options to reduce dependency on sacks. These include, among others, adjusting the pallet preparation minimums; allowing the entry of smaller, local mailings at destination facilities in alternate containers or by unloading bundles straight into a container (such as rolling stock or a pallet box); and non-sack alternatives for the preparation of origin-entered sacks (such as tubs and origin mixed pallets). USPS-T-29 at 23; USPS-LR-K-49 at 20.

Please provide information on the manner in which the Service is exploring the referenced options, such as conducting studies or surveys, working with Mailers Technical Advisory Committee groups, or seeking affected mailers’ input via other steps, as well as anticipated timetables for action.

**RESPONSE:**

The Postal Service has solicited feedback from both postal field operations and various industry stakeholders during the identification, development, and implementation of many of the referenced options. For example, all of the referenced options have been or will be topics of discussion at both the Periodicals Operations Advisory Committee and MTAC Flat Mail Preparation Optimization meetings. There have also been informal discussions with representative associations to identify additional opportunities for Periodicals. The expectation is that these discussions will be ongoing as our mutual interest to lower the cost of Periodicals remains at a high level.

Many of the options are considered to be obvious opportunities for cost reductions by moving mail closer to destination, increasing the use of automated equipment for piece distribution, and reducing the use of sacks within both the customer preparation and postal processing of Periodicals. As far as the specific timetables are concerned, the consolidation of the outgoing bundle and piece distribution is already underway, with the required mailer compliance for labeling by mid-May, 2005. For the increased emphasis on the use of automated equipment for the piece distribution of

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Periodicals, this has been an ongoing effort but additional directives will be issued within the next 30 days to focus additional attention. Finally, the effort to reduce sacks is also ongoing with a recent change that allows the entry of bundles of Periodicals into delivery units outside of sacks. Furthermore, a Postal Bulletin notice allowing greater flexibility on the required minimum pallet weight for flat mail entered at destination is expected to be published within the next two weeks. This will be followed shortly thereafter with notices requiring lower weight pallets in certain situations and eliminating the preparation of less than minimum sacks in most situations, both with the certain result of reducing the number of Periodicals sacks.

Benefits are already being realized through local exceptions that are consistent with these initiatives. For example, a newspaper publisher in the Northeast has significantly reduced the dependency on sacks by using alternate containerization when presenting their flats at processing facilities.

Finally, additional changes to allow flats to be entered into plants out of sacks and the preparation of flats in tubs or on mixed (residual) pallets are still under investigation for possible future implementation.

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POIR NO. 3, QUESTION 7

7. Postal Service witness McCrery states, in connection with Periodicals mail, that “We are studying how to reduce bundle breakage both by improving our specifications for forming bundles and by improving bundle handling.” USPS-T-29 at 28. Please provide information on what referenced measures are underway, or have been completed in the last three years, including anticipated timetables for action.

**RESPONSE:**

Over the last three years, an MTAC workgroup was formed to address mail preparation irregularities, with a focus on bundle breakage. From the workgroup, a system was developed and implemented called Electronic Mail Improvement Reporting (eMIR). This system was designed to address a concern of the industry participants that the information regarding their bundle integrity problems was not consistently communicated back to the mail preparer/owner. The new electronic system, which replaced the old manual process, addresses this issue and provides a great deal more information for use in fixing the problem and includes levels of accountability to ensure that necessary action is taken.

Over the next several months, a concerted effort will be undertaken to “blitz” the issue of bundle breakage through the eMIR process. Dedicated resources will be established at 30 to 35 facilities in order to identify and collect information on bundle integrity problems. The specifics of each problem (e.g. mail piece characteristics, mail preparation characteristics (sacks vs. pallets), bundle securing method, volume affected, digital photos, etc.) will be input into eMIR. Not only will there be an expectation for improvements, but the data will be used as a baseline for the problems, and will help to focus attention on specific mail preparation and postal handling processes.

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In addition, we are in the process of considering changes to our mailing standards as they relate to bundle preparation. These changes would strengthen the language related to the acceptable level of integrity and include additional requirements around the preparation of certain bundles. For example, thin bundles, which are currently required to only be single-strapped, are almost certain to be addressed. These changes should be finalized and published within the next two months.

Also, within the next two months, a communications campaign will be undertaken to educate mailers, in particular smaller mailers, of the importance of bundle integrity. The smaller volume segment is not likely a participant in Mailers Technical Advisory Committee groups nor the recipient of information through trade associations. Posters, brochures, and videos will be distributed to customers through business mail acceptance channels, which are often the only points of contact with the Postal Service for these customers.

Finally, the shift of bundled flats from sacks to pallets as described in Question 6 will in itself improve bundle integrity. This is because the bundle breakage rate is substantially lower for palletized mail as compared to sacked mail.