USPS-T-33

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

POSTAL RATE AND FEE CHANGES, 2001

Docket No. R2001–1

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

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USPS-LR-J-120	Parcel Post and Special Services Final Cost Adjustments for Delivery Confirmation

AUTOBIOGRAPHICAL SKETCH

My name is James M. Kiefer. I am an Economist in Pricing and Classification, United States Postal Service. Since joining the Postal Service in 1998, I have worked on issues related to Package Services, Special Services, nonletter-size Business Reply Mail, and other pricing issues.

Prior to joining the Postal Service I worked for the Vermont Department of Public Service, first as Power Cost Analyst, and later as Planning Econometrician, where I investigated utility costs, rates, load forecasts and long-term plans. I also developed long range electric generation expansion plans for the State, performed economic impact studies, and contributed to a long-term energy use plan for Vermont. I have testified as an expert witness before the Vermont Public Service Board on many occasions on economic issues involving cost of power, generation expansion plans, least cost integrated planning, load forecasts, and electric utility rates.

Before working in Vermont, I was a Principal Analyst with the Congressional Budget Office. Past work experience also includes work with the U.S. Department of Commerce and work in production management in private industry.

I earned a BA in Chemistry from the Johns Hopkins University and an MBA from Rutgers University, and an MA degree in International Relations from the Nitze School of Advanced International Studies. I then returned to Johns Hopkins in Baltimore to study Economics where I earned further graduate degrees in 1983 and 1986.

I have testified before the Postal Rate Commission previously in Docket No. MC99-1, Docket No. MC99-2, and Docket No. R2000-1.

I. PURPOSE AND SCOPE OF TESTIMONY

My testimony presents the Postal Service's pricing and classification change proposals for Package Services mail: Parcel Post (including Parcel Select), Bound Printed Matter, Media Mail and Library Mail.[1] My testimony will describe these four mail subclasses, discuss their rate and volume histories, describe the design of the new rate and classification changes, and discuss the financial impacts of my proposals.

Accompanying my testimony is Library Reference USPS-LR-J-106. This library reference consists of electronic and paper versions of my workpapers. I also sponsor Library References USPS-LR-J-115 and USPS-LR-J-120. Chapter II of my testimony describes all of these library references and states how they relate to my testimony and the testimony of other witnesses.

In developing my testimony I have relied on the testimony and work of several other witnesses. These witnesses are identified in my testimony. Detailed citations to their testimonies, workpapers, and library references are provided in the notes accompanying my workpapers.

[1] Package Services mail typically consists of parcels containing merchandise. It is also used to mail heavy catalogs and directories. Any mailable matter not required to be sent as First-Class Mail, or that is entered as Periodicals, can be sent via one or more of the Package Services rates.

II. LIBRARY REFERENCES

As part of my testimony I am sponsoring the following library references: USPS-LR-J-106, USPS-LR-J-115, and USPS-LR-J-120. The following sections describe each of these library references and state how they relate to this case.

A. USPS-LR-J-106

This library reference consists of paper and electronic versions of my workpapers. I created these workpapers to produce my rate proposals for Package Services rates. Organizationally, I have divided my workpapers into three primary sets of workpapers and four supplemental workpapers. The supplemental workpapers develop some basic inputs that are used in the primary workpapers to produce my rate proposals. In this section I describe each set of workpapers.

1. Parcel Post Workpapers

This set of workpapers consists of 31 workpapers (labeled WP-PP-1 to WP-PP-31) plus a table of contents. These workpapers contain the fundamental input assumptions and the calculations I employed to allocate Parcel Post costs; to develop per-piece and per-pound costs for each Parcel Post rate category; to mark up these cost elements to produce preliminary rates; and to adjust these preliminary rates to produce my proposed rates.

2. Bound Printed Matter Workpapers

This set of workpapers consists of 28 workpapers (labeled WP-BPM-1 to WP-BPM-28) plus a table of contents. These workpapers contain the fundamental input assumptions and the calculations I employed to allocate Bound Printed Matter costs; to develop per-piece and per-pound costs for each

Bound Printed Matter rate category; to mark up these cost elements to produce preliminary rates; and to adjust these preliminary rates to produce my proposed rates.

3. Media Mail/Library Mail Workpapers

This set of workpapers consists of 15 workpapers (labeled WP-MM-1 to WP-MM-15) plus a table of contents. These workpapers contain the fundamental input assumptions and the calculations I employed to allocate Media Mail and Library Mail costs; to develop per-piece and per-pound costs for each Media Mail and Library Mail rate category; to mark up these cost elements to produce preliminary rates; and to adjust these preliminary rates to produce my proposed rates.

4. Supplemental Workpaper 1

This set of workpapers consists of 5 workpapers (labeled SWP1-1 to SWP1-5) plus a table of contents. This set of workpapers is used to adjust the Parcel Post FY 2000 Billing Determinants for Parcel Select to incorporate the results of a study that developed separate weight profiles for DBMC Zones 1&2, DSCF, and DDU. The unadjusted billing determinants assume that all three components of Parcel Select have the same weight profile in the close-in zones.

This supplemental workpaper relies on FY 2000 Billing Determinants plus the Parcel Post weight study contained in Library Reference USPS-LR-J-113. It produces adjusted Parcel Select Base Year Billing Determinants which are incorporated in my Parcel Post workpapers as WP-PP-6.

5. Supplemental Workpaper 2

This set consists of a single workpaper, labeled SWP2-1. It is used to develop the estimated shares of Bound Printed Matter flats that are expected to

use the new flats rate and flats barcode discount. The workpaper uses data from Library Reference USPS-LR-J-112 to calculate flats shares. The shares are incorporated in my Bound Printed Matter workpapers as input assumptions in workpaper WP-BPM-1.

6. Supplemental Workpaper 3

This set consists of a single workpaper, labeled SWP3-1. It is used to develop the shares of Bound Printed Matter drop shipped as DBMC, DSCF, and DDU. The workpaper uses RPW data plus data from a Bound Printed Matter mail characteristics study to estimate these shares. The shares are incorporated in my Bound Printed Matter workpapers as input assumptions in workpaper WP-BPM-1.

7. Supplemental Workpaper 4

This set consists of a single workpaper, labeled SWP4-1. This workpaper calculates the Parcel Post pickup revenue and shares of On-Call and Scheduled pickups for Parcel Post from volume and revenue data. The workpaper's outputs are incorporated in my Parcel Post workpapers as input assumptions in workpaper WP-PP-1.

B. USPS-LR-J-115

This library reference was prepared at my request to derive the one- and two-pound volume shares for Parcel Post to allow me to develop separate one- and two-pound rates for all Parcel Post rate categories.

C. USPS-LR-J-120

This library reference calculates the Test Year after-rates (TYAR) final cost adjustments to Parcel Post costs and Special Services costs arising from making no-fee Delivery Confirmation available to Parcel Select.

I produced Library Reference USPS-LR-J-120, which consists of a single worksheet. The details of the calculations are described in the documenting notes that accompany the worksheet.

The worksheet uses input data from witnesses Nieto (USPS-T-26), and Tolley (USPS-T-7) to calculate cost adjustments; it also calculates TYAR Delivery Confirmation volume for Parcel Select. Witnesses Patelunas (USPS-T-12) and Kay (USPS-T-21) use the cost adjustments. Witness Mayo (USPS-T-36) uses the volume and volume-share projections for Delivery Confirmation used by Parcel Select and other Package Services mail that are reported in the worksheet.

III. SUMMARY OF PROPOSED RATE AND CLASSIFICATION CHANGES

A. Parcel Post

The Postal Service proposes an average increase in Parcel Post of 6.5 percent, with a corresponding cost coverage of 116 percent. Measured using the same volume mix before and after the rate change, the rate increase is 10.0 percent.[2]

Under this rate proposal, on average, Inter-BMC Parcel Post rates would increase 17.2 percent, Intra-BMC rates would increase 18.1 percent, and Parcel Select rates would increase 4.8 percent. Within Parcel Select, average DBMC rates would change by 9.6 percent, DSCF rates -1.2 percent and DDU rates -3.1 percent. The rate changes for DBMC and DSCF are adjusted to remove the impacts of a proposed classification change that would permit mailers to enter nonmachinable parcels at DSCFs if presorted to 3-digit ZIP Codes. A significant number of nonmachinable parcels are expected to migrate from the DBMC rate category to DSCF in response to this classification change. This migration has the effect of lowering the average DBMC rate and increasing the DSCF rate. Including the impacts of the migrating parcels, DBMC's average rate would go up by 8.5 percent and DSCF's rate by 16.0 percent.[3]

In addition to the new DSCF rate, the Postal Service is also proposing a separate one-pound rate for all Parcel Post rate categories, and no-fee Delivery Confirmation for Parcel Select.

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[2] This calculation incorporates the migration of nonmachinable parcels from DBMC to DSCF in response to the new 3-Digit DSCF rate discussed in the next paragraph.

[3] Despite the amount they push up the average DSCF rate, these migrating nonmachinable parcels would still face significantly lower rates than if they had remained as DBMC parcels.

B. Bound Printed Matter

The Postal Service proposes an average increase of 9.1 percent for Bound Printed Matter (BPM), yielding a cost coverage of 128 percent. New initiatives include separating the rates for flats and parcels/irregular pieces, and offering automatable flats a barcode discount. The existing three-cent barcode discount for machinable parcels will be retained. The structure of discounts for drop-shipped mail is maintained, with increased passthroughs of estimated cost savings. The Carrier Route Presort discount is maintained at its present level, a passthrough of 116 percent of estimated cost savings.

C. Media Mail and Library Mail

The Postal Service proposes to increase Media Mail rates by 4.0 percent and Library Mail rates by 3.3 percent, with a cost coverage of 115 percent for the consolidated Media Mail-Library Mail product.[4] The Postal Service is also proposing to replace the existing BMC Presort level with a Basic Presort level, and to eliminate the requirement for separate 500 piece mailings to be eligible for both levels of presort discounts. Under the Postal Service's proposal, single mailings of 300 properly prepared and entered Media Mail pieces or Library Mail pieces will be eligible to take advantage of both discounts.

[4] Media Mail and Library Mail costs are only available on a consolidated basis. Hence the cost coverage can only be calculated for the combined products.

IV. PARCEL POST

A. Product Description

Parcel Post is any Package Services mail that is not mailed as Bound Printed Matter, Media Mail or Library Mail. It may weigh up to 70 pounds and be up to 130 inches in combined length plus girth. Any Package Services mail may be mailed at Parcel Post rates.

The Parcel Post subclass consists of two basic retail rate categories and three drop-shipped rate categories. The latter are known collectively as Parcel Select. Which retail rate category is applicable depends on whether or not both the origin and destination of the parcel lie within the service territory of the same Bulk Mail Center (BMC) or auxiliary service facility (ASF). Which Parcel Select rates are applicable depends on whether the mail is deposited at the destination BMC or ASF (DBMC), the destination sectional center facility (DSCF), or the destination delivery unit (DDU). The following section describes the rate and volume history of Parcel Post, including a description of the current rate structure.

B. Rate and Volume History

1. Rates and Rate Design

The current rate structure has evolved significantly since Postal Reorganization. When the Postal Service was established, Parcel Post rates consisted of a single schedule of rates that varied by weight from two pounds to 70 pounds. The rate schedule also had eight zones plus a local zone to reflect the distance between the parcel's origin 3-digit ZIP-Code area and its destination 3-digit ZIP-Code area. The original rates also contained a separate "balloon rate" (as do current rates), charged for parcels with large physical dimensions but

low weight. The detailed history of Parcel Post rates from Postal Reorganization to the present is contained in Library Reference USPS-LR-J-90.

Docket No. R80-1 introduced two significant modifications to the Parcel Post rate design. These changes represented the first steps in an ongoing process of restructuring rates to better align them with cost causation. These two changes were:

- Separate rates were introduced for Intra-BMC parcels (those that originated and destinated within the same BMC or ASF service area), and Inter-BMC parcels (those that had to travel between BMCs).
- Separate, lower, rates were introduced for Inter-BMC parcels that were capable of being processed on the Postal Service's parcel sorting equipment.

Originally, the rate difference between Intra-BMC and Inter-BMC parcels consisted of a flat 14 cents per piece, and the difference between the machinable and nonmachinable Inter-BMC parcels was set at 50 cents. Docket No. R80-1 also eliminated the balloon rate.

This basic rate design continued until Docket No. R90-1 when the Postal Service introduced Parcel Post's first drop-ship discount. Bulk mailings of at least 50 properly prepared parcels entered at the DBMC or destination ASF were eligible for a further discount off the Intra-BMC rates. The DBMC rates became popular with mailers and, in Docket No. R97-1, the Postal Service introduced two further drop-ship discounts for bulk mailings entered at the DSCF and DDU. In Docket No. R2000-1, the Postal Service named the DBMC, DSCF and DDU rate categories Parcel Select, to distinguish these commercial rate categories from the "retail" categories: Inter-BMC and Intra-BMC Parcel Post.

In addition to expanding Parcel Post drop-ship rate categories, Docket No. R97-1 also introduced or re-introduced the following additional rate elements:

- *OBMC (Origin BMC) discount*. This discount is available to mailings of at least 50 properly prepared Inter-BMC parcels that are sorted to destination BMCs and entered at a BMC that is not the destination BMC.
- *BMC presort discount*. This discount is available to mailings of at least 50 properly prepared Inter-BMC parcels that are sorted to destination BMCs, but not entered at a BMC.
- *Barcode discount*. This discount is available to properly prepared parcels bearing a barcode with the correct destination ZIP Code that are part of a mailing of at least 50 Parcel Post pieces. It is only available to parcels that are normally processed on the Postal Service's parcel sorting equipment.
- *Balloon rate*. This rate was re-introduced in Docket No. R97-1. Parcels having a combined length plus girth that exceed 84 inches but that weigh less than 15 pounds are charged the applicable rates for 15 pound parcels.
- *Oversized rate*. The maximum dimension for parcels was increased from 108 inches (length plus girth) to 130 inches. Parcels that fall between the old and new size limits are charged a flat oversized rate, regardless of weight.

Docket No. R2000-1 retained these new rate elements and added two new surcharges for mail that could not be processed on Postal Service parcel sorting equipment. In addition to the existing surcharge for nonmachinable Inter-BMC parcels that had existed since Docket No. R80-1, similar surcharges were established for Intra-BMC and DBMC nonmachinable parcels. The Postal

Service also sought and obtained an elimination of the lower weight limit for Parcel Post, though no new rate was established for parcels weighing one pound or less.

2. Volumes

For almost two decades after Postal Reorganization, Parcel Post volumes declined regularly. By 1989, the number of pieces was only one-quarter of what it had been in 1972. In the years following 1989, growth returned, led in part by rapid growth in the DBMC rate category. By FY 2000, DBMC mail accounted for 62 percent of all Parcel Post, and Parcel Select (DBMC plus DSCF and DDU) mail accounted for three-fourths of total volume. Despite the growth in drop-shipped Parcel Post over the last decade, the total volume of Parcel Post remains only 65 percent of its 1972 level. Year-by-year volume details are shown in Library Reference USPS-LR-J-91.

C. Proposed Changes to Rate Design

In this docket the Postal Service proposes to retain the current rate structure, with the following three minor modifications.

- *One Pound Rate*. In Docket No. R2000-1 the Postal Service proposed and the Commission recommended the elimination of the one-pound minimum weight requirement for Parcel Post, although without a separate rate for the lower-weight parcels. The Postal Service now proposes a separate rate for parcels weighing up to one pound for both retail Parcel Post and Parcel Select rate categories.
- *Three-Digit Nonmachinable DSCF Rate*. Currently, nonmachinable parcels entered at a DSCF must be sorted to 5-digit ZIP Codes to receive the DSCF discount. The Postal Service proposes that nonmachinable

DSCF parcels sorted to 3-digit ZIP Codes be eligible for a separate rate that reflects both the transportation savings from drop-shipping and the partially offsetting higher costs to the Postal Service of having to sort this mail to 5-digit ZIP Codes.

- *No-fee Delivery Confirmation*. At present, Parcel Post is eligible for Delivery Confirmation upon paying the appropriate fee. In this docket the Postal Service proposes to bundle the estimated costs of electronic Delivery Confirmation services used by Parcel Select into Parcel Select rates, making Delivery Confirmation available without paying any additional fee.

D. Parcel Post Rate Design

The Postal Service's overall rate design has followed the same general pattern as the rate designs used in the last two omnibus rate cases. Accordingly, in this docket, I developed separate rates for each of the Parcel Post rate categories (Inter-BMC, Intra-BMC, DBMC, DSCF, DDU), rather than defining a single set of benchmark rates and taking simple discounts off the per-piece rate component.

As in past rate cases, I have built Parcel Post's rates for each category by combining a per-piece charge and a per-pound charge, with the per-pound charge varying by zone. I developed the per-pound charges by marking up the volume-variable transportation costs and weight-related non-transportation costs. I developed the per-piece charges by marking up the portion of Parcel Post's volume variable costs that do not vary by weight and distance. The factor I used to mark up the per-piece and per-pound costs was designed to cover a reasonable contingency and Parcel Post's share of the Postal Service's

institutional costs. Witness Moeller's testimony (USPS-T-28) supports the Postal Service's Parcel Post cost coverage. The following subsections describe these elements of the Parcel Post rate design in more detail.

1. Pound Component

To create the pound component of the rate, I allocated the test year unit transportation costs (in dollars per cubic foot) for each rate category to each weight increment using the pounds-per-cubic-foot relationships developed for the appropriate rate categories of Parcel Post. As shown in my workpapers, witness Eggleston (USPS-T-25) provided the unit transportation costs, which include the costs in Cost Segments 14 and 8 (including piggybacked costs); she also provided the cubic foot-weight regression results used for the allocation.[5] Workpaper WP-PP-15 shows the allocation of these unit transportation costs.

Pound costs also include the usual two cents per pound for weight-related non-transportation costs. I have followed the practice initiated by the Commission in Docket No. R2000-1 of determining these costs in the aggregate and then allocating them to each weight increment using the same cubic foot-pound relationships used to allocate transportation costs. See workpaper WP-PP-16 for the calculation and distribution of these costs.

I then marked up the combined pound costs for each weight cell to reflect both the contingency and the target cost coverage for Parcel Post, supplied by

[5] Cubic foot-weight relationships have been developed for Inter-BMC, Intra-BMC and Parcel Select. Data limitation did not permit Parcel Select data to be further disaggregated to estimate separate cubic foot-weight relationships for DBMC, DSCF and DDU parcels. See workpaper WP-PP-8.

witness Moeller (USPS-T-28), to produce the preliminary pound charges. (See workpaper WP-PP-21).[6]

2. Piece Component

I developed the piece component by dividing the balance of test year Parcel Post costs (after netting out transportation and weight-related non-transportation costs) by the number of test year pieces to obtain per-piece costs. I then marked up the per-piece component to produce the preliminary benchmark piece charge. The details are presented in workpaper WP-PP-20.

The benchmark for the Parcel Post piece rate is a machinable Inter-BMC mail piece that does not claim any discount. As discussed below, the benchmark rate was adjusted for various mail preparation and entry practices to produce the rates for each of the different Parcel Post rate categories.

3. New Rate Initiatives

One Pound Rate.

In this docket I am proposing that parcels weighing up to one pound receive a rate that is lower than the two-pound rate. Since parcels weighing under one pound were not eligible to be mailed at Parcel Post rates prior to January 7, 2001, I have based my estimates of the volume of parcels weighing one pound or less on the share of such parcels observed after that date.[7] I otherwise developed the preliminary rates for one-pound pieces using the same methodology as I used for every other weight increment.

No-fee Delivery Confirmation for Parcel Select

[6] These charges also contain a component to recover the excess weight related costs of handling balloon parcels. See WP-PP-19.

[7] Library Reference USPS-LR-J-115 contains the one- and two-pound volume

(continued...)

At present, Delivery Confirmation is available to all Parcel Post pieces as an ancillary service for an additional fee. Delivery Confirmation is currently available in two service options: electronic and retail.[8] I propose that the electronic option be made an integral part of Parcel Select, and be offered without payment of an additional fee.

Based on discussions with representatives of major parcel mailers, I have estimated that, when fully ramped up, 75 percent of Parcel Select mail pieces will use no-fee Delivery Confirmation, with half of this amount, 37.5 percent of Parcel Select pieces, taking advantage of the service in the Test Year. Witness Nieto (USPS-T-26) has estimated that the variable cost of providing electronic option Delivery Confirmation is $0.0851 per piece. I have incorporated these costs for the estimated test year volume of no-fee Delivery Confirmation into my proposed Parcel Select rates. The calculations for deriving this rate element are shown in my workpaper WP-PP-20.

To simplify the fee schedule, the Postal Service is also proposing to eliminate the Delivery Confirmation retail option (also known as manual option) for Parcel Select. Since the demand for the retail option by Parcel Select mailers is expected to be minimal, and since these mailers are sophisticated users of postal services, eliminating this option is not expected to have any significant adverse consequences.

NMO DSCF Rate.

(...continued)
splits used to adjust test year volumes. See also workpaper WP-PP-7.
[8] A more detailed description of these two options can be found in section S918 of the Domestic Mail Manual.

In this case, I am also proposing a separate rate for nonmachinable parcels sorted to 3-digit ZIP Codes and deposited at the DSCF. This is described more fully in the Parcel Select rate design discussion, below.

4. Inter-BMC and Intra-BMC Rates

I calculated the preliminary Inter-BMC machinable rates by summing the Inter-BMC pound charges and the benchmark piece charge. I developed the preliminary Intra-BMC machinable rates by adding the Intra-BMC pound charges to the benchmark piece charge and deducting the Intra-BMC/Inter-BMC per-piece cost differential. This cost differential was supplied by witness Eggleston (USPS-T-25).

5. Parcel Select Rates

To develop the preliminary Parcel Select rates, I added the applicable pound charges (DBMC, DSCF, or DDU) to the benchmark piece charges and subtracted the appropriate per-piece cost differentials I obtained from witness Eggleston (USPS-T-25).

In this case I am also proposing a new rate for nonmachinable parcels that are sorted to 3-digit ZIP Codes and entered at the destination SCF. Currently, nonmachinable parcels entered at DSCFs must be sorted to 5-digit ZIP Codes to be eligible for the discounted DSCF rates. Following the implementation of the DBMC nonmachinable surcharge, the Postal Service became aware that mailers of nonmachinable parcels were interested in options that would avoid the surcharge, but they did not have the density to presort these parcels to 5-digits. In response to this interest, witness Eggleston investigated the costs of processing 3-digit presorted nonmachinable parcels at DSCFs and estimated that the additional cost would amount to $1.09 per piece.

I propose that 3-digit nonmachinable parcels, prepared and entered at destination SCFs as directed by the Postal Service, be eligible to receive the appropriate DSCF rates plus a surcharge of $1.09 per piece. The Postal Service is aware that some mailers might perceive an incentive in the new rate structure to convert some of their machinable parcels to nonmachinables in order to take advantage of the new 3-digit nonmachinable DSCF rate. The Postal Service intends to develop implementation rules that will forestall any such conversions.

Based on discussions with representatives of major parcel mailers, I project that, in the Test Year, 40 percent of parcels that would have paid the DBMC nonmachinable parcel surcharge will take advantage of this new rate.

6. Balloon and Oversized Rates

I propose to retain the balloon parcel rate, reintroduced in Docket No. R97-1, for lightweight, large size parcels. Parcels having combined length plus girth exceeding 84 inches, but less than 108 inches, and weighing less than 15 pounds pay the rate for a 15 pound parcel in the appropriate rate schedule and zone.

I am also proposing to retain the separate rate for oversized parcels: parcels whose length plus girth exceeds 108 inches, but does not exceed 130 inches. These parcels pay a separate rate that is independent of the weight of the parcel, but that varies by rate category and zone. I developed the oversized parcel rates in the same way I developed regular parcel rates. I allocated transportation and weight-related non-transportation costs to oversized parcels using the cubic foot-weight relationships supplied by witness Eggleston (USPS-T-25) and then marked them up to produce the preliminary pound

charges.[9] The per-piece charge is the same as the per-piece charge for the applicable rate category, adjusted to reflect the piece-related cost differences between oversized and regular parcels for that category. I obtained these cost differentials from witness Eggleston.

7. Other Rate Components

Nonmachinable Surcharges.

In Docket No. R2000-1 the Postal Service proposed that the surcharge for parcels that are not suitable for processing on the Service's parcel sorting machines should be extended to Intra-BMC and DBMC parcels. The Commission recommended this change with a 100 percent passthrough.

Witness Eggleston (USPS-T-25) has estimated the cost savings per piece in the test year from machine processing parcels in the Inter-BMC, Intra-BMC and DBMC rate categories. These savings amount to $3.33 for Inter-BMC parcels, $2.53 for Intra-BMC parcels and $1.91 for DBMC parcels (all figures have been rounded to whole cents). If these amounts were charged to nonmachinable parcels as surcharges to cover the additional costs associated with manually processing these pieces, the increases would be excessive. For this reason, I am proposing that the Intra-BMC and DBMC nonmachinable surcharges remain at their current levels: $1.35 for Intra-BMC parcels and $1.45 for DBMC parcels. I also propose that the Inter-BMC nonmachinable surcharge be set at $2.75, an increase of only $0.75, rather than $1.33.

In making these proposals I have taken two factors into consideration. First, these three rate categories will already bear significant rate increases in

[9] Though I refer to these charges as "pound" charges here, they are the same for all oversized parcels regardless of their weight.

their base (machinable parcel) rates, even after rate mitigation. And, second, Intra-BMC and DBMC nonmachinable parcels have recently experienced a significant rate increase when nonmachinable surcharges were inaugurated with full 100 percent passthroughs on January 7, 2001.

BMC Presort Discount.

I am also proposing a discount of $0.28 per piece for Inter-BMC parcels that are part of a mailing of 50 or more Parcel Post pieces and are prepared and presorted to BMC destinations (for machinable parcels) and BMC/ASF destinations (for nonmachinable parcels) as specified by the Postal Service, and are entered at a facility that is not a BMC. Witness Eggleston (USPS-T-25) has estimated the cost savings per piece for the BMC presort, and my proposed discount will pass through 100 percent of these savings.

OBMC Discount.

I propose a discount of $1.17 per piece for Inter-BMC parcels that are part of a mailing of 50 or more Parcel Post pieces prepared and presorted to BMC destinations (for machinable parcels) and BMC/ASF destinations (for nonmachinable parcels), and are entered at a BMC (other than a DBMC) as specified by the Postal Service. Witness Eggleston (USPS-T-25) has estimated the cost savings per piece for this OBMC presort and entry, and my proposed discount will pass through 100 percent of these savings.

Barcode Discount.

Witness Eggleston (USPS-T-25) has estimated the cost savings from barcoding machinable parcels to be three cents per piece. I propose that Inter-BMC, Intra-BMC and DBMC machinable parcels that are part of a mailing of 50 or more Parcel Post pieces, and that bear a correct readable destination ZIP

Code barcode as specified by the Postal Service, receive a discount of three cents per piece. DBMC parcels entered at an ASF, other than the Phoenix, AZ ASF, would not be eligible for the discount.

E. Rate Adjustments

Applying the rate design principles outlined in the previous section produces rates that, in many rate cells, lead to quite large increases when compared to existing rates. The Postal Service believes that making the transition from the existing rate structure to one that closely reflects underlying costs would yield rates with unacceptably high percentage changes. For this reason, I have adjusted the preliminary rates. The following subsections describe the adjustments I made.

1. Rate Change Constraints

To mitigate the overall increases that the Parcel Post rate classes would experience, I imposed caps on the percentage increases by rate cell. I used a general cap of 20 percent for all Inter-BMC and Intra-BMC parcels, 18 percent for Parcel Select non-oversized parcels, and 20 percent for Parcel Select oversized parcels. I also imposed a maximum rate decrease cap of 3 percent for all rate classes to avoid large downward jumps in rates.[10]

In the preliminary rates I developed, there are many rate cells that would have increased by more than 50 percent. I have allowed rate cells with preliminary rate increases greater than a threshold value of 50 percent, to increase by an additional 10 percent above the normal rate increase cap of 18

[10] I exempted the one-pound rate cells from this downward constraint because the one-pound rate is a new rate in this case, based on de-averaging the two-pound rate.

percent or 20 percent.[11]

As described in Section D.7, above, I also mitigated the increases in the nonmachinable surcharges by adjusting the cost passthrough percentages. I limited the Inter-BMC passthrough to 82.6 percent to constrain the increase to $0.75. I also constrained the surcharges for Intra-BMC and DBMC nonmachinable parcels to their current values for the reasons stated in Section D.7. Holding these surcharges constant requires a passthrough of 53.4 percent for Intra-BMC nonmachinable parcels and 75.9 percent for DBMC nonmachinable parcels.

2. Rate Relationship Constraints

I also imposed a number of constraints to ensure that the final Parcel Post and Priority Mail rates bear appropriate relationships to each other. After imposing the various constraints described in the previous subsection, I further constrained the Intra-BMC Local rates to be at least ten cents below the corresponding Priority Mail Local rates. Likewise, I constrained Inter-BMC Zones 1&2 through Zone 8 rates to be no greater than the corresponding Priority Mail rates, less ten cents.

In addition to these constraints that ensure reasonable rate relationships between Parcel Post and Priority Mail, I imposed other constraints to ensure appropriate relationships within Parcel Post. I constrained Intra-BMC rate cells to ensure that each cell was at least five cents below its corresponding Inter-BMC

[11] These cells are still subject to other constraints, such as those to ensure proper rate relationships among rate classes, so the rates may not go up by the full amount the rate increase constraint is eased.

rate.[12] I also constrained DBMC rates to ensure that they were at least five cents below the corresponding Intra-BMC rates.

The DBMC/Intra-BMC rate relationship produces some special challenges. Because of the hub-and-spoke nature of the Postal Service's mail collection and delivery system, Intra-BMC transportation costs (other than for Local parcels) bear no readily identifiable relationship to the distances between the origin and destination ZIP Codes. Intra-BMC transportation costs reported by witness Eggleston do not differ by zone from Zones 1&2 to Zone 5.

If these undifferentiated transportation costs were allowed to flow into rates without adjustment, they would lead to a single Intra-BMC rate for each weight between Zones 1&2 and Zone 5. Since DBMC costs and rates do increase by Zone, there is potential for anomalous rate effects to occur, particularly in the more distant zones. To counteract this tendency, I have adjusted Intra-BMC rates using Zoning Factors (see workpaper, WP-PP-23). These factors are applied to the rates to push them down in the close-in zones and raise them in the farther zones to create a rate profile that increases with distance between origin and destination. Although this increasing rate trend is somewhat artificial, it is a reasonable way to help reduce the tendency for Intra-BMC rates to dictate DBMC rates via the DBMC/Intra-BMC rate relationship constraint, regardless of DBMC costs.

[12] To prevent rate anomalies in Intra-BMC Zone 5, where the proposed rates were lower than the current rates, I imposed a further constraint to ensure that the rates in Zone 5 increased by at least five cents per pound.

F. Proposed Rates

Attachment A, pages 1 through 3 show the rates I am proposing for Intra-BMC, Inter-BMC and Parcel Select Parcel Post. The rates in these tables are for machinable parcels only. Nonmachinable parcels must add the appropriate nonmachinable surcharge to the rates shown in the table. By definition, all parcels exceeding 35 pounds are nonmachinable. DSCF nonmachinable parcels sorted to 3-digit ZIP Codes pay a separate surcharge (shown on page 3, Note 4) on top of the appropriate DSCF rates.

Certain machinable parcels are also eligible for the barcode discount of three cents. Inter-BMC machinable and nonmachinable parcels are also eligible for BMC or OBMC presort discounts. My proposed values for these discounts are presented in the notes accompanying the appropriate rate tables.

G. Pickup Service Fee

Witness Scherer (USPS-T-30) is proposing a pickup fee of $12.50. I propose that single-piece rate Parcel Post continue to be eligible for pickup service at the fee sponsored by witness Scherer.

H. Financial Impact of Rates

Attachment B presents the financial impacts of the rates I propose. Revenue per piece for Parcel Post increases 6.52 percent, producing a cost coverage of 116 percent. This percentage increase reflects the effects of changes in the mix of retail and Parcel Select pieces that occur as the result of the proposed rate changes and initiatives. Using a constant mix of Parcel Post pieces (except for the migration of nonmachinable pieces to the new 3-digit DSCF rate), the average revenue per piece increases 10.0 percent.

Retail rates increase more than Parcel Select rates, averaging 17.6 percent for Intra-BMC and Inter-BMC Parcel Post. Parcel Select rates increase 4.8 percent overall, with DBMC increasing 9.6 percent, about the same as the Parcel Post average. Both DSCF and DDU rates experience slight declines: -1.2 percent for DSCF and -3.1 percent for DDU. The DBMC and DSCF rate changes reflect pricing changes that exclude the impacts of migrating nonmachinable pieces. Including this migration in the calculation lowers the average increase for DBMC pieces to 8.5 percent, and raises the average increase for DSCF to 16.0 percent. While this may appear to be a steep increase in DSCF rates, it masks two important facts. First, those DSCF pieces that have not migrated will, on average, experience a modest rate *decrease*. And, second, the nonmachinable pieces migrating from the DBMC rate will experience a substantial rate decrease, even though they will be paying a significant surcharge above the DSCF base rates.

I. Classification Criteria

In recommending classifications, the Commission is required to consider the following factors, which I refer to in my testimony as Criteria 1 to 6:

(1) the establishment and maintenance of a fair and equitable classification system for all mail;

(2) the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail;

(3) the importance of providing classifications with extremely high degrees of reliability and speed of delivery;

(4) the importance of providing classifications which do not require an extremely high degree of reliability and speed of delivery;

(5) the desirability of special classifications from the point of view of both the user and of the Postal Service; and

(6) such other factors as the Commission may deem appropriate.

The classification change I propose for Parcel Post (a separate rate for 3-digit nonmachinable DSCF parcels) is consistent with these criteria. My proposed change will enhance an existing mail classification by offering people who send Parcel Select mail a lower rate option. Mailers have indicated to the Postal Service that such an option is desirable. In return, these mailers will presort mail beyond the BMC level and transport it closer to its destination than if the mail had continued to be entered at the DBMC. This worksharing is desirable to the Postal Service, and to the mailers who will use it (Criteria 2 and 5).

Parcel Post is a classification for mail that does not require an extremely high degree of reliability and speed of delivery. My proposed classification change will enhance and further promote Parcel Post (Criterion 4). Criterion 3 does not apply in this case.

My proposed change offers customers a lower rate for certain mail, but requires them to perform valuable services in return. This proposal will produce benefits for both the Postal Service and its customers without imposing any undue or unfair burden on either. On the whole it is fair and equitable (Criterion 1).

V. BOUND PRINTED MATTER

A. Product Description

Bound Printed Matter (BPM) is a subclass of Package Services mail. It consists of catalogs, books, telephone directories, manuals and similar permanently bound volumes that are printed, are not stationery, and that do not have the nature of personal correspondence. Since Docket No. MC97-3, BPM mail pieces may weigh up to 15 pounds. Mail sent using Bound Printed Matter rates can also use Delivery Confirmation and Signature Confirmation services.

Bound Printed Matter has a single-piece rate category and two presort rate categories: Basic Presort and Carrier Route. Within the presort categories the rates depend on whether the mail is deposited at the destination BMC (DMBC), destination SCF (DSCF), the destination delivery unit (DDU), or at some other entry unit.

The Bound Printed Matter subclass originated as a catalog subclass and remained restricted to catalogs and similar bound advertising matter until Docket No. MC73-1 broadened its eligibility to include bound printed matter other than catalogs, although most books were still excluded. In the years following Postal Reorganization, the rates for Media Mail (formerly Special Standard Mail) and BPM evolved in such a way that, in some instances, BPM rates became cheaper than the corresponding Media Mail rates. Many book publishers responded to these rate differentials by including non-incidental advertising in books to make them eligible for the cheaper BPM rates. In Docket No. R90-1, the Postal Service sought to conform the subclass eligibility requirements to this reality. The Commission agreed and extended eligibility for BPM rates to books without advertising that otherwise met BPM standards.

The following section describes the rate and volume history of Bound Printed Matter, including a description of the current rate structure.

B. Rate and Volume History

1. Rates and Rate Design

Since Postal Reorganization, Bound Printed Matter's fundamental rate structure has consisted of a per-piece charge and a charge that varies by weight and by distance between the origin and destination of the mail piece as measured by zone. At the time of Postal Reorganization, there were two basic rate categories, a single-piece rate and a single bulk rate. In 1985, the Basic Presort and Carrier Route Presort rates replaced the bulk rate. In Docket No. R97-1, a barcode discount was introduced. This discount was available to properly prepared parcels bearing a barcode with the correct destination ZIP Code. It was only available to parcels that would normally be processed on the Postal Service's parcel sorting equipment.

In 2001, with the implementation of rates recommended by the Commission in Docket No. R2000-1, BPM's rate design further changed in several important ways:

- The stand-alone Local rate was eliminated, since the assumptions underlying this rate no longer reflected the realities of the way BPM was being processed.
- The one-pound minimum weight requirement was removed, with pieces weighing under one pound paying the applicable rate for one-pound pieces.

- Three destination entry discounts (for DBMC, DSCF and DDU entry) were introduced for presorted BPM, increasing the worksharing savings available to BPM mailers.

Under the current rate design for Single Piece BPM rates, the per-piece and per-pound charges are combined into rate cells, like those for Parcel Post. Single Piece rates have half-pound weight increments from one to five pounds, and one-pound increments thereafter. Presorted mail pays a per-piece charge and a per-pound charge based on the aggregate weight of the mail travelling to each zone. The Basic Presort rates have lower per-piece and per-pound charges than Single Piece rates do. Additional discounts off the Basic Presort rates are available if the mail is sorted to carrier routes, is barcoded, or is drop-shipped to a destination facility, though not all worksharing discounts may be combined.

The detailed history of Bound Printed Matter rates from Postal Reorganization to the present is contained in Library Reference USPS-LR-J-90.

2. Volumes

For the first several years after Postal Reorganization, Bound Printed Matter volumes followed a generally declining trend. In 1977, that trend reversed and, since then, BPM volumes have experienced robust growth, with year to year volume declines in only two years. By FY 2000, BPM volumes had grown to over five times as high as they were in 1972. Most of the growth occurred in the worksharing categories. Consequently, Single Piece BPM's volume share has gradually shrunk, and in FY 2000 it was less than 5 percent of total volume. Year-by-year volume details are shown in Library Reference USPS-LR-J-91.

C. Proposed Changes to Rate Design

In this docket, I propose to retain the current rate structure, except for two modifications. I am proposing separate rates for BPM flats and parcels/irregular pieces, based on delivery cost savings for flats. I also propose to add a new barcode discount for automatable flats. Details for both of these initiatives are presented in Section D.

D. Bound Printed Matter Rate Design

My basic rate design continues the per-piece and per-pound zoned rate structure that has been used for Bound Printed Matter in recent rate cases. First I allocated total volume variable costs between weight-related and non-weight-related costs, and between single piece costs and presorted mail costs. I used the weight-related costs to develop the per-pound component of the rates, and recovered the balance of the costs in the per-piece component.

The details of my calculation of the piece and pound rate elements and discounts are contained in my workpapers WP-BPM-12 through WP-BPM-14.

1. Pound Component

Witness Eggleston (USPS-T-25) has provided me with the estimated transportation costs per pound by zone for both drop shipped and non-drop shipped BPM. I then apportioned the standard two cents per pound allowance for weight-related non-transportation costs between single piece and presort and by zone and combined these costs with the transportation costs. I marked up the combined weight-related costs per pound by a factor that reflected both the contingency and the target cost coverage for BPM, provided by witness Moeller

(USPS-T-28) to produce the preliminary pound charges for Basic Presort BPM and for the three destination entry rate categories.

2. Piece Component

To derive the piece component I removed the transportation and non-transportation weight-related costs from total costs. I apportioned these non-weight-related costs between single piece and presort costs, employing the 2 to 1 ratio for single piece to presort unit non-transportation costs used by the Postal Service and the Commission in all recent rate cases. I adjusted the unit non-weight-related costs for revenue leakages and marked the result up by the same factor used to mark up the per-pound costs to produce the preliminary benchmark piece charges.[13]

3. Flats Rate Differential

Witness Eggleston (USPS-T-25) has estimated that that BPM flats save 7.7 cents per piece compared to BPM parcels and irregular pieces because carriers can case flats, and do not have to hold them out like parcels. In this case, I am proposing that BPM flats and parcels/irregular pieces pay separate rates based on these carrier cost savings. There may be additional cost differences between BPM flats and parcels/irregular pieces, such as mail processing cost differences, which potentially could also contribute to a rate differential between flats and parcels/irregular pieces. The Postal Service expects to explore these cost differentials for use in future rate cases.

[13] The leakages include the flats-parcels/irregular pieces cost differential.

I propose to pass along approximately 100 percent of witness Eggleston's estimated cost savings through a lower per piece rate for BPM flats.[14] This lower rate will be available to all BPM pieces prepared and entered as flats, since it is based on delivery savings, rather than mail processing savings.

I recognize that my proposed rate differential will mean higher rates for BPM parcel mailers, but at this time, we have limited the proposed differential to only reflect delivery cost savings. At the same time, I believe it provides a more equitable means to allocate the associated costs among customers. In addition, the drop-ship discounts (particularly the DSCF and DDU discounts) offer significant ways to offset the proposed price increases. Even with these increases, BPM still offers our commercial customers the most attractive rates for mailing parcels containing books to most zones.

4. Discounts

Bound Printed Matter currently has discounts available for barcoding, carrier route presorting, and for drop shipping presorted mail.

Barcoded mail.

Witness Eggleston (USPS-T-25) reports a mail processing cost savings of three cents per piece on barcoded machinable parcels. I propose that machinable BPM parcels that are part of a mailing of 50 or more BPM pieces and that bear a correct readable barcode representing the 5-digit ZIP Code, as specified by the Postal Service, receive a discount of three cents off the applicable Single Piece or Basic Presort per-piece rate. Consistent with current practice for Package Services mail, this discount would only be available for mail

[14] For presorted rates I propose a 100 percent passthrough. I round the 7.7 cents up to 8 cents for Single Piece rates, a passthrough of 103.9 percent.

that can take advantage of the Postal Service's parcel sorting equipment capable of reading barcodes. For this reason, the discount would not be available in conjunction with the Carrier Route, DSCF or DDU discounts, or for DBMC mail that is entered at an ASF other than the Phoenix, AZ ASF.

In this case, the Postal Service is also proposing to offer automatable BPM flats a barcode discount. In addition to allowing these BPM pieces to be scanned by barcode readers on the Postal Service's flat sorting equipment, barcoding would potentially offer other benefits to Postal Service operations. It would promote address hygiene by giving mailers a monetary incentive to pursue address cleansing. It would also diminish any perceived incentive for some mailers to prepare flats as parcels by removing the rate advantage that barcoded machinable parcels had enjoyed in the past.

There are no studies that estimate directly the cost savings attributable to having a barcode on BPM flats. Lacking any direct costs for BPM, I have used the difference in costs between Standard Mail 3/5 presort automation and nonautomation flats estimated by witness Miller (USPS-T-24) to proxy the BPM flats barcode cost savings. Witness Miller has estimated these saving at 1.2 cents per piece. To encourage adoption of the flats barcode, and to ensure that automatable BPM flats are not at a cost disadvantage compared to machinable parcels, I propose that the discount be inaugurated at three cents per piece for barcoded automatable flats prepared and entered as directed by the Postal Service.[15] This rate discount represents a passthrough of 250 percent.

[15] Since there is no cost savings to be had from barcoding carrier route pieces, the automatable flats barcode discount would not be available for carrier route flats.

Carrier Route Presort.

Witness Eggleston (USPS-T-25) has estimated that carrier route presorting saves 8.6 cents per piece in mail processing costs. I propose that properly prepared and entered mailings of at least 300 pieces that are sorted to carrier routes receive a discount of 10.0 cents off the applicable rates, to maintain the incentive to sort to carrier routes the same as it is under the current rate structure. This represents a passthrough of cost savings of 116 percent. Because the Postal Service expects all flats weighing one pound or less to be finalized to carrier routes at the SCF, I propose that the DDU rate not be available to flats weighing one pound or less, unless they are also sorted to carrier routes.

Destination entry rates.

I subtracted witness Eggleston's estimates of per-piece cost savings for drop shipped mail from the applicable presort per-piece charges to develop the preliminary per-piece components of BPM's destination entry rates. I combined these with the per-pound charges developed separately for drop shipped mail to produce the preliminary drop ship rates.

E. Rate Adjustments

In Docket No. R2000-1, the Postal Service introduced drop-ship discounts for BPM. As I explained in my testimony in that docket, de-averaging BPM rates to accommodate these drop-ship discounts would have led to unacceptable rate increases for non-drop-shipped mail. For that reason, the Postal Service proposed to pass through only a portion of the expected savings in drop-ship rates.

In the present case, I propose to increase the passthrough for BPM drop-ship discounts. As in Docket No. R2000-1, because so much mail is already drop shipped, making the jump to 100 percent passthroughs of drop-ship savings would once again produce unacceptable rate changes for non-drop-shipped BPM. As a consequence, I reduced the cost savings passthroughs once again to keep non-drop-shipped mail rates within acceptable bounds. While I have mitigated the rate increases for non-drop-shipped mail, that mail will still incur significant rate increases. In deciding upon the degree of rate mitigation and cost savings passthroughs to propose, I have carefully weighed the following considerations:

- The shorter-run impact on customers, both those who drop-ship, and those who do not;
- The need to better reflect the cost savings produced by drop-shipping mail so that rates send a more appropriate price signal to BPM customers to reduce handling costs and, therefore, rates in the longer run.

I believe that my mitigation and passthrough proposals reflect a reasonable balance of these considerations.

Workpaper WP-BPM-14 shows where I made adjustments to the preliminary rates. The principal adjustments I made were to reduce the per-piece rate for non-drop-shipped mail slightly and to reduce the per-pound rates to keep the percentage rate increases within acceptable bounds. Following these adjustments, it became necessary to also adjust drop-shipped mail's per-pound rates slightly to maintain appropriate rate relationships. I recovered the revenue forgone by these rate reduction adjustments by increasing drop-shipped mail's per-piece rates.

F. Proposed Rates

Attachment C, pages 1 through 3 show the rates I am proposing for Single Piece and Presorted BPM. The Single-Piece rates in Attachment C, page 1, are for machinable parcels and irregular pieces only. The rates for flats are calculated by deducting 8 cents from the Single-Piece rates. Page 3 contains separate tables for Presorted flats. These rates are 7.7 cents per piece less than the corresponding Presorted parcel/irregular-piece rates (including drop-shipped and carrier route BPM).

Certain machinable parcels and automatable flats are also eligible for the barcode discounts presented in the appropriate rate tables.

G. Financial Impact of Rates

Attachment D presents the financial impacts of the rates I propose. My proposed rates would increase BPM revenue per piece by 9.1 percent, yielding a cost coverage of 128 percent.

H. Classification Criteria

The classification changes I propose for Bound Printed Matter are consistent with the classification criteria listed in Chapter IV, Section I. My proposed changes will enhance an existing mail classification by offering BPM mailers who mail flats a way to lower their rates. The separate flats rate also permits the Postal Service to recognize lower cost mail with lower rates. Further, as mentioned in Section D.4 above, barcoding BPM flats should improve address hygiene. Lower rates, aligning rates better with cost causation, and improved

address hygiene are all factors that make the proposed changes desirable to both the Postal Service and its customers (Criteria 2 and 5).

Bound Printed Matter is a classification for mail that does not require an extremely high degree of reliability and speed of delivery. My proposed classification change will enhance and further promote Bound Printed Matter (Criterion 4). Criterion 3 does not apply in this case.

My proposed changes offer customers a lower rate for certain mail. In the case of barcoding, it also requires them to perform valuable services in return. In the case of the flats differential, it will better align rates with cost causation. These proposals produce benefits for both the Postal Service and its customers without imposing any undue or unfair burdens on either. Overall, they are fair and equitable (Criterion 1).

VI. MEDIA MAIL AND LIBRARY MAIL

A. Product Description

Media Mail and Library Mail are two Package Services subclasses that have similar content restrictions and rate structures. Media Mail can contain books, sound and video recordings, certain films and film catalogs, printed music, certain test materials, playscripts and manuscripts, computer readable media, and certain other qualified items. Library Mail is largely similar in content, but also can contain other qualified items like bound volumes of academic theses, scientific or mathematical kits, museum specimens, as well as other library and museum materials.

An important distinction between the two subclasses is that only qualified mailers may use Library Mail rates. To qualify, either the mailer or the recipient must be a school, college, university, library, museum, herbarium, or be a nonprofit organization as described in the Domestic Mail Manual, section E670.

Media Mail and Library Mail rates are not zoned by law, and mail pieces can range in weight from less than one pound up to 70 pounds. Most Media Mail and Library Mail pieces consist of small parcels: half weigh less than one pound, and 95 percent weigh under six pounds. Mail sent using either Media Mail or Library Mail rates can also use Delivery Confirmation and Signature Confirmation services.

The following section describes the rate and volume history of Media Mail and Library Mail, including a description of their current rate structures.

B. Rate and Volume History

1. Rates and Rate Design

At the time of Postal Reorganization, both Media Mail and Library Mail had simple rate structures. Rates consisted of a two parts: one rate for the first pound, and a second, lower rate for each additional pound. Rates were unzoned, reflecting the intent of Congress that the rates for these subclasses should not vary by the distance transported.

In 1975 the rate structure of Media Mail (then called Special Rate Fourth-Class Mail) was changed slightly to the three-part structure that exists today: one rate for the first pound, a second rate for pounds two through seven, and the third rate for each additional pound. In 1978, the same structure was instituted for Library Mail.

The Postal Service began offering presort discounts to Media Mail customers in 1978. Currently, properly prepared and sorted mailings of 500 or more pieces of Media Mail are eligible for discounts depending on whether the mail is sorted to the 5-digit destination ZIP Code level, or to the destination BMC. Library Mail followed suit in January 1999, when, as a result of Docket No. R97-1, the Media Mail and Library Mail schedules were effectively merged. In addition to these presort discounts, properly prepared machinable parcels that were part of a mailing of at least 50 pieces of Media Mail or 50 pieces of Library Mail, and that bore a barcode with the correct destination ZIP Code were eligible for a barcode discount. The discount was only available to parcels that would normally be processed on the Postal Service's parcel sorting equipment.

Library Mail's status as a preferred, and historically subsidized, subclass has complicated its rate history since Postal Reorganization. On several occasions, Congress has attempted to develop mechanisms within the

framework of the postal ratemaking system that would retain Library Mail's status as a preferred subclass, while ensuring that it would cover its costs. Most recently, it became evident in Docket Nos. R97-1 and R2000-1 that the pricing mechanism outlined in the Revenue Foregone Reform Act of 1993 could not achieve these twin aims. At the request of mailers and the Postal Service, Congress passed PL106-384 in 2000, which addressed pricing for Library Mail and other nonprofit mail subclasses. Accordingly, Library Mail's rates are now set to be, as nearly as practicable, five percent lower than the corresponding Media Mail rates.

The detailed histories of Media Mail and Library Mail rates from Postal Reorganization to the present are contained in Library Reference USPS-LR-J-90.

2. Volumes

In the years after Postal Reorganization both Media Mail and Library Mail first experienced some volume growth, followed by decline. Media Mail reached its peak volume in 1976 at 307 million pieces and then entered an extended period of decline. This declining trend lasted up to 1990, with volumes falling rapidly at first, then later at a slower pace. By 1990, Media Mail volume was less than half of its 1976 peak. The trend then reversed itself and from 1990 through 2000, Media Mail saw a decade of generally rising volumes, although it still remained far below its peak.

Library Mail volumes have demonstrated a similar trend of growth, decline, and recovery, although the timing has differed. Library Mail reached its peak volume in 1978 when 72 million pieces were sent. It then followed a generally declining trend for the next two decades, reaching a low of 27 million pieces in 1997. Since then there has been a slow recovery up to just over 28 million

pieces in 2000. Year-by-year volume details for both Media Mail and Library Mail are contained in Library Reference USPS-LR-J-91.

C. Proposed Changes to Rate Design

In this docket the Postal Service proposes no fundamental changes to the Media Mail or Library Mail rate designs. The only changes proposed are to the presort requirements. I propose to retain two presort levels, but to change these slightly to bring them more in line with mail processing realities. Under this proposal the 5-Digit Presort level will remain as it is today, but the BMC Presort level will be replaced by a Basic Presort level. This change would affect both Media Mail and Library Mail. Changing to a Basic Presort will allow the Postal Service to adjust the presort requirements for flat-shaped and nonmachinable Media Mail and Library Mail to reflect the way such pieces are currently processed by the Postal Service. Machinable parcels would continue to be presorted to BMCs under the Basic Presort requirements.

I further propose to eliminate the requirement for separate minimum mailings for each presort level and reduce the size of these minimum mailings. At the present time a Media Mail or a Library Mail customer must mail at least 500 pieces to take advantage of the 5-Digit Presort discount, and another 500 or more pieces to qualify for the BMC Presort discount. Under my proposal, the customer would only be required to make a single mailing of 300 or more pieces, properly prepared and presorted as specified by the Postal Service, to qualify for presort discounts.[16] Those pieces in the mailing that meet the 5-Digit Presort

[16] Media Mail and Library Mail pieces could not be commingled for the purposes of meeting the 300 piece minimum. The minimum must be met separately for each subclass. The 300 piece minimum is consistent with BPM presort minimum requirements.

requirements would be eligible for the 5-Digit Presort discount. The remaining pieces in the mailing could obtain the Basic Presort discount, if properly prepared.

D. Media Mail/Library Mail Rate Design

With the passage of PL 106-384, Media Mail and Library Mail have been effectively joined for rate-making purposes. The Postal Service now collects cost data for Media Mail and Library Mail on a consolidated basis. This means that in developing rates, I have had to apportion costs and develop rate elements for the joint Media Mail/Library Mail product before splitting them into separate rate elements for the two subclasses. The rate design methodology follows the standard per-piece and per-pound rate-development approach for the joint product up to the point of splitting the rate elements.

1. Pound Component

I derived the per-pound component of the rate by allocating all transportation costs (Cost Segment 14 plus piggybacked Segment 8) plus the customary two-cent per pound add-on for weight-related non-transportation costs to the total number of postage pounds. I allocated all other costs plus revenue leakages to the per-piece component of the rate.

I calculated the per-pound charges by then dividing the total transportation and non-transportation weight-related costs by the total postage pounds and marking up these unit costs by a factor that reflected the contingency and target markup for Media Mail/Library Mail provided by witness Moeller (USPS-T-28). I added these weight-related unit costs together to derive the preliminary per-pound charge. Workpapers WP-MM-7 and WP-MM-10 contain the details of these calculations.

2. Piece Component

To derive the piece component, I removed the transportation and non-transportation weight-related costs from total costs and divided the result by the total number of pieces. I marked up this unit cost by the same markup factor used for the pound component and added in the per-piece revenue leakages to produce the preliminary per-piece charge. The detailed calculations are presented in workpapers WP-MM-8 to WP-MM-10.

3. Discounts

Media Mail and Library Mail currently have discounts available for barcoding and presorting mail.

Barcoded mail.

Witness Eggleston (USPS-T-25) reports a mail processing cost savings of three cents per piece for barcoded machinable parcels. As with the other subclasses of Package Services mail, I propose that machinable Media Mail and Library Mail parcels that are part of mailings of 50 or more pieces of Media Mail or Library Mail, and that bear a correct readable barcode as specified by the Postal Service, receive a discount of three cents off the applicable Single Piece or Basic Presort per-piece rate. This discount would not be available for pieces entered at the 5-Digit Presort rate.

Presort Discounts.

Media Mail and Library Mail are eligible for two levels of presort discounts, described in Section C, above. Witness Eggleston (USPS-T-25) has estimated the cost savings for the Media/Library Mail 5-Digit Presort to be $0.38, and for

the Basic Presort to be $0.25. In developing the preliminary rate elements, I have passed these worksharing savings along into discounts at 100 percent.

E. Rate Adjustments

Splitting the Rate.

After I developed the Single Piece and Presort rate elements, I multiplied them by de-averaging factors as shown in workpaper WP-MM-11. These factors adjust the composite rate elements, based on the relative number of Media Mail and Library Mail postage pounds in each rate category. Multiplying by the de-averaging factors yields the Media Mail rate elements. The Library Mail rate elements are then calculated by multiplying the Media Mail elements by 0.95, in line with the statutory requirement.

Other Adjustments.

If the preliminary rate elements were allowed to flow through to rates unadjusted, they would have produced rate increases—particularly in the first pound rate cells—that were unacceptably large. Offsetting these large rate increases would have been large rate decreases for heavier mail pieces.

In the past, both the Postal Service and the Commission have mitigated these large first pound rate increases by shifting some of the increase from the first pound to the second through seventh pounds and, to a lesser extent, to heavier rate cells. I have followed this mitigation strategy in this case as well. I lowered the first pound rate for the Single Piece rate, and for the two Presort rates. I offset the potential revenue loss mainly by raising the rates for the second through seventh pounds, although I also raised the rates for pounds 8 to 70 by a lesser amount.

These changes bring down the first pound percentage increases for both Media Mail and Library Mail to acceptable levels. The two presort rates experience the largest first pound percentage increases because the bases for both presort rates are much smaller than the bases for single piece mail. Despite the larger percentage increases for the presort rates, under my proposed rates, the discount for Basic Presort Media Mail remains the same as the current BMC Presort discount, and the discount for 5-Digit Presort Media Mail *increases* by two cents. And, in both cases, the passthroughs well exceed 100 percent.

F. Proposed Rates

Attachment E, pages 1 and 2, show the rates I am proposing for Single Piece and Presorted Media Mail and Library Mail. The rate elements used to develop these rate tables are shown in Attachment E, page 3. Certain machinable parcels are also eligible for the barcode discount of three cents per piece as described in the note accompanying the tables on pages 1 and 2.

G. Financial Impact of Rates

Attachment F presents the financial impacts of the rates I propose. On a consolidated basis, Media Mail-Library Mail average revenue increases by 3.9 percent, with a corresponding cost coverage of 115 percent. Following the linking of Media Mail and Library Mail with the passage of PL106-384, costs are only available for these two products on a consolidated basis. For this reason the cost coverage is only calculated for the consolidated Media Mail-Library Mail product.

The average rate for Media Mail will increase by 4.0 percent under my proposals. Library Mail rates are calculated as a 5 percent discount off the

corresponding Media Mail rates. On average, Library Mail rates will increase 3.3 percent.

H. Classification Criteria

The classification changes I propose for Media Mail and Library Mail are consistent with the classification criteria listed in Chapter IV, Section I. My proposed changes will enhance existing mail classifications by offering mailers who presort Media Mail and Library Mail lower minimum mailing requirements and by abolishing the need to have separate mailings to take advantage of both the 5-digit and Basic Presort discounts. Replacing the BMC discount with a Basic Presort discount is also valuable to the Postal Service since it will ensure that mailers presort mail in a way that corresponds better to the way the mail is processed. These proposals are desirable to both the Postal Service and its customers since they will make Media Mail and Library Mail easier to use for our presort customers and make presorted mail more efficient to process (Criteria 2 and 5).

Media Mail and Library Mail are classifications for mail that do not require an extremely high degree of reliability and speed of delivery. My proposed classification changes will enhance and further promote Media Mail and Library Mail (Criterion 4). Criterion 3 does not apply in this case.

My proposed changes offer customers greater access to worksharing discounts, while requiring mail to be presorted more consistently with the way it is processed. These proposals produce benefits for both the Postal Service and its customers without imposing any undue or unfair burden on either. Overall, they are fair and equitable (Criterion 1).