

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

POSTAL RATE AND FEE CHANGES

Docket No. R2006-1

NOTICE OF THE UNITED STATES POSTAL SERVICE
OF FILING CORRECTED COPY OF RESPONSE OF WITNESS SMITH TO
PRESIDING OFFICER'S INFORMATION REQUEST NO. 10, QUESTION 2
[ERRATA]
(August 18, 2006)

The United States Postal Service hereby provides notice that it is today filing a corrected copy of the response of witness Smith to Presiding Officer's Information Request No. 10, Question 2, filed on August 17, 2006. The original response to this question only included one of four attachments. The attached copy being filed today, with all four attachments, should replace the original response. No other changes have been made. Though the Excel file associated with this response has not been changed, the Postal Service is including a copy of it with today's filing for the convenience of all the parties.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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August 18, 2006

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2. In response to PSA/USPS-T13-1.c. and 1.d, witness Smith acknowledges that the unit mail processing costs for First-Class presort parcel and ECR parcels seemed to be anomalous, but that he can not explain why. The table below shows that the unit costs have been anomalously high, at least, since R2001-1.

Test Year Unit Attributable Mail Processing Cost (Cents) - Parcels

	<u>R2001-1</u>	<u>R2005-1</u>	<u>R2006-1</u>
First-Class Presort	270.32	288.91	303.81
<u>ECR</u>	<u>205.95</u>	<u>893.44</u>	<u>2405.04</u>

Source: Docket No. R2001-1, USPS-LR-J-53

Docket No. R2005-1, USPS-LR-K-53

Docket No. R2006-1, USPS-LR-L-53

Witness Czigler's response to PSA/USPS/T13-1.b. shows coefficients of variation (CVs), associated with the unit mail processing costs above, for First-Class presort parcels and ECR parcels, of 11.4 percent and 13.4 percent, respectively. Generally, CVs of this magnitude are considered to be high. These unit costs are important because they are used to design parcel rates in ECR and First- Class.

- a. When your analysis showed that the average cost simply of processing each ECR parcel (not counting transportation, delivery, etc.) was \$24.00 did you consider this anomalous? If not, why not? If yes, did you convey your concerns to your superiors? If not, why not?
- b. Did you alert the rate design analyst responsible for ECR of this potential problem? If not, why not?
- c. Have you undertaken any additional studies or analysis to identify the cause of this outcome? If not, why not?
- d. Have you undertaken any analysis to develop an appropriate adjustment? If not, why not?
- e. If no additional studies or analysis has been performed to identify the cause of this outcome, please undertake such an effort and indicate when a discussion of the actual cause can be provided.
- f. If no appropriate adjustment has yet been identified, please develop such an adjustment.

RESPONSE:

- a. Yes, I considered the Standard ECR parcel processing cost, which exceeds \$24, as anomalous. I did not alert my manager or others regarding the high processing unit costs for Standard ECR parcels because such results had

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been occurring in previous years (as indicated by the table provided in the question) and had been seen by managers and other staff.

Prior to Docket No. R2005-1, pricing managers and staff had requested a look into an apparent inconsistency between costs and volumes for Standard Regular parcels, as I indicate in my response to PSA/USPS-T13-3. Pricing personnel identified what they thought was the reason for the inconsistency—that parcel shaped pieces which qualified for automation flat rates were reported as flats in RPW, but as parcels in our costs – as I discuss in my testimony, USPS-T-13, pages 34-35.

In looking into the inconsistency in costs and volumes for Standard Regular parcels, the anomalously high processing unit costs for Standard ECR parcels came to my attention and that of my manager and others. The inconsistency arising from parcel shaped pieces qualifying for automation flats rates for Standard Regular did not apply to ECR. Moreover, there didn't seem to be the same interest or need for resolving the ECR parcel cost anomaly.¹ It should also be noted that in preparations for this docket and the last docket, I was not aware of the Postal Rate Commission's interest in addressing the anomalous Standard ECR parcel costs.

For these reasons, it was not pursued.

b. No, I did not alert the rate design analyst responsible for ECR of this cost anomaly. As I indicated in my response to part a, I addressed inconsistencies

¹ See Postal Service response to POIR No. 2, question 3 in Docket No. R2005-1.

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between volumes and costs for Standard Regular parcel costs; no indication of need was forthcoming on ECR parcels.

c. No, see my response to part a.

d. No, see my response to part a.

e. As I indicate above, the source of the Standard ECR parcels cost anomaly is unclear. In addition, I am not able to say when the actual cause of this anomaly can be determined. I am told that the Postal Service has been investigating this issue in response to the questions raised in POIR No. 5, question 16, and is considering collecting additional data. The result of this work is not likely to be available for this rate case.

Data currently available, however, can shed some light on this. I have attached, in Attachment 1, the mail processing labor costs per piece using Postal Service and Postal Rate Commission cost methodologies for First-Class single-piece, First-Class presort, Standard ECR and Standard Regular parcels for the years 1996, 1998, 1999, 2000, 2004 and 2005.² Please note the unit cost for Standard ECR parcels has exceeded First-Class single-piece parcels unit costs since FY 1999, under both Postal Service and Postal Rate Commission cost methods. In addition, the Standard ECR parcel unit cost has risen at a rapid pace, suggesting that the cost anomaly is growing over time.³ While the source

² These are the base years for all the omnibus rate case filings for Docket No. R97-1 and since. It was in Docket No. R97-1 that the MODS cost pool based method for mail processing labor costs was introduced.

³ Changes in cost and volume data systems and methodology changes over this time period have no doubt contributed to changes in Standard ECR parcel unit costs for some years. For instance see witness Bozzo, USPS-T-46, pages 38-39 on the discussion of the impact of IOCS redesign on Standard ECR

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of the anomaly is unclear, there does appear to be an inconsistency between determining processing labor costs and developing volumes for Standard ECR parcels.

In my testimony, USPS-T-13, page 35, I indicate that an estimate of the inconsistency between Standard Regular parcel costs and volumes can be obtained by comparing RPW by shape Report data (from USPS LR-L-87) and ODIS-RPW sample based Standard Regular volumes by shape. The basis for this indication is that ODIS-RPW sample based system and the cost systems (which are also sample based) have the same definition of shape and, therefore, diverge from RPW by shape data in the same way. Thus, parcel shaped mail pieces which qualify for automation flats rates and which are reported as flats in RPW, and as parcels in cost systems, would also be reported as parcels in ODIS-RPW volumes by shape. Attachment 2 shows the comparison of RPW by shape and ODIS-RPW volumes by shape for Standard Regular. The last column has the ratio of RPW by shape volumes (USPS LR-L-87/ mailing statement based) to ODIS-RPW sample based system volumes for Standard Regular parcels for the fiscal years 1996 to 2005. This ratio shows that the Standard Regular parcel volumes for the years FY 1996 to FY 1998 were about the same for the two systems. However, starting in FY 1999 -- which is when the parcel rate surcharge and DMM 301.3.4.2 allowing certain parcel-shaped pieces to

costs. Nevertheless, most of the observed changes in Standard ECR parcel unit costs can not be accounted for due to changes in data systems or methodology. For additional information on the changes in data systems or methodology over the period FY 1996 to FY 2005, see the documentation provided in each of the Dockets listed in Attachment 1.

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qualify for automation flats rates were implemented -- RPW by shape parcel volumes have declined relative to those reported by ODIS-RPW. The decline in the ratio of RPW by Shape volumes to ODIS-RPW volumes for Standard Regular parcels since 1999 is consistent with the rise in the Standard Regular parcels unit costs, thus showing the value of the ratio as a measure of the cost and volumes inconsistency.

For Standard ECR parcels, the reason for cost and volume inconsistency is unknown. If, however, this inconsistency is reflected by inconsistency between RPW by Shape volumes and ODIS-RPW volumes for Standard ECR parcels, as may well be the case, then we can again use the ratio of RPW by Shape volumes to ODIS-RPW volumes for Standard ECR parcels to get a measure of inconsistency between costs and volumes. Attachment 3 shows a very large divergence between RPW by Shape volumes and ODIS-RPW volumes for Standard ECR parcels. It is one that has grown over time and it appears that this divergence has been present in the whole FY 1996 to FY 2005 time period. This divergence was present before the FY 1999 implementation of the parcel rate surcharge for Standard Mail.

f. An approach is to apply the same adjustment process used for Standard Regular using ODIS and RPW as shown in my testimony, USPS-T-13, Attachment 13, to Standard ECR parcels. Even without knowing the source for the cost anomaly, one can support the use of this method to adjust Standard ECR parcel costs on the basis that ODIS-RPW and the cost systems are both

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sample based and have the same definition of shape and, therefore, both may well diverge from RPW by shape data in a parallel way.

I provide a version of my testimony Attachment 13 for Standard ECR parcels, in Attachment 4 of this response. This shows the adjustment to be made to both Standard ECR flats and parcels as done for Standard Regular flats and parcels in USPS-T-13, Attachment 13. The test year Standard ECR parcel unit cost of \$2450.04 cents as reported in USPS-T-13, Attachment 14, would be 27.87 cents, if adjusted as proposed. In addition, Standard ECR flats processing unit costs would rise by 3.5 percent from 1.94 cents to 2.01 cents.

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**ATTACHMENT 1
TO QUESTION 2**

**MAIL PROCESSING LABOR UNIT COSTS FOR PARCELS FOR USPS AND PRC METHODS
BASE YEARS FY 1996 TO FY 2005***

USPS LABOR UNIT COST TRENDS

BASE YEAR	1996	1998	1999	2000	2004	2005
FIRST- CLASS SINGLE-PIECE	43.77	45.52	47.55	53.33	61.06	67.68
FIRST-CLASS PRESORT	20.68	110.59	87.78	163.68	184.02	203.95
STD ECR	9.07	21.59	91.50	117.14	595.08	1,637.91
STD REGULAR	17.22	30.77	31.62	37.89	50.43	46.58
DOCKET NO.	R97-1	R2000-1	R2000-1	R2001-1	R2005-1	R2006-1
USPS LR-SPREADSHEET	H-106 CSTSHAPE.XLS	I-81 MPSHAPBN.xls	I-464 SP99USPS.xls	J-46 shp00usps.xls	K-148 shp04usps.xls	L-143 shp05usps.xls

PRC LABOR UNIT COST TRENDS

BASE YEAR	1996	1998	1999	2000	2004	2005
FIRST- CLASS SINGLE-PIECE	58.81	48.19	51.89	58.77	68.54	70.92
FIRST-CLASS PRESORT	26.55	85.10	62.00	121.58	159.17	207.36
STD ECR	12.30	25.01	82.08	125.79	604.06	1,376.17
STD REGULAR	23.90	32.52	33.67	40.46	58.46	50.23
DOCKET NO.	R97-1	R2000-1	R2000-1	R2001-1	R2005-1	R2006-1
USPS LR-SPREADSHEET	H-320 CSTSHAPE.XLS	I-137 MPSSHA~1.xls	I-466 SP99PRC.xls	J-81 shp00prc.xls	K-99 shp04prc.xls	L-99 shp05prc.xls

*USING THE SPREADSHEETS LISTED ABOVE, CALCULATIONS WERE DONE BY TAKING THE TOTAL LABOR PROCESSING COSTS FROM SHEET PARCELS (2) AND DIVIDING BY BASE YEAR VOLUMES FOR EACH CATEGORY. FOR DOCKET NO. R97-1 SEE SHEET ADJ. PARCEL CST. COSTS FOR THESE SHEETS INCLUDE CRA WORKSHEET AND PREMIUM PAY ADJUSTMENTS.

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COMPARISON OF STANDARD REGULAR RPW AND ODIS VOLUMES BY SHAPE FOR FY1996 TO FY2005

FY	RPW SHAPE REPORT VOLUME BY CLASS & SHAPE Volume In Thousands				ORIGIN-DESTINATION INFORMATION SYSTEM DESTINATING VOLUME BY CLASS & SHAPE Volume In Thousands Controlled to RPW				RATIO OF RPW TO ODIS FOR PARCELS/IPPS VOLUMES
	Letters/Cds.	Flats	Parcels/IPPs	All Shapes	Letters/Cds.	Flats	Parcels/IPPs	All Shapes	
	<i>Source: LR-L-87 Shape GFY 2005rV.xls and predecessors.</i>				<i>Source: ODIS-RPW UDS file and predecessors.</i>				
1996	26,762,761	11,776,419	911,794	39,450,974	26,556,590	12,080,851	813,533	39,450,974	1.121
1997	27,987,649	13,865,284	852,716	42,705,649	29,015,635	12,859,065	830,949	42,705,649	1.026
1998	30,082,582	14,714,976	854,093	45,651,650	31,179,949	13,614,401	857,300	45,651,650	0.996
1999	33,724,748	15,421,273	799,839	49,945,860	34,345,319	14,688,773	911,769	49,945,860	0.877
2000	37,872,913	15,771,844	711,753	54,356,510	38,223,109	15,308,226	825,175	54,356,510	0.863
2001	40,421,962	14,996,482	676,623	56,095,067	40,344,656	14,968,069	782,342	56,095,067	0.865
2002	40,725,213	13,497,171	640,574	54,862,958	40,047,299	14,011,353	804,306	54,862,958	0.796
2003	43,928,876	13,625,157	610,021	58,164,054	43,298,128	14,048,555	817,371	58,164,054	0.746
2004	48,117,714	13,859,534	590,572	62,567,820	47,479,534	14,306,463	781,823	62,567,820	0.755
2005	51,289,509	14,028,861	600,304	65,918,674	50,560,811	14,573,851	784,012	65,918,674	0.766

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COMPARISON OF STANDARD ECR RPW AND ODIS VOLUMES BY SHAPE FOR FY1996 TO FY2005

FY	RPW SHAPE REPORT VOLUME BY CLASS & SHAPE Volume In Thousands				ORIGIN-DESTINATION INFORMATION SYSTEM DESTINATING VOLUME BY CLASS & SHAPE Volume In Thousands Controlled to RPW				RATIO OF RPW TO ODIS FOR PARCELS/IPPS VOLUMES
	Letters/Cds.	Flats	Parcels/IPPs	All Shapes	Letters/Cds.	Flats	Parcels/IPPs	All Shapes	
	<i>Source: LR-L-87 Shape GFY 2005rV.xls and predecessors.</i>				<i>Source: ODIS-RPW UDS file and predecessors.</i>				
1996	15,102,584	16,915,917	70,853	32,089,354	15,105,610	16,858,478	125,266	32,089,354	0.566
1997	13,938,145	20,383,605	55,043	34,376,793	16,148,760	18,145,232	82,801	34,376,793	0.665
1998	15,091,974	21,564,244	49,997	36,706,215	16,757,151	19,863,665	85,400	36,706,215	0.585
1999	13,531,544	22,118,596	23,674	35,673,814	14,365,305	21,231,515	76,994	35,673,814	0.307
2000	11,892,684	23,790,828	17,125	35,700,637	12,092,096	23,501,006	107,535	35,700,637	0.159
2001	10,307,620	23,529,662	6,080	33,843,362	9,867,071	23,868,419	107,872	33,843,362	0.056
2002	9,716,807	22,640,951	9,920	32,367,678	8,804,191	23,457,370	106,117	32,367,678	0.093
2003	8,737,941	23,453,648	2,873	32,194,462	8,011,783	24,045,575	137,104	32,194,462	0.021
2004	8,500,989	24,492,946	1,766	32,995,701	8,650,349	24,253,825	91,528	32,995,701	0.019
2005	9,040,800	25,981,881	737	35,023,418	9,039,834	25,918,785	64,798	35,023,418	0.011

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STANDARD ECR FLATS-PARCEL COST ADJUSTMENT FOR COSTS BY SHAPE

PART I: CALCULATION OF RPW/RPW-ODIS RATIO FOR STANDARD ECR PARCELS

ORIGIN-DESTINATION INFORMATION SYSTEM - REVENUE PIECES & WEIGHT
STANDARD MAIL DESTINATING VOLUME BY SHAPE, FY2005
Volumes in 000s

ODIS		Letters & Cards	Flats	IPPS/Parcels	Total		
STANDARD MAIL	<i>ECR-RT</i>	6,867,690	19,690,868	49,228	26,607,786		
All	<i>OTHER</i>	52,739,909	15,201,963	817,802	68,759,674		
	<i>ALL</i>	59,607,600	34,892,831	867,030	95,367,461		
ODIS		Letters & Cards	Flats	IPPS/Parcels	Total		
Distribution Key %	<i>ECR-RT</i>	25.8%	74.0%	0.2%		1	1
	<i>OTHER</i>	76.7%	22.1%	1.2%		1	1
	<i>ALL</i>						
RPW Volumes with ODIS Shape Shares							
		Letters & Cards	Flats	IPPS/Parcels	Total		
RPW Adjusted	<i>ECR-RT</i>	9,039,834	25,918,785	64,798	35,023,418		
STANDARD MAIL	<i>OTHER</i>	50,560,811	14,573,851	784,012	65,918,674		
All	<i>ALL</i>	59,600,645	40,492,636	848,810	100,942,091		
				100,942,091			
RPW Volumes by Shape							
RPW	<i>ECR-RT</i>	9,040,800	25,981,881	737	35,023,418		
STANDARD MAIL	<i>OTHER</i>	51,289,509	14,028,861	600,304	65,918,674		
All	<i>ALL</i>	60,330,308	40,010,742	601,041	100,942,091		
					100,942,091		
RPW/RPW-ODIS	<i>ECR</i>			0.011374118			

PART II: CALCULATION OF ADJUSTMENT

					Unit Costs With Final Reconciliation Factor	
		Unadjusted Costs			Unadjusted Unit Costs	
Std. ECR Unit Costs	n/a		1.96	2,472.41	1.94	2,450.04
Total ECR Costs			508,840	18,222		
Split of Parcel Costs to Flats & Parcels			18,015	207		
		Adjusted Costs			Adjusted Unit Costs	
Total ECR Costs			526,854	207		
Std. ECR Unit Costs			2.03	28.12	2.01	27.87
Adjustment Ratios			1.035	0.011374118	1.035	0.011374118