

USPS-T-32

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

POSTAL RATE AND FEE CHANGES, 2001

Docket No. R2001-1

**DIRECT TESTIMONY
OF
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ON BEHALF OF
UNITED STATES POSTAL SERVICE**

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Autobiographical Sketch

My name is Joseph D. Moeller. I am an Economist in Pricing and Classification at Postal Service Headquarters. Prior to my assignment in Pricing, I was a Marketing Specialist for Advertising Mail in Product Management. I joined the Postal Service in 1987 as a Staff Economist in the Rate Studies Division of the Office of Rates.

I have testified on behalf of the Postal Service in several Postal Rate Commission proceedings. In Docket No. R90-1, I presented direct testimony regarding second- and third-class presort-related and shape-related cost differentials. I also presented rebuttal testimony in that proceeding regarding the third-class minimum-per-piece rate structure. In Docket No. MC93-1, I presented cost estimates and proposed rates for the Bulk Small Parcel Service. I offered testimony in support of the Postal Service's proposals for Standard Mail (A) in Docket No. MC95-1, and in Docket No. MC96-2, Nonprofit Classification Reform. In Docket No. R97-1 and Docket No. R2000-1, I presented the rate design for Standard Mail (A).

My previous experience includes work as an Industrial Engineer for the Batesville Casket Company of Hillenbrand Industries. My responsibilities included time study analysis of indirect labor.

I received a Master of Science Degree in Management in 1986 and a Bachelor of Science Degree in Industrial Management in 1983 from Purdue University.

1 I. PURPOSE OF TESTIMONY

2 The purpose of my testimony is to present the proposed classification changes
3 and rates for Standard Mail Regular and Nonprofit. Rates for the Regular subclass
4 are developed using cost data from various cost witnesses and the rate level
5 requirements developed in USPS-T-28. Rates for the Nonprofit subclass are also
6 developed from cost data provided by cost witnesses, and reflect the statutory
7 requirements of Public Law No. 106-384.

8 Library Reference USPS-LR-J-132 contains workpapers cited throughout this
9 testimony. This library reference is incorporated by reference in my testimony.¹

10 I begin with an overview of the proposals, and then address each subclass
11 individually.

12

13 II. PROPOSAL OVERVIEW

14 The following table displays the percentage change in revenue per piece for
15 Regular and Nonprofit Standard Mail:

Regular 8.0%

Nonprofit 6.7%

16

¹ For convenience and ease of reference, the workpapers in the library reference are cited using the acronym “WP” in lieu of the library reference number.

1 **III. CLASSIFICATION CHANGES**

2 The Postal Service is proposing three classification changes for the Standard
3 Mail Regular and Nonprofit subclasses.² I address each of these below.

4 **A. Nonmachinable Letter Surcharge**

5 The Postal Service proposes a new surcharge in both the Regular and
6 Nonprofit subclasses for nonmachinable Presort letters. Currently, letters in the
7 presort category are subject to the same rate, regardless of whether they are
8 compatible with letter sorting equipment. Also, some mailers request manual
9 handling of their letters, but pay the same rate as those presort letters that can be
10 upgraded to automated handling by the Postal Service. In order to better reflect the
11 additional cost of handling letters that are not processed on automated equipment for
12 the reasons stated above, the Postal Service is proposing a surcharge on Presort
13 letters that do not meet the basic machinability standards for letters.³

14 Creation of this surcharge is consistent with the classification criteria of the
15 Postal Reorganization Act. It would enhance fairness and equity in that it helps
16 relieve the non-surcharged letters of the additional costs of the nonmachinable
17 letters, as well as the additional costs incurred by the Postal Service to accommodate
18 mailer requests for manual handling. Postal Service processing and efficiency would
19 benefit to the extent that the surcharge leads mailers to produce machinable pieces,
20 or reconsider their requests for manual handling. Creation of the surcharge does add
21 some complexity to the rate schedule; however, the advantages of the surcharge in

² Several edits are proposed in the footnotes to the Standard Mail rate schedules. These are intended to be nonsubstantive in nature and are designed to reduce duplication with the DMCS.

³ USPS-T-39 at Sections II.A.3 and II.A.4.

1 recovering some of the added costs of processing, as described by Witness Kingsley
2 (USPS-T-39 at 10-12), outweigh disadvantages posed by the added complexity.

3 **B. Subdivision of Basic Automation Letters**

4 The Postal Service is also proposing to divide Automation Basic letters into
5 two separate rate categories: Mixed AADC and AADC. As the acronyms of these
6 proposed categories imply, AADC category letters would be presorted to designated
7 automated area distribution centers, while Mixed AADC letters would represent a sort
8 encompassing multiple automated area distribution centers. The proposed division
9 of the basic tier better accounts for the higher cost characteristics of mixed AADC
10 mail. As described by witness Kingsley, AADC trays offer significant cost advantages
11 over Mixed-AADC trays. (USPS-T-39 at 13). Currently, letters in these two types of
12 trays are subject to the same rate, despite this cost difference. Creation of the
13 separate rate for AADC would enhance fairness and equity in that mailers that are
14 able to create AADC trays due to the density of their mailings will not have to
15 shoulder the additional costs associated with Mixed-AADC trays. Processing and
16 efficiency would benefit to the extent mailers can merge mailings or take other steps
17 to increase their ability to achieve the density for AADC trays. There is little added
18 complexity to the rate schedule, especially since the tray preparation tiers exist today.

19

20 **C. Extension of the Weight Limit for Automation Letters**

21 In Docket No. R2000-1, the Postal Service explained that, as an administrative
22 matter, it planned to extend the weight limit for automation letters to 3.5 ounces,
23 without any additional postage. The Commission, however, recommended
24 classification language in the footnotes to the rate schedules fixing the breakpoint
25 weight at 3.3 ounces. The Governors rejected this recommended change on

1 grounds that it “was not explicitly addressed or supported on the record.” Governors’
2 Decision on Selected Classification Changes (December 4, 2000).

3 In this proceeding, the Postal Service is proposing that heavy automation
4 letters be eligible for letter piece rates combined with the pound rate for pound-rated
5 flats. The additional weight above 3.3 ounces (but less than 3.5 ounces) will be
6 charged additional postage. In effect, the mailers will pay the applicable pound rate
7 for the additional weight above 3.3 ounces. As in Docket No. R2000-1, it is expected
8 that any effect on revenues and costs would be *de minimis*.

9 This proposed change is intended to permit automation letter mailers to avoid
10 the substantial rate increase for letter-shaped pieces exceeding 3.3 ounces. Under
11 the current schedule, once an automation letter exceeds the 3.3 ounce maximum
12 weight, the pieces become subject to the rates for pound-rated presort nonletters.
13 This results in a substantial increase, as shown in the table below.

	Current Rate⁴	Proposed
3.3 Ounce Automation Letter	\$0.190	\$0.203
3.4 Ounce Automation Letter	\$0.270	\$0.207
3.5 Ounce Automation Letter	\$0.274	\$0.212

14
15 As shown in the table above, under current rates, a tenth of an ounce added to a 3.3
16 ounce letter results in an eight cent increase in the rate. Under the proposed rates,
17 the increase will only be 0.4 cent. This proposal will thus enable some mailers to
18 avoid the big increase in postage that occurs when an automation letter crosses the
19 breakpoint weight. This proposal is also advantageous to the Postal Service, since

⁴ This example is for a 3-digit automation letter. Assumes that a piece exceeding 3.3 ounces is rated as a pound-rated Presort Nonletter.

1 automated letter processing (even for pieces of this weight) is more cost-effective
2 than manual letter or automated flat processing.⁵

3 The proposal amends the Automation Rate Schedule to include a per-piece
4 discount (dependent upon the tray preparation level) for automation letters to be
5 applied to the piece-pound rates for automation flats. As described above,
6 processing and efficiency would benefit since these pieces can be handled in the
7 automation letter mailstream. There is added complexity to the rate structure;
8 however, the mailers who would take advantage of this proposed option should be
9 familiar with the complexity of the current structure, and willing to accept the added
10 complexity in exchange for the rate relief offered by the proposal.

11

12 **IV. STANDARD MAIL REGULAR SUBCLASS**

13 **A. Characteristics**

14 In Docket No. MC95-1, the Commission recommended, and the Governors
15 approved, a series of changes to First-Class, Periodicals, and Standard Mail
16 schedules. Implemented on July 1, 1996, the changes split the former third-class
17 bulk regular rate subclass into two new subclasses: Regular and Enhanced Carrier
18 Route (ECR). The Regular subclass consists primarily of advertising mail that is
19 targeted to recipients based on demographic factors, whereas the ECR subclass is
20 geared toward more geographically-dense advertising. Examples of Regular
21 subclass users include mail-order firms targeting specific markets, such as
22 professional uniform buyers or coin collectors.

⁵ See generally witness Kingsley (USPS-T-39).

1 Detailed revenue, volume and rate histories are available in Library
2 References USPS-LR-J-90 and USPS-LR-J-91.

3 **B. Recent History of Rate Design**

4 In Docket No. R90-1, the Postal Service proposed, and the Commission
5 adopted, a rate design methodology for bulk third-class mail that uses an equation to
6 calculate rates.⁶ That basic formula, with a few modifications, has been used in
7 every proceeding since then. The modifications include: development of separate
8 formulas for the subclasses created as a result of classification reform, a change in
9 the variable for which the formula solves, and the accommodation of new discounts
10 and surcharges. The rate design employed in this proposal uses the same basic
11 formula, as described in the next section.

12 **C. Proposed Rate Design**

13 1. Rate Design Formula and Process

14 The proposed rate design uses the Commission's methodology and rate
15 design formula from Docket No. R2000-1. It also includes a few adaptations to the
16 rate design, as discussed below.

17 First, as a result of Public Law No. 106-384, separate costs for Regular and
18 Nonprofit are no longer available. Instead, one cost measure, consisting of the
19 combined cost of Regular and Nonprofit, is provided. Since the rate design
20 equations have volume variable costs as an input for both Regular and Nonprofit, an
21 estimate of the cost for each must be developed. The volume variable costs for
22 these subclasses are estimated by applying the cost share of each subclass from

⁶ PRC Op., MC95-1 ¶ 5639.

1 Docket No. R2000-1, relative to the combined total costs of both Regular and
2 Nonprofit subclasses. In other words, the volume variable cost for the combined
3 Regular/Nonprofit grouping is split in proportion to the TYAR volume variable costs
4 from the Docket No.R2000-1 proposal.⁷ As will be described below, the splitting of
5 the costs is merely a placeholder to allow the formula to function and produce rates.

6 These estimated volume variable costs for Regular (and Nonprofit) serve as
7 the starting point in the rate design formula. For Regular, a markup is then applied to
8 generate the desired percentage change in revenue that would likely produce the
9 target cost coverage for the combined Regular/Nonprofit subclass (See USPS-T-28).
10 For Nonprofit, the procedure differs since the markup applied is intended to produce
11 the statutory revenue-per-piece relationship with the commercial mail.⁸ As a practical
12 matter, the splitting of the cost into Regular and Nonprofit is strictly to allow the
13 application of the rate design equation methodology. It does not purport to
14 unambiguously measure volume variable costs of these two subclasses of Standard
15 Mail in isolation. For example, if an alternative allocation technique were chosen and
16 that alternative resulted in a higher cost for Regular (than is obtained in the method
17 of splitting described above), a lower markup would be input into the rate design
18 formula to achieve the desired percentage increase and the resulting cost coverage
19 for the Regular/Nonprofit grouping. While this procedure is a bit cumbersome, and
20 the markups that are input into the rate design formula are not directly related to the
21 eventual after-rates cost coverage, the iterative nature of rate design allows the user
22 of the formulae to foresee the likely outcome of the inputs, both in terms of
23 percentage changes, and after-rates cost coverage.

⁷ Docket No. R2000-1, Moeller WP1 p.16, and Moeller WP2 p.16.

1 Second, as will be described in the sections below, the rate design formula
2 requires modifications to incorporate new discounts and surcharges. New cost data
3 will be used, and some alternative benchmarks may be useful.

4 In order for the rate design formula to function, revenue “leakages” must be
5 calculated, which requires that decisions first be made regarding passthroughs for
6 discounts and other rate elements, such as the pound rate. The following sections
7 will discuss each of these rate elements. Although the text may imply that each
8 decision is made independently, in fact the decisions are interdependent, and are
9 reached after an iterative process that is employed until the rate design objectives
10 are met. For example, in consideration of the effect on users, the rate design is
11 sensitive to the amount by which an individual rate cell is proposed to increase. To
12 limit the increase on an individual rate category, it may be necessary to adjust
13 several passthroughs. Also, rate relationships, such as the one between 5-digit
14 automation letters and ECR basic letters, must be examined, and passthroughs
15 adjusted in order to maintain the desired relationship, if necessary. In general, the
16 rate design process begins with the passthroughs underlying the current rates, with
17 modifications made to meet the rate design objectives.

18 2. Shape Recognition

19 a. Letter/Nonletter Differential 20

21 The proposed rates for the Regular subclass continue the rate differential
22 based on shape, which was first introduced in 1991. The differentials incorporated in

(continued...)

⁸ The revenue per piece for Nonprofit is to be 60 percent of the commercial revenue
(continued...)

1 the current rates reflect 73 percent of the cost difference between letters and flats at
2 the Basic presort tier, and 67 percent of the difference between letters and flats at the
3 3/5-digit presort tier. In this proceeding, the Postal Service proposes shape-based
4 passthroughs of 73 percent for the Basic tier, and 85 percent for the 3/5-digit tier.
5 These passthroughs are similar to those recommended in Docket No. R2000-1,
6 recognize a significant portion of the cost differential, and result in reasonable
7 percent change levels for the affected categories.

8 b. Residual Shape Surcharge
9

10 The Residual Shape Surcharge was proposed and recommended in Docket
11 No. R97-1 in order to better reflect cost differences due to shape in the rates for
12 Standard Mail. The proposed rate design for Standard Mail retains the residual
13 shape surcharge, albeit at a higher level. The residual shape surcharge applies to
14 Standard Mail pieces that are not letter- or flat-shaped, or are prepared as parcels.

15 In Docket No. R2000-1 the surcharge was increased to 18 cents from the
16 original level of 10 cents for both Standard Regular and Nonprofit, and a slightly
17 lower surcharge was recommended for ECR and NECR. The original passthrough
18 was 24 percent of the identified cost difference between parcels and flats in Docket
19 No. R97-1. In Docket No. R2000-1, the passthrough was increased to 27.5 percent.

20 In this proceeding, the Postal Service proposes to increase the surcharge to
21 23 cents per piece for Standard Mail Regular mail that is neither letter- nor flat-
22 shaped, or is prepared as a parcel. A three-cent parcel barcode discount is again
23 proposed that partially offsets the surcharge for parcels that meet automation

(continued...)

per piece.

1 eligibility requirements.⁹ Using the passthrough methodology employed by the
2 Commission in its Docket No. R97-1 Recommended Decision,¹⁰ the 23-cent
3 surcharge equates to a 27.4 percent passthrough.¹¹ This passthrough figure is the
4 surcharge divided by the cost difference adjusted for presort and dropship
5 differences.

6 3. Pound Rate

7 The Postal Service proposes a modest increase in the pound rate for the
8 Regular subclass, from 66.8 cents to 70.8 cents. The Postal Service has previously
9 demonstrated that the changing shape mix between flats and parcels as weight
10 increases supports a higher pound rate than would be necessary if there were no
11 shape mix change.¹² In other words, if parcels are more prevalent at the higher
12 weight increments, the pound rate results in a higher revenue-per-piece for parcels
13 than for flats. In this filing, the Residual Shape Surcharge is proposed to increase,
14 further limiting the need for the pound rate to act as a proxy for shape change. The
15 added revenue comes more directly from the “parcels” in the form of the surcharge,
16 so the pound rate does not have to generate the revenue associated with the shape-
17 related costs of these residual shaped parcels. The shape surcharge in part takes
18 account of the changing shape mix, since it applies to pieces that are neither letter-
19 or flat-shaped.

⁹ Since most parcels are machinable, and since many already are barcoded, the net surcharge for many parcels will be 20 cents.

¹⁰ PRC Op., R97-1 ¶¶ 5485-86.

¹¹ $23/83.9 = 27.4\%$. Cost figure from USPS-LR-J-58, Table 6 and Table 7. Table 6 has the unadjusted parcel-flat differential of 93.4 cents, and Table 7 has the adjustment for presort and destination entry profile of 9.5 cents, for a net of 83.9 cents.

1 passthrough for nonletters. The shape passthroughs were selected as described
2 above in section IV.C.2.a.

3 Selection of a letter presort passthrough affects not only the rate for 3/5-digit
4 presort, but also the rates for 3-digit and 5-digit automation letters, 3/5-digit presort
5 nonletters, and 3/5-digit automation flats.¹⁴ The passthrough, therefore, is very
6 sensitive in that it plays a significant role in determining a majority of the rates in the
7 subclass and indirectly affects all rates in Regular. Witness Miller (USPS-T-22)
8 provides a measurement of cost avoidance due to presort, and the proposed rates
9 recognize the cost savings. Although 100 percent is often viewed as the optimal
10 passthrough, selection of 100 percent may result in outcomes for other rate cells that
11 are contrary to rate design objectives.

12 Selection of 158 percent for the letter presort passthrough, and the resulting
13 82 percent passthrough for nonletter presort, generously recognize the savings due
14 to presort. These passthroughs maintain the current rate differential for these
15 categories, and help facilitate the rate design objective of limiting the percentage
16 change for individual categories.

17 5. Automation/Machinability

18 a. Letter Automation
19

20 Witness Miller (USPS-T-22) provides estimates of cost avoidances due to
21 mailer preparation of automation letters. While the passthrough underlying the
22 current discounts is 100 percent, it may be necessary to deviate from it in order to

¹⁴ A change in the rate for 3/5-digit presort letters changes the rate for all of these other categories. See WP1, page BB for a graphic depiction of the “presort tree” and the importance of the letter presort passthrough.

1 avoid substantial changes in the discounts,¹⁵ or to meet particular rate relationship
2 objectives. Also, the proposal to include a surcharge on nonmachinable presort
3 letters raises questions as to the appropriate benchmark to be used to calculate the
4 automation discounts, as described below.

5 For the Mixed-AADC category, the passthrough in the rate design model is 82
6 percent. The cost basis to which that passthrough is applied is the difference
7 between Basic Presort Letters and Mixed-AADC automation letters. An alternative
8 cost basis that would more directly reflect the costs avoided when these letters meet
9 the automation requirements would be the difference between Mixed AADC
10 machinable presort letters (instead of all Basic Presort letters) and Mixed-AADC
11 automation letters. As presented by witness Miller, this cost difference is 2.528
12 cents.¹⁶ The implied passthrough, then, for the discount of 4.9 cents is 194 percent.
13 Nevertheless, the resulting rate for Mixed-AADC automation letters is reasonable,
14 given that the percentage change for this category of mail is still a higher-than-
15 average 9.5 percent.

16 For the AADC category, the passthrough in the rate design model is 95
17 percent. The cost basis to which that passthrough is applied is the cost difference
18 between Mixed-AADC Automation Letters and AADC Automation Letters, as
19 presented by witness Miller. This benchmark and the passthrough are reasonable in
20 that they recognize nearly all of the workshare-related cost difference between the
21 tiers, and result in a reasonable percentage change of 6 percent for the AADC tier.¹⁷
22 Also, the volume-weighted discount for the two new categories (Mixed AADC and

¹⁵ Since discounts encourage mailers to make investments in order to qualify for them, changes in these incentives are carefully evaluated.

¹⁶ USPS-LR-J-60.

¹⁷ This category benefits from the de-averaging of the Basic tier.

1 AADC) off of the Basic Presort letter category is 5.3 cents, the same as the current
2 Basic Automation discount (the combined Mixed-AADC and AADC category in the
3 current rate schedule).¹⁸

4 For the 3-digit category, the passthrough in the rate design model is 77
5 percent. The cost basis to which that passthrough is applied is the difference
6 between 3/5-digit Presort Letters and 3-digit automation letters, as was the case in
7 Docket No. R2000-1. An alternative cost basis that would more directly reflect the
8 costs avoided when these letters meet the automation requirements would be the
9 difference between 3-digit machinable presort letters (instead of all 3/5-digit Presort
10 letters) and 3-digit automation letters. As presented by witness Miller, this cost
11 difference is 3.167 cents.¹⁹ The implied passthrough, then, is 142 percent for the 4.5
12 cent discount. Nevertheless, the resulting rate for 3-digit automation letters is
13 reasonable, given that the resulting percentage change for this mail is 6.8 percent,
14 and the discount is very near the current level.

15 For the 5-digit category, the passthrough in the rate design model is 130
16 percent. The cost basis to which that passthrough is applied is the cost difference
17 between 3-digit Automation Letters and 5-digit Automation Letters, as presented by
18 witness Miller. This benchmark and the passthrough are reasonable in that they
19 recognize the workshare-related cost difference between the tiers, maintain the
20 discount at the current level, help create the desired relationship between 5-digit

¹⁸ The volume-weighted average is calculated using data from WP1, page M. Columns (5-6) Lines (9-10).

¹⁹ USPS-LR-J-60.

1 automation letters and ECR Basic letters²⁰, and result in a reasonable percentage
2 change for the 5-digit tier of 7.3 percent.

3

4 b. Automation Letter Weight Limit

5 As described in section III, the Postal Services proposes that automation
6 letters in the 3.3 to 3.5 ounce weight range be subject to the automated flat rate less
7 the associated letter/flat discount. For example, a 3.4 ounce, 5-digit automation letter
8 would pay the 3/5-digit automation flat rate for pound rated flats (\$0.115 per piece
9 plus weight charges of $(3.4/16)*0.708 = 0.266$), less the 5-digit automation letter/flat
10 differential (\$0.071 for 5-digit), for a net rate of \$0.195. This is slightly above the
11 minimum-per-piece rate of \$0.190 for 5-digit automation letters. The difference of
12 \$0.005 is the rate effect of the weight charge. This proposal is limited to Regular and
13 Nonprofit Automation Letters.

14

15 c. Nonmachinable Surcharge for Letters

16 As described in section III above, the Postal Service is proposing a new
17 surcharge to apply to presort letters that do not meet machinability standards.
18 Witness Miller presents cost figures that detail the cost implications of
19 nonmachinability. (USPS-LR-J-60). The added cost due to nonmachinability ranges
20 from 4.9 cents per piece for 5-digit presorted letters, to 21.3 cents for Mixed-ADC
21 presorted letters. The average for all presort levels is 9.1 cents. The proposed

²⁰ The current rate for 5-digit automation letters is lower than the ECR Basic rate. This has led to significant, beneficial changes in mail preparation. Prior to the establishment of this rate relationship, mailers had the incentive to prepare 10-piece (or greater) packages of carrier route presorted mail. Now, many mailers with the density for ECR Basic instead choose 5-digit automation letters. From a mail processing perspective, this preparation is advantageous, and the Postal Service desires to maintain this rate relationship. USPS-T-39 at II.A.4.

1 surcharge of four cents is applicable to all presort letters, regardless of presort level,
2 yet is still less than the lowest cost differential (4.9 cents for 5-digit automation). It
3 represents a 23 percent passthrough of the differential for the Basic tier, and 52
4 percent of the 3/5-digit tier. These passthroughs are reasonable for a new
5 surcharge.

6

7 d. Flats

8 As described by witness Kingsley (USPS-T-39 at II.B), the processing
9 environment for flats continues to evolve with a movement toward greater use of
10 mechanization and automation. Future systems will continue to rely on mailer
11 preparation of machinable, barcoded flats. Therefore, the rate design strives to
12 continue the strong price signal for machinable/barcoded flats. Witness Miller
13 (USPS-T-24) presents studies that quantify the workshare-related cost differences
14 associated with automation flats. As was the case in Docket No. R2000-1, these cost
15 differentials are lower than the existing discounts. The passthroughs underlying the
16 current discounts are 160 percent and 330 percent for the Basic and 3/5-digit tier,
17 respectively.²¹ The passthroughs used in the proposed rate design are 160 percent
18 and 225 percent, which retain the current discounts of 4.4 cents for Basic flats, and
19 2.7 cents for 3/5-digit flats. These discounts recognize the “long-term operational
20 value”²² of machinability and barcoding, and also result in reasonable percentage
21 changes for the automation flats categories.²³

²¹ The Decision of the Governors of the United States Postal Service on the Recommended Decision on Further Reconsideration of the Postal Rate Commission, Docket No. R2000-1, GOVS-LR-11, WP1, p.12, lines 2 and 4.

²² USPS-T-39 at II.B.6.

²³ The 3/5-digit category minimum-per-piece increase is 9.2 percent. This category contains 82 percent of all Regular nonletters.

1 e. Parcels

2 The parcel barcode discount applies to machinable parcels that meet the
3 physical requirements for the discount. The Postal Service proposes to maintain a
4 discount of three cents, which is at the same level as is found in current rates.
5 Witness Eggleston (USPS-T-25) provides the cost analysis, and the discount is
6 consistent with the discount offered in Package Services.

7 Although some machinable parcels are required to be prepared to 5-digit and
8 therefore generally do not benefit from the barcode,²⁴ the discount is maintained in
9 this proceeding since a rate anomaly would occur otherwise. Currently, BMC-
10 prepared machinable parcels receive the same rate as 5-digit presorted machinable
11 parcels, that is, the 3/5-digit nonletter rate. Therefore, if only BMC-prepared parcels
12 received the discount, they would have a lower effective rate than 5-digit presorted
13 parcels, even though the latter entirely avoid the sortation in which the barcode is
14 used.

15 6. Destination Entry

16 Destination entry discounts for Standard Mail were first offered in 1991. As a
17 matter of practice, the discounts have not varied by subclass within Standard Mail.
18 To continue that practice, the rate design for Regular and Nonprofit incorporates the
19 destination entry discounts as proposed by witness Hope (USPS-T-31).

20

21

22

²⁴ They will not benefit since the barcode is used to sort to the 5-digit level. Pieces presorted to 5-digit, therefore, will not be processed on the equipment.

1 **D. Summary of Proposed Regular Subclass Rates**

2 Below is a summary of proposed Regular Rates:

		Entered at destination:	
		BMC	SCF
Automation			
Letters			
Mixed AADC	0.219	0.198	0.193
Auto AADC	0.212	0.191	0.186
3-digit	0.203	0.182	0.177
5-digit	0.190	0.169	0.164
Flats (pc-rated)			
Basic	0.300	0.279	0.274
3/5-digit	0.261	0.240	0.235
Flats (lb-rated)			
Per piece:			
Basic	0.154	0.154	0.154
3/5 digit	0.115	0.115	0.115
per pound:			
Basic	0.708	0.608	0.583
3/5 digit	0.708	0.608	0.583
<hr/>			
Presort			
Letters			
Basic	0.268	0.247	0.242
3/5-digit	0.248	0.227	0.222
Nonletters			
(piece-rated)			
Basic	0.344	0.323	0.318
3/5-digit	0.288	0.267	0.262
Nonletters			
(lb-rated)			
Per piece:			
Basic	0.198	0.198	0.198
3/5 digit	0.142	0.142	0.142
Per pound:			
Basic	0.708	0.608	0.583
3/5 digit	0.708	0.608	0.583
Residual Shape Surcharge			0.230
Parcel Barcode Discount			0.030
Nonmachinable Letter Surcharge			0.040

1 **V. STANDARD MAIL NONPROFIT**

2 **A. Characteristics**

3 The Nonprofit subclass is the nonprofit counterpart to the commercial Regular
4 subclass. Nonprofit subclass mail consists primarily of charitable solicitations and
5 informational and promotional materials. Examples of users of Nonprofit mail include
6 philanthropic organizations and universities.

7 Detailed revenue, volume, and rate histories are available in USPS Library
8 References J-90 and J-91.

9 **B. Brief History of Rate Design**

10 Prior to Docket No. R2000-1, nonprofit rates were set according to the
11 Revenue Forgone Reform Act (RFRA). This law established a six-year phasing
12 schedule that ultimately resulted in rate levels for nonprofit that were one-half the
13 comparable commercial markup. Public Law No. 106-384, which was enacted in
14 October 2000, replaced the “half-the-markup” method for determining Nonprofit rates,
15 and is the foundation for the current rates. Specifically, the law requires that
16 Nonprofit revenue-per-piece should be 60 percent of commercial revenue per
17 piece.²⁵

²⁵ The revenue-per-piece is to be calculated using TYBR volumes.

1 **C. Proposed Rate Design**

2 1. Rate Design Formula and Process

3 In keeping with the effort to mirror the commercial subclass, the proposed
4 Nonprofit rate design uses the same basic formula as described in Section IV.C.1
5 above. Similar modifications are made to the formula to accommodate the new rate
6 elements, and to deal with the fact that Nonprofit-specific volume variable costs are
7 no longer collected. In the formula, a “markup” is entered that will generate a
8 revenue-per-piece that is approximately 60 percent of the commercial revenue per
9 piece.²⁶ The rate design process begins with the selection of passthroughs and the
10 pound rate in accordance with the rate design objectives, such as maintenance of
11 existing discounts and avoidance of rate increases significantly different from the
12 overall subclass average.

13

²⁶ As a practical matter, for any given set of proposed rates, the Regular rate design must be completed prior to the Nonprofit rate design. Also, choosing a markup is the first rough cut at hitting the revenue-per-piece target. Other inputs such as passthroughs and the pound rate can be altered slightly as a means to get closer to the target.

1

2 2. Pound Rate

3 The current pound rate is 55 cents. The Postal Service is proposing a pound
4 rate of 58.4 cents. This modest increase in the pound rate is consistent with the
5 overall increase for the subclass. The proposed breakpoint weight which is
6 incorporated into the rate design formula is 3.3 ounces. As discussed in Section
7 IV.C.3, the Postal Service intends to use the proposed 3.3 ounces as the breakpoint,
8 rather than a calculated breakpoint.

9 3. Shape Recognition

10 a. Letter/Nonletter Differential
11

12 As in the Regular subclass, the rate structure recognizes a cost
13 differential between letters and nonletters. The proposed shape-based passthrough
14 is 62 percent at the Basic tier, and 63 percent at the 3/5-digit tier. These are higher
15 than the passthroughs underlying the current rates (50 and 40 percent), but provide
16 for a reasonable recognition of the shape-related cost differences.

17 b. Residual Shape Surcharge

18 Consistent with the proposals for the commercial subclasses, the Postal
19 Service proposes a residual shape surcharge of 23 cents for Nonprofit pieces that
20 are not letter- or flat-shaped, or are prepared as parcels.

21 4. Presort Tiers

22 The proposed presort passthrough for letters is 100 percent, and the
23 passthrough of the cost differential for nonletters is 69 percent. These passthroughs
24 are reasonable, and keep the discounts within one-tenth of a cent of their current
25 levels.

1

2 5. Automation/Machinability

3 a. Letter Automation
4

5 As in Regular, the Basic Automation Letter category is replaced with Mixed-
6 AADC and AADC letter categories.

7 For the Mixed-AADC category, the passthrough in the rate design model is 35
8 percent. The cost basis to which that passthrough is applied is the difference
9 between Basic Presort Letters and Mixed-AADC automation letters. An alternative
10 cost basis that would more directly reflect the costs avoided when these letters meet
11 the automation requirements would be the difference between Mixed AADC
12 machinable presort letters (instead of all Basic Presort letters) and Mixed-AADC
13 automation letters. As presented by witness Miller, this cost difference is 2.528
14 cents.²⁷ The implied passthrough, then, for the discount of 2.1 cents is 83 percent.
15 This is a reasonable passthrough, especially given the resulting percentage change
16 for this mail is 8.3 percent.

17 For the AADC category, the passthrough in the rate design model is 100
18 percent. The cost basis to which that passthrough is applied is the cost difference
19 between Mixed-AADC Automation Letters and AADC Automation Letters, as
20 presented by witness Miller. This benchmark and the passthrough are reasonable in
21 that they recognize all of the workshare-related cost difference between the tiers, and
22 result in a reasonable percentage change for the AADC tier of 2.3 percent.²⁸ Also,
23 the volume-weighted discount for the two new categories (Mixed AADC and AADC)

²⁷ USPS-LR-J-60.

1 off of the Basic Presort letter category is the same as the current Basic Automation
2 discount (the combined Mixed-AADC and AADC category in the current rate
3 schedule).²⁹

4 For the 3-digit category, the passthrough in the rate design model is 41
5 percent. The cost basis to which that passthrough is applied is the difference
6 between 3/5-digit Presort Letters and 3-digit automation letters, as was the case in
7 Docket No. R2000-1. An alternative cost basis that would more directly reflect the
8 costs avoided when these letters meet the automation requirements would be the
9 difference between 3-digit machinable presort letters (instead of all 3/5-digit Presort
10 letters) and 3-digit automation letters. As presented by witness Miller, this cost
11 difference is 3.167 cents.³⁰ The implied passthrough using this figure, then, is 73
12 percent for the 2.4 cent discount. Nevertheless, the resulting rate for 3-digit
13 automation letters is reasonable, given that the resulting percentage change for this
14 mail is 4.9 percent, and the discount is very near the current level.

15 For the 5-digit category, the passthrough in the rate design model is 150
16 percent. The cost basis to which that passthrough is applied is the cost difference
17 between 3-digit Automation Letters and 5-digit Automation Letters, as presented by
18 witness Miller. This benchmark and the passthrough are reasonable in that they
19 recognize the workshare-related cost difference between the tiers, maintain the
20 discount at the current level, and result in a reasonable percentage change for the 5-
21 digit tier of 5.6 percent.

(continued...)

²⁸ This category benefits from the de-averaging of the Basic tier.

²⁹ The volume-weighted average is calculated using data from WP2, page M. Columns (5-6) Lines (9-9a).

³⁰ USPS-LR-J-60.

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b. Automation Letter Weight Limit

As described in section III, the Postal Services proposes that automation letters in the 3.3 to 3.5 ounce weight range be subject to the automation flat rate less the associated letter/flat discount. The proposal includes Nonprofit Automation letters.

c. Nonmachinable Surcharge for Letters

As described in section III above, the Postal Service is proposing a new surcharge to apply to presort letters that do not meet machinability standards. Witness Miller presents cost figures that detail the cost implications of nonmachinability. (See USPS-LR-J-60). The added cost due to nonmachinability ranges from 4.9 cents per piece for 5-digit presorted letters, to 21.3 cents for Mixed-AADC presorted letters. The average for all presort levels is 9.1 cents. The proposed surcharge of 2 cents is applicable to all presort letters, regardless of presort level, yet is still less than the lowest cost differential (4.9 cents for 5-digit automation). It represents a 12 percent passthrough of the differential for the Basic tier, and 26 percent of the 3/5-digit tier. These passthroughs are reasonable for a new surcharge, and are lower than those proposed for the commercial subclass.³¹

d. Flats

³¹ The surcharge in the Regular subclass is 4 cents; in Nonprofit it is 2 cents. Due to the lower prices in Nonprofit, a 4 cent surcharge would result in unacceptably large percentage changes for affected letters.

1 As described by witness Kingsley (USPS-T-39 at II.B.6), the processing
2 environment for flats continues to evolve with a movement toward greater use of
3 mechanization and automation. Future systems will continue to rely on mailer
4 preparation of machinable, barcoded flats. Therefore, the rate design strives to
5 continue the strong price signal for machinable/barcoded flats. Witness Miller
6 (USPS-T-24) presents studies that quantify the workshare-related cost differences
7 associated with automation flats. As was the case in Docket No. R2000-1, these cost
8 differentials are lower than the existing discounts. The passthroughs underlying the
9 current discounts are 150 percent and 200 percent for the Basic and 3/5-digit tier,
10 respectively.³² The passthroughs used in the proposed rate design are 150 percent
11 and 140 percent, which retain the current discounts of 4.1 cents for Basic flats, and
12 1.7 cents for 3/5-digit flats. These discounts recognize the “long-term operational
13 value”³³ of machinability and barcoding, and also result in reasonable percentage
14 changes for the automation flats categories.³⁴

15 e. Parcels

16 Consistent with the Regular subclass (section IV.C.5.e), the parcel barcode
17 discount of 3 cents is proposed for Nonprofit pieces that meet the physical dimension
18 requirements for the discount.

19 6. Destination Entry

20 Destination entry discounts are determined for this subclass in the same
21 manner as the other subclasses. Since the cost study used is a measure of all

³² The Decision of the Governors of the United States Postal Service on the Recommended Decision on Further Reconsideration of the Postal Rate Commission, Docket No. R2000-1, GOVS-LR-11, WP2, p.12, lines 2 and 4.

³³ USPS-T-39 at II.B.6.

- 1 subclasses combined, and since the passthroughs selected are the same for each
- 2 subclass, the discounts do not vary by subclass. Details of destination entry
- 3 discounts are provided by witness Hope (USPS T-31).

(continued...)

³⁴ The 3/5-digit category minimum-per-piece increase is 7.8 percent, and the Basic category increase is 5.6 percent.

1 **D. Proposed Nonprofit Rates**

2 Below is a summary of the proposed rates for Nonprofit:

3

		Entered at destination:	
		BMC	SCF
Automation			
Letters			
Mixed AADC	0.144	0.123	0.118
Auto AADC	0.136	0.115	0.110
3-digit	0.129	0.108	0.103
5-digit	0.114	0.093	0.088
Flats (pc-rated)			
Basic	0.189	0.168	0.163
3/5-digit	0.166	0.145	0.140
Flats (lb-rated)			
per piece:			
Basic	0.069	0.069	0.069
3/5 digit	0.046	0.046	0.046
per pound:			
Basic	0.584	0.484	0.459
3/5 digit	0.584	0.484	0.459
<hr/>			
Presort			
Letters			
Basic	0.165	0.144	0.139
3/5-digit	0.153	0.132	0.127
Non-letters (pc-rated)			
Basic	0.230	0.209	0.204
3/5-digit	0.183	0.162	0.157
Non-letters (lb-rated)			
per piece:			
Basic	0.110	0.110	0.110
3/5 digit	0.063	0.063	0.063
per pound:			
Basic	0.584	0.484	0.459
3/5 digit	0.584	0.484	0.459
Residual Shape Surcharge			0.230
Parcel Barcode Discount			0.030
Nonmachinable Letter Surcharge			0.020

1 **VI. TEST YEAR 2003 FINANCIAL SUMMARY**

2

3 The following table depicts the financial implications of Standard Mail
 4 proposal.³⁵ The revenue, cost, and contribution figures are in millions of dollars:

5

Test Year After Rates Financial Summary

6

	<u>Revenue</u>	<u>Cost</u>	<u>Contribution</u>	<u>Coverage</u>
Regular/Nonprofit	\$12711.544	\$8690.374	\$4021.170	146.3%

7

The coverage for Regular/Nonprofit meets that proposed in USPS-T-28.

8

³⁵ WP 1 p.W; WP 2 p.W.