

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

DIRECT TESTIMONY
OF
ALTAF H. TAUFIQUE
ON BEHALF OF
UNITED STATES POSTAL SERVICE

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AUTOBIOGRAPHICAL SKETCH

My name is Altaf H. Taufique. I currently serve as an economist in the office of Pricing, which is a component of the Pricing and Classification Department, within the Marketing group at the United States Postal Service headquarters.

I have testified before the Postal Rate Commission on ten occasions. I have testified in all omnibus rate cases since Docket No. R97-1. In Docket Nos. R97-1, R2000-1, and R2001-1, I was the pricing witness for Periodicals. In Docket No. R2005-1, I was the pricing and rate design witness for all mail classes. I have also filed rebuttal testimonies in Docket Nos. MC96-3, MC97-5, and R97-1 on a variety of subjects. My testimony in Docket No. MC99-3 addressed the issue of a rate anomaly affecting Nonprofit and Classroom Periodicals mailers. In Docket No. MC2000-1, I presented the Postal Service's proposal for an experimental "Ride-Along" classification for Periodicals. My testimony in Docket No. MC2002-3 proposed an experimental per-piece discount for co-palletized and dropshipped mail lacking density to make ADC pallets absent co-palletization. My testimony in Docket No. MC2004-1 supported the extension of the co-palletization experiment to high-editorial, heavier weight, small circulation publications, using a different discount structure.

Prior to joining the Postal Service in July 1996, I was employed by the Gulf States Utilities Company (GSU) in Beaumont, Texas, from 1980 to 1994. At GSU, I served as an economic analyst in the Corporate Planning department. I was subsequently promoted to Economist, Senior Economist, and finally to the

position of Director, Economic Analysis and Forecasting. My responsibilities at GSU included the preparation of the official energy, load, and short-term revenue forecasts, and the economic forecasts, for the regions served by the company. I testified before the Public Utility Commission of Texas in Austin and the Federal Energy Regulatory Commission in Washington, D.C, defending GSU's official energy and load forecasts.

I received a Master's Degree in Economics from Central Missouri State University in Warrensburg, Missouri in 1976, and a Bachelor's degree in Economics & International Relations from Karachi University in Karachi, Pakistan. I have also completed thirty-three credit hours of coursework towards a Ph.D. in Economics at Southern Illinois University. I taught economics at Chadron State College in Chadron, Nebraska between 1978 and 1980. During my employment at GSU in Texas, I taught courses in economics at Lamar University in Port Arthur, Texas.

1 **I. PURPOSE OF TESTIMONY**

2 The purpose of my testimony is to describe the Postal Service's proposed
3 rate design for First-Class Mail. My testimony presents the Postal Service's
4 proposed changes in First-Class Mail rates and classifications and explains why
5 these changes would be consistent with the policies of the Postal Reorganization
6 Act.

7 **II. GUIDE TO TESTIMONY AND SUPPORTING DOCUMENTATION**

8 This testimony is structured as follows. In Section III, I summarize the Postal
9 Service's First-Class Mail rate and classification proposals. Sections IV and V
10 then provide background information on First-Class Mail historical trends
11 concerning rates, volumes, and revenues.¹

12 In Section VI, my testimony explains in detail the rate design issues relating to
13 my proposed delinking of the rate design for Single-Piece and Presort letter mail
14 within the Letters and Sealed Parcels subclass. Specifically, delinking issues are
15 elaborated in Section VI.A. 1. Section VI.A.2 discusses the classification
16 changes related to the derivation of separate letter, flat, and parcel rates for both
17 Single-Piece and Presort Mail within the Letters and Sealed Parcels subclass.
18 These proposed shape-based changes lead me also to propose elimination of
19 the heavy-piece discount and a limitation in the application of the nonmachinable
20 surcharge. Section VI.A.3 explains the basis for my proposed elimination of the

¹ The following USPS Library References are associated with these sections of my testimony: Domestic Mail Revenue and Volume History, USPS LR-L-74; Domestic Mail Rate History, USPS-LR-L-73; and FY 2005 Billing Determinants, USPS-LR-L-77.

1 rate and classification for Automation Carrier Route Letters. Section VI.B
2 discusses the rate design for Single-Piece Letters, Flats and Parcels. Section
3 VI.C focuses on Presort Letters, Flats, and Parcels. Section VI.D deals with the
4 Cards subclass.

5 In Section VII, I discuss these classification change proposals in light of the
6 criteria in § 3623(c) of the Postal Reorganization Act. My testimony concludes
7 with a summary of the financial results of the proposed rates in Test Year 2008.

8 The rate design for First-Class Mail depends on inputs from several of my
9 colleagues. Witness O'Hara (USPS-T-31) provides the overall and subclass
10 revenue requirements for First-Class Mail. Witness Waterbury (USPS-T-10)
11 provides the rollforward costs for the Letters and Cards subclasses, as well as for
12 Single-Piece and Presort First-Class Mail within the Letters and Sealed Parcels
13 subclass. Key inputs, i.e., mail processing cost estimates for Presort Letters and
14 Cards to determine Automation rates, are provided by witness Abdirahman
15 (USPS-T-22). Witness Miller (USPS-T-20) provides similar data for Flat and
16 Parcel shaped pieces. Witness Kelley II (USPS-T-30) provides delivery costs by
17 shape for First-Class Mail, and witness Smith (USPS-T-13) provides mail
18 processing costs by shape. Witness Loetscher (USPS-T-28) provides Revenue,
19 Pieces & Weight (RPW) data by shape and weight. Witness Berkeley (USPS-T-
20 39) provides the Test Year Fee Revenue. Last but not the least, the Test Year
21 volume forecast is provided by witness Thress (USPS-T-7).

22 I am sponsoring two Library References with my testimony. USPS LR-L-129
23 contains my spreadsheets dealing with First-Class Mail rate design, the

1 derivation of proposed rates, and the calculation of test year volumes and
2 revenues. USPS LR-L-130 is associated with the calculation of volume and
3 revenue adjustments related to Negotiated Service Agreements.

4 **III. FIRST-CLASS MAIL RATE PROPOSALS**

5 First-Class Mail consists of mailable matter weighing 13 ounces or less,
6 including business and personal correspondence, cards, sealed parcels, bills,
7 invoices, remittances, financial statements, and advertising. All mailable matter
8 weighing 13 ounces or less may be sent as First-Class Mail.

9 The proposed average changes in revenue per piece for First-Class Mail,
10 including fee revenue, are as follows:

11	Letters Subclass	7.1%
12	Single-Piece Letters	7.7%
13	Presort Letters	6.4%
14	Cards Subclass	10.5%
15	Total Class	7.2%

16 These changes result in revenues that are 228 percent of volume-variable
17 cost for Letters and 177 percent of volume-variable cost for Cards. For the class
18 as a whole, the resulting cost coverage is 226 percent.

19 My testimony proposes a fundamental change in how costs related to
20 various shapes are recognized in First-Class Mail rate design. Currently, while
21 the mail processing and delivery costs they impose on the postal system are
22 vastly different, letters, flats, parcels and other shapes weighing more than one
23 ounce pay the same rate. My testimony proposes the establishment of First-

1 Class Mail rate and classification schedules that move in the direction of
2 recognizing the cost differences related to whether a piece is a letter, a flat, or a
3 parcel. I also propose the establishment of a First-Class Mail Business Parcels
4 rate category with its own eligibility requirements and rate differentials based on
5 ADC, 3-Digit and 5-Digit presortation. The goal is to recognize the shape
6 differences in rates more fully as we move forward.

7 The most visible postage rate is the first-ounce rate for single-piece First-
8 Class Mail letters. The Postal Service proposes a three-cent, or 7.7 percent,
9 increase in this rate, from 39 to 42 cents. In conjunction with this proposed rate
10 increase, the Postal Service also requests approval of a classification change
11 that would create an opportunity for single-piece First-Class Mail users to
12 purchase a "Forever Stamp." This First-Class Mail basic rate stamp would serve
13 as postage equivalent to the First-Class Mail initial ounce rate prevailing at the
14 time of its use, irrespective of how long that might be after – or how many First-
15 Class Mail rate changes might have been implemented since -- the Forever
16 Stamp was purchased. The availability of this Forever Stamp would add an
17 unprecedented level of convenience for domestic postal rate payers as they
18 adjust to the transition from one basic First-Class Mail rate to the next.

19 The Postal Service is proposing a reduction in the rate for single-piece
20 additional ounces, from 24 cents to 20 cents. This is a decline of 16.7 percent in
21 the rate recently established in Docket No. R2005-1. Historically, the additional
22 ounce rate bore, not only the cost of additional weight, but also recovered the
23 cost caused by differences in shapes. As the Postal Service explicitly recognizes

1 the shape differences in First-Class Mail rates, the additional ounce rate may be
2 reduced, as illustrated in the instant request. Revenue generated from additional
3 ounces is substantial and an important source in meeting the revenue
4 requirements for the subclass and the Postal Service as a whole. Given the
5 specific circumstance of any particular docket and all of the factors that must be
6 balanced in any given case, there is no guarantee that shape recognition will be
7 an overriding objective that leads to greater changes in additional ounce rates.

8 While a decline in the additional ounce rate applicable to all shapes is
9 proposed, the Postal Service also is proposing substantial increases in basic
10 first-ounce rates applicable to flat and parcel shaped pieces. A one-ounce flat-
11 shaped piece currently pays 52 cents (39 cents plus the 13-cent nonmachinable
12 surcharge). Under the rates that I propose, this one-ounce flat would pay 62
13 cents, an increase of 19.2 percent. The adverse impact of this redesign tapers off
14 as pieces become heavier. For instance, I propose that a 13-ounce flat-shaped
15 piece that currently pays \$3.27 would pay \$3.02, a reduction of 7.6 percent.

16 The impact of my proposed rates on single-piece parcels is similar in nature.
17 As reflected below, I propose that a one-ounce First-Class Mail single-piece
18 parcel that currently pays 52 cents (39 cents plus the 13-cent nonmachinable
19 surcharge) be required to pay \$1.00, a rate increase of 92 percent. Again, the
20 increase for heavier parcels would be lower, e.g., a 13 ounce single-piece parcel
21 that currently pays \$3.27, would pay \$3.40 under my proposal, an increase of
22 only 4.0 percent.

23

1

SINGLE-PIECE

2

Current Proposed Percent Change

First-Ounce Letters	\$0.39	\$0.42	7.7%
First-Ounce Flats	\$0.52	\$0.62	19.2%
First-Ounce Parcels	\$0.52	\$1.00	92.3%
Additional Ounces	\$0.24	\$0.20	-16.7%
Qualified Business Reply Mail	\$0.358	\$0.395	10.3%

3

4

Automation Letters make up over 96 percent of the volume of workshare

5

First-Class Mail. Assuming the proposed elimination of the Automation Carrier

6

Route Letters rate category, four presort levels for automation letters would

7

remain: Mixed AADC, AADC, 3-Digit and 5-Digit. As reflected below, I propose

8

rate increases for these categories ranging between 5.7 and 7.5 percent. I

9

propose that the additional ounce rate for automation letters be reduced from

10

23.7 cents to 15.5 cents, a decline of 34.6 percent.

11

AUTOMATION LETTERS

12

Current Proposed Percent Change

Mixed AADC	\$0.326	\$0.346	6.1%
AADC	\$0.317	\$0.335	5.7%
3-Digit	\$0.308	\$0.331	7.5%
5-Digit	\$0.293	\$0.312	6.5%
Additional Ounce Rate	\$0.237	\$0.155	-34.6%

13

14

Automation Flats made up 1.5 percent of First-Class Mail workshare

15

volume in FY 2005. Automation Flats grew by 19 percent between FY 2004 and

1 FY 2005, significantly higher than the relatively anemic growth of 1.4 percent
 2 they experienced between FY 2003 and FY 2004, and generally higher than their
 3 growth of 7 to 8 percent during FY 2002 and FY 2003. The proposed rate
 4 increases and percent changes for Automation Flats are as follows:

5 **AUTOMATION FLATS**

	Current*	Proposed	Percent Change
Mixed ADC	\$0.417	\$0.465	11.5%
ADC	\$0.409	\$0.433	5.9%
3-Digit	\$0.397	\$0.423	6.5%
5-Digit	\$0.376	\$0.398	5.9%
Additional Ounce Rate	\$0.237	\$0.200	-15.6%

7 *Current rates include the nonmachinable surcharge for to 1 ounce pieces.

8 Because of the proposed reduction in the additional ounce rate, the
 9 proposed percentage rate increases for heavier Automation Flat pieces are
 10 considerably lower than the increases depicted above for one ounce pieces.

11 The Postal Service proposes the establishment of a new rate category for
 12 First-Class Mail Business Parcels. The details of this rate category are discussed
 13 below in Section VII.C.3. The proposed rates for First-Class Mail Business
 14 Parcels are as follows:

15 **FIRST-CLASS MAIL BUSINESS PARCELS**

	Current*	Proposed	Percent Change
ADC	\$0.429	\$0.727	69.5%
3-Digit	\$0.429	\$0.717	67.1%
5-Digit	\$0.429	\$0.643	49.9%
Additional Ounce Rate	\$0.237	\$0.200	-15.6%

17 *Current rates include the nonmachinable surcharge for 1-ounce pieces.

18 Since there are currently no price tiers within the presort category, the
 19 comparison is made against the same price for all tiers.

1 VI.C.6, I have designed the additional ounce rates for all rate categories based
2 on my assessment of these factors.

3 In terms of volume, the First-Class Mail Cards subclass has remained
4 fairly stable over the last few years. Between FY 2001 and FY 2005, the growth
5 in volume over the five-year period was slightly over 2 percent. The growth
6 category for this subclass is automation cards. Single-piece and nonautomation
7 card rate categories have lost volume over the last few years. The proposed
8 rates for this subclass are reflected in the charts below:

9 **REGULAR - CARDS**

Single-Piece	\$0.240	\$0.270	12.5%
Qualified Business Reply Mail	\$0.211	\$0.245	16.1%

10
11 **NONAUTOMATION PRESORT - CARDS**

Presorted	\$0.223	\$0.241	8.1%
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12
13
14 **AUTOMATION – CARDS**

Mixed AADC	\$0.204	\$0.222	8.8%
AADC	\$0.197	\$0.215	9.1%
3-Digit	\$0.193	\$0.211	9.3%
5-Digit	\$0.186	\$0.204	9.7%

15
16
17 **IV. FIRST-CLASS MAIL VOLUME AND REVENUE TRENDS**

18 As discussed earlier, all mailable matter weighing 13 ounces or less may
19 be sent as First-Class Mail. In FY 2005, First-Class Mail volume was 98 billion

1 pieces, which generated \$36 billion in postal revenue. First-Class volume peaked
2 in FY 2001, at 103.7 billion pieces, and has declined ever since, with the
3 exception of a slight (0.15 percent) increase in FY 2005.

4 The overall decline during this time period was mainly in Single-Piece
5 Letters. Workshare Letters in First-Class Mail have shown positive, but small
6 increases since FY 2001, with the following two exceptions: in FY 2003, there
7 was a small reduction; and the increase in FY 2005 was relatively healthy, almost
8 4 percent. Notwithstanding this overall decline, First-Class Mail has maintained
9 its position as the primary source of postal revenues. However, First-Class Mail
10 has fallen behind Standard Mail in terms of volume. In FY 2000, First-Class Mail
11 was 50 percent of total domestic mail volume and generated 59 percent of
12 domestic mail revenue (excluding special services). By comparison, in FY 2005,
13 First-Class Mail represented only 46 percent of total domestic mail volume and
14 generated 54 percent of domestic revenue. First-Class Mail volume increased in
15 every year from 1976 to 2001, but the rate of increase declined in the 1990s.
16 Over the last three years, this volume declined from 103.7 billion pieces to 98
17 billion pieces, a -1.4 percent compound rate from 2001 to 2005. As stated earlier,
18 one category that has continued to grow, albeit at a declining rate, is workshare
19 mail (includes nonautomation presort letters, flats, and parcels and automation
20 presort letters and flats). A comprehensive revenue and volume history is
21 available in USPS Library Reference L-74.

22

23

1 **V. RATE HISTORY**

2 A history of First-Class Mail rate changes since postal reorganization is
3 included in USPS Library Reference L-73. Since reorganization in 1971, the
4 First-Class Mail, single-piece, first-ounce rate has increased 13 times, including
5 the Docket No. R2005-1 establishment of the current 39-cent rate.

6 For First-Class Mail, an additional ounce rate is charged for each ounce or
7 fraction of an ounce that the piece weighs above the first ounce. This additional
8 ounce rate is uniform for all ounce increments above one ounce and, historically,
9 was the same for single-piece and workshare mail until Docket No. R2001-1.

10 That case established separate additional ounce rates for single-piece and
11 workshare mail. The “degression” (or amount that the additional ounce rate is
12 below the single-piece, first-ounce rate) has increased over time to the current 15
13 cents (39 cents less 24 cents).

14 The Postal Service first introduced workshare discounts in First-Class Mail
15 with the establishment of a 3/5-Digit presort letter rate in 1976. Workshare
16 opportunities have increased with the introduction of Carrier Route presort
17 discounts in 1981, ZIP+4 discounts in 1983, and prebarcode discounts in 1988.

18 While the requirements for these discounts have evolved over time, most notably
19 following Docket No. MC95-1, the Postal Service’s goal of increasing the
20 automation compatibility of First-Class Mail (particularly of letter-shaped pieces)
21 has been implemented largely through the rate structure.

1 **VI. RATE DESIGN**

2 **A. Three Proposals for Change**

3 On behalf of the Postal Service, I propose that the Commission recommend
4 First-Class Mail rates and classifications designed to achieve three principal
5 objectives:

- 6 delinking of Workshare rate design from Single-Piece rate design;
- 7
- 8 establishment of shape based rates, accompanied by elimination of the
- 9 heavy piece discount and limitations in the application of the
- 10 nonmachinable surcharge; and
- 11
- 12 elimination of the Automation Carrier Route rate categories.
- 13

14 Each of these proposals is discussed below.

15

16 **1. Delinking of Workshare rate design from Single-Piece**

17 Since classification reform in Docket No. MC95-1, the structure of and
18 approach to the relationship between the Single-Piece and Workshare rate
19 categories in First-Class Mail have remained relatively constant. Workshare
20 rates are determined by applying discounts to Single-Piece rates. These rate
21 differentials (discounts) are based on estimates of costs avoided through each
22 type of worksharing activity (e.g., prebarcoding and/or various levels of
23 presortation). The cost differentials are developed by estimating avoidance of
24 postal mail processing and related operations costs in comparison to a
25 representative benchmark for workshare mail generally.

26 While the Commission has endorsed the logic of this approach in several
27 cases, the approach has generated considerable controversy and opposition.

1 Intervenor who send presort letters have contended that using what they regard
2 as a narrowly defined range of cost characteristics to establish rate differentials
3 between Single-Piece Letters and Presort Letters may ignore cost-causing
4 characteristics that, while not expressly associated with the worksharing activity
5 for which the cost avoidance and discount are being measured and developed,
6 nevertheless are associated with their mail. The Single-Piece Letters category
7 includes mail with a broad array of characteristics: various sizes, different levels
8 of automation compatibility and machine readability. A significant percentage
9 has handwritten addresses. A substantial percentage consists of courtesy reply
10 envelopes used for bill payment, are of standard size, and bear a machine-
11 generated address, Facing Identification Mark, and a barcode.

12 As noted in many previous dockets, furthermore, Single-Piece Letters
13 include bulk metered mail (BMM) letters which are, for the most part, of uniform
14 size with machine-generated addresses. Presort Letters mail pieces are more
15 similar to the BMM letters in physical characteristics. BMM letters have long
16 been regarded as the type of mail most likely to convert to workshare.
17 Intervenor have argued that the Postal Service should use a broader brush
18 when comparing Presort Letters to Single-Piece Letters. They have testified that
19 the Postal Service should be comparing the full range of cost-causing
20 characteristics between the two broad groups, not just considering the
21 comparison of BMM mail characteristics to Presort Letter characteristics.

22 The CRA and the rollforward model, which forecasts costs by using the
23 base year CRA as a starting point, have long reported separate, independently-

1 derived estimates of the costs and revenue for Single-Piece Letters and for
2 Presort Letters.² The costs developed for these CRA line items are “bottom-up”
3 costs, reflecting the results of the full range of cost estimation systems and
4 techniques used to inform the CRA (e.g., the In-Office Cost System, the City
5 Carrier Cost System, TRACS, etc.).

6 The comparison of costs as reported for Single-Piece Letters and for
7 Presort Letters does not simply reflect the cost avoided by the Postal Service
8 when a mailer chooses to perform worksharing activities, such as presorting or
9 applying a barcode. Because the costs are developed in total, they reflect the full
10 range of differences between the two sets of mail – differences perhaps
11 unrelated to the actual worksharing activity but reflective of the different cost
12 characteristics of business-originated mail entered in large quantities, as
13 compared to those of single-piece mail. These cost characteristics may reflect
14 such things as the number of postal facilities through which the mail traverses,
15 the proportion of the mail transported via air rather than ground transportation,
16 the readability of the mail, the proportions of the mail that are undeliverable-as-
17 addressed, the utilization of retail facilities for entry, etc. Thus, a comparison of
18 the relative costs and rates (and the resulting cost coverages) for Single-Piece
19 Letters and Presort Letters reflects more than simply the costs avoided by
20 performing worksharing activities which the Postal Service and the Postal Rate
21 Commission have determined are appropriately reflected in rate differences.

² Likewise for Single Piece and Presort Cards, although this discussion will focus on the “Letters and Sealed Parcels” categories. Throughout this discussion, the term “Letter” is used in reference to the entire Letters and Sealed Parcels” subclass.

1 Without conceding the numerous assertions about workshare cost
2 differentials and rate design offered by intervenors in past dockets, the Postal
3 Service’s approach to rate design in Docket No. R2006-1 puts aside past
4 irreconcilable divisions and takes a fresh look at the recurring task of First-Class
5 Mail workshare rate design. The Postal Service de-links the cost and rate
6 development for Single-Piece Letters from the cost and rate development for
7 Presort Letters. Accordingly, the Postal Service proposes that the rates for
8 Single-Piece Letters and for Presort Letters be developed independently of each
9 other. No longer should the rates for Presort Letters look to the cost base of
10 Single-Piece Letters; the rates for Presort Letters should be developed with
11 reference only to the CRA line item of “Presort Letters.” No longer should there
12 be debate regarding which cost pools from Single-Piece Letters should be used
13 for comparison to Presort Letters. No longer should there be a need for debate
14 regarding the degree to which the impact of the characteristics of the mail aside
15 from the specific activities avoided by worksharing activities is reflected in the
16 rates. And the debate over the appropriate benchmark of “dirty” versus “clean”
17 mail can be silenced.

18 The Postal Service proposes that the rate design process begin with
19 establishment of separate revenue requirements for Single-Piece Letters and
20 Presort Letters, with the goal of obtaining similar unit contributions from Single-
21 Piece Letters in the aggregate and from Presort Letters in the aggregate. The
22 objective of the approach introduced here is to gradually achieve a rate design
23 paradigm in which both workshare and single-piece mail contribute equally to

1 institutional costs on a unit contribution basis. The goal of similar unit
2 contributions from these two mail categories is not an absolute one; other rate
3 design and rate impact considerations may require the Postal Service and the
4 Commission to deviate from this goal. However, to the extent practicable, the
5 Postal Service's intention going forward is to equalize the unit contribution from
6 the Single-Piece Letter category and from the Presort Letter category. It should
7 be noted that this will be performed at an aggregate level; it is not the Postal
8 Service's objective that each piece of mail individually reflect the same unit
9 contribution as every other piece of mail.

10 Thus, after developing a required revenue for Single-Piece Letters such
11 that the unit contribution target is met, all of the applicable rates (i.e., the first-
12 ounce First-Class Mail stamp rate, the additional ounce rate for single-piece, the
13 rates for single-piece flat-shaped and parcel-shaped pieces, and the Qualified
14 Business Reply Mail (QBRM) rates) are derived using an estimate of required
15 revenue for Single-Piece Letters, with reference to the Cost and Revenue
16 Analysis Report (CRA) rollforward costs for Single-Piece Letters. Within Single-
17 Piece Letters, the first-ounce rate for letter-shaped pieces would be the starting
18 point, or benchmark, from which to derive all discounted and surcharged rates.

19 All of the rates for workshared First-Class Mail would be developed by
20 reference to the CRA rollforward costs for Presort Letters, after establishing a
21 required revenue for Presort Letters such that the unit contribution target is met.
22 The workshare rates would no longer be designed as discounts off of the Single-
23 Piece first-ounce rate. Rather, the starting point would be the Mixed AADC rate,

1 a benchmark internal to Presort Letters. Calculation of the subsequent cost
2 avoidances and cost differences for different presort levels and mail
3 characteristics for Presort Letters would be based on the Presort Letters cost,
4 consistent with past practice.

5 **2. Shape Based Rates**

6 Currently in First-Class Mail, single-piece flats and parcels weighing one-
7 ounce or less pay a nonmachinable surcharge of 13 cents. For pieces weighing
8 more than an ounce, additional ounce postage is charged. That additional
9 postage is presumed to reflect the transition from letters to flats and parcels, as
10 weight increases, along with other factors. Parcels and flats are priced in a
11 similar fashion in the nonautomation presort rate category. The only difference is
12 that the nonmachinable surcharge and additional ounce rate are lower, and there
13 is a heavy piece discount of 4.3 cents applicable to pieces weighing over 2
14 ounces.

15 Preliminary cost studies suggest that lighter weight flats and parcels may
16 not be covering their costs. In FY 2005, 94.6 percent of the pieces in the Letters
17 subclass were actually letter-shaped pieces, while 4.8 percent were flat-shaped
18 and one-half of one percent of the pieces were parcel-shaped. Flat and parcel-
19 shaped pieces appear to be quite small as a percent of the total, due to the sheer
20 size of the Letters subclass volume of 92 billion pieces. Still, in absolute terms
21 the volume of First-Class Mail flats and parcels is actually larger than the volume
22 for many subclasses not in First-Class Mail. In FY 2005, there were 4.5 billion

1 First-Class Mail flat shaped pieces and almost a half-billion First-Class Mail
2 parcel shaped pieces.

3 As reflected in testimonies of witnesses Smith (USPS-T-13) and Kelley II
4 (USPS-T-30), there are substantial differences in costs associated with
5 processing and delivering First-Class Mail letters, flats and parcels. The Postal
6 Service is sensitive to the impact on mailers that would result if the full extent of
7 those cost differences were reflected in proposed rates. Accordingly, it should be
8 emphasized that the choice of passthroughs to derive the basic rate for flat and
9 parcel shaped pieces was strongly influenced by a desire to mitigate the impact
10 of this significant change on these pieces. These passthroughs range from 15 to
11 55 percent, considerably less than 100 percent that would be used if the Postal
12 Service were to recover all of the additional cost caused by shape.

13 The passthroughs to calculate the presort discounts for flat and parcel
14 shaped Presort pieces were also kept considerably below 100 percent. The
15 Postal Service is proposing new rate categories and, in some cases, projection of
16 their volumes is as much of an art as it is a science. Accordingly, the prudent
17 course is to be conservative in passing through both the additional costs and
18 additional savings until we gain additional experience with these rate categories.

19 **a. Single-Piece**

20 In addition to a Single-Piece first ounce letter rate, the Postal Service also
21 proposes a first ounce rate for flat-shaped pieces and a first ounce rate for
22 parcel-shaped pieces. The additional ounce rate for the three shapes is
23 proposed to be the identical and, in this docket, lower than the 24-cent additional

1 ounce rate that resulted from Docket No. R2005-1. Since the additional ounce
2 rate has been used, at least in part, as a mechanism to recover costs caused by
3 shape differences, it is understandable that the partial recognition of these costs
4 directly through shape charges, would reduce the rate for additional ounces.

5 Pieces that do not meet the letter machinability criteria (defined by length,
6 height, width, thickness, rigidity, variation in thickness, or aspect ratio) become
7 eligible for the next higher rate element, i.e., the first ounce rate for flat shaped
8 pieces. In some rare cases, where a piece is too rigid, it may be required to pay a
9 single-piece parcel rate. The Postal Service also proposes that a piece must
10 weigh 3.5 ounces or less to be eligible for letter rates. A piece weighing more
11 than 3.5 ounces, regardless of its dimensions, would have to pay the higher flat
12 or parcel rate.

13 **b. Presort**

14 The nonautomation presort rate category currently includes letter, flat, and
15 parcel shaped pieces. I propose that it be limited to only letter and flat shaped
16 pieces. First-Class Mail bulk parcels are proposed to be classified in the rate
17 category of First-Class Mail Business Parcels.

18 Bulk-entered pieces that do not meet the machinability criteria (weight,
19 dimension, thickness or rigidity requirements) for letters or flats may qualify as
20 First-Class Mail Business Parcels. First-Class Mail Business Parcels mailings,
21 besides having to meet the minimum piece requirement for First-Class workshare
22 (500 pieces), would be required to be sorted to the finest level of 5-Digit, if they
23 consist of ten pounds or more pieces destinating to a 5-Digit ZIP Code. Also, a 5-

1 Digit barcode will be required. A nonbarcoded piece will be required to pay the
2 proposed nonmachinable surcharge of \$0.05. Parcel-shaped pieces that weigh
3 less than two ounces or are nonmachinable on the Automated Package
4 Processing System (APPS) equipment (e.g., rolls, etc.) would also be assessed
5 the proposed nonmachinable surcharge. Pieces that are sorted to the 5-Digit
6 level would not be required to pay the nonmachinable surcharge, regardless of
7 the per-piece weight minimum of two ounces, nonmachinability, thickness
8 variations, unusual shape, or the absence of a 5-Digit barcode. The minimum
9 and maximum dimensions for First-Class Mail Business parcels are proposed to
10 be as follows: maximum length, 18 inches; maximum height, 15 inches;
11 maximum width, 22 inches; minimum height, 3 inches; minimum length, 3.5
12 inches; and minimum thickness, 0.5 inch.

13

14 **3. Elimination of Auto Carrier Route Letters Rate Category**

15 Current and future processing of letter-shaped mail requires delivery point
16 sequencing of mail at destinating Processing & Distribution Centers. Mail
17 prepared in this fashion saves in-office time at the delivery unit. In this
18 environment, furthermore, presortation of mail to the carrier route level has little
19 or no value to the Postal Service.

20 The volume in the Automation Carrier Route presort rate category has
21 declined by more than 16 percent over the last two years. This is because fewer
22 delivery units have Carrier Sequence Bar Code Sorter (CSBCS) equipment and
23 the discount has decreased.

1 The current discount is only 0.3 cent greater than the discount for the 5-
2 Digit Automation rate category. Elimination of this Carrier Route discount would
3 not cause a large rate impact for the relatively small number of pieces that
4 currently are presorted to the carrier route level. Furthermore, as discussed
5 below, the Postal Service is proposing to mitigate this rate impact by adopting a
6 greater than 100 percent passthrough for 5-Digit Automation Letters. When
7 CSBCS equipment is removed from the remaining delivery units, all of this mail
8 will be merged in the 5-Digit Automation rate category, where it has migrated
9 over the past few years. From the perspective of mail processing, it is desirable
10 for all of this mail to move to 5-Digit. This change also would simplify the mail
11 preparation for certain First-Class Mail users.

12

13 **B Single-Piece Letters, Flats And Parcels**

14 **1. Rate Design – Basic Methodology**

15 The rate design for Single-Piece First-Class Mail starts with the Test Year
16 Before Rates (TYBR) rollforward costs for Single-Piece and Presort mail within
17 the First-Class Mail Letters and Sealed Parcels subclass. A per-unit contribution
18 is simultaneously estimated for both Single-Piece and Presort mail to meet the
19 Letters subclass revenue requirement. The target per-piece revenue estimate is
20 then multiplied by the TYBR volume to derive the target revenue for both Single-
21 Piece and Presort.

22 To many, the most visible rate in this docket is the First-Class Mail first
23 ounce rate. I propose that it be increased by 3 cents, from 39 cents to 42 cents,

1 an increase of 7.7 percent. This rate, which is also referred to as the First-Class
2 Mail stamp rate, is the largest provider of Single-Piece revenue for First-Class
3 Mail. The remaining revenue for from Single-Piece mail is derived from first-
4 ounce rates for flat and parcel shaped pieces, Qualified Business Reply Mail
5 pieces, and additional ounces related to all shapes. To avoid unnecessary
6 complexity for the general mailing public, and for administrative ease, the Postal
7 Service is proposing retail rates in whole cents.

8 **2. Flat and Parcel Shaped Pieces**

9 As stated earlier in my testimony, the Postal Service is proposing
10 substantial increases in rates for flat and parcel shaped First-Class Mail pieces.
11 A one ounce flat-shaped piece that currently pays 52 cents (39 cents plus 13
12 cents nonmachinable surcharge), under the proposed rates will pay 62 cents, an
13 increase of 19.2 percent. This increase of 19 percent declines over heavier
14 weight pieces, e.g., a 13 ounce flat-shaped piece that currently pays \$3.27
15 would, under the proposed rates, pay \$3.02, a reduction of 7.6 percent.

16 Perhaps an easy way to illustrate the proposal is to consider two-ounce items.
17 Currently, all two-ounce pieces, regardless of shape, pay the same 63 cents
18 postage, yet they have vastly different costs. The proposed rate changes better
19 align prices with costs and allow mailers to consider the costs that their items
20 place upon the postal system. It is expected that, in those instances where the
21 costs of conversion to lower cost shapes are relatively low, and the converted
22 mail pieces are consistent with the needs of our customers, the Postal Service
23 will benefit from a conversion to lower cost items. If the conversion is expensive

1 and/or is not consistent with the needs of the customer, then the Postal Service
 2 will continue to see higher cost shapes. In either event, this proposal would
 3 encourage customers to consider both their own needs and costs and the impact
 4 on the Postal Service to make an appropriate decision.

5 On average, single-piece flats cost 37.1 cents more to process and deliver
 6 compared to single-piece letters. Witness Smith, USPS-T-13; witness Kelley II,
 7 USPS-T-30. In order to mitigate the rate impact on lighter weight flat-shaped
 8 pieces, I am proposing only a 55 percent passthrough.

9 A First-Class Mail single-piece parcel weighing 1 ounce currently pays 52
 10 cents (39 cents plus the 13 cent nonmachinable surcharge). The proposed rate
 11 for this piece is \$1.00, an increase of 92 percent.

12 On average single-piece parcels cost \$1.17 more to process and deliver
 13 compared to single-piece letters. Witness Smith, USPS-T-13; Witness Kelley II,
 14 USPS-T-30. In order to mitigate the rate impact on lighter weight parcel-shaped
 15 pieces, I am proposing only a 50 percent passthrough.

	Mail Processing Unit Cost¹	Delivery Unit Cost²	Total	Diff. From Letters	Pass-Throughs	Srchg	Proposed Rates
Ltrs.	\$ 0.120	\$ 0.077	\$ 0.197				
Flts.	\$ 0.425	\$ 0.143	\$0.569	\$ 0.037	55%	\$ 0.20	\$ 0.62
Prcl	\$ 1.023	\$0.345	\$ 1.368	\$ 1.17	50%	\$ 0.58	\$ 1.00

¹Witness: Smith USPS-T-13

²Witness: Kelley II USPS-T-30

Library Reference: USPS-LR-L-53

Library Reference: USPS-LR-L-67

16

17 Differentiation of First-Class Mail rates on the basis of shape adds a level
 18 of complexity for retail customers, within the meaning of the ratemaking criteria,
 19 particularly § 3622(b)(7). However, that additional complexity is minimal, and is
 20 offset by the fact that the rate differentials are transparently identifiable to

1 material differences in shape. The moderate passthroughs that I select for the
2 shape-based rate design reflect sensitivity to the adverse impact on mailers,
3 within the meaning of § 3622(b)(4), that could result from a more robust
4 recognition of the impact of shape-based costs on rates. And, to the extent that
5 mailers of flats and parcels are able to adapt their mailing practices to move to
6 less expensive rate categories, the proposed rate differentials have the effect of
7 rewarding them for mail preparation designed to reduce postal costs, within the
8 meaning of § 3622(b)(6).

9 **3. Qualified Business Reply Mail**

10 As a result of Docket No. R97-1, the Postal Service implemented a
11 discounted rate for Qualified Business Reply Mail (QBRM). To qualify for the
12 discounted QBRM rate, mailers need to be pre-approved and prepare
13 prebarcoded, automation-compatible Business Reply Mail. For the current
14 docket, the Postal Service proposes a 3.7 cent increase in the current QBRM
15 postage rate, from 35.8 to 39.5 cents. This is a 10.3 percent rate increase.

16 The proposed increase in the QBRM postage rate will maintain the QBRM
17 discount at 2.5 cents below the single-piece rate, which is the same discount that
18 prevailed prior to the across-the-board rate increases of Docket No. R2005-1.
19 The cost study prepared by witness Abdirahman for the current docket (USPS-T-
20 22) shows a QBRM cost avoidance of 1.52 cents, applicable to both letters and
21 cards. I propose to pass through 165 percent of this measured cost avoidance in
22 order to maintain the discount of 2.5 cents that prevailed prior to the
23 implementation of Docket No. R2005-1.

1 QBRM is clean, prebarcoded mail and incurs less cost than non-barcoded
2 single-piece mail. Automation-compatible Business Reply Mail is used daily by
3 millions of individuals and small businesses. By recognizing cost savings
4 associated with this mail, the Postal Service is able to permit a broader base of
5 customers to more directly share in the benefits of automation.

6 **4. Additional Ounce Rate – Single-Piece**

7 Revenue from additional ounces comprised 7.5 percent, or approximately
8 \$3.9 billion, of the revenue from the First-Class Mail Letters subclass in FY2005.
9 It is an important source of revenue for both First-Class Mail and the Postal
10 Service. As stated earlier, additional ounce rates have been used as a
11 mechanism to reflect the cost caused by differences in shapes, such as flats and
12 parcels, especially the lighter-weight flat and parcel-shaped pieces. Additional
13 ounce revenue is also a tool to manage the overall revenue requirement from
14 First-Class Mail. In this docket, the Postal Service is proposing classification
15 changes to introduce separate first-ounce rates, not only for letters, but also for
16 flats and parcels, thereby, at least partially, recognizing the costs caused by
17 differences in shapes. As the cost-causing characteristics of shape are being
18 reflected more explicitly in the rate design, the additional ounce rate, through
19 which the cost differences related to shape previously have been reflected
20 indirectly, is being reduced. The Postal Service is proposing a rate of 20 cents for
21 single-piece additional ounces, a 16.7 percent reduction from the current 24
22 cents.

1 foremost in their thoughts. Notwithstanding public notice and the general
2 widespread availability of inventory, obtaining make-up stamps appears to be an
3 inconvenience for many that is easily and often postponed and that is then easily
4 and often compounded by that postponement.

5 The availability of a Forever Stamp would increase convenience for
6 customers who affix postage almost exclusively by hand. It would give them the
7 opportunity, in advance of a rate change, to purchase a stamp that can be used
8 for basic postage transactions, both before and after a rate change. The
9 extended "shelf-life" of Forever Stamps could serve as a sufficiently attractive
10 financial incentive for mailers to make the effort to obtain them and to realize the
11 benefit of their convenience when it matters most. Customers who make it a
12 practice of maintaining an inventory of Forever Stamps will find it easier to
13 transition from one rate regime to the next. Ease of use of the postal system
14 benefits customers, strengthens their relationship to the Postal Service, and
15 could encourage more use of the mails than might otherwise occur.

16 Quantitative and qualitative research is currently underway that is
17 expected to shed light on the degree of postal customer interest in a Forever
18 Stamp, and to provide a basis or evaluating the financial impact associated with
19 the concept. The Postal Service will file such information in this docket as
20 expeditiously as possible. Concurrently, the Postal Service will provide additional
21 information regarding the conditions and terms under which Forever Stamps
22 should be made available.

23

1 **C. Presorted Letters, Flats, and Parcels**

2 This rate category is predominantly made up of Automation Letters, but
3 also includes Automation Flats, the newly proposed category of First-Class Mail
4 Business Parcels, and Nonautomation Presort. With the creation of the First-
5 Class Mail Business Parcels rate category, Nonautomation Presort mail is
6 proposed to include only letter and flat shaped pieces.

7 Calculation of revenues as a percent of volume variable costs indicates
8 that the automation mail stream provides a relatively high contribution to the
9 Postal Service's institutional costs. In the FY 2005 base year (which does not
10 include the effect of either the R2005-1 rate increases or the R2006-1 proposed
11 rate increase), that implicit coverage was 286.7 percent, considerably higher than
12 has been implied by the Postal Rate Commission's recent Recommended
13 Decisions.³

14 Cost coverage is traditionally not calculated below the subclass level, but
15 the implicit cost coverage for Presort (or workshare) Letters has been
16 significantly higher than the comparable implicit Commission recommended cost
17 coverage of 265.9 percent in last traditional omnibus case, Docket No. R2001-1.

³ Methodological differences in the estimation of costs do not permit straightforward comparisons between the Postal Service's and the Postal Rate Commission's calculated ratio of revenue to costs for workshared mail. Using the Postal Rate Commission's costing methodology, the ratio of revenue to costs for workshared mail in the base year is 286.7 percent. USPS-LR-L-94. Compare this ratio to the similar ratio from the Docket No. MC95-1 Recommended Decision: 237.1 percent (Docket No. MC95-1, PRC Op. at Appendix F); the 248.1 percent ratio from Docket No. R2000-1 (Revenues: PRC Op. R2000-1 at Appendix G, p. 2; costs: PRC Op. R2000-1 at App J, p. 1); and the ratio from Commission's R2001-1 Recommended Decision: 265.9 percent. (Revenues: PRC Op. R2001-1 at Appendix G, p. 2; costs: PRC Op. R2001-1 at Appendix F, p. 1)

1 The comparable implicit cost coverage for Presort (workshare) letters in Docket
2 No. R2005-1 was 312.1 percent.⁴

3 **1. Automation Letters**

4 The current rate structure for bulk automation letters consists of five tiers:
5 Mixed AADC, AADC, 3-Digit, 5-Digit, and Carrier Route. The Postal Service is
6 not proposing any changes in the piece minimums associated with the rate
7 structure. However, we are proposing the elimination of Automation Carrier
8 Route rate category. I have discussed the justification for this elimination in
9 Section VII.A.3 above. The Carrier Route rate category is proposed to be
10 eliminated for both Automation Letters and Cards. Pieces that resided in the
11 Automation Carrier Route Letters rate category are expected to migrate to the 5-
12 Digit Automation Letters rate category.

13 The major departure in my rate design (discussed above in Section VI.A.1
14 under the heading of “Delinking of Workshare rate design from Single-Piece”), is
15 that I do not rely on the bulk metered mail benchmark to calculate the cost
16 savings that constitute the basis for proposing discounts for various presort
17 levels. Instead, an internal benchmark of Mixed AADC is developed within the
18 framework of Presort (workshare) mail using the estimated revenue. All other
19 Automation Letter rates are calculated as follows:

20 **Automation Letters – Cost Savings, Discounts and Passthroughs**

	Mail Processing Unit Cost*	Savings	Proposed Rates	Workshare Discounts	Pass-Throughs
--	-----------------------------------	----------------	-----------------------	----------------------------	----------------------

⁴ Docket No. R2005-1 Recommended Decision: 312.1 percent. (Revenues: PRC Op. R2005-1, at Appendix G, p. 2; costs: PRC Op. R2005-1, Appendix F, p. 1.)

	(Dollars)				
Mixed AADC	\$ 0.065		\$ 0.346		
AADC	\$ 0.053	\$ 0.011	\$0.335	\$0.011	100%
3-Digit	\$ 0.049	\$ 0.004	\$ 0.331	\$ 0.004	100%
5-Digit	\$ 0.036	\$ 0.013	\$ 0.312	\$ 0.019	146%

*Source: Witness Abdirahman, USPS-T-22; USPS-LR-L-38

The proposed rate for Mixed AADC is an internally derived number based on leakages and additional costs (for flat and parcel shaped pieces, nonautomation presort rate letters, etc.) and the estimated revenue requirements of the Presort mail. Calculation of cost savings, as well as discounts, is based on an internal benchmark -- the Mixed AADC Automation Letter rate within Presort letters. Neither the Bulk Metered Mail benchmark, nor the first-ounce Single-Piece rate, is used to estimate the proposed rates for Automation Letters.

The passthroughs and the discounts that underlie the proposed rates were selected to balance several goals, including: (1) achieving the cost coverage target provided by witness O'Hara (USPS-T-31); (2) recognizing the value of mailer worksharing; (3) avoiding changes in discount levels which result in unduly disruptive rate impacts; (4) acknowledging the importance of mailer barcoding and presortation in overall postal operations, and; (5) recognizing that, overall, automated letters are a low cost, high contribution mail stream. Mailers have invested significantly in automation equipment and have changed their mail processes as a result of the expansion in worksharing incentives over the last decade or so, and it would be unfair to reduce these incentives. At the same time, the Postal Service could experience operational difficulties if a large portion

1 of the workshared First-Class Mail stream reverted to the Postal Service for
2 sorting and barcoding.

3 If I had adhered to a strict 100 passthrough of the 1.3 cents measured
4 cost savings for 5-Digit Automation Letters, the increase in the 5-Digit
5 Automation rate would be 8.5 percent, higher than all other rate categories within
6 Automation Letters. Additionally, in this docket, the Postal Service is proposing to
7 eliminate the rate category of Automation Carrier Route Letters. This volume is
8 expected to shift to 5-Digit Automation Letter rate category. Approximately 700
9 million pieces that are expected to make this migration would face a 9.7 percent
10 increase, if I were to adopt a passthrough of 100 percent. As I have earlier, the
11 elimination of this rate category is based on the current and future operating
12 environment at the Postal Service, and we would like to make this change
13 without an undue impact on the migrating pieces.

14 The Postal Rate Commission has generally preferred 100 percent
15 passthroughs of cost savings as the basis for recommending workshare
16 discounts, but does not apply them mechanically without consideration of other
17 factors. In a discussion of passthroughs in its Opinion and Recommended
18 Decision in Docket No. R2001-1, the Commission emphasized:

19 [3061] Passthroughs close to 100 percent of avoided costs provide an
20 appropriate price signal to mailers to perform worksharing activities only
21 when they can do so at a lower cost than can be done by the Postal
22 Service, promoting the policy of efficient component pricing.

23 . . .

24

25 [3063] . . . The Commission believes that circumstances may exist
26 where strict adherence to this policy is not appropriate, and when
27 competing policies may weigh more heavily in the decision making
28 process.

1
2 [3064] The Commission is required to consider all of the factors of section
3 3622(b) when reviewing appropriate discount rates for workshared mail.
4 . . . [D]ifferent factors receive different weights depending on the specific
5 circumstances of the rate category under review. For instance in PRC Op.
6 R2000-1 . . . , where the Commission endorsed passthroughs at 100
7 percent of avoided costs, the Commission also recommended a discount
8 for carrier route letters that passed through 67 percent of avoided costs to
9 prevent a disruptive effect on the rate schedule. In contrast, the
10 Commission recommended a discount with a greater than 100 percent
11 passthrough for presort letters to moderate the impact of its
12 recommendation to shrink that discount from 2.5 cents to 2.0 cents. In
13 both these instances, other factors outweighed the benefits of strictly
14 adhering to a 100 percent passthrough policy. The Commission concludes
15 that establishing discounts to pass through 100 percent of avoided costs is
16 an appropriate policy, but that other considerations sometimes preclude its
17 application.

18
19 Docket No. R2001-1, Opinion and Recommended Decision, pp. 72-73.

20 I have passed through 100 percent of cost savings to estimate the
21 discounts and rates for the AADC and 3-Digit presort levels, based not only
22 on the measured costs of the presort levels, but also based on the impact on
23 mailers, and the current operational environment for processing letters. The
24 objective of passing through 146 percent of cost savings for 5-Digit
25 Automation Letters is to mitigate the impact of a 8.5 percent increase in this
26 rate and an almost 10 percent increase on the Automation Carrier Route
27 Letters pieces that are expected to shift to the 5-Digit Automation Letters rate
28 category.

29 Witness McCrery (USPS-T-42) points out the value 5-Digit Automation

30 Letter trays:

31 The availability of extra sort bins on the DBCS equipment provides the
32 ability to process a significant portion of the letters to the 5-digit ZIP Code
33 level on the incoming primary sort scheme even when the scheme has
34 been established to sort the entire service area of the plant, a service area

1 likely containing multiple 3-digit ZIP Codes. Therefore, a pure 3-digit letter
2 tray versus a multiple 3-digit letter tray can have similar value in terms of
3 the reduction in pieces handlings. **Barcoded automation letters**
4 **presorted to the 5-digit level provide additional value, since these**
5 **trays bypass the additional upstream handlings prior to incoming**
6 **secondary distribution.** [Emphasis added.]
7

8 Docket No. R2006-1, USPS-T-42 at 11. In the current processing
9 environment, the Postal Service would like to encourage mailers to sort their
10 letter mail to the 5-Digit level. To propose an increase for this rate category
11 higher than all other presort levels is not consistent with that goal.

12 Evaluation of passthroughs and rate design is a complex process. It requires
13 a series of judgments over time, as the rates are developed and evaluated
14 against the revenue requirements, and a host of other factors, such as impact on
15 mailers and operational issues. The initial passthrough for 5-Digit Automation
16 Letters was 160 percent, as can be seen in my spreadsheets in Library
17 Reference LR-L-129. After the rates were preliminarily designed, I realized that
18 the rate increase for 5-Digit Automation Letters was 5.8 percent, lower than any
19 increase for Automation Letter rates. Rather than disturbing the rates and rate
20 relationships, I increased the 5-Digit Automation Letter rate by \$0.002. This
21 change increased the rate from \$0.31 to \$0.312 and brought the increase in this
22 particular rate in line with rate increases for other presort levels for Automation
23 Letters. The passthrough resulting from this change is 146 percent.

24 **2. Automation Flats**

25 Based on the data provided by witnesses Smith (USPS-T-13) and Kelley II
26 (USPS-T-30) for mail processing and delivery unit costs by shape, on average

1 presort flats cost 30 cents more to process and deliver than letters. I am using a
 2 40 percent passthrough to propose a differential between Mixed AADC Letters
 3 and Mixed ADC Flats of 11.9 cents, which is added to the Mixed AADC Letter
 4 rate of \$0.346. Thus, the Mixed ADC rate for Automation Flats is proposed to be
 5 \$0.465. This is an 11.5 percent increase from the current first-ounce Mixed ADC
 6 rate for Automation Flats of \$0.359, plus a nonmachinable surcharge of \$0.13.
 7 The presort tiers for Automation flats are determined using witness Miller's
 8 (USPS-T-20) unit cost estimates for the various presort levels.

9 **Automation Flats – Cost Savings, Discounts and Passthroughs**

	Mail Processing Unit Cost* (Dollars)	Savings	Proposed Rates	Workshare Discounts	Pass-Throughs
Mixed ADC	\$ 0.386		\$ 0.465		
ADC	\$ 0.314	\$ 0.072	\$ 0.433	\$0.032	45%
3-Digit	\$ 0.263	\$ 0.051	\$ 0.423	\$ 0.010	20%
5-Digit	\$ 0.201	\$ 0.062	\$ 0.398	\$ 0.025	40%

10

11 **3. Discount Structure -- Automation Letters and Flats**

12 For comparison purposes below, I display the discount structure of the
 13 proposed rates as well as Docket Nos. R2005-1 and R2001-1 rates. The
 14 justification for looking back to Docket No. R2001-1 is simply that the across-the-
 15 board increase in R2005-1 did not address the discount structure and would not
 16 make for a valid comparison. For raising the Escrow Fund requirement, the
 17 Docket No. R2005-1 across-the-board methodology was fair and equitable, but
 18 since rates and discounts all were increased by the same percentage without

1 considering changes in costs, the discount structure changed because of the
 2 mechanical application of 5.4 percent across-the-board increase.

3 **Proposed Discount Structure**

4 Single-Piece to Mixed AADC Automation Letter Rate Difference = \$ 0.074

	Auto Letters	Difference	Auto Flats	Difference
Mixed AADC	\$ 0.346		\$ 0.465	
AADC	\$ 0.335	\$ 0.011	\$ 0.433	\$ 0.032
3-Digit	\$ 0.331	\$ 0.004	\$ 0.423	\$ 0.010
5-Digit	\$ 0.312	\$ 0.019	\$ 0.398	\$ 0.025

5 Mixed AADC to 5-Digit Rate Difference Letters= \$ 0.034 Flats \$ 0.067

6 **R2005-1 Discount Structure**

7 Single-Piece to Mixed AADC Automation Letter Difference = \$ 0.064

	Auto Letters	Difference	Auto Flats	Difference
Mixed AADC	\$ 0.326		\$ 0.359	
AADC	\$ 0.317	\$ 0.009	\$ 0.351	\$ 0.008
3-Digit	\$ 0.308	\$ 0.009	\$ 0.339	\$ 0.012
5-Digit	\$ 0.293	\$ 0.015	\$ 0.318	\$ 0.021

8 Mixed AADC to 5-Digit Rate Difference Letters= \$ 0.033 Flats \$ 0.041

9 **R2001-1 Discount Structure**

10 Single-Piece to Mixed AADC Automation Letter Difference = \$ 0.061

	Auto Letters	Difference	Auto Flats	Difference
Mixed AADC	\$ 0.309		\$ 0.341	
AADC	\$ 0.301	\$ 0.008	\$ 0.333	\$ 0.008
3-Digit	\$ 0.292	\$ 0.009	\$ 0.322	\$ 0.011
5-Digit	\$ 0.278	\$ 0.014	\$ 0.302	\$ 0.020

11 Mixed AADC to 5-Digit Rate Difference Letters= \$ 0.031 Flats \$ 0.039

12 In the current docket, the Postal Service is proposing a rate structure that
 13 is fair and equitable and is conducive to a high degree of worksharing. Due to
 14 the de-linking of the rate design for Single-Piece and workshare mail, the Presort

1 categories are priced on the basis of cost causation attributes (preparation, entry
2 profile, etc.) unrelated to Single-Piece mail. This approach provides appropriate
3 signals to the mailers to make economic choices regarding preparation of their
4 mail to the finest level of presort or letting the Postal Service perform the work. I
5 propose a passthrough of greater than 100 percent of the measured savings for
6 5-Digit Automation Letters. That is a necessary result of balancing the goals of
7 efficiency and impact on mailers. Neither the Postal Service nor the Commission
8 has mechanically applied one theoretical concept of rate making without
9 evaluating the impact on mailers.

10 **4. First-Class Mail Business Parcels**

11 Eligibility requirements for this rate category are discussed above in
12 Section VII.A. 2. The rates are designed using the estimated average mail
13 processing and delivery cost differences between presort letters and parcels.
14 Parcels (currently in the presort category, primarily in Nonautomation Presort), on
15 average, cost \$ 3.368 to process and deliver -- compared to automation letter
16 mail pieces at \$ 0.087. Witness Smith, USPS-T-13; witness Kelley II, USPS-T-
17 30. The difference is \$ 3.28. I pass through only 15 percent of this cost
18 difference to develop a surcharge of \$ 0.489 above the Mixed AADC presort level
19 for Automation Letters as a benchmark to derive the finer presort rates. Since the
20 Postal Service is not proposing a Mixed ADC rate for the First-Class Mail
21 Business Parcels, this benchmark is used to derive the presort level rates for
22 ADC, 3-Digit and 5-Digit using witness Miller's (USPS-T-20) cost estimates.

23

1

FCM – Business Parcels

	Mail Processing Unit Cost (Dollars)	Savings	Proposed Rates	Workshare Discounts	Pass Throughs
	\$ 0.771		\$ 0.835		
ADC	\$ 0.532	\$ 0.239	\$ 0.727	\$ 0.108	45%
3-Digit	\$ 0.482	\$ 0.050	\$ 0.717	\$0.010	20%
5-Digit	\$ 0.298	\$ 0.185	\$ 0.643	\$ 0.074	40%

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First-Class Mail Business Parcels that do not meet the automation requirements specified above in Section VII.A.2 are subject to a proposed surcharge of \$ 0.05. The exception is that pieces sorted to the 5-Digit level would not be subject to this surcharge. The surcharge was derived by using the Parcel model estimated by witness Miller (USPS-T-20) and proposing a 10 percent passthrough.

9

5. Nonautomation Presort

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The Postal Service proposes a nonautomation presort rate of 40.0 cents for letters. This is 2.0 cents below the proposed single-piece rate of 42 cents and 5.4 cents above the highest Automation Letter rate of 34.6 cents for Mixed AADC Letters. Witness Abdirahman (USPS-T-22) measures the additional cost of nonautomation machinable letters at 1.317 cents. I have used a passthrough of 290 percent of this measured savings over the Mixed AADC rate for Automation Letters to propose a rate of 40 cents. This is done to maintain the rate relationship discussed below.

18

19

I propose that flat-shaped nonautomation presort pieces pay 51.9 cents. This rate for nonautomation presort flats is derived by adding the 11.9 cents (a

1 portion of the additional 30 cents cost discussed above) to the Mixed AADC rate
2 for Automation Letters.

3 The Postal Service wants to encourage pieces that are compatible with its
4 increasingly automated work environment and would like to maintain a rate
5 relationship between nonautomation presort mail similar to the relationship that it
6 has had historically with the Single-Piece mail.⁵

7 For operational reasons, the Postal Service is changing the presort
8 requirements for machinable letters in this rate category. Currently, at least 3-
9 Digit sortation is required. The Postal Service now proposes that AADC sortation
10 be required. For non-machinable letters and flat-shape pieces, 5-Digit would
11 remain the required presortation level.

12 **6. Additional Ounce Rate – Workshare**

13 As discussed in VI.A.2, I propose the establishment of a First-Class Mail
14 Business Parcels rate category and a separate rate for flat-shaped pieces within
15 the nonautomation presort rate category. These proposals reflect explicit
16 recognition of shape as a cost-driving factor within all workshare First-Class Mail
17 rate categories. Even if the passthroughs are less than 100 percent for shape
18 based additional costs, explicit recognition of shapes in all rate categories
19 relieves the additional ounce rate of the burden of recovering the costs caused
20 by differences in shapes.

21 Accordingly, I also am proposing to reduce the additional ounce rate for
22 nonautomation presort automation flats and the newly proposed Business

⁵ Over the last few dockets, the rate difference between nonautomation presort and single-piece has ranged from 1.8 cents to 2.5 cents.

1 Parcels rate categories from the current 23.7 cents to 20 cents, a 15.6 percent
2 reduction. For Automation Letters, where shape is not an issue and all of the
3 proposed Letter dimensions (including aspect ratio and maximum weight
4 requirement of 3.5 ounces) are met, I propose an even lower additional ounce
5 rate of 15.5 cents. This is a 34.6 percent reduction from the current rate of 23.7
6 cents.

7 In summary, the proposed additional ounce rate is 20 cents for all Presort
8 rate categories (nonautomation letter and flat shaped pieces, Automation Flats
9 and First-Class Mail Business Parcels) except Automation Letters, where it is
10 proposed to be 15.5 cents.

11 **D. Cards Subclass**

12 The proposed percentage increases for cards are somewhat higher than
13 those proposed for letters. The major reason is that, compared to letters, the
14 absolute increases for cards are applied to lower base rates for cards, starting at
15 the Single-Piece level. I have proposed a mitigation strategy as we move down to
16 presort rates. To avoid unnecessary complexity for the general mailing public,
17 and for administrative ease, the Postal Service is proposing retail rates in whole
18 cents.

19 **1. Single-Piece Cards**

20 Single-Piece cards account for about 51 percent of card revenues. The
21 Postal Service is proposing an increase of three cents in the basic card rate,
22 similar to the Postal Service's proposal for Single-Piece Letters. The proposed

1 rate of 27 cents represents an increase of 12.5 percent. The gap between the
2 rates for single-piece cards and letters remains at 15 cents.

3 As in the past, this rate is proposed in whole cents for administrative ease
4 and to avoid unnecessary complexity for the general mailing public. Also, a
5 three-cent increase is the amount consistent with the subclass cost coverage
6 target.

7 **2. Qualified Business Reply Cards**

8 To qualify for the discounted rate, mailers need to be pre-approved and
9 prepare prebarcoded, automation-compatible Business Reply Mail cards. For this
10 docket, the Postal Service is proposing a rate of 24.5 cents for QBRM cards.

11 This 24.5 cent QBRM card rate maintains the current QBRM card discount
12 at 2.5 cents below the Single-Piece card rate, and matches the 2.5 cent discount
13 I propose for QBRM letters. The cost study prepared by witness Abdirahman
14 (USPS-T-22 at 15) shows a cost avoidance of 1.52 cents, applicable to both
15 letters and cards. My proposal passes through 165 percent of this measured
16 cost avoidance.

17 QBRM is clean, prebarcoded mail and incurs lower costs than non-
18 barcoded mail. Automation-compatible First-Class Mail reply cards are used
19 daily by millions of individuals and small businesses. By recognizing some cost
20 savings associated with this mail, the Postal Service is able to permit a broader
21 base of customers to more directly share in the benefits of automation.

1 **3. Nonautomation Presort Cards**

2 The Postal Service proposes a 1.8 cent increase in the nonautomation
3 presort card rate, which results in an 8.1 percent rate increase. The proposed
4 difference between single-piece and nonautomation card rates is 2.9 cents,
5 compared to the 2.0 cent difference proposed for single-piece and
6 nonautomation presort letter rates. The absolute increase in single-piece letter
7 and card rates is 3 cents, but the percent increase for Single-Piece card rates is
8 12.5 percent, compared to 7.7 percent for Single-Piece letters. To mitigate the
9 impact of this difference in percentage increase on nonautomation presort cards,
10 I propose an increase in the degression between the Single-Piece card rate and
11 the nonautomation presort rate from the current 0.7 cent difference to 2.9 cents.
12 Otherwise, as indicated below, I propose that the current discount relationships
13 for other Card rate categories be maintained at their current levels.

14 **4. Automation Presort Cards**

15 The proposed rate structure for automation presort cards consists of four
16 tiers: Mixed AADC, AADC, 3-digit, and 5-digit. This structure assumes the
17 elimination of the Carrier Route category, as discussed above in Section VI.A.3.
18 The volume from Automation Carrier Route Cards is expected to shift to 5-Digit
19 Automation Cards rate category.

20 As with letters, a mailing must consist of 500 or more prebarcoded pieces
21 to be eligible for the AADC, 3-Digit and 5-Digit rates. Further, to be eligible for
22 the AADC, 3-Digit or 5-Digit rate, the mailing must have at least 150 pieces to the
23 same AADC, 3-Digit or 5-Digit ZIP Code/scheme destination. Pieces that do not

1 meet the 150-piece volume minimum pay the Mixed AADC rate. Thus, the Mixed
2 AADC automation rate can be viewed as a rate for bulk residual prebarcoded
3 pieces. No changes in the piece minimums are proposed.

4 The cost analysis performed for this docket indicates the cost savings for
5 the AADC, 3-Digit and 5-Digit automation tiers are now smaller than the current
6 discounts for these tiers (USPS-T-22 at 15). Consequently, if the proposed
7 workshare discounts for AADC, 3-Digit and 5-Digit automation cards were tied
8 strictly to avoided costs, these discounts would need to be reduced. Instead, as
9 was the case with letters, the passthroughs and the discounts that underlie the
10 proposed rates were selected to balance several goals, including: (1) achieving
11 the cost coverage target provided by witness O'Hara, (2) recognizing the value of
12 mailer worksharing, (3) avoiding changes in discount levels which result in unduly
13 disruptive rate impacts, and (4) acknowledging the importance of mailer
14 barcoding in overall postal operations.

15 As a result, the Postal Service's rate proposal in this docket will maintain
16 the AADC, 3-Digit and 5-Digit discounts at their present levels for cards.

17 As discussed in detail below, this approach to rate design mitigates the
18 size of the percentage increases in the rates for automation cards. Each
19 proposed card automation rate is 1.8 cents above its present level.

20 **a. Mixed AADC Automation Cards**

21 This rate is currently 1.9 cents below the nonautomation presort rate. The
22 cost data suggest a 1.4 discount from the nonautomation presort rate of 24.1
23 cents. Using a passthrough of 134 percent, I maintain this discount at the current

1 level of 1.9 cents. The resulting rate for Mixed AADC Automation Cards is 22.2
2 cents, an 8.8 percent increase over the current rate.

3 **b. AADC Cards**

4 I am proposing a 21.5 cent rate for automation cards presorted to the
5 AADC level, which is a 9.1 percent increase from the current rate of 19.7 cents.
6 The proposed discount is 0.7 cents, which is the same as the current discount
7 (20.4 minus 19.7). This is a 108 percent passthrough of the estimated cost
8 savings of 0.647 cents.

9 **c. 3-Digit Cards**

10 The Postal Service proposes retention of the current 0.4 cent rate
11 differential between the AADC automation rate and the 3-Digit rate,
12 notwithstanding the 0.225-cent measured cost difference. The resulting rate of
13 21.1 cents is 9.3 percent above its current level of 19.3 cents. The Postal Service
14 is mitigating the impact on card rates that rigid adherence to a 100 percent
15 passthrough would imply. Moreover, coupled with the larger nonautomation
16 discount for cards, the proposal reflects a larger discount from the single-piece
17 rate.

18 **d. 5-Digit Cards**

19 The proposed 5-Digit rate represents the maintenance of the existing
20 difference of 0.7 cents between 3-Digit and 5-Digit cards, notwithstanding the
21 0.735 cents measured cost difference between the two automation tiers. Use of

1 this rate category is optional. Mailers can be expected to use this rate only when
2 their cost of making the 5-Digit separation is less than the rate difference.

3 **VII. CLASSIFICATION CRITERIA**

4 Section 3623(c) of the Postal Reorganization Act requires the Commission to
5 make its decision on establishing a new classifications in accordance with the
6 following factors:

- 7 1. the establishment and maintenance of a fair and equitable
8 classification system for all mail;
9
- 10 2. the relative value to the people of the kinds of mail matter entered into
11 the postal system and the desirability and justification for special
12 classifications and services of mail;
13
- 14 3. the importance of providing classifications with extremely high degrees
15 of reliability and speed of delivery;
16
- 17 4. the importance of providing classifications which do not require an
18 extremely high degree of reliability and speed of delivery;
19
- 20 5. the desirability of special classifications from the point of view of both
21 the user and of the Postal Service; and
22
- 23 6 such other factors as the Commission may deem appropriate;
24

25 The establishment of separate classifications for letter, flat and parcel
26 shaped Single-Piece First-Class Mail, and the establishment of First-Class Mail
27 Business Parcels rate categories would satisfy criterion one -- fairness and
28 equity. Due to their shapes, both flat and parcel shaped pieces are more
29 expensive to process and deliver than letters. The establishment of
30 classifications within First-Class Mail that more precisely recognize the impact of

1 shape upon cost leads to rates that distribute the burden of supporting the postal
2 system among mailers in a more fair and equitable manner.

3 Mailers who prepare non-letter shaped-pieces (flats, parcels, or some
4 other shape) in some cases may have the ability and may find it economically
5 feasible to convert these pieces to shapes that qualify for lower postal rates.
6 Both the Postal Service and those First-Class Mail customers would benefit from
7 such conversions. It is expected that many mailers will continue to send flat or
8 parcel shaped First-Class Mail pieces. The establishment of distinct
9 classifications for this mail reflects the value of this mail to the Postal Service and
10 is consistent with consideration of criterion two, the value to people of different
11 kinds of mail matter.

12 The proposed classification changes also would further satisfy criterion
13 five -- the desirability of special classifications from the user's and Postal
14 Service's point of view. Greater recognition of the cost impact of shape on
15 mailflows and mail processing provides more accurate signals to the mailers and
16 provides an opportunity for them to evaluate their mail preparation in light of such
17 information.

18 Elimination of the heavy piece discount for workshare mail pieces
19 weighing more than 2 ounces, and the nonmachinable surcharge for non-letter
20 shaped pieces weighing one ounce or less, both in Single-Piece and workshare
21 rate categories, are classification changes that follow from the major
22 classification change discussed above. The introduction of shape-based rates
23 automatically eliminates the need for the nonmachinable surcharge, except in the

1 case of First-Class Mail Business Parcels. The heavy piece discount was
2 introduced by the Commission in Docket No. R87-1 and supported and proposed
3 by the Postal Service in Docket No. R90-1. During Docket No. R87-1, mailers
4 expressed concern that there were inadequate incentives for presorting flats.
5 This served as part of the original basis for establishment of the heavy piece
6 discount. The rate structure for First-Class Mail has changed considerably since
7 then. The proposed changes in First-Class Mail rate design give greater
8 recognition to shape, automation compatibility and mailer's work in preparing
9 mail for lower cost processing. Accordingly, the Postal Service believes that the
10 elimination of this discount is both fair and equitable. In addition, the proposed
11 shape-based classification schedule recognizes mailer's worksharing in a more
12 direct fashion, thus reducing a level of complexity. As a result, both criteria 2 and
13 5 are satisfied.

14 Elimination of the Automation Carrier Route Letter and Card rate
15 categories also reflects consideration of criterion 5. Automation of letters and
16 cards has been a phenomenal success story for both the Postal Service. Faster
17 sorting machines, better barcodes, and better optical readers have allowed for
18 greater control of postal costs, which has benefited both the Postal Service and
19 the mailers. Technology has evolved to permit delivery point sequencing further
20 upstream at destinating mail processing centers. Currently, the only letter-shaped
21 mail that is processed at the delivery units are Automation Carrier Route Letters.
22 Moving this mail upstream to larger Processing and Distribution Centers would
23 be desirable both from the perspective of the Postal Service and the mailers.

1 Finally, the establishment of a Forever Stamp classification would promote
2 several of the policies reflected in § 3623(c). Easing the ability of stamp-
3 dependent retail customers to transition from one basic First-Class Mail rate to
4 the next would bring an additional measure of fairness and equity to their
5 dealings with the Postal Service. It is expected that the Forever Stamp would be
6 desirable to retail customers and would increase customer satisfaction.

VIII. EXHIBIT A

**First-Class Mail
Subclass By Rate Category
Test Year After Rates
(000)
USPS-T-32 Exhibit A**

	TYAR Revenue	TYAR Cost	Revenue/ Cost
<u>Rate Category</u>			
Letters and Sealed Parcels Subclass			
Single Piece	\$ 19,124,695	\$ 10,424,565	183%
Workshared	\$ 16,674,353	\$ 5,263,369	317%
Total Letters Revenue	\$ 35,799,048	\$ 15,687,934	228%
Total Letters Volume (TYAR) ¹	85,749,198		
Letters Revenue per Piece (at TYAR Volume)	\$ 0.417		
Cards Subclass			
Single Piece	\$ 669,175	\$ 530,022	126%
Workshared	\$ 702,602	\$ 247,115	284%
Total Cards Revenue	\$ 1,371,777	\$ 777,136	177%
Total Cards Volume (TYAR)	5,657,451		
Cards Revenue per Piece (at TYAR Volume)	\$ 0.242		
Total First-Class Mail Revenue	\$ 37,170,825	\$ 16,465,070	226%
Total First-Class Volume (TYAR)	91,406,649		
First-Class Mail Revenue per Piece (at TYAR Volume)	\$ 0.407		

¹ Includes NSA Volume of 115,559 thousand pieces.