

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

RESPONSE OF THE UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION
REDIRECTED FROM POSTAL SERVICE WITNESS MARC D. MCCRERY
[PSA/USPS-T42-1]
(May 26, 2006)

The United States Postal Service hereby provides its response to the above-listed interrogatory of Parcel Shippers Association, filed on May 12, 2006. The interrogatory was redirected from Postal Service witness Marc D. McCrery. The interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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PSA/USPS-T42-1. Please refer to page 34 of your testimony where you discuss future network considerations including “shifting much of the allied activities (e.g., bundle sorting, parcel distribution, container breakdown) to Regional Distribution Centers (RDCs) when efficiencies can be realized.”

- (a) Please confirm that in the future network parcel distribution will occur at RDCs, not at the 21 bulk mail centers (BMCs) and 7 Auxiliary Service Facilities (ASFs). (Note: For simplicity, I use BMC to refer to BMCs and ASFs in the following subparts of this interrogatory.) If not confirmed, please explain fully.
- (b) Please provide your best estimate of the number of RDCs there will be in the future network once the transition to the future network is complete.
- (c) Please confirm that during the transition period from the current network to the future network, parcel distribution will occur in a combination of BMCs and RDCs. If not confirmed, please explain fully.
- (d) To qualify for DBMC rates, please confirm that, as the Postal Service transition to the future network, shippers will be required to enter their parcels at the destination facility where distribution of the parcel will occur (whether it be a DBMC or a DRDC). If not confirmed, please explain fully.
- (ii) How many of these destination facilities (i.e., no. of BMCs plus no. of RDCs) will there be by the end of FY 2006?
- (ii) How many of these destination facilities will there be by the end of FY 2007?
- (iii) How many of these destination facilities will there be by the end of FY 2008?
- (e) Has the Postal Service developed a list of facilities that will serve as Regional Distribution Centers? If so, please provide it. Also, please provide a schedule of when each facility will begin performing the function of an RDC.
- (f) Will all BMCs be retrofitted to serve as RDCs? If not, which BMCs will be retrofitted for this purpose?
- (g) Please provide a schedule for retrofitting BMCs to serve as RDCs.
- (h) Do you expect that parcel shippers will be allowed to enter bedloaded parcels at RDCs? Please explain your response fully. If not, how do you expect parcels will have to be containerized to be entered at RDCs?
- (i) Do you agree that presorting parcels to and entering parcels at a larger number of destination facilities increases parcel preparation and transportation costs for parcel shippers? If not, please explain fully.
- (j) Do you agree that not allowing shippers to bedload parcels will increase transportation costs for parcel shippers? If not, please explain fully.
- (k) Do you agree that parcel shippers presorting parcels to and entering parcels at additional destination facilities and containerizing parcels (as opposed to bedloading them) to qualify for DBMC rates will reduce Postal Service costs for DBMC parcels? Please explain fully.
- (l) If your response to subpart (k) of this interrogatory is yes, has the Postal Service reflected these savings in its revenue requirement? Please explain fully.
- (m) If your response to subpart (k) of this interrogatory is yes, has the Postal Service reflected these additional savings in its dropship cost avoidance models for parcels? Please explain fully.

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RESPONSE:

(a)-(c), (d)(ii)-(g) The United States Postal Service, over the course of nearly 35 years, has incrementally developed a product-specific distribution network. For example, a nation-wide network of 21 Bulk Mail Centers [BMC] was constructed in the 1970's with the intent of processing parcels and bundles. Another, more limited, example in the 1990's a regional network of Priority Mail Processing Centers [PMPC] was implemented. Both of these distribution networks employ basic material handling technology.

This incremental network development took place around product classifications, such as priority, parcels, and standard mail. Over this same period of time, significant technology improvements were taking place with the equipment utilized for individual mail piece distribution. The key components of this technology improvement were Optical Character Recognition [OCR], utilization of a variety of Barcode formats, and improvements in mechanical transport systems for letters, flats and packages. The result was a distribution network designed around mail product classifications, while technology improvements were shaped-based.

The disconnect, between the distribution network and the available distribution technology, results in a less than optimal system. There are redundancies in both individual mail piece and container handlings, as well as overlapping transportation networks. There are multiple points of entry into this distribution network, combined with multiple distribution facilities and supporting

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transportation to move among these facilities. At the end of the distribution network is the final point of distribution prior to the City or Rural Carrier being presented the mail for delivery on their route. This end-node in the network reaches the approximately 145 million delivery points served by the Postal Service each day.

The last point of distribution, prior to presenting to mail carrier for delivery, will always be required. The revised network will minimize the number of facilities required to distribute mail and process containers, prior to the last point of distribution. In turn, the redundant transportation required among product-specific facilities, can be reduced.

The intent of network optimization is to move to shaped-based distribution that makes best use of available technology. This effort will minimize the number of distribution handlings required for individual mail pieces. As these mail pieces are distributed, they will be placed in containers (trays, tubs and sacks), in turn these containers are aggregated and placed into larger/mobile containers (General Purpose Mail Containers, Pallets, etc), and finally the aggregate of containers are transported by truck, train and plane. An optimized network reduces the number of material handlings for these containers and reduces the transportation redundancies caused by product-based networks.

Two basic types of facilities will exist in this network:

- 1) Processing Centers that will perform
 - a. individual mail piece distribution
 - b. Mail destined for ZIP Codes within that facility service area will be processed for carrier delivery

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- c. Mail destined for ZIP Codes serviced by other facilities will be processed and containerized
- 2) Regional Distribution Centers [RDC] that will perform
 - a. Material handling distribution of containers
 - b. Virtually no individual mail piece distribution, other than oversized parcels that cannot be containerized

Some small number of facilities will handle both sets of responsibilities.

The RDCs will be larger facilities, typically 200,000 square feet or more. Beyond just space, the RDC will require a significant number of dock doors to handle the constant flow of inbound and outbound transportation. An RDC will need to be in locations with available access to major highways and airports. The technology employed in RDCs will be focused upon material handling; the movement of individual containers such as trays, tubs and sacks. To the extent possible, this material handling technology will employ barcodes for distribution. When financially viable, Radio Frequency Identification [RFID] tags could also be employed.

Given the general criteria for an RDC, the existing network of 21 BMCs and 7 Auxiliary Service Facilities (ASF) serves as excellent candidates for conversion. The conversion process of a BMC/ASF to an RDC begins with the removal of legacy material handling technology. Once this outdated / oversized fixed mechanization is removed, it can be replaced with faster OCR/BCR capable material handling systems. The conversion of a BMC/ASF is complicated by the need to continue to process mail in that facility during the renovation. The renovation must be done in a manner to minimize the cost of off-loading to other less efficient manual operations. The Postal Service literally must “change the

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wings, while the plane is still flying". Given the complexity of this conversion of BMC/ASF to RDC, combined with limited capital expenditures, the exact schedule of conversion is still to be determined.

There is a need for RDCs beyond the potential conversion of 21 BMCs and 7 ASFs. The exact number of RDCs has not been determined and will continue to change over time. In general terms, at the end of the conversion process, there may be roughly 28 - 100 RDCs. The number of RDCs and locations are impacted by a number of factors:

- 1) Mail volumes by product
- 2) Mailer adoption of pricing discounts
- 3) Method of containerization utilized by mailers
- 4) Service requirements by product
- 5) Availability of transportation to support service requirements
- 6) Proximity of facility to highways and airports
- 7) Space in existing USPS facilities
- 8) Future distribution and material handling technology
- 9) Future mail preparation alternatives resulting from technology advances
- 10) If appropriate USPS facilities are not available, then the need to determine the availability of suitable properties in the market
- 11) Provisions of pending postal reform

In addition, to all of these factors, the Postal Service must continue to examine the pace at which this capital investment in the infrastructure can be accomplished. Even if an exact number and specific location for each RDC could be determined, the implementation of such a change would spread over many years. It is likely that during that time further variation in the factors considered would cause continuing updates to the plan.

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(d) Confirmed. However, the Postal Service is reviewing the current dropship rate structure to determine if it appropriately supports the mailer entry in the future network environment.

(h) No. When a facility is activated as or converted to an RDC, it is expected that DBMC parcels be prepared on a pallet or in a pallet box.

(i)-(j) The USPS does not have enough information to draw such conclusions. It is possible that additional transportation costs could be offset by lower containerization costs. Without looking at the full range of costs -- the customers' own costs to prepare and transport the mail as well as their postage costs -- there is not sufficient information to respond to this question. The USPS does not have knowledge of customers' costs and practices, nor does the USPS have the wherewithal at this point to predict how those practices would change as the RDUs are implemented. It is possible that the result depends on the individual customer. For instance, is the customer in question preparing and transporting only mail that is generated by that customer's production processes, or is the customer in question a consolidator handling mail generated by several different customers? With regard to the question of increasing costs relative to bedloading, again it would be necessary to understand the customers' cost structures including the processes, equipment and wage rates paid for labor, as well as what the relative costs of the alternative to bedloading would be in order to fully understand the cost implications. These questions would be better answered by customers who could testify to their cost structures.

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(k) A complete analysis of the impact of required containerization has yet to be conducted, so it is unknown at this time. Since bedloaded dropshipments that are not scheduled as a "drop and pick" must be unloaded by the driver while palletized vehicles are unloaded by USPS personnel, in some cases the USPS costs may increase.

(l) No specific savings for presorting parcels to and entering parcels at additional destination facilities and containerizing parcels have been factored into the revenue requirement. If savings related to any network realignment activities are achieved by the test year (FY08), the savings are accounted for in the Breakthrough Productivity Initiative (see USPS-T-42, pages 33 and 34).

(m) Not applicable.