

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

POSTAL RATE AND FEE CHANGES

Docket No. R2006-1

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO  
PRESIDING OFFICER'S INFORMATION REQUEST NO. 10  
(August 17, 2006)

The United States Postal Service hereby provides its responses to Presiding Officer's Information Request (POIR) No. 10, issued August 4, 2006. A response to Question 7 is forthcoming. Responses to Question 5 and Question 6 were filed on August 10 and August 15, respectively. The following witnesses are sponsoring the identified responses to this POIR:

Institutional	Question 1
Witness Smith	Questions 2-4

Each question is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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RESPONSE OF UNITED STATES POSTAL SERVICE  
TO POIR NO. 10, QUESTION 1

1. Please refer to witness Van-Ty-Smith Tables 5.1, 5.2, and 5.3 provided in USPS.T.11.Rule.53.Tables.xls showing volume variable costs by subgroup of cost pools for Plants, Post Offices, Stations and Branches, and BMCs. Examining the growth rate in total mail processing costs by subclasses between FY 2005 and FY 2004 shows that certain subclass cost increases appear disproportionate to their volume changes for the same period. For example, Outside County Periodicals volumes declined by .8% while its mail processing costs increased by 5%. Similarly, Standard ECR volume increased by 6% while its corresponding costs went up by 53%.
  - a. Identify the cost drivers including any operational or cost methodological changes that may have led to such increases in Periodicals, Standard ECR, etc.
  - b. Please provide an explanation in those instances where the cost pool has increased or decreased more than 10 percent in FY 2005 compared to FY 2004.

**RESPONSE:**

Please see the response of witness Bozzo, USPS-T-46, to POIR no. 9, question 6.

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

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

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

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

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

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

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

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

**RESPONSE:**

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

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

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

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

For these reasons, it was not pursued.

b. No, I did not alert the rate design analyst responsible for ECR of this cost anomaly. As I indicated in my response to part a, I addressed inconsistencies between volumes and costs for Standard Regular parcel costs; no indication of need was forthcoming on ECR parcels.

c. No, see my response to part a.

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

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d. No, see my response to part a.

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

Data currently available, however, can shed some light on this. I have attached, in Attachment 1, the mail processing labor costs per piece using Postal Service and Postal Rate Commission cost methodologies for First-Class single-piece, First-Class presort, Standard ECR and Standard Regular parcels for the years 1996, 1998, 1999, 2000, 2004 and 2005.<sup>2</sup> Please note the unit cost for Standard ECR parcels has exceeded First-Class single-piece parcels unit costs since FY 1999, under both Postal Service and Postal Rate Commission cost methods. In addition, the Standard ECR parcel unit cost has risen at a rapid pace, suggesting that the cost anomaly is growing over time.<sup>3</sup> While the source of the anomaly is unclear, there does appear to be an

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

<sup>3</sup> Changes in cost and volume data systems and methodology changes over this time period have no doubt contributed to changes in Standard ECR parcel unit costs for some years. For instance see witness Bozzo, USPS-T-46, pages 38-39 on the discussion of the impact of IOCS redesign on Standard ECR costs. Nevertheless, most of the observed changes in Standard ECR parcel unit costs can not be accounted for due to changes in data systems or methodology. For additional information on the changes in data systems or methodology over the period FY 1996 to FY 2005, see the documentation provided in each of the Dockets listed in Attachment 1.

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inconsistency between determining processing labor costs and developing volumes for Standard ECR parcels.

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

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

f. An approach is to apply the same adjustment process used for Standard Regular using ODIS and RPW as shown in my testimony, USPS-T-13, Attachment 13, to Standard ECR parcels. Even without knowing the source for the cost anomaly, one can support the use of this method to adjust Standard ECR parcel costs on the basis that ODIS-RPW and the cost systems are both sample based and have the same definition of shape and, therefore, both may well diverge from RPW by shape data in a parallel way.

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

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In addition, Standard ECR flats processing unit costs would rise by 3.5 percent from 1.94 cents to 2.01 cents.

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**ATTACHMENT 1  
TO QUESTION 2**

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

USPS LABOR UNIT COST TRENDS

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

PRC LABOR UNIT COST TRENDS

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

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

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3. Please identify the source and verify the amount of \$124,054,000 for the FY05 Parcel Sorting Machine (PSM) cost pool as shown in tab PPSM&SPSM of both MPPGBY08PRC.xls in USPS-LR-L-98 and MPPGBY08.xls in USPS-LR-L-52. Please explain the rationale for using accrued costs instead of volume variable cost when calculating the PSM adjustment factor used to adjust Primary and Secondary PSM volume variable costs. Please provide a revised version of the aforementioned spreadsheets if deemed necessary.

**RESPONSE:**

The source for the \$124,054,000 for the FY05 PSM cost pool for both spreadsheets is Witness Van-Ty-Smith, USPS-T-11, Table 1. This is the accrued costs for both the USPS and PRC PSM mail processing labor cost pool (see also Witness Van-Ty-Smith, USPS-T-11, Table 5, which is the same as for the USPS cost, except for rounding).

Using accrued costs for the adjustment accounts for differences in the operations or activities included in the PSM labor cost processing cost pool as compared with the PSM operation used by witness Miller, USPS-T-21, in developing the PSM productivities. The primary PSM and Secondary PSM piggyback factors as initially developed (without the adjustment) are based on the PSM mail processing labor cost pool cost of \$124,054,000 for FY 2005. The PSM productivities are based on the MODS PSM operation, the cost of which was approximately \$177,712,139 in FY 2005. The difference is that the former only includes some of the support work for sweeping the PSM runouts and tying out the sacks, while the latter includes all of this support work. A piggyback factor appropriate for the PSM labor cost pool would be inappropriate for the labor costs associated with the PSM MODS operation, since it would overstate the amount of equipment and facility-related costs. The ratio, 1.43 (which is equal to  $\$177,712,139/\$124,054,000$ ), applied in the adjustment is meant to

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expand the labor costs to be consistent with the MODS operation in order to get a more accurate piggyback factor.

This adjustment is required due to two changes made since Docket No. R2005-1. First, witness Miller, USPS-T-21, adopted MODS work hours for developing PSM productivities, as he discusses at pages 4-5 of his testimony. Second, IOCS redesign led to an expanded PSM cost pool, since some "Allied" cost pool activities related to the PSM were shifted to the PSM cost pool (see witness Bozzo, USPS-T-46, pages 30-31). In Docket No. R2005-1, the cost pool and the workhours used in the productivity were consistent in that both covered only the keying work. In R2006-1, both the cost pool and workhours used in the productivity calculation grew, but the latter grew more. As a result the adjustment is needed. The PSM piggyback factors for R2006-1 are lower than in Docket No. R2005-1 due to the broader labor cost base for the piggyback factors.

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4. Please refer to the revised USPS-LR-L-98, spreadsheet MPPGBY08PRC.xls, Tab I which produces a reference error when attempting to update the link to TY08Equipment.xls. The equipment depreciation spreadsheet provided in USPS-LR-L-54 is not the same as the one used in Tab I of MPPGBY08PRC.xls. Please either correct the linkage in MPPGBY08PRC.xls or provide a new TY08Equipment.xls.

**RESPONSE:**

Revised versions of MPPGBY08PRC.xls and MPPGBY05PRC.xls for USPS-LR-L-98 and MPPGBY08.xls for USPS-LR-L-52 will be provided to address these reference errors. No results have changed, but the references in these spreadsheets now correctly line up with the equipment cost spreadsheets in USPS-LR-L-54.