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POST OFFICE

October 18, 2002

Honorable Steven Williams  
Secretary  
Postal Rate Commission  
1333 H Street, N.W.  
Suite 300  
Washington, D.C. 20268-0001

Re: Initial Priority Presort Experiment Status Report

Mr. Williams:

Enclosed are copies of the first of the required quarterly status reports summarizing the operation of the experiment authorized by the Decision of the Governors of the United States Postal Service on the Recommended Decision of the Postal Rate Commission on Experimental Presorted Priority Mail Rate Categories, Docket No. MC2001-1 (June 4, 2001).

Sincerely,

A handwritten signature in cursive script that reads "Daniel J. Foucheaux, Jr.".

Daniel J. Foucheaux, Jr.  
Chief Counsel  
Legal Policy & Ratemaking Law

Enclosures

cc: All parties of record in Docket No. MC2001-1

**United States Postal Service  
Priority Mail Presort Experiment**

**First Quarterly Status Report  
(October 18, 2002)**

## I. Introduction

As stipulated in the Statement of Understanding Regarding Periodic Reporting, filed in support of the Stipulation and Agreement approved in Docket No. MC2001-1, the Postal Service is responsible for filing status reports with the Postal Rate Commission, starting four to six weeks after completion of the fourth full fiscal quarter of the experiment. The first presort mailing under the experiment was made in Fiscal Year 2001 Quarter 4, on July 20, 2001. Therefore, the fourth full fiscal quarter of the experiment was Fiscal Year 2002 Quarter 4, which ended on September 6, 2002. Accordingly, this is the first of the status reports due to the Postal Rate Commission. This report summarizes the first full year of operation. Subsequent reports will be filed on a quarterly basis and will summarize the most recently concluded fiscal quarter.

## II. Overview

The Postal Service began soliciting customer participation in the Priority Mail Presort Experiment with a description of the experiment and an application form in the May 31, 2001 issue of Postal Bulletin. Later, an application form was included in the July 2001 issue of Mailers Companion, and the application form was also made available online at [ribbs.usps.gov](http://ribbs.usps.gov).

Approximately 70 mailers submitted applications in response. Applying the mailer selection criteria specified in Docket No. MC2001-1,<sup>1</sup> the Postal Service initiated discussions with about 15-20 of these applicants. These discussions were limited in number so that the experiment's intended first-year quota of about 10 participants would not be exceeded. In six cases, representatives from Postal Service headquarters visited the mailer's facility to discuss in greater detail the terms for a prospective Priority Mail Presort Experiment Service Agreement. Altogether from these 15-20 applicants, only four signed a Service Agreement. In the other cases, often despite extensive

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<sup>1</sup> In particular, that mailers are diverse with respect to size, location, and mail characteristics (e.g., shape), and that mailings are preferably on a regular or continuing basis rather than infrequent or sporadic. Docket No. MC2001-1, USPS-T-1 at 4.

discussions with the Postal Service, applicant interest generally waned. Additional efforts by the Postal Service later during the first year of the experiment to find other candidates from among the original 70 applicants did not result in any signed Service Agreements. Apparent impediments to mailer participation in the experiment are discussed below in Section III of this report.

A notice describing the terms of the experiment was published in the Federal Register on June 22, 2001. 66 FR 33472-75. This Federal Register notice gave the Postal Service some leeway "to work with each participant on a one-on-one basis, determining the best method of containerization and preparation." *Id* at 33472.

Specific containerization and preparation requirements could vary from mailer to mailer due to the mailer's geographical location and mail densities. Since this is an experiment, the Postal Service will be able to reasonably adjust the requirements during the experiment.

*Id.* During the course of the experiment, such adjustments have been made to facilitate two mailers' participation. One, a distribution and fulfillment operation (Mailer #2), was allowed to receive the ADC discount for sorting to a list in which some ADCs were collapsed to Priority Mail Processing Centers (PMPCs). These latter facilities, located mainly in the northeastern United States, perform the same kind of sorting as ADCs. Therefore, the Postal Service avoids the same number of sorts from Mailer #2's presorting to PMPCs as from presorting to ADCs. Mailer #2 has limited its participation in the experiment to mail destined just for PMPCs in the northeastern U.S. As a result, only about 10 percent of total Priority Mail volume originating at Mailer #2's participating distribution and fulfillment center has been a part of the experiment.

For the other mailer, a provider of communications and document services (Mailer #3), the Postal Service lowered the required separation minimum of 10 parcels per sack to seven parcels per sack. Mailer #3 was finding in some cases that 10 parcels exceeded a sack's volume or weight capacity. The Postal Service considered seven parcels -- the standard for Parcel Select -- to still be a

worthwhile level of separation for purposes of the experiment. Anything lower, though, is arguably not worth testing.<sup>2</sup>

Summary statistics for the Priority Mail Presort Experiment until the end of Fiscal Year 2002 are provided in attached Table 1. The statistics are compiled from 888 postage statements completed by the four participating mailers. As the table shows, the total number of presorted Priority Mail pieces until the end of Fiscal Year 2002 was 7.1 million. By presort option, 3-digit accounted for 4.6 million pieces ( 65 percent), 5-digit accounted for 1.5 million pieces (21 percent), and ADC accounted for 1.0 million pieces (14 percent). Presort mailings included an additional 1.0 million residual pieces which did not qualify for a discount. The total value of presort discounts was slightly over \$1.2 million. Among the four participants, Mailer #1 accounted for the vast majority of presorted volume, 94 percent.

Note in the table that Mailer #4's presort volume is all destined to Zone 7. Mailer #4 uses Standard Mail for most of its mailings. Priority Mail is used, however, for mailings to Puerto Rico. Just four 3-digit ZIP Codes in Puerto Rico (Zone 7 from the point of origin) account for all of Mailer #4's participation in the experiment.

Two of the subject mailers in Table 1 are no longer participating in the experiment. Mailer #3 entered its last presort mailing on August 19, 2002, and Mailer #2 stopped presorting shortly into Fiscal Year 2003. For Mailer #3, presorting did not prove to be cost-effective. Its costs of sorting and generating necessary documentation manually were exceeding savings from the discounts. With its mail pieces coming off the processing line in no particular order, i.e., unsorted, it was also difficult for Mailer #3 to gauge whether, by dispatch time, it would achieve, after sorting, the minimum of 7 parcels per sack (despite the agreed reduction from 10 parcels per sack).

Mailer #2 has been shifting its volume from Priority Mail to Parcel Select, with the use of consolidators. Ultimately its Priority Mail volume fell to the point

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<sup>2</sup> This was problematic for one applicant who could not fit more than six of its preferred Postal Service-supplied Priority Mail boxes in a sack.

where it could no longer meet the minimum per-mailing volume requirement of the experiment.

### III. Impediments to Customer Participation

To understand why many mailers have encountered impediments to participating in the Priority Mail Presort experiment, it is necessary to distinguish between mailers of identical-weight pieces and mailers of nonidentical-weight pieces. Both types of mailers must generate documentation indicating weight and zone (among other things) for every single mail piece, allowing the Postal Service to verify postage and eligibility for presort discounts. These documentation requirements are easier, however, for mailers of identical-weight pieces, who can sum across pieces having identical postage rates and thereby avoid accounting for those pieces individually.

Another advantage for mailers of identical-weight pieces is that they tend to mail from prepared address lists. This generally means that sorting operations can easily be automated. Mailers of nonidentical-weight pieces, in contrast, generally do not have prepared address lists and must sort manually.

#### A. Identical-Weight-Piece Mailers

As an identical-weight-piece mailer, Mailer #1 has faced fewer impediments to participating in the experiment than nonidentical-weight-piece mailers. Still, its participation has not been without some hitches. For the better part of Fiscal Year 2002, Mailer #1 used First-Class Mail presort software to make Priority Mail separations. This was not the optimal solution because Priority Mail's transportation and distribution network differs from First-Class Mail's. Eventually, the Postal Service required Mailer #1 to change its labeling list to reflect the Priority Mail network.

Further, in May 2002, representatives from Postal Service headquarters visited Mailer #1 and the nearby postal mail processing facility to check on the status of the experiment. Several problems were found, including breakage — and therefore lost separations — on some pallets that were not properly shrink-wrapped; some 3-digit separations that were combined on pallets; and some mail

that was not in flat trays as required. The Postal Service attributes these lapses to miscommunication among postal headquarters, the field, and the mailer, exacerbated by unexpected turnover in the Postal Service's local business mail entry operation. In response, Mailer #1's presorting was halted until the problems could be resolved. Postal headquarters personnel made several follow-up visits to observe the mail processing facility and Mailer #1's operations to help resolve the problems.

Mailer #1 did not presort after June 20, 2002 until August 14, 2002. In addition to the interruption required to resolve the problems cited above, there were several other important explanatory factors. First, Mailer #1's Priority Mail volume normally falls precipitously after approximately March-May. Second, the reintroduction of zoned Priority Mail rates from one to five pounds on June 30, 2002 had the effect of complicating presort documentation procedures for identical-weight-piece mailers like Mailer #1. Previously, postage rates for identical-weight pieces under five pounds did not vary by zone. Now, for pieces over one pound, they vary by zone, and it is necessary for purposes of postage and presort verification to account for each zone separately. Third, Mailer #1 required a software solution, both to sort to the required new Priority Mail labeling list and to account for the new zoned rates. Such presort software was recently developed for identical-weight-piece mailers by a third-party vendor and deployed at Mailer #1 as a test site, at no charge, in August 2002.

#### B. Nonidentical-Weight-Piece Mailers

Nonidentical-weight-piece mailers with permit accounts (i.e., who do not meter each piece) employ postage payment systems such as Manifest Mailing Systems in order to provide the Postal Service with the documentation it requires to verify postage. These systems require conversion to also verify eligibility for presort discounts. A piece-by-piece accounting is needed, for example, of weight, zone, and presort level. Such documentation systems are more complicated than those used by identical-weight-piece mailers. Software solutions are needed, but thus far in the experiment none have been developed. A Catch-22 of sorts is involved: until a presort discount becomes permanent,

nonidentical-weight mailers have expressed reluctance to invest in software (to some extent customized) that may have only temporary use. The unavailability of software has been a holdup to participation in the experiment for a number of nonidentical-weight-piece mailers, including some major package fulfillment operations. While many such mailers have their own internal manifesting systems, it is not always easy and/or inexpensive to convert these systems to the presort experiment. One vendor reportedly is currently developing software at the request of two nonidentical-weight-piece mailers.

Any such software can help in generating the necessary documentation for the presort experiment, but because they do not mail from prepared address lists, most nonidentical-weight-piece mailers will still have to sort manually. Therefore, *nonidentical-weight-piece mailers not only face more complicated presort documentation procedures than identical-weight-piece mailers, but they are also likely to have higher sortation costs. As a result, cost-effectiveness has been an issue for some nonidentical-weight-piece mailers. For example, as mentioned earlier, Mailer #3 dropped out of the experiment after discovering from three months of participation that presorting was not cost-effective.*

#### IV. Recent Developments

The Postal Service still considers that there is potential for additional mailers to participate in the experiment. Phase I of the experiment can be said to have ended on its one-year anniversary in late July 2002. On August 1, therefore, the Postal Service began an initiative to contact all 66 customers who applied during Phase I but did not end up participating (even those who, despite applying, later indicated a lack of interest). Many of the Phase I applicants, for example, indicated an interest in participating later in the experiment, during Phase II.

In addition, the Postal Service sales force was alerted to solicit additional applicants for the experiment. This has so far generated four leads, of which two can be described as serious prospects.

Following are key findings from the outreach effort to the 66 applicants who did not participate in the experiment during Phase I:

- Eight applicants, including several presort agencies, have demonstrated a serious interest in participating in Phase II of the experiment. The presort agencies are currently checking with their customers on volume potential. Around ten other applicants have indicated some interest in Phase II of the experiment.
- Seven applicants, citing the June 30, 2002 rate increase and/or the rezoning of rates from one to five pounds, have moved away from Priority Mail to competitors or consolidators.
- Five applicants have determined upon further analysis that they do not have sufficient mail densities to make the presort separations. In some cases, they literally do not have enough physical space to accommodate all the ADC separations.
- Fourteen applicants have experienced volume declines to the point where they can no longer meet the minimum of 300 pieces or 500 pounds per presort mailing.
- A couple of applicants have indicated, surprisingly, that the rezoning of rates from one to five pounds has undermined their ability to qualify for the ADC discount. While 3-digit and 5-digit separations correspond in all cases to only one zone, ADC separations can run across several zones. As a result, for pieces over a pound, more than one postage rate can apply to single ADC separations, making documentation procedures more complicated. Of greatest concern is that the separation being undermined, ADC, is the one for which necessary mail densities are easiest to achieve. This issue therefore merits serious further study.
- Three applicants, in accordance with the mailer selection criteria, were not considered during Phase I because their mailings are seasonal. Due to the low level of participation in the experiment, the Postal Service is relaxing its original preference for mailers with regular or continuing volume during Phase II, and is pursuing the three seasonal-mail

applicants. One, a letter shop, just signed a presort Service Agreement in mid-September 2002, and did a test presort mailing near the end of that month. Working from a prepared list of addresses mainly in the northeastern U.S., the letter shop anticipates mailing about 1,000 pieces twice a month, with a seasonal spike every October of about 20,000 pieces. The limited geographic scope is expected to allow the mailer to achieve mail densities for 3-digit and 5-digit separations, and to avoid doing ADC sorts which are now more complicated to document, as discussed above.

- A couple of identical-weight-piece applicants have been told about the software that was developed by the third-party vendor. However, it is not known if this software will be available for free, as it is to Mailer #1 as a test site.
- Two applicants, both presort houses, are considering metering presorted Priority Mail flats and generating required documentation manually.

**Table 1. Priority Mail Presort Experiment: Summary Statistics, End Fiscal Year 2002**

	Mailer #1	Mailer #2 *	Mailer #3 *	Mailer #4	Total
Start	7/20/01	10/1/01	5/14/02	1/2/02	
Last	8/14/02	9/6/02	8/19/02	9/6/02	
Mail-Piece Shape	Flats	Parcels	Parcels	Parcels	
Identical-Weight Pieces?	Yes	No	No	No	
Zones	All	1 - 5	All	7	
Volume					
5-Digit Presort	1,494,356	0	0	0	1,494,356
3-Digit Presort	4,526,167	0	0	44,597	4,570,764
ADC Presort	646,142	337,990	32,716	0	1,016,848
Residual	925,819	0	5,174	43,337	974,330
Total Presort	6,666,665	337,990	32,716	44,597	7,081,968
Total w/ Residual	7,592,484	337,990	37,890	87,934	8,056,298
Volume Distribution					
5-Digit Presort	100%	0%	0%	0%	100%
3-Digit Presort	99%	0%	0%	1%	100%
ADC Presort	64%	33%	3%	0%	100%
Residual	95%	0%	1%	4%	100%
Total Presort	94%	5%	0%	1%	100%
Total w/ Residual	94%	4%	0%	1%	100%
Presort Discounts					
5-Digit (@ \$.25/piece)	\$373,589	\$0	\$0	\$0	\$373,589
3-Digit (@ \$.16/piece)	\$724,187	\$0	\$0	\$7,136	\$731,322
ADC (@ \$.12/piece)	\$77,537	\$40,559	\$3,926	\$0	\$122,022
Total	\$1,175,313	\$40,559	\$3,926	\$7,136	\$1,226,933
Total Weight (Lbs., w/ Residual)	10,975,486	619,976	79,603	96,610	11,771,675
Avg. Weight per Piece (Lbs.)	1.45	1.83	2.10	1.10	1.46

\* Have dropped out of the experiment