UNITED STATES OF AMERICA
POSTAL RATE COMMISSION

Before:

Chairman Gleiman, Vice Chairman Haley,
Commissioners LeBlanc, and Omas

Postal Rate and Fee Changes, 1997 Docket No. R97-1

OPINION

AND

RECOMMENDED DECISION

VOLUME 1

Washington, DC 20268-0001
May 11, 1998

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*Commissioner Goldway did not participate in this decision.

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SUMMARY

Since the Commission last recommended rate increases, the Postal Service has experienced unprecedented operating surpluses totaling $4.6 billion. These surpluses have continued to grow, even since the Postal Service filed its Request on July 10, 1997. The most recent information available to the Commission indicates that the Postal Service had an additional net operating surplus of more than $1.3 billion in the first half of Fiscal Year 1998, a larger surplus than it generated during the same six months of 1997.

The Postal Service has requested rate increases designed to produce additional net revenues of $2.4 billion annually. The Postal Service supported its request with projections of costs and revenues based on Fiscal Year 1996 data. These data do not fully reflect the impact of mail classification reforms that the Service started to implement in the fourth quarter of that year. When it became apparent that the Service had failed to forecast accurately its operating surpluses, and was not in immediate need of additional funds, the Commission attempted to initiate a cooperative procedure designed to allow rates to reflect more recent actual operating results.

The Commission wrote to the Chairman of the Postal Service Board of Governors suggesting that the Board provide the Commission with actual Fiscal Year 1997 data for incorporation into its decision. This more recent and representative data would have allowed the development of fairer and more equitable, cost-based rates. The Commission proposed to provide rate recommendations approximately three months after receiving these data.

The Governors indicated that it was their preference that the Commission complete its analysis without delay, even if that meant foregoing the use of information that would more accurately reflect operating realities. The Commission has done so. Nonetheless, the Commission considers it unfortunate that the two agencies were not able to cooperate in an action that would have ameliorated many of the concerns raised on the

current record. The correspondence between the Commission and the Governors is provided as Appendix L to this decision.

Adjustments to Projected Expenses. The Commission's recommendation reduces the Service's $2.4 billion request by approximately $745 million. The largest adjustment to the revenue requirement corrects Postal Service overestimates of the impact of inflation on its costs (such as cost-of-living wage adjustments). Another large correction accepts a party's evidence that the Service failed to reflect some savings it will obtain from cost reduction and other programs. The Commission also has recognized that because the Service failed to anticipate the size of its 1997 operating surplus, the annual revenue earmarked for the recovery of prior years' losses can be reduced by $70 million.

The Postal Service attempted to buttress its original estimate of a $1.4 billion operating loss in 1998 by claiming near the conclusion of this case that it would spend $300 million more than initially projected on three discretionary programs (e.g. automated data processing). The Commission found this forecast too speculative to include in the Service's revenue requirement. The table below sets out the Commission changes to the Service's requested revenue requirement.

Adjustments to USPS Projected FY 98 Revenue Requirement	
(in millions of dollars)	
Postal Service revisions and acknowledged corrections	-67
Overestimates of the impact of inflation	-511
Correction of cost reduction and other programs estimates	-101
Attribution adjustments	+28
Miscellaneous adjustments	-24
Prior Years' Losses update	-70
Total	**-745**

Although the Postal Service currently is enjoying operating surpluses, the Commission recommends a one-cent increase in the price of a First-Class letter, and

similar small changes to the rates applicable to other categories of mail. These changes will provide added funds to enable the Postal Service to proceed with its plans to spend $5.6 billion on equipment and service enhancement programs in the 1998 fiscal year. The Commission notes, however, that the record developed in this case indicates that the Postal Service has not yet initiated fully this massive spending program. The Commission joins the many mailers that have participated in this proceeding in urging the Governors of the Postal Service to delay increasing rates until additional revenues are needed to offset actual (as opposed to planned) expenditures.

The following table compares rates requested by the Postal Service with rates recommended by the Commission:

	Average Percent Increase Requested	**Average Percent Increase Recommended**
First-Class letters	3.2	1.7
First-Class cards	5.9	0.2
Priority Mail	6.7	5.6
Express Mail	3.6	8.1
Periodicals	3.9	4.6
Advertising Mail (regular)	1.8	1.2
Advertising Mail (saturation)	3.0	2.2
Parcel Post	9.2	12.4
Special (books & music)	(0.4)	(9.6)

The small size of the rate changes the Commission recommends should not mask the importance of the issues addressed in this proceeding. This has been the most technically complex case ever faced by the Commission. The Postal Service and participants have presented numerous suggested improvements to the existing methods of costing and pricing postal services.

The Service proposed a new econometric analysis of mail processing which would have shifted a total of $3.7 billion of mail processing and associated costs from attributable to institutional (overhead) cost. It proposed a new, more accurate method for

distributing mail processing costs to the classes of mail. It presented a new and pioneering analysis of incremental costs which are used in the economic literature to test for cross subsidy. The Service's presentation advanced the state of knowledge in all these areas. On the record before it, the Commission finds inadequate support for the proposed change in mail processing attribution. It hopes and expects the Service and parties to continue to explore this important area. Extensive effort also was put forth by the Service and the parties to analyze several other complex issues that allowed the Commission to refine the attribution of delivery and transportation costs.

Reclassification of Standard B (parcel mail) was also dealt with in this proceeding. This was the fourth in a series of reclassification proposals by the Postal Service designed to better align rates with costs and to enable the Service to compete more effectively. The Commission accepted the Service's proposals to institute new worksharing discounts and to deepen existing ones based largely on new analyses of transportation costs.

I. INTRODUCTION

[1001] *Procedural history.* The Postal Service filed a request for a recommended decision on proposed changes in rates, fees, and classifications on July 10, 1997. The Commission's Notice and Order No. 1186 (July 11, 1997) provided public notice of the Service's request; instituted formal proceedings; and designated W. Gail Willette, director of the Commission's Office of the Consumer Advocate, as the representative of the general public. *See generally* 62 FR 39660-39709 (July 11, 1997). In addition to the Service and the OCA, 82 intervenors participated.

[1002] Commission Chairman Edward J. Gleiman acted as presiding officer. The Commission, sitting *en banc*, held 37 days of evidentiary hearings on the testimony of 111 witnesses. The Commission requested trial briefs from parties, in addition to initial briefs (filed April 1, 1998) and reply briefs (filed April 10, 1998). No participants requested oral argument.

[1003] In the course of the proceeding, the Presiding Officer issued 19 Information Requests, and the Commission issued five Notices of Inquiry. Notice of Inquiry No. 1 (September 17, 1997) addressed the evidentiary status of library references. Notice of Inquiry No. 2 (November 19, 1998) addressed Domestic Mail Classification Schedule (DMCS) issues. Notice of Inquiry No. 3 (January 12, 1998) invited comments on the Service's proposals to redefine a component of load time as access time and to make other changes in the way remaining coverage-related load time is analyzed. Notice of Inquiry No. 4 (January 16, 1998) addressed the statistical support for an assumption in Postal Service witness Bradley's mail processing variability model. Notice of Inquiry No. 5 (January 28, 1998) raised issues related to the recognition of interim year financial results.

[1004] *Significant procedural issues: compliance with recently revised rule 54(a).* This proceeding is the first conducted since amendment of Commission rule 54(a)

requiring the Postal Service to provide additional information when it supports a rate request with cost projections using attribution methodologies that differ from those used in the previous rate decision. A series of rulings addressed concerns about the adequacy of the Service's compliance with the new rule. The rulings generally recognized the Service's preliminary attempts to satisfy its obligations under the rule, but noted the need for certain corrections and supplementation in this proceeding. They also signaled the Commission's interest in avoiding future controversies. Specifically, the presiding officer noted: "With advance knowledge of the obligation of rule 54(a), there will be no reason for the Service to have difficulty meeting this requirement [of a satisfactory representation of base year and test year costs] in a timely fashion. Furthermore, the table of relative markups, while not specifically required . . . , would be a very helpful indication of the effect of variations from established attribution methodologies." P.O. Ruling R97-1/8 at 5 (August 25, 1997).

[1005] *Sponsorship of Postal Service Library References.* The Postal Service's decision to file certain studies and their results, detailed data, and other information on which its proposals rely as library references—rather than as testimony or exhibits sponsored by its witnesses—has significantly complicated the procedural course of this docket. Several participants, in the exercise of their due process rights under 39 U.S.C. § 3624(a), directed discovery requests to the Postal Service regarding some of these materials, only to receive responses expressing unfamiliarity with, or outright disavowal of any role in the preparation or sponsorship of, the library reference under scrutiny. Responses of this kind led several participants to seek relief from the Presiding Officer in the form of motions to compel responses to discovery requests, motions to strike portions of the testimony of Postal Service witnesses, and motions to stay or extend the proceeding. Motions of this nature were filed by Alliance of Nonprofit Mailers and American Library Association; Nashua Photo, Inc., District Photo Inc., Mystic Color Lab, and Seattle Filmworks (collectively, NDMS); and Newspaper Association of America. A number of other participants filed pleadings in support of the various requests for relief.

[1006] The Presiding Officer, and the Commission as a whole, undertook to address these requests for relief by the parties, to clarify the evidentiary status of the Postal Service's library references at issue, and to accommodate the procedural schedule to the parties' exercise of their due process rights. These efforts imposed a considerable demand on the Commission's resources, and made achievement of an already exacting statutory deadline more difficult.

[1007] Presiding Officer's Ruling R97-1/20, issued September 17, 1997, found that the Postal Service had failed to meet the evidentiary standards of the Commission's rules by submitting an unsponsored library reference upon which it intended to rely, and allowed the Service one week to identify a sponsor for the study, if desired. Realizing the potentially broad impact of P.O. Ruling R97-1/20, the Commission issued Notice of Inquiry No. 1 on Interpretation of Commission Rules Authorizing the Use of Library References on the same date. Participants were asked to identify and comment on other instances where the Service had improperly failed to designate as evidence material filed as library references. In response, intervenors identified five other library references that they contended should have been sponsored by a Postal Service witness.

[1008] On September 25, 1997, the Postal Service announced that its witness Daniel had prepared Library Reference H-112, and it provided supplemental testimony [ST-43] in which she would sponsor it as evidence. Presiding Officer's Ruling R97-1/38, issued October 3, 1997, scheduled receipt of this supplemental testimony on the date already established for witness Daniel to present her testimony in USPS-T-29. In response to Presiding Officer's Ruling R97-1/42, issued October 10, 1997, the Postal Service subsequently indicated that it was prepared to sponsor as evidence numerous other library references that contained analyses relied on by its witnesses.

[1009] The Postal Service began offering library references for admission into evidence during the evidentiary hearings scheduled to receive its direct case, commencing October 6, 1997. A number of participants contended that they had not had adequate notice to prepare full cross-examination on these documents. The Postal Service contended that the proffered library references had been prepared by the

witnesses in support of their testimony, and that a full opportunity for discovery on these library references had been provided to the objecting parties, many of whom had taken the opportunity to pose numerous questions concerning these library references.

[1010] The Presiding Officer admitted sponsored library references into the record, subject to motions for procedural relief to be submitted by October 16, 1997. On that date, three related motions were filed by intervenors contesting the admission of library references.[1] These motions were certified to the Commission in P.O. Ruling R97-1/49 on October 17, 1997. By Order No. 1198, issued the same day, the Commission accepted certification of these rulings. To minimize delay during the consideration of these matters, the Commission advised participants in Order No. 1200 that written discovery on materials identified by the Postal Service in response to P.O. Ruling R97-1/42, *supra*, was permitted as of the date of that order's issuance, October 27, 1997.

[1011] In Order No. 1201, issued November 4, 1997, the Commission found merit in the parties' arguments that the Postal Service's conduct with respect to certain library references it had filed worked to the detriment of their due process rights, but concluded that staying the proceeding, or refusing to consider evidence premised on the library references at issue, was unwarranted. Order No. 1201 at 12. That order also found that the Service's conduct had thereby caused delay that would jeopardize the Commission's ability to issue a recommended decision within 10 months, as required by 39 U.S.C. § 3624(c)(1). Id. at 2, 19-20. Nevertheless, in an effort to allow participants to exercise fully their due process rights while striving to achieve the statutory deadline, the Commission decided to admit the controversial materials into the record, but also to direct the Presiding Officer to schedule an additional period for written discovery on

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[1] Motion of Alliance of Nonprofit Mailers and American Library Association to Stay Proceedings, filed October 16, 1997; Nashua Photo Inc., District Photo Inc., Mystic Color Lab and Seattle Filmworks, Inc. Motion to Strike Specific Portions of the Testimony of Various Postal Service Witnesses and Certain Library References and For Other Relief, filed October 16, 1997; and Newspaper Association of America Motion in Opposition to Admission Into Evidence of Certain Library Reference Materials and Supplemental Testimony USPS-ST-44, filed October 16, 1997.

these materials, and hearings for the purpose of conducting oral cross-examination of sponsoring witnesses. *Id*. at 18-20. The Commission also announced its intention to initiate a rulemaking to evaluate potential improvements in the pertinent sections of the rules of practice concerning library references following the conclusion of this docket. *Id*. at 2.

[1012] In accordance with Order No. 1201, P.O. Ruling R97-1/54, issued on the same date, adopted a revised procedural schedule for the remainder of the case. The Presiding Officer noted therein that, as a consequence of providing for additional discovery and hearings, the date for filing each participant's case-in-chief, including rebuttal to the Postal Service, was thereby delayed by six weeks. *Id*. at 2. The result of these adjustments to accommodate the due process rights of participants has been a significantly shortened period for the Commission's deliberations in this highly complex omnibus rate proceeding.

[1013] *Access to the Postal Service Disqualification Logs.* Another procedural due process issue arose during ANM's efforts to determine whether the Postal Service properly allocated costs to the nonprofit subclasses when setting the proposed rates. ANM and its expert witness, Dr. John Haldi, theorized that the increase in nonprofit costs was due primarily to a mismatch between the Service's RPW (volume) and IOCS (cost) data for mail bearing nonprofit indicia of postage, but entered at commercial rates or later charged back postage based on commercial rates.

[1014] To this end, ANM served the Postal Service with a set of interrogatories on December 9, 1997 requesting, among other things, that the Service quantify the amount of mail bearing Standard A nonprofit indicia but charged commercial rates during a certain time period. The Service objected to several of the questions on the basis of timeliness and undue burden. It maintained that a complete response to the information sought "would require the Postal Service to survey every point at which business mail may be entered, in order to review each mailing statement for a two-year period." Objection of United States Postal Service to Interrogatories of the Alliance of Nonprofit Mailers (ANM/USPS-20-23, and 25-26) (December 19, 1997).

[1015] ANM then filed a motion to compel responses, claiming that the interrogatory answers would relate to operating procedure and data available only to the Service. The Service opposed for its earlier reasons, and further argued that the RPW and IOCS information sought could have been obtained by discovery on the testimony filed initially by the Service on July 10, 1997. The Service also maintained that certain ANM questions actually requested new information requiring extensive Service research and analysis of data available only from "the field."

[1016] On January 9, 1998, the Presiding Officer issued a ruling that granted in part ANM's motion, and compelled the Service to provide general information such as its accounting treatment of mail marked as Standard A nonprofit but assessed commercial rates, as well as its instructions to tally takers on this issue. P.O. Ruling R97-1/86 at 8-9. However, the Presiding Officer agreed with the Service that compelling answers to those ANM questions asking for extensive detail on nonprofit mail that ultimately paid commercial rates would impose a significant burden on the Postal Service, and that the questions were not likely to generate probative evidence. *See id*. at 7-8. Additionally, the underlying information requested by ANM focused on the Service's data systems and their outputs, which was the subject of extensive testimony in the Service's direct case. *Id*. at 7. The Commission affirmed this ruling. *See* PRC Order No. 1207 (February 9, 1998).

[1017] Consequently, ANM conducted its own limited study of nonprofit mailers to determine the extent of the mismatch problem. *See* Chapter 5, Section C.10. for details. According to ANM witness Haldi, the survey results indicated that 7.85 percent of mail entered with nonprofit markings actually paid commercial rates. He thus recommended a 7.85 percent shift of total attributable costs from the Standard A nonprofit subclasses to their commercial subclass counterparts.

[1018] The Postal Service disputed ANM's findings, and undertook a study to assess any mismatched nonprofit costs and mail volume. Postal Service rebuttal witness Schenk surveyed 30 post offices selected from the universe of sites with Standard A nonprofit bulk permit imprint revenues in FY1996. She quantified the alleged

problem by checking available disqualification logs — the prime source recording mailing problems — as well as questioning post office personnel. However, when challenged by ANM to produce the disqualification logs for verification, the Service argued that it would be quite difficult to access the materials at the sites, and that not every site surveyed actually possessed these logs. ANM responded by filing a motion to compel production of the acceptance logs or, in the alternative, to strike portions of Schenk's testimony relating to the logs (the foundation of her study). On March 19, 1998, the Postal Service filed its opposition.

[1019] By this point, the Commission was in the midst of conducting hearings on rebuttal to participants' direct evidence. The Presiding Officer ruled from the bench on the issue. He compelled the Service to produce all available mail disqualification logs for ANM's review in a timely fashion (within six days), with opportunity for ANM and other parties to question Schenk on the materials at a subsequent hearing scheduled for that purpose. Tr. 36/19643-46. The Presiding Officer noted that the Commission would give proper weight to the evidence, however limited. In the alternative, the Service could choose to dispense with the logs and have Schenk's relevant testimony stricken. *Id.* at 19645. The Service chose to produce the available mail disqualification logs.

[1020] As is discussed in detail in the Standard A Nonprofit subclass analysis in Chapter V.C., the Commission ultimately found both the ANM and Schenk studies of limited value. However, while the parties' due process rights were preserved, the Commission believes that had the Postal Service produced the available data sooner, analysts may have been able to conduct a more meaningful analysis of the data, thereby better quantifying the extent of the misallocated nonprofit costs.

[1021] *Access to PMPC Contract Information.* A discovery dispute arose early in this case when UPS sought access to information concerning a contract between the Postal Service and Emery Worldwide Airlines, Inc. (hereafter referred to as "Emery"). The material, relevant to Priority Mail costs, generally consisted of the contract (or contracts) between the Postal Service and its contractors for operation of the Postal Service's Priority Mail Processing Center ("PMPC") network, together with any other

documents bearing on services to be performed and the costs of those services to the Postal Service.

[1022] The Service objected to discovery of the materials, primarily on the grounds that the requested information was confidential business information containing trade secrets of the Postal Service, of the PMPC contractor, Emery, and of other affected business entities which submitted proposals for the PMPC bid. In an attempt to informally resolve the dispute, the Postal Service filed a redacted version of the contract with the Commission as a library reference on August 28, 1997. *See* Library Reference H-235.

[1023] UPS then sought more detailed information referenced in LR-H-235. The categories of information requested ranged from the general (estimated portion of the total contract price to be paid by the Service that relates to test year operations of the PMPC network) to the highly specific (*e.g.,* estimated amount of aviation and diesel fuel cost to be passed through during the ramp-up period and period 1 of the contract). Most of the information requested pertained to specific cost elements and average prices under the contract.

[1024] UPS argued the information was highly relevant to the proceeding, was similar to other transportation contract information the Postal Service had already produced in the case, and was not proprietary or confidential. UPS claimed that it did not wish to discover information concerning Emery's costs, but only sought information bearing on the costs of the PMPC contract that should be recovered by Priority Mail. According to UPS, the requested information constituted the best evidence of what a substantial portion of Priority Mail costs will be, and is superior to rollforward estimates.

[1025] The Postal Service disputed UPS' arguments. First, the Service disputed UPS' claim that each of its interrogatories was carefully designed to elicit only information related to the Postal Service's costs under the contract. Second, the Service reiterated the seriousness of its concerns, and those of its contractor Emery, regarding the commercial sensitivity of the information sought by UPS. The Service pointed to its unique and financially significant cooperative business venture with Emery and also

argued that it and the Commission are bound, as federal agencies, by the Trade Secrets Act, which bars disclosure of trade secret information by officers and employees of the United States "except as provided by law[.]" 18 U.S.C. § 1905. The Service further claimed that disclosure of the requested information would reveal details of Emery's pricing strategies for the regions included in the PMPC network, with the likely consequence of competitive injury to Emery's commercial interests, given that UPS and Emery are competitors. The Service concluded that should UPS' motion to compel the production of the information be granted, production should be made only under highly restrictive protective conditions which it proposed.

[1026] Emery, though not a participant in these proceedings, filed an opposition to the release of the information. Emery claimed that revealing the redacted portions of the PMPC contract would disclose pricing strategies, which have been found to be exempt from disclosure under the Freedom of Information Act and the Trade Secrets Act by several judicial authorities. According to Emery, the price variations reflected in the contract's redacted pricing schedules reflect Emery's experience in the industry and its analysis of costs and profits on various routes, and disclosing this detailed pricing information would allow UPS, or another competitor, to infer Emery's costs and undercut its bids on other commercial and government air freight contracts. Emery contended that its proprietary and confidential information could be adequately protected if disclosed only under protective conditions that will effectively bar access by UPS competitive decision-makers.

[1027] After considering the arguments, the Commission decided that "most of the requested categories of information evidently are highly relevant to Priority Mail costs[,]" but "the commercial sensitivity of materials responsive to the interrogatories at issue is highly variable." Presiding Officer's Ruling R97-1/62, November 17, 1997, at 9 and 11. Consequently, the Commission ordered the information produced, much of it subject to protective conditions slightly modified from those proposed by the Postal Service. These conditions allow only Commission employees and participants in the proceeding access to the information for use only in the proceeding. Also, no persons involved in

competitive decision-making that might gain competitive advantage from use of the material were to be granted access to it. *Id.* at 12.

[1028] The information in question was the subject of testimony and briefs submitted subject to the same protective conditions. The Commission expects that these conditions should serve as a means of avoiding protected motions practice on access to sensitive business information in future dockets.

II. REVENUE REQUIREMENT

A. Overview

[2001] In this omnibus rate proceeding, the Postal Service has submitted a request for new rates in order to avoid a test year revenue deficiency. Since the Commission's decision in R94-1, the Postal Service has enjoyed a profitable period, earning large surpluses each year.

Year	Net Income
1995	$1.770 billion
1996	$1.567 billion
1997	$1.264 billion

This has enabled the Postal Service to improve equity by $4.6 billion.

[2002] Nonetheless, the Postal Service contends that revenue will fall short of costs by $1.4 billion in 1998 if new rates are not implemented. USPS-T-9 at 41. The explanation for this predicted turnaround is simple: the Postal Service plans to increase capital spending dramatically on numerous management-initiated projects.

[2003] The Postal Service's Capital Investment Plan calls for the investment of $17 billion over five years, with $5.6 billion spent in 1998 alone. 1997 Comprehensive Statement on Postal Operations at 81. The expenses associated with this investment comprise a large portion of what the Postal Service terms "other programs" expense and result in an unprecedented $2.5 billion in increased expenses in 1998, the test year. Without this ambitious investment plan, the Postal Service would not need any rate increase. The Postal Service acknowledges this fact, stating that the expenditures, "oriented around various critical programs, in large part drive the Postal Service's revenue needs as embodied in the current Request." Postal Service Brief at I-3.

[2004] The Postal Service acknowledges that the test year should be representative of the period for which the proposed rates are to be in effect. *See* Postal Service Reply Brief at I-7. Some parties have suggested that the Postal Service could have chosen a more representative test year than 1998, a year in which it plans to invest $5.6 billion of the $17 billion in its Five-Year Capital Investment Plan. *See* Joint Reply Brief of ANM, ALA and CRPA at 6 (arguing investment and expenses are front-loaded). However, the choice of 1998 as a test year is consistent with Commission rules and the discretion of the Postal Service. *See* Commission Rule 54(f)(2).

[2005] The Postal Service forecasts volumes for each subclass and special service for the test year, using as a base the four most recent quarters for which data are available at the time of preparation.[2] Volumes are inputs to the cost roll-forward model which is used to estimate interim year and test year costs. Estimated test year revenues based on forecasted volumes are compared with estimated test year costs to determine a deficiency in net income. This deficiency, plus an allowance for contingency and for prior year loss recovery, determines the size of the rate increase needed to break even in the test year. Total estimated cost for the test year plus the contingency amount and the recovery of prior year losses, is referred to as the revenue requirement.

[2006] The Postal Service has estimated its test year revenue requirement as $61.6 billion, which primarily consists of $60.564 billion in costs which it expects to incur in the test year. The Postal Service's estimate of its future costs is derived from actual costs incurred in the base year (1996). These costs are projected or "rolled forward" into the test year (1998). This roll-forward process reflects factors that will affect the Postal Service's expenses in the test year.

[2007] Once the Postal Service has estimated costs for the test year, the Postal Service, as provided for in the Postal Reorganization Act of 1970 (PRA), requests an additional one percent of estimated costs for contingencies, adding $605.6 million to its revenue requirement. Finally, a provision of $446.9 million is added to recover one-ninth

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[2] In this proceeding these quarters are Q3 FY 96, Q4 FY 96, Q1 FY 97, and Q2 FY 97.

of the Service's $4.022 billion accumulated net losses. The recovery of past losses over a reasonable period of time is part of its total revenue requirement. Consequently, in its request in R97-1, the Postal Service seeks a revenue increase of $2.442 billion to cover the expected deficiency, provide a contingency, and recover a fraction of prior years' losses. USPS-T-9 at 47.

[2008] During the course of the rate case, intervenors and the Commission raised certain issues pertaining to the validity of the Postal Service's cost estimates, and proposed adjustments to the Postal Service's revenue requirement.

[2009] The Commission makes two significant downward adjustments in the revenue requirement. The Commission adjusts for known and certain cost decreases described in the rebuttal testimony of Postal Service witness Porras. The Commission also accepts an adjustment proposed by DMA, which the Service opposes but does not seriously challenge. These issues are addressed following a discussion of the derivation of the Postal Service's revenue requirement.

B. Postal Service Estimates

[2010] *Base Year Costs*. Postal Service witness Alexandrovich presents the base year total accrued costs of the Postal Service. He develops the base year costs from actual costs incurred in the most recent fiscal year for which data are available, 1996. USPS-T-5 at 2. Accrued Costs are broken down by cost segment, component and subcomponent. He totals all cost segments, yielding accrued costs for the base year of $54,976,597,000. USPS Exhibit 5C.

[2011] *Roll Forward Adjustments.* To project costs, witness Tayman presents nine separate adjustments to the base year costs in order to compensate for expected changes in the interim year (1997) and the test year (1998): 1) cost level, 2) mail volume effect, 3) non-volume workload effect, 4) additional workday effect, 5) cost reductions, 6) other programs, 7) reclassification volume mix (interim year only), 8) workyear mix adjustments, and 9) final adjustments. USPS-T-9 at 10.

[2012] Cost level adjustments account for increases in prices for resources used such as personnel, fuel, transportation and other inputs. Personnel compensation, the largest component of costs, is expected to increase 1.8 percent in FY 1997. *Id.* at 11. Always a significant factor, the total cost level adjustment totals $2,195 million for 1997 and 1998, assuming the proposed rates are in place. USPS Exhibit 9M.

[2013] The mail volume effect reflects anticipated changes in costs due to forecasted changes in mail and special services volume. When volume increases, the Postal Service incurs additional costs to process and deliver the additional volume. For the test year and interim year, volume growth is expected to increase costs $1,452 million after rates. USPS Exhibit 9M.

[2014] The non-volume workload effect consists of cost changes resulting from variation in workload characteristics other than mail volume. Witness Tayman cites as an example, city carrier street costs that vary with the number of possible deliveries. USPS-T-9 at 11. He forecasts the effect to increase costs $257 million over 1997 and 1998. USPS Exhibit 9M.

[2015] The additional workday effect simply recognizes that the Postal Service's costs are linked to the number of actual work days in a year. It is estimated to have no effect in the test year, but it decreased costs $8 million in the interim year. *Ibid.*

[2016] The cost reductions effect includes adjustments for management cost reduction programs affecting the test year. Witness Tayman indicates that most of the savings in the test year result from automation and other equipment. USPS-T-9 at 13. Savings total $1,676 million over 1997 and 1998. USPS Exhibit 9M.

[2017] The "other programs" adjustment accounts for 1) expenses incurred when the Postal Service's management initiates new programs or services in the test year, and 2) other expense increases which do not fit any of the above mentioned categories. The Postal Service originally forecast $2,542 million in additional expenses as a result of new programs for the test year and $1,101 million in additional expenses for 1997. USPS Exhibit 9M. Some of these expense increases result from the startup and equipment costs associated with new services, such as Delivery Confirmation. Tr. 9/4568. A large amount of the increases come from investment in programs and equipment, such as Point of Service terminals and the Priority Mail Redesign program. *Id.* at 4554. Late in this proceeding, Postal Service witness Porras, Controller of the Postal Service, testified on rebuttal that the Service would spend $362 million more than it previously estimated for "other programs" expense. He expects $298 million of this amount to be spent in the test year to deal with the Year 2000 computer software problem. Because of the significant impact the Postal Service's "other programs" expense has on the revenue requirement, the subject is treated in a separate section.

[2018] Base year costs reflect the mail mix prior to classification changes which occurred in late 1996. In order to reflect these changes and the impact of other mail mix changes that occurred in FY 1997, witness Tayman adjusts Postal Service cost segments 2 and 3 mail processing costs. The derivation of the adjustment is explained in library reference H-126. USPS-T-9 at 16. The Commission makes corrections to this adjustment as explained in Appendix D.

[2019] *Volume Forecasts.* Forecasts of volumes and estimates of price elasticities for every subclass of mail and special service are an essential aspect of estimating the test year revenue requirement under alternate rate regimes. The price elasticities and forecasts show directly the impact of the Postal Service's proposal on postal volumes and revenues. The price elasticities also are used to evaluate the impact on postal volumes and revenues of any alternative set of postal rates.

[2020] Forecasts of volume shares are also needed for those categories of mail that receive worksharing discounts. The volumes that receive such discounts are large and among the fastest-growing segments of the mailstream. Accurate forecasts of the shares of subclass volumes receiving discounts are needed for accurate forecasts of postal revenues.

[2021] In recent proceedings a division of labor has developed among Postal Service volumes witnesses. Forecasts of volumes are made for all subclasses, services and worksharing categories, except Priority Mail and Express Mail, by witness Tolley. A complete set of base year and test year forecasts for the preexisting and requested rates, along with a voluminous description of the forecasting methodology, may be found in witness Tolley's direct testimony. *See* USPS-T-6. Witness Tolley's forecasts are based upon econometric research by witness Thress, his co-worker. Witness Thress' research falls into two general categories. These are, first, extensions and improvements in the econometric models used to forecast volumes and estimate elasticities at the subclass and special service level, and, second, continuing the development of share models to predict workshared volumes of First-Class and Standard A mail. *See* USPS-T-7. The econometric models and forecasts for Priority and Express Mail are described in the direct testimony of Postal Service witness Musgrave. *See* USPS-T-8.

[2022] The only challenges to the volume forecasts and price elasticity estimates presented by the Postal Service concerned whether these estimates accurately measured impact when varying percentage increases are imposed on different rate cells within a subclass. NDMS witness Haldi and OCA witness O'Bannon raise this concern

with regard to Priority and zoned Standard B subclasses. The Commission accepts the Postal Service analyses. Appendix H to this Opinion contains a thorough technical review of these presentations and offers suggestions for potential refinements.

C. Contingency and Recovery of Prior Years' Losses

[2023] *Contingency.* A "reasonable" provision for a contingency is provided for in the Postal Reorganization Act. 39 U.S.C. § 3621. In the past, contingencies have been higher: in Docket Nos. R84-1, R87-1, and R90-1, the contingency was 3.5 percent of total accrued costs, and in the most recent case, R94-1, it was lowered to 2 percent.

[2024] The Postal Service seeks a 1 percent contingency in this case, or $605.6 million. "The one percent included in this case represents the Postal Service's desire to keep rate increases as low as possible and below the level of growth in general inflation." USPS-T-9 at 38. Witness Tayman argues that the Service's recent financial success, the current favorable economic climate, and management's concern about the effect of the contingency on rate levels all suggest that a smaller contingency is reasonable. *Ibid.* The Postal Service leaves the door open to a return to a larger contingency in the future, stating it might be necessary if circumstances change. *Ibid.*

[2025] Postal Service rebuttal witness Porras urges that no changes be made in the revenue requirement initially filed by the Service, but he argues that if the Commission reduces the Postal Service's revenue requirement by updating Postal Service estimates with the actual numbers he provides, the Commission should offset the reduction by assuming a need for a contingency of 1.5 percent. Porras points to Tayman's statement that "[t]he Postal Service might have opted for a larger contingency if the test year costs projected by this filing had been lower." Tr. 9/4458. He states that he would have recommended a higher contingency to the Board if the lower expenses he presented in his testimony had been known at the time. Alluding to the Asian and Latin American financial crises, he suggests the economic climate is more uncertain than when the Postal Service filed its case. Also, he notes that there is draft legislation in Congress which would force the Postal Service to correct financial inequities for employees placed in the wrong retirement plan.

[2026] The Postal Service further explained its position in its reply brief. Postal Service Reply Brief at I-27-I-29. In the Service's view, its suggestion concerning the

contingency is similar to its position in past cases, although it is the reverse situation. "In several instances, rather than formally ask for a higher revenue requirement, the Postal Service expressed a willingness to accept recommendations based on its original revenue requirement, even though the practical result of that decision would be that no or less money would be available for contingencies, in light of the increased costs in the test year." *Id.* at I-28. (citing PRC Op. R71-1, Vol. I at 1-273, n.7; PRC Op. R74-1, Vol. 1 at 65; PRC Op. R77-1, Vol. 1 at 20). For example "in Docket No. R90-1, in the face of the extraordinary imposition of Omnibus Reconciliation Act (OBRA) liability that developed during the course of the proceeding, the Postal Service again declined to revise its revenue requirement, recognizing that the practical effect would be to reduce the contingency amount as a percentage of total costs." *Id.* at I-29 (citing PRC Op. R90-1 at II-12-13).

[2027] On brief, the OCA contends there is no need for a contingency because the Postal Service is prospering. OCA Brief (First Section) at 23. OCA, after outlining the Commission's role in past cases, suggests that the Commission must evaluate the reasonableness of the Service's proposed contingency. OCA notes that the Commission has stated that the contingency provision "'provides insurance against the possibility of misestimates of test year accrued revenues and expenses.'" *Id.* at 24 (quoting PRC Op. R84-1, para. 1017). The provision also is intended to "'protect against unforeseeable events, not capable of being prevented through honest, efficient and economical management, and which might have a significantly adverse impact on the Service or upon its operations.'" *Ibid.* Factors to be evaluated in determining the proper contingency include "'the Postal Service's financial condition, the state of the economy, and any other factors deemed appropriate by the Commission.'" *Ibid.* (quoting PRC Op. R84-1, para. 1051). In light of the strength of the economy and the fact that most costs are fixed by labor contracts, a smaller contingency is indicated. OCA Brief (First Section) at 28. The OCA recommends subtracting 5/13 of the amount requested by the Postal Service because this much of the test year is known. *Ibid.*

[2028] OCA rejects witness Porras' suggestion that the Commission accept the Service's original revenue requirement and view the difference between it and the figure arrived at after adjusting for actual cost decreases as an increase in the contingency. "This view totally ignores the policies and purposes of the legislative framework. The Postal Service theory would wrench from its very foundation the Commission's authority to recommend rates consistent with the break-even policies of the Act. The Commission should not even seriously consider such a request." OCA Brief (Second Section) at 42. DMA agrees with the OCA on this issue. It characterizes Porras's testimony as offering no substantive arguments for a larger contingency. Instead, Porras merely states that a larger contingency would be reasonable to cover the gap between its original estimate and its revised estimate. DMA Brief at 8.

[2029] *Commission Analysis*. The Commission views Porras' testimony on the contingency as inconsistent with accepted practices. First, his testimony lowers estimated total accrued costs in the test year by only $195.1 million. This results in a slightly lower contingency of $603.7 million, rather than the original $605.6 million. Porras suggests that if he had known total accrued costs would be $60,368.7 million, rather than the $60,563.6 million originally estimated, he would have recommended a 50 percent larger contingency of $905.5 million, rather than $605.6 million. This makes little sense, and the Service does not explain this assertion. Tr. 35/18587. A changed economic conditions rationale for a higher contingency is a more plausible argument, but whether or not economic conditions were more or less favorable when Porras filed his testimony in March 1998 than July 1997 is at least open to debate.

[2030] However, Porras undermines his contention of changed circumstances by stating that the "Postal Service remains satisfied with its filing based on its original estimates and its original revenue requirement … recommending the revenue requirement requested by the Postal Service could be viewed as the recognition of moderately lower expense levels that are offset by a slightly larger contingency." Tr. 35/18588. Thus, witness Porras only claims an "increased potential for adverse economic and legislative impacts" if the Commission accepts his cost reductions. Simply

put, witness Porras seems to be suggesting the 1.5 percent contingency only in order to counterbalance the reduced expenses he identifies. This suggests that the contingency is simply a plug figure used to justify a predetermined revenue total.

[2031] The Statute requires that the revenue requirement include a "reasonable provision for contingencies." 39 U.S.C. § 3621. This requires that the amount be reasoned. Changed circumstances affecting the likely impact on the Postal Service's ability to break even must be considered by this Commission. Arguments attempting to justify an arbitrary amount will not be accorded much weight. The Postal Service's conservative estimates of its 1998 surplus militate against increasing the contingency. Consequently, the Commission will reject the suggestion of a 1.5 percent contingency. The Commission will also reject the OCA's suggestion that it reduce the contingency by 5/13 to reflect the passage of five of the thirteen accounting periods: contingencies are designed to offset events occurring at any time in the test year. There is no expectation that an equal amount will be needed in each accounting period.

[2032] *The Recovery of Prior Years' Losses.* The Postal Service has requested that a provision for the recovery of accumulated past losses be included in its revenue requirement. In fact this has become a standard item, having been included in every omnibus rate decision since R76-1. Tayman's calculation is straightforward: net operating income (losses) for all periods from the inception of the Postal Service to the beginning of the test year are added, and the funds received under Public Law No. 94- 421 are subtracted. This totals $4.023 billion. Amortized over nine years, it yields $446.9 million. USPS-T-9 at 40. The nine year amortization period is standard, having been used in Docket Nos. R80-1, R84-1, R87-1, R90-1, and R94-1. The Service still believes it is appropriate. *Id.* at 41.

[2033] Witness Tayman observes that without the provision for recovery of prior years' losses (RPYL) the Service's equity position would be even worse. Indeed, he argues that "[w]ithout the provision for recovery of prior years' losses, the Postal Service would have no mechanism to ultimately meet the statutory requirement to break even." *Ibid.*

[2034] Witness Tayman also affirms the Postal Service's commitment to restoring positive equity. *Ibid.* In Resolution No. 95-9, adopted on July 10, 1995, the Board of Governors outlined the goal of restoring equity between general rate increases, cumulatively, in relation to the amount included for recovery of prior years' losses in the most recent rate case. The resolution stipulates that whenever it is projected that restoration of equity might not be achieved, the Board and the Postal Service will take action to reduce costs and/or increase revenues. A report by Price Waterhouse LLP for the Board of Governors provided background to the Board's policy Resolution. *Ibid.* The Commission is gratified that the Board has adopted this policy, which will restore Postal Service equity and consequently the Service's ability to cope with adverse circumstances should they occur.

[2035] During the course of the rate case, the Postal Service reported greater than expected profits in the interim year 1997. These additional profits mean the Postal Service has a smaller amount of prior years' losses to recover. Hence, the Postal Service's estimate of the allowance must be reduced by $69.9 million (one ninth of the difference between actual and estimated 1997 profits). Witness Porras suggests this straightforward adjustment on rebuttal. Tr. 35/18571.

[2036] On brief, the OCA argues against any provision for a recovery of prior years' losses. The OCA believes that the Service has not carried its burden of demonstrating that it is needed in light of several profitable years and a recovery that is ahead of schedule. OCA Brief (First Section) at 28. The Postal Service opposes discontinuing the practice of providing a provision. Postal Service Reply Brief at I-29.

[2037] The OCA's argument is not persuasive, and the Commission will include the provision for prior years losses in the Postal Service's revenue requirement. While the Postal Service may be ahead of schedule based on R94-1, it still has negative net equity. Until the Postal Service's equity is restored, it would be premature to eliminate an item that the Commission has argued is vital to the financial health of the Postal Service. As the Commission has stated previously, "[w]hen the total RPYL reaches the goal targeted

by the Postal Service, it would no longer be necessary to include such a provision in the revenue requirement." PRC Op. R94-1, para. 2092.

D. Postal Service's Misestimates of Net Income

[2038] As the rate case progressed, the Commission was faced with the unusual situation that the Postal Service's estimate of its FY 1997 results differed dramatically from its actual results. The Postal Service reported net income of $1.264 billion for FY 1997, although it forecast net income of only $636 million in its rate case filing in July of 1997. The large difference, $629 million, reflects a much better than anticipated financial performance in the interim year. Faced with the 1997 results, the Commission must decide whether to attempt to incorporate the discrepancy between forecast and actual results into its analysis. Of course, if the Commission chooses to adjust for the actual results in the interim year or even the test year, the Commission must determine how to account for the difference. To help it make its decision with respect to these results, the Commission solicited suggestions from the parties in a Notice of Inquiry. Notice of Inquiry No. 5 (January 28, 1998).

[2039] Compounding the problem, the Postal Service reports net income of $1.36 billion through seven accounting periods (7/13 of the test year) despite estimating a test year before rates loss of more than a billion dollars. USPS Financial and Operating Statement for Accounting Period 7 (1998).[3] Hence, in order to incur the projected before rates loss of $1.2 billion, the Postal Service would have to lose $2.6 billion over the final six counting periods of 1998. *See* Postal Service Reply Brief at I-16.

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[3] The Commission may take official notice of public documents (Postal Service's Annual Report, Comprehensive Statement on Postal Operations, and Financial and Operating Statements) filed with the Commission pursuant to Commission Rules 101 and 102.

"The Postal Service does not dispute that these documents are generally of the type of which the Commission may take official notice." Response of United States Postal Service to OCA Motion for Official Notice at 1. The Service suggests that the Commission should give these documents the appropriate weight based upon their status. *Ibid.* Moreover, the Postal Service relies upon data from Financial & Operating Statements for Accounting Period 7 in its Reply Brief. Postal Service Reply Brief at I-10. Consequently, the Commission takes official notice of Financial & Operating Statements from A/P 5 A/P 7 of 1998 and gives them the appropriate weight based upon their status as interim year reports. *See also* Tr. 35/18561-62 (taking official notice of 1997 Annual Report and Financial & Operating Statements from A/P 1 of 1996 to A/P 5 of 1998 and stating that the Commission is according the documents the proper weight based upon their status.)

Because the Postal Service's test year financial success became apparent late in the rate case, the parties could only address the implications of Postal Service's misestimates of its test year profitability on brief. See OCA Brief (Second Section) at 25; ANM Brief at 2; Joint Brief of AMMA, DMA, MOAA, Advo, SMC, NDMS, Val-Pak and Carol Wright Promotions Regarding the Revenue Requirement (Joint Brief); MOAA Brief at 3; ALA Brief.

[2040] The Postal Service sponsored detailed rebuttal testimony addressing issues raised by the interim year results and early indications that the Service would continue to be profitable in the test year. Tr. 35/18567. Although ostensibly responding to the claim of Dr. John Stapert of the Coalition of Religious Press Association that the Postal Service's test year forecast is overly pessimistic, Tr. 22/11745, witness Porras explains why the Postal Service performed better than forecast in 1997 and why this performance would not continue in the test year. Although he provides information on cost decreases for the test year, he offsets these with estimates of new spending on "other programs" and concludes that no adjustment to the test year revenue requirement is appropriate.

[2041] Porras details several decreases in test year costs resulting from actual events overtaking estimates, such as a forecast of a cost of living adjustment (COLA) being higher than the actual COLA now being paid to employees. Tr. 35/18581-84. Test year costs are lower by approximately $557 million after accounting for these items. *Id.* at 18595. However, Porras then offsets these by estimating $362 million more spending on "other programs" in the test year. *Ibid.* The net effect on the test year is to decrease costs by $195 million. *Ibid.* Nonetheless, Porras suggests the Commission not make any changes to the revenue requirement. "In total, these changes have a relatively minor impact and for that reason I would argue that there is no compelling reason to make the adjustments, particularly when the numerous problems associated with updating are considered." *Id.* at 18581. The additional spending on "other programs" and the known and certain cost decreases are discussed in Sections E and F.

[2042] Arguing the Commission should not adjust the revenue requirement to reflect the lower costs he identifies, Porras suggests the Service might have asked for a

larger contingency if the lower expenses he describes had been known when the Service filed the Request. *Id.* at 18587. The Service also points to the R90-1 decision as a flawed Commission attempt to reflect expenses that became known after the filing. *Id.* at 18589. In that case, Porras argues that the Commission's misestimates of revenues and costs consumed a larger contingency than the 1 percent requested in this case. *Id.* at 13589-91. The Service urges the Commission to not make a similar error in this case. *Ibid.*

[2043] Porras also emphasizes the importance of the new programs the Postal Service is financing through the requested rate increase. "Any proposal which could result in a substantial reduction in the net revenue requested by the Postal Service must address the issue of how the Postal Service can carry out programs and policy choices determined by management and the Board to be in the best interests of the Postal Service and the public without the rates and revenue requested." *Id.* at 18573.

[2044] According to Porras, one should not extrapolate the Postal Service's operating results from 1997 into the test year. *Id.* at 18572. He asserts that "several significant variances which contributed to the favorable financial outcome in FY 1997 will not recur in the test year." *Ibid.* Porras points to Tayman's testimony identifying shortfalls in spending on "other programs," and workers compensation expense. *Id.* at 18572 (citing Tr. 9/4437-40). Lower spending on "other programs" resulted from "some programs [ ] taking longer than originally planned to execute." Tr. 9/4438. The UPS strike also is identified as a nonrecurring cause of unanticipated higher revenues, and Porras states that "most of the favorable variance to FY 1997 estimated net income was related to revenue. …" Tr. 35/18577. Porras indicates that 1997 expenses were only 0.3 percent under the estimate. *Ibid.* "This relatively minor difference is a strong indication that the substitution of actual FY 1997 expenses for the FY 1997 estimates reflected in this filing would add needless complexity to the case and is unnecessary." *Ibid.*

[2045] Porras explains that there are substantial technical difficulties involved in attempting to update for 1997 results. *Id.* at 18578-81. The complexity of the undertaking is equivalent to "completely redoing the revenue requirement." *Id.* at 18580.

Because of the likely small impact on test year expenses, the lack of scrutiny of the data by participants, and the possibility of undetected errors, Porras concludes the Commission should not attempt to revise the Postal Service's test year cost estimates. *Id.* at 18581.

[2046] According to Porras, considerations of fairness and the possibility of error are also reasons not to update for 1997 results.

> Updated information does not receive the thorough analysis and review by interested parties that the ratemaking process provides for original estimates. It seems unfair for intervenors to spend months evaluating the Postal Service's estimates only to have them changed after the fact. A Recommended Decision based on information substituted for original estimates at the end of the case does not afford rate case participants the opportunity to review, analyze and comment on the ramifications of the changes. Without a complete update of all affected testimonies, workpapers, and a re-running of the rollforward model (i.e. starting over again from scratch), updating also increases the odds of errors and a flawed revenue requirement. When major changes are made to the original filing, issues that might otherwise have been resolved during the process of discovery and hearings would not even surface until after the Commission's Recommended Decision is a fait accompli.

Id. at 18576-77. Thus, Porras concludes that the Commission should make no changes to the revenue requirement based upon 1997 results, the known and certain cost decreases he identifies, or the estimates of additional spending for "other programs." *Id.* at 18581.

[2047] *Interim Year Results.* In response to the Commission's Notice of Inquiry, the Postal Service argues that the Commission should not attempt to reflect the 1997 results in its Recommended Decision. Response of the United States Postal Service to Notice of Inquiry No. 5 at 1 (Postal Service Response). The Service contends that any substantial reduction in the revenue requirement threatens the Governors' policy of equity restoration and the ability of the Postal Service to "carry out and sustain programs and policy choices determined by the Board to be in the best interests of the Postal Service and public." *Id.* at 3. The Postal Service also suggests that a reduction in the

revenue requirement would threaten the "Board's financial policy, including consideration of sources of funding, the size and frequency of increases, and the restoration of equity." *Ibid.* Relying on witness Tayman's testimony, the Service argues that no adjustment is necessary and that a significant difference between actual and forecast results "was contemplated early in this case." *Id.* at 2. Postal Service witness Tayman also cautioned against selective updating and testified that "should the Commission choose to update the Postal Service's revenue requirement, all subsequent events should be considered. …" Tr. 9/4519-20. Finally, the Service suggests that if the Commission feels compelled to adjust for actual results in FY 1997, the Commission should reduce only the allowance for Recovery of Prior Years' Losses. Postal Service Response at 3.

[2048] Intervenors Advo, AMMA, DMA, MOAA, and PSA agree with the Postal Service that the 1997 results should not be reflected in the revenue requirement, but these parties offer different reasons from the Postal Service for this conclusion. Joint Comments of AMMA, Advo, DMA, MOAA and PSA to Notice of Inquiry No. 5 (Joint Response). They argue that an attempt to recognize the surplus would result in a "mismatch between revenue and costs." Joint Response at 2. With the CRA for 1997 unavailable, they contend the Commission would need to roll forward estimated interim year costs with actual revenues from the Postal Service's 1997 Annual Report. *Ibid.* Furthermore, according to these intervenors, the Commission never adjusts revenues in the interim year without also adjusting accrued costs. This would make it all but impossible for the Commission to conclude that the rates it recommends will generate revenues "that 'equal as nearly as practicable' anticipated test year costs." *Ibid.* (footnote omitted). These parties also believe that the Commission should not recognize the FY 1997 surplus because reducing the costs of subclasses of mail based upon the surplus implies that each particular subclass earned that portion of the surplus. *Id.* at 3. To apportion the surplus in this fashion would conflict with the PRA's directive to the Commission to recommend "'fair and equitable'" rates. *Ibid.* Except for reflecting the 1997 results in the allowance for prior years' losses, the Commission should not make any changes to test year estimates. *Id.* at 4.

[2049] The Office of Consumer Advocate presented a different view in its memorandum in response to the Notice of Inquiry. OCA Response to Notice of Inquiry No. 5 (OCA Response). It argues that the Postal Service's revenue requirement should be adjusted to recognize the large surplus. OCA Response at 5. The OCA notes the huge gap between actual and forecast income in the interim year, which is continuing into the test year. *Id.* at 11. For the first three accounting periods of the test year, OCA observes that the Postal Service reported net income of $996 million. *Id.* at 12. This is $427 million greater than in the same period in FY1997, and the OCA projects a test year net income of $1,402 million, in contrast to the test year loss of $1,391 million adhered to by the Postal Service. *Ibid.* With financial miscalculations of this magnitude, the Commission must take "unusual steps." *Id.* at 2.

[2050] However, the OCA believes that the Commission lacks the information to identify precisely where the unanticipated cost reductions occurred in FY 1997, and unless the Postal Service provides updated data, the "best approximation of the impact of the unexpected 1997 profit is to apportion, pro rata, … expense increase." *Id.* at 6. The OCA urges the Commission to stay the R97-1 proceedings until the Service provides new cost data. *Id.* at 16. The OCA realizes that the basis for this action is unclear under the PRA and Commission's own regulations, but argues that it is necessary to bring the Postal Service's case into conformance with reality. *Ibid.* Lastly, as also outlined in the Postal Service's response, the OCA believes the Commission should adjust the amount provided for Prior Years' Losses (PYL) by $70 million. *Id.* at 5.

[2051] MMA agrees with the OCA that the Commission should adjust for actual results and argues the "Commission cannot lawfully ignore the Service's 1997 windfall that has caused the Service's projections to become outmoded and misleading." MMA Response to Notice of Inquiry No. 5 at 1 (MMA Response). While the task might be "perplexing," the MMA believes this can be accomplished. Pointing out that other commissions have asked for updated test year data, MMA suggests the Commission should ask the Postal Service to provide new data and update the test year. *Id.* at 3. Realizing that the Postal Service may refuse to provide updated information, MMA

suggests asking another party to prepare an adjusted test year projection. *Id.* at 4. In the alternative, the Commission could "treat the unquantified increase in the Service's test year net income as a substitute for a contingency allowance." *Ibid.* MMA adds that if the Postal Service refuses to estimate the effect of its erroneous interim year projection on the test year, the Commission would be justified in assuming that the information it will not divulge is unfavorable to its interests. *Ibid.* MMA believes this means that the Postal Service's test year estimate should be adjusted by at least $628 million to account for the interim year error rolled forward into the test year. *Ibid.* Consequently, the "Commission could treat the underestimate of test year net income as a proxy for a contingency allowance, eliminating the need for a separate allowance." *Id.* at 5.

[2052] ANM agrees that the Commission's recommended decision should reflect 1997 Postal Service net income. ANM Response to Notice of Inquiry No. 5 (ANM Response). ANM observes that the Postal Service's test year "projections have been eclipsed by the data on actual earnings …." ANM Response at 2. Because "an ounce of experience is worth a pound of logic," the Commission should replace 1997 numbers with actual earnings results. *Ibid.* Similarly, ABA, EEI and NAPM believe that the Commission should recognize actual Postal Service results, and the Commission should do so as it has done in past cases such as R94-1. ABA, EEI NAPM Joint Response to Notice of Inquiry No. 5.

[2053] *Commission Analysis.* Under the Postal Reorganization Act, the Commission has an obligation to recommend rates that will enable expenses to equal, as nearly as practicable, revenues in the test year. The continuation of favorable results through 1997 suggests to the Commission that the Postal Service's forecasts are unrealistically pessimistic. In 1997, operating revenue was 0.74 percent over the Postal Service's estimate, Tr. 35/18594, and mail volume was 0.64 percent over the Postal Service's forecast. *See* USPS 9C (forecasting volume of 189.671 billion pieces) and United States Postal Service 1997 Annual Report at 26 (reporting volume of 190.89 billion). However, total costs fell below the Service's estimate by 0.33 percent in 1997. Tr. 35/18594. These numbers make it likely that the Postal Service will have more

volume, revenue and income in the test year than its forecasts indicate, since test year forecasts start from interim year results. While witness Porras ascribes greater than expected revenues and volumes to the UPS strike, he does not explain why revenues and volumes were greater in classes of mail which probably were unaffected by the strike (*e.g.* First Class and Standard A). Indeed, 1998 year to date results continue to suggest greater volumes and revenues and lower expenses than the Postal Service forecasts in its rate case filing.

[2054] The Postal Reorganization Act compels the Commission to make revenues equal expenses "as nearly as practicable." 39 U.S.C. § 3621. The Commission wanted to ascertain if it was reasonable to update the 1998 estimates based upon 1997 actual results in order to more accurately reflect the costs and revenues of the subclasses of mail and special services. Cost information from 1997 would likely explain the Postal Service's improving fortunes and aid the Commission in fulfilling its statutory mandate of making expenses equal revenues in the test year. The rate burden on many mailers could be reduced by incorporating this information into the Commission's projections.

[2055] With the Postal Service's continuing favorable results and no pressing need for new rates, the Commission thought that the Postal Service's Board of Governors might respond favorably to an entreaty to forge a more cooperative working relationship with the Commission. Hence, the Commission made a special request to the Board of Governors for updated cost data from FY 1997. The Commission noted that because of classification changes, "[t]here are reasons to question whether 1996 results are representative of what the Postal Service's costs, volumes and revenues are likely to be" (Notice to Participants, February 24, 1998 at 3) as the current structure was not implemented until the last quarter of 1996. Furthermore, with 1997 cost data, the Commission could "incorporate recent unexpected surpluses attributable to the Postal Service's successful cost reduction programs and favorable trends in the volumes and mix of mail." *Ibid.*

[2056] Unfortunately, the Board of Governors responded negatively to the Commission's request for new data, stating that

> [i]n light of our statutory responsibilities, the Board of Governors has concluded that it should not comment at this time on the state of the evidentiary record currently being developed by the Commission. … The Board recognizes that it is a challenge in every omnibus rate proceeding for the Commission to develop a sound evidentiary record and recommend rates based on that record. Nevertheless, we are confident that, as in prior cases, the Commission will develop recommendations consistent with the policies of the Act, within the ten months mandated by Congress.

Response of the Board of Governors, March 4, 1998 at 2-3.

[2057] The OCA's and other parties' concerns about the accuracy of the Postal Service's test year forecasts are well grounded. The Commission can not estimate the degree to which the error in forecasting 1997 results will continue into the test year, primarily because it lacks the Cost and Revenue Analysis for 1997 (CRA). The non-recurring items witness Porras identifies, such as the 1997 UPS strike and underspending on other programs, contributed to the Postal Service's profitability in 1997 and may not continue into the test year. As witness Porras argues, they prevent the Commission from extrapolating 1997 results into the test year. In light of substantial methodological impediments, the Commission cannot adjust for 1997 actual results other than accounting for known and quantifiable events, as the Commission has always done.

[2058] *1998 Results.* The Postal Service's actual operating results in 1998 also contrast sharply with its rate case before rates forecast of a loss of more than one billion dollars. The 1998 results call into question the accuracy of the Postal Service's forecasts, primarily its spending estimates. Indeed, some participants urge the Commission to reject the Service's entire filing based upon the Service's net income for 1998 to date. Other parties believe that such a drastic step is not necessary for the Commission to fulfill its duty under the Postal Reorganization Act.

[2059] MOAA argues the continuing profitability of the Postal Service presents no problem. MOAA, on brief, points out that the Commission has criticized the Postal Service in past cases for waiting too long to ask for new rates and running chronic deficits. MOAA Brief at 4 (citing PRC Op. R94-1 at II-27, 28). MOAA reminds the Commission that it advised the Postal Service that as "a matter of fact, revenue must

exceed costs if the RYPL is to be accomplished." *Id.* at 5 (quoting PRC Op. R94-1 at II-33). The early filing in this case, before the Postal Service began to lose money, could be viewed as a response to the Commission's admonition. *Ibid.* "[T]he restoration of equity and the avoidance of any red ink in any year, clearly were a major driving force in the timing of this rate proceeding. … The Commission should not penalize the Postal Service for taking its advice." *Id.* at 5, 6.

[2060] MOAA argues that in practice, "there is no way to predict revenue needs with the precision that would be necessary to achieve a perfectly balanced position in any given year. If, as the Commission has so strongly urged, the Postal Service is to avoid 'chronic deficits' it must necessarily establish a higher rate plateau. The net result might be 'chronic surpluses' rather than 'chronic deficits.'" *Ibid.*

[2061] DMA, on brief, observes that the Commission is faced with the unusual circumstance of the Postal Service reporting huge profits and requesting rate increases. "If this case were to be viewed from the traditional 'test-year-break-even' perspective, the Commission should simply reject the request on the ground that no additional revenue is needed in the test year." DMA Brief at 10.

> The statutory structure is awkward under these circumstances, because it is based on the assumption that the USPS has an immediate need for additional revenue. This assumption does not apply in this case. … Rather, the Postal Service claims that 'Reducing the revenue requirement would undermine the Board' s financial policy with respect to program initiatives, the size and frequency of rate increases, and the restoration of equity.' It is saying, in effect, 'Our rate request reflects important policy considerations.' The Commission should approve the rates we have requested, and we will take responsibility for putting them into effect when we decide we need the extra money.

DMA Brief at 2 (footnote omitted). DMA suggests that the Commission not concern itself with the precise size of the revenue requirement and instead focus on ensuring that it recommends rates that are "'fair and reasonable' in relation to each other." *Id.* at 2-3 (footnote omitted).

[2062] ANM (along with OCA and ALA) believes a harsh remedy is appropriate in this case: the rejection of the Postal Service's Request in its entirety. ANM Brief at 3; OCA Brief (Second Section) at 25; ALA Brief at 1. ANM sees the performance of the Postal Service in the test year as undermining the projections underlying its Request. ANM Brief at 3. Specifically, the Service projected a billion dollar loss for the test year without rates, but it is reporting a $1.2 billion surplus through the first six accounting periods. *Ibid.* It is implausible that the financial state of the Service could turn around so dramatically during the last half of the year. *Ibid.* Spending would have to increase to 11 percent over 1997 in order to achieve the projected deficit, something that has never occurred during the past 35 years. *Id.* at 4.

[2063] ANM also disputes Postal Service witness Porras' suggestion that any reduction in the revenue requirement so that the Service will break even would infringe on the Service's management perogatives. ANM Brief at 7. ANM believes the Commission has the "power and duty to enforce the statutory break-even requirement." ANM Brief at 8.

[2064] ANM characterizes the Service's projections as stale, unbelievable and unsupported by the record. *Ibid.* ANM also argues that some portion of test year spending should be capitalized and expensed over future years, reducing test year expenses. *Ibid.* Furthermore, the Service has refused to provide better data in response to the Commission letter of February 24, 1998 to the Board of Governors. ANM points to the revenue requirement document found in witness Porras' files, *see* Tr. 35/18730, and asserts that "dismissal of the Postal Service's case is an appropriate sanction for its attempt to mislead the Commission." *Id.* at 9.

[2065] The OCA, generally agreeing with ANM, argues that the Service has vastly and consistently overstated its revenue needs. The Service originally forecast a test year loss of $1.39 billion, but subsequent events make the original estimates seem unrealistic. OCA Brief (First Section) at 4. The Postal Service reported double the 1997 earnings it forecast in its filing and is earning comparable profits in 1998.

[2066] OCA insists that the Postal Service demonstrate its need for more revenue. "The Postal Service, seeking adjustments to the rate structure, is the proponent of change. The Administrative Procedure Act states that "'[e]xcept as statutes otherwise provide, the proponent of a rule or order shall have the burden of proof.'" 'Burden of proof' in this context refers to the burden of going forward with the evidence. The general rule is that 'the party who has the burden of pleading a fact will have the burdens of producing evidence and of persuading the jury of its existence as well.'" *Id.* at 6-7 (citations omitted).

[2067] According to the OCA, 1998 actual results to date demonstrate a profitable test year. *Id.* at 7. The OCA does not believe that the Postal Service, having earned $1.155 billion through A/P 5 can lose well over a billion dollars in the test year. *Id.* at 8. The Postal Service is actually ahead of FY 1997 in net income through A/P 5. *Id.* at 14. OCA contends the Service cannot reliably forecast even a few accounting periods into the future. In A/P 11 of 1997, the Postal Service forecast a loss of $519 million over the last three accounting periods of that year; in fact, the Service only lost $28 million. *Id.* at 5. The OCA's brief presents numbers in a graph from the Postal Service's operating plan in comparison to results by accounting periods. *Id.* at.19. The graph shows that the Service dramatically underestimated profitability in the later accounting periods of 1996 and 1997. This raises serious questions, in the OCA's view, about the ability of the Postal Service to predict its net income and casts doubt on its test year forecast. *Id.* at 6.

[2068] The Postal Service's forecast for the test year, perhaps reasonable when made, now would lead to "unreasonable results," i.e. excessive profits. *Id.* at 10. OCA also disputes the Postal Service suggestion that the financial and policy goals of postal management will be undermined without a rate increase. As yet there is certainly no evidence that new rates are needed to finance spending. *Id.* at 12. OCA speculates that given the size of the misestimates, "something significant is happening with Postal Service operations," but it is unclear exactly what is causing the discrepancy. *Id.* at 15. The OCA concludes that the Service has failed to carry its burden of showing that there will be a revenue deficit in the test year. *Id.* at 33.

[2069] The OCA raises the issue of whether stale data could undermine the Commission's decision. "OCA concludes there is danger that this entire proceeding will be in peril upon appeal if the Commission fails to take into account the large actual FY 98 earnings reported to the Commission." *Id.* at 17. Hence, the OCA argues that FY 98 numbers should be used: "If detailed actuals are to be collected, the FY 1998 actuals should be gathered in light of the high earnings so far this test year to determine whether any rate level increase is justified or, if so, to what extent the revenue requirement should be reduced." OCA Brief (Second Section) at 28.

[2070] The OCA also attacks the Postal Service's forecasts based on a comparison of the Postal Service's operating budget and rate case filing.

> The Postal Service budgeted an FY 1998 loss of $228 million assuming a rate increase on June 1 of the test year. The rate increase assumes an annual increase of approximately $2.4 billion. The increased revenue would average about $200 million per month. Accordingly, in the four months the new rates would be in effect, it is reasonable to assume the new rates would recover an additional $800 million that would not otherwise be recovered. Adding $800 million to the budgeted deficit for FY 1998, it appears the budget numbers implicitly assumed that without the rate increase the Postal Service would experience a loss of $1.028 billion. This is distinctly at odds with the rate-filing deficit of $1.4 billion.

Id. at 40 (footnotes omitted). Witness Porras testifies that new rates implemented in July 1998 would generate about $900 million through the end of FY 1998, even though this period comprises the slower summer months, which should generate less revenue and make the discrepancy between the budget and rate case filing larger. Tr. 35/18671. OCA believes this means there is a large inconsistency between the budget and the evidence presented in the Request. OCA Brief (Second Section) at 40.

[2071] In sum, the OCA believes that no rate increase is warranted at this time. "The Commission must reject the Postal Service rate request altogether for failure to meet its burden of demonstrating that the current rate level is insufficient to meet test year expenses." OCA Brief (First Section) at 17. OCA speculates that if the

Commission denies the Service's request, the Board of Governors might ask for reconsideration and the Commission would then have updated cost data. *Id.* at 33. OCA also suggests raising commercial mailers' rates and retaining the First-Class stamp. "The Commission may instead retain the First-Class 32-cent stamp rate and increase other rates at this time in order to avoid excessive Postal Service earnings." *Id.* at 20 (footnote omitted).

[2072] Several mailers (ANM, ALA and CRPA) filed a joint brief generally disagreeing with the OCA's recommendations. Joint Brief at 2. First, they argue it is unlawful to ignore cost data and raise commercial mailers rates while retaining a 32-cent stamp. They claim there is no basis for making a distinction between First-Class and commercial mailers, as both contributed to better than expected profits for the Postal Service. *Id.* at 2-3.

[2073] These mailers also attack the OCA's proposed strategy that the Commission deny the Postal Service's request in its entirety and hope that the Board of Governors asks for reconsideration. The mailers point out that the Governors may choose not to ask for reconsideration and file a new rate case. *Id.* at 3. They suggest that the Commission reject this "exercise in power politics." *Ibid.*

[2074] These mailers also disagree with the OCA's suggestion that the Commission use recent data that has become available since the Request was filed. *Id.* at 4. They argue that "the Commission itself has repeatedly stressed that its adjustments to the revenue requirement must involve recognition of post filing changes in both revenues and costs. The state of this record will not permit the Commission, under its own precedent, to substitute actual FY 1997 data for the estimated FY 1997 data now in the record because the critical cost information — the Cost and Revenue Analysis — is not available." *Id.* at 5 (citation omitted).

[2075] Moreover, due process requires that the parties have time to review, analyze and perhaps challenge the data. *Ibid.* DMA agrees with this conclusion. "As explained by Postal Service witness Porras, using actual FY 1997 data in this case would have entailed substantial burdens and delays, even if the requisite data were available, which

it is not. Substantial changes would have to have been made in a large number of analyses and spreadsheets, and the parties would have had to have been given adequate time to analyze and challenge the results." DMA Brief at 4 (citation omitted).

[2076] As a solution, the parties suggest that the Commission urge the Governors to delay implementation of new rates until the Service needs additional revenues. Joint Brief at 7. The Governors share the responsibility of making the Postal Service break even. *Id.* at 9. DMA suggests the PRC's recommendations can stay "'on the shelf'" until the Board decides the additional revenues are needed. DMA Brief at 9. "The DMA believes that the members of the Board (each of whom has important fiduciary obligations to fulfill) can be trusted to implement new rates no sooner than can be fully justified to the American people." *Ibid.* MASA does not believe the Commission should advise the Governors when to implement rates. MASA Reply Brief at 2-3.

[2077] While the Postal Service offered generic arguments in its Brief and in response to the Commission's Notice of Inquiry, in its Reply Brief, the Service directly attacks the participants' suggestions for reducing the revenue requirement. Postal Service Reply Brief at I-3. The Postal Service believes its "lack of precise anticipation … of recent financial results" has "prompted a loud hue and cry" from OCA and ANM. *Ibid.*

[2078] According to the Postal Service, the "record does not support conclusions about test year cost estimates based on projections of partial-year results." *Id.* at I-6. The Service points out that the Commission has made mistakes when attempting to forecast based on partial-year results. *Id.* at I-11. In 1992, the test year for R90-1, the Commission's poor estimates led to revenue shortfalls of $1.628 billion in the test year. *Ibid.* The Service also cites Commissioner's LeBlanc's forecast of a loss of $2.4 billion for 1994, when, in fact the Service only lost $913 million. *Ibid.*

[2079] The Postal Service also disputes OCA's comparison of the operating budget loss to the rate case budget loss. *Id.* at I-9. The OCA does not consider, according to the Service, that the $900 million figure cited by Porras was carefully developed and based on volume projections and a number of other considerations such as lag. *Ibid.*

[2080] The Postal Service maintains that it still may suffer the tremendous turnaround in finances that it originally forecast. "The Postal Service has provided credible evidence that its program expenses are likely to increase dramatically during the second half of the test year, resulting in losses large enough to come close to a $1.2 billion loss." *Id.* at I-16.

[2081] *Commission Analysis.* The participants' views are especially helpful as the Commission considers how best to respond to a unique situation in which the Postal Service's operating results continue to contradict its filings in this case. However, the OCA's and ANM's suggestions to reject the Postal Service's case cannot be accepted.

[2082] The OCA's argument that the Commission must reject the Service's Request because it has not met its burden of proof does not persuade the Commission to conclude that the Service's case must be rejected. Witnesses Tayman and Porras testified that the Postal Service needs additional revenue to finance huge increases in spending. While a proportional amount of the spending has not occurred in the first half of the test year, no party has presented evidence suggesting that the Postal Service will not spend funds for any particular program during the remainder of 1998.

[2083] Similarly, the OCA concerns about the staleness of the cost data, while valid, are not a basis for rejecting the Postal Service's Request: rather, they suggest that the Commission should seek better data, which it has done by making a special request to the Board of Governors. As to the suggestion that the Commission freeze First-Class rates and raise other rates, there is no reason to discriminate among mailers in the manner suggested by the OCA.

[2084] A plausible explanation for the Postal Service's recent surpluses is that it significantly overestimated its spending on discretionary programs. It has a recent history of such overestimates. Tr. 35/18694. Obviously, the Commission depends on accurate Postal Service estimates of its spending on these programs to establish the revenue requirement. If the Postal Service, for whatever reason, grossly misestimates its spending, it does a disservice to the public and does not act responsibly as a partner with the Commission in working to achieve a break even result.

[2085] Even when the Service has no immediate need for more revenue, rate cases also provide the opportunity to establish more equitable relationships between rates and fees based on recent costs and other factors. *See* DMA Brief at 2-3. The parties also correctly point to the Postal Service's responsibility in meeting the break even requirement, and the Commission is confident that the Governors will delay implementing new rates until there is a real need for the additional revenues.

[2086] If the Commission had evidence that the Postal Service filed its Request in bad faith, then perhaps a rejection of the Postal Service's Request in its entirety would be indicated. The Commission does not have evidence demonstrating this. Consequently, it is not appropriate to completely reject the Service's Request.

[2087] The Commission also cannot accept Postal Service witness Porras' suggestion that cost increases and decreases nearly offset each other, so the Commission should make no changes to the revenue requirement. Witness Porras argues that the known and certain cost decreases (COLAs, FERS, health benefits, etc.) are more or less offset by the "other program" increases he presents. The contrast between "known and certain" costs and the more speculative "other program" expenses is striking: the former definitely will occur while the latter may or may not be incurred. These two cost categories are not on an equal footing in terms of their nature or the likelihood of actually being incurred and must be considered separately and not as a package.

[2088] Moreover, Porras' presentation ignores the bigger picture: what is happening to all other relevant factors that affect the test year revenue requirement. The influence of factors such as productivity, revenue per piece, and mail volume on the Service's test year forecast are not even alluded to in Porras's rebuttal testimony. These factors could have a significant effect on the test year revenue requirement. The Commission is attempting to determine the extent to which the Service's filing misestimates the need for additional revenue in the test year. Instead of a thorough, systematic examination of all significant factors, the Commission is offered a selective presentation that focuses solely on "other programs," and the "other program"

presentation is itself selective. It is this presentation that is used to argue against updating for known and certain events. The Service's arguments fail to persuade the Commission not to adjust the revenue requirement.

E. Other Programs Expense

[2089] The $2.5 billion which witness Tayman describes as the increase in spending in various management-initiated programs engendered much criticism by the participants. First, the Postal Service's need for new rates stems from plans for massive investments in the test year. Second, the Service did not spend as much on these programs as it expected to in 1997. Tr. 9/4562-65. The Postal Service's continuing profitability in 1998 suggests this may be continuing. Consequently, some participants urge the Commission to reduce the Postal Service's estimates of its spending on these programs and reject witness Porras' claim for even more funds presented on rebuttal.

[2090] The OCA, in particular, does not have much faith in the reliability of the Postal Service's testimony on its other programs expense. "[T]he structure of the rate filing allows the Postal Service virtually free reign to add whatever expenses it chooses on the flimsiest of rationales in order to reach any desired expense goal. The expenses estimated by the Postal Service for 'other programs' for FY 1998 exceed the prior year 'other program' expenses by over $2.5 billion." OCA Brief (Second Section) at 33 (footnote omitted). OCA believes that the Commission should examine the Postal Service's assurances that it will spend the amount it claims for new FY 1998 programs. OCA points out the significance of these estimates: "It does not require a large shortfall in new program expenses to totally decimate, if not eradicate, the Postal Service claims of revenue deficiency." *Id.* at 34.

[2091] OCA attacks the Postal Service's maintenance of its original estimates. "Witness Porras assures the Commission that the Postal Service will lose what it has projected if the program managers spend funds as promised. But his pleas are unconvincing. The basis for the large loss estimates and all hopes of actually losing $1.3 billion in the last five accounting periods or upwards of $2 billion assuming there is no rate increase, rely on the program managers' spending program money." *Id.* at 26-27 (footnotes omitted).

[2092] OCA also disparages the Postal Service's original estimates of program expenses. OCA contends that witness Porras knew remarkably little about the spending: he could not tell which programs are ahead or behind in their spending schedules, and how much is to be spent on them in the test year. When asked, he responded, "'I don't have that information with me.'" *Id.* at 38 (quoting cross-examination of Porras at Tr. 35/18710) (footnote omitted). Witness Porras' claim of a systematic review of the 81 programs and related expenditures is also belied by his admission that there may be some programs with lower costs but that such information has not been given to him. *Ibid.* (citing Tr. 35/18706).

[2093] Hence, OCA advocates a downward adjustment in other program expenses of approximately 10 percent.

> If one looks to last year's FY 1997 record, the Postal Service expenditures fell at least 10 percent below the spending goal. Witness Porras concedes that last year the Postal Service was "geared-up" to spend the money on new programs but it nevertheless did not meet its spending goals. Projecting the FY 1997 experience to FY 1998, when about twice as much is planned to be expensed on new programs, it does not stretch the imagination that the Postal Service will fall at least 10 percent short, or even more, of its spending goal again this year. The Postal Service has not presented any numbers demonstrating that it is on its spending target for FY 1998. Given all the experience of the Postal Service, the most reasonable conclusion is that the Postal Service cannot reasonably be expected to spend all the money it projects to spend on new programs in FY 1998. The Commission should therefore make a reasonable downward adjustment in the Postal Service estimates.

Id. at 39-40 (footnotes omitted).

[2094] OCA is even more skeptical of Porras' late additions to "other program" expense, detailed at Tr. 35/18598, and the OCA believes that despite the assurances of witness Porras that program managers claim funds will be spent, other facts contradict this conclusion, and the Commission should reject the new estimates of other program expenses. OCA Brief (Second Section) at 34.

[2095] OCA believes that Porras has adopted a different standard for expense reductions in comparison to expense increases. *Id.* at 34. "The downward adjustments to cost reductions discussed above reflect known and certain changes in the prior estimates for items such as COLA, inflation, etc. On the other hand, the upward adjustments for the year 2000 software are not known and not certain. To the contrary, the claimed expenses are not, at this time, 'known, quantifiable, actual events.'" *Id.* at 35 (footnote omitted).

[2096] The OCA also argues that the Postal Service has not provided the same documentation for the new expenses that it provided for the original expenses in library reference H-10, which sets out the spending by segment. Porras was asked about spending by accounting period, but as OCA notes, he could not provide the information. Id at 36. Porras only could repeat that he has been told the money will be spent. *Ibid.* (citing Tr. 35/18700).

[2097] In evaluating what the OCA terms "deficient" estimates, OCA also suggests the Commission should evaluate the credibility of the witnesses and the "reasonableness" of the estimates. *Id.* at 37. "To accept them, one must assume the Postal Service is willing to throw money at projects to insure that expenditures meet the rate case estimates made only one year ago but which have proven to be unrealistic." *Ibid.*

[2098] The OCA also argues that the lack of spending so far calls the Postal Service's estimates into question. "The total ADP program expense estimate is to spend $1.019 billion during the test year, yet as of accounting period 5 only $56 million was spent. … The Postal Service needs to offer better justification for such expenditures offered at the last minute, just one day before the end of the scheduled hearings when the time for interrogatories is long past. There should be internal justifications, approvals, budgeted expenditures and the like." *Id.* at 36-37 (footnotes omitted). In short, the Commission should reject these undocumented expenses.

[2099] In the same vein as the OCA, ANM also attacks the Postal Service's evidence underlying the other programs expense. ANM finds the record devoid of

evidence that such expenditures will actually occur in the test year. ANM Brief at 4. ANM believes Porras "conceded" on cross-examination that the spending might carry over into 1999. Spending on some of the projects has not been approved by the Board of Governors, signed into contract, performed by vendors or recognized on the books of the Postal Service. *Ibid.*

[2100] ANM also argues it is inappropriate to make current mailers pay for the capital investment of the Postal Service. ANM contends the benefits of the spending should exceed the amount spent, and consequently, the Postal Service's financial position should improve. ANM Brief at 5. If the investment is economical yet producing a loss, "there must be a timing mismatch between recognition of the expected outflows and recognition of the expected benefits of the project. *Ibid.* Consequently, ANM believes that the Service must be treating items as expenses that should be capitalized. *Id.* While witness Porras states that the Service follows Generally Accepted Accounting Principles (GAAP), ANM finds this to be "both unverifiable and insufficient." *Id.* at 6. ANM suggests that the Postal Service should use debt to match the life of the goods and services the Postal Service acquires. *Id.* at 8.

[2101] Along with OCA and ANM, DMA also argues against acceptance of Porras' $298 million for the Year 2000 Software Program, because it seems doubtful it will be spent in the test year. DMA Brief at 7.

[2102] The Postal Service argues at length in its reply brief that the Commission should not reduce "other programs" expense. Postal Service Reply Brief at I-12-23. The Commission must not "factor in prior years' program experience into 'predicting' program expenses in the test year. …" *Id.* at I-4. This would be improper because the programs "represent major Board policy commitments" and the implementation of the programs is "part of the management process." *Ibid.* The Commission must heed those "competent to represent management plans and actions." *Id.* at I-5. Even programs not yet approved by the Board must be included in the revenue requirement as the Board needs to know the funds are available in order to approve the project. *Id.* at I-14, n.8.

[2103] The Postal Service submits that the Commission should not try to estimate how much the Postal Service will actually spend in the test year. *Id.* at I-12. Later, the Service suggests that it is not particularly important. "Whether every last penny budgeted and required as part of the rate change actually ends up being spent this year is not only something that cannot be known, but is irrelevant to recommending rates, which will last beyond the test year and are needed to support these programs." *Id.* at I-15, n.9.

[2104] The Service also contends the Commission has no role in estimating these particular test year costs. "The Commission's review of the revenue requirement is limited to whether the programs have been properly calculated within the revenue requirement for the test year." *Id.* at I-14.

[2105] In this vein, the Service believes that OCA inappropriately passes judgment on various programs. *Id.* at I-13. This is a matter reserved to management, and ANM's contention that the Service should have considered using debt timed to the nature of the investment is similarly dismissed as inappropriate. *Ibid.*

[2106] In response to OCA's assertion that spending is behind schedule, the Service presents a possible explanation for the apparent lack of actual spending on ADP Supplies and Services. On brief, the Service argues that witness Porras suggested that some of the ADP Supplies and Services may be improperly charged to miscellaneous supplies and services (cost component 177) instead of ADP supplies and services (cost component 174). *Id.* at I-10. The Service points out that spending in this component is $572 million through A/P 7. *Ibid.* Porras stated under cross-examination:

> When you're looking at a line in terms of our current performance, that may not be the total program cost. You have to go pull it out of supplies and services, and I don't think we're looking at the same thing, because I could — I don't have it with me but I can go back and show you the total program cost, which some of it may be — for example, Priority Redesign is a supplies and service cost.

Tr. 35/18696. Also, the Service, on brief, reports that $116 million has been spent in component 174, ADP Supplies and Services through A/P 7. Postal Service Reply Brief at I-10. Thus, in the Service's view, the "latest information" does not show that "program expenses have been overestimated." *Ibid.*

[2107] Furthermore, the Postal Service recites the cross-examination of witness Porras who indicated the money budgeted for other programs would be spent. "He explained that 'a lot of those programs have contracts signed already,' that 'we now have processes in place to have managers accountable,' that 'the way they're set up is that the moneys are going to be spent between now and the end of the year,' and that 'I think we're going to be very close to that number.'" *Id.* at I-16-I-17 (quoting Tr. 35/18607).

[2108] Taking issue with OCA, the Postal Service characterizes the distinction between costs within the control of the Postal Service and those outside of its control as a "false dichotomy." *Id.* at I-19. "Other programs" also includes workers' compensation and annuitant costs that are not discretionary. *Id.* at I-20. Also, many of the "other programs" cost increases result in cost reductions. *Ibid.*

[2109] The Service notes that the OCA does not object to the Service's reduction of the estimate of spending on the Mail Transportation Equipment Centers and only disputes the Year 2000 Software Program, though both are based on program managers' forecasts. *Ibid.* (citing OCA Brief (Second Section) at 30-31, 33-37).

[2110] Disputing the OCA's suggestion that support for the Year 2000 Software Program is lacking, the Service argues that it is not a new program, was incorporated in the original filing, and is adequately supported by the record. *Id.* at I-21-I-22. The Service also denies a suggestion by the OCA that it has withheld information concerning changes in its "other programs." *Id.* at I-22.

[2111] The Service disputes ANM's contentions that the Service's spending projects cannot generate losses recoverable by ratepayers. *Id.* at I-23. Some investments, the Service points out, have intangible benefits relating to safety, infrastructure or service or generate cost reductions. *Ibid.* ANM also does not point to

any specific costs that should be expensed or depreciated over a longer period. *Id.* at I-24-1-25.

[2112] The Postal Service devotes several pages in its reply brief to a discussion of a document, Tr. 35/18730, it inadvertently included in witness Porras' electronic workpapers. Postal Service Reply Brief at I-30-I-36. *See also* P.O. Ruling R97-1/121 (admitting document into evidence over Postal Service objection). Previously, the Service disputed its authenticity, *id.* at I-1, but the Service now argues that the document is "a clear window on the testimony" of witness Porras. *Id.* at I-30.

[2113] The document outlines witness Porras' testimony, and it has been suggested that the document shows that Porras was misleading the Commission by selectively furnishing the Commission cost increases. *See* ANM Brief at 7.

[2114] The Service disputes the allegation that the document evinces an intent to mislead. "If the Postal Service were truly attempting to manipulate the revenue requirement, it seems unlikely that the alleged 'smoking gun memorandum' outlining this strategy would have suggested voluntarily providing information about decreases not currently on the record. Rather, the document represents the honest attempt made in the rebuttal testimony to provide comprehensive information about changes known to the Postal Service." Postal Service Reply Brief at I-31.

[2115] The Postal Service complains that some persons have read words into the document that are not there in an effort to show that the Service was trying to deceive the Commission. *Id.* at I-31, I-36. The document, the Service points out, does not say "'find *enough* increases …;'" it just indicates the Service will: "'[p]rovide updated information on cost increases to offset the decreases. …'" *Id.* at I-31 (emphasis added).

[2116] The Postal Service insists, contrary to what ANM alleges, that it did not selectively furnish cost information to the Commission to offset the decreases contained in witness Porras' testimony. *Id.* at I-32 (citing ANM Brief at 7). If this had been its goal, it would not have provided unknown decreases and would have provided all increases, not just the major ones. *Id.* at I-33. The Service claims it presented "only major increases, resulting in only a partial offset of the decreases." *Ibid.*

[2117] The Service maintains that it was not particularly upset that the document was made public. *Id.* at I-35. Rather, it is troubled by the fact that it was not notified pursuant to the Commission's own procedures that the document was to be used as an exhibit in the cross-examination of witness Porras. *Ibid.* (citing P.O. Ruling R97-1/107 at 1).

[2118] *Commission Analysis.* The Commission cannot accept the Postal Service's proposition that the Commission's mission is simply to check the math of the Postal Service with regard to "other programs" expense. In order for the Commission to fulfill its duty of ensuring that its recommended rates will generate revenue that equal expenses in the test year, the Commission must estimate actual spending and expenses in the test year. "[The Commission's] expertise is in the setting of rates and fees that are fair and equitable, and its authority therefore reasonably extends to all aspects of such decisions, including review of budget estimates, allocation of postal costs, establishment of rates for postage. …" *Nat'l Ass'n of Greeting Card Publishers v. U. S. Postal Service*, 569 F.2d 570, 597 (D.C. Cir. 1976).

[2119] The Commission has serious doubts about the Postal Service's forecasts in the area of other programs expense, but it does not scrutinize the wisdom of Postal Service spending plans. It presumes good faith on the part of the Postal Service in preparing these forecasts of dramatic spending increases. *See West Ohio Gas v. Public Utilities Comm. of Ohio,* 294 U.S. 63, 72 (1935). The intervenors must remember that the Postal Service does not face the same constraints as a typical regulated utility in its decisionmaking: this Commission cannot disallow expenses except in extraordinary circumstances. The Commission does not have sufficient grounds to reduce the initial estimate of other programs expense.

[2120] While the Postal Service's spending on other programs expense is behind schedule, its operating plan calls for expenses to skyrocket at the end of the year. Tr. 35/18661. Although it is highly unlikely that the Postal Service will attain the level of test year spending projected by witness Tayman and detailed in Postal Service library reference H-10, witness Porras testified on rebuttal that the "program managers have

indicated that they will catch up as the year progresses." *Id.* at 18585. No intervenors were able to demonstrate that this spending would not occur.

[2121] As the Postal Service devotes considerable energy on brief discussing the revenue requirement document found in Porras' workpapers, the Commission will address the arguments it raises. In the Commission's view, it may be best to allow the document to speak for itself.[4] Nonetheless, the document says "increases to offset." It

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[4] Tr. 35/18730.

Docket R97-1 Revenue Requirement Updating Strategy for Rebuttal Testimony

1- Provide updated test year cost changes for known, quantifiable, actual events that have been raised on the record. These include the impact of the August 1997 and February 1998 Colas on personnel costs and the CSRS Unfunded Liability, the impact of the actual 1997 calendar quarter III CPI on annuitant Cola, FY 1998 POD workers' compensation cost, and the impact of actual FY 1997 borrowing on FY 1998 note interest expense. The impact of FY 1997 actual results on the prior year loss recovery has also been reflected. Although not currently on the record, the impact of the following actual information has been reflected: 1) actual January 1998 health benefit premiums, 2) the FY 1998 reduction in the FERS contribution rate, 3) actual January 1998 health benefit premiums on annuitant health benefits and, 4) actual FY 1997 non-personnel cost inflation indices.

2- Provide updated information on cost increases to offset the decreases included under number 1. These include building depreciation for the write off of impaired assets (FASB 121), and a more realistic estimate of capitalized interest. In order to balance back to the original revenue requirement an argument will be made for an increase in the contingency from 1.0% to 2.0%.

3- Maintain FY 1996 as the base and do not change forecasted indices. In order to accurately determine the impact of changing the base to FY 1997, all cost factors would have to be updated and the rollforward model would have to be re-run. This would constitute a total update to the revenue requirement which would defeat the purpose of the current rate case process where the estimates supporting the rate request are reviewed on the record. Changing the base without changing the cost change factors would result in erroneous and understated test year costs. FY 98 program cost factors were zero based relative to estimated FY 97 costs and they do not relate logically to FY 1997 actual costs. Servicewide personnel cost change factors were developed using computer models which project from FY 96 actual data as the base. FY 98 change factors for these costs do not relate logically to FY 97 actual costs. A complete revenue requirement update would be time consuming and would probably result in a further reduction in test year costs. The Commission may also request that we calculate an FY 1997 adjustment for UPS strike costs that would not rollforward into the test year. We should argue against updating due to its complexity and the amount of work involved and because it makes the entire rate review process that has occurred up to that point largely irrelevant. While arguing against updating we should recommend updating to reflect actual data (with the exception of the base year), but not forecasts, as an alternative.

4- Another alternative would be not to file rebuttal testimony and make these arguments in the brief. Since there was little intervener testimony filed that relates to the revenue requirement, there is little on the record to rebut. The risk is that the brief provides less support for our position than would be provided by the Controller making these arguments. However, there is also risk in exposing the rebuttal witness to cross examination which could result in even more impetus for updating and reducing the revenue requirement.

does *not* say “provide all significant changes” or “provide all increases and decreases.” A fair interpretation is that the Service was looking for increases rather than decreases in order to offset the decreases disclosed by witness Porras. These decreases, to reflect actual expenses for COLAs, FERS, Health Benefit Premiums etc., are simply the adjustments for known events that the Commission has typically made; the Commission would have made many of witness Porras’ adjustments even if he had not offered his testimony. *See* PRC Op. R94-1, para. 2026; PRC Op. R90-1, paras. 2007-12; PRC Op. R87-1, para. 2141; PRC Op. R84-1, paras. 1188-90.

[2122] The document may not demonstrate an intent to mislead. However it indicates that the Service was looking for potential cost increases. This would explain how witness Porras could identify net potential cost increases in test year spending on “other programs,” even though current operating results demonstrate the Service is behind schedule on such spending.

[2123] Regardless of the significance of the document, the Commission is not prepared to accept witness Porras’ late adjustments to Postal Service estimates of spending on other programs. He does not present a systematic reevaluation of the revenue requirement. Instead, he offers suggestions based on a few, isolated, discretionary “other programs.”

[2124] Had Porras provided a systematic presentation that showed how other programs expenses had varied from budget in the early part of 1998 and why these shortfalls would be overtaken by increased expenditures, his presentation would have been far more persuasive. The Commission does not dispute the soundness or wisdom of the additional spending witness Porras introduces on rebuttal, but it is neither convinced that it will occur nor comfortable in accepting these new estimates so late in the case. Several reasons force the Commission to reach this conclusion.

[2125] The Commission also must examine witness Porras’ assertion that “other programs” expense should be increased by $362 million in the context of reported financial data. Postal Service data indicates that capital commitments were less than budgeted through Accounting Period 7 by $965 million. USPS Financial & Operating

Statements for Accounting Period 7, at 1. "Other programs" spending is in large part associated with these capital commitments or investment. As noted, the Service has projected total capital commitments of $5.6 billion for 1998, yet it is well behind schedule, having committed only 15 percent of the $5.6 billion. This casts serious doubt on the Porras testimony that the Service's associated expenses will be *above* its forecast by $362 million.

[2126] When asked if he could tell the Commission which of the 81 "other programs" was ahead or behind schedule, he replied that he did not have the information with him. *Id.* at 18710. Porras also testifies that he knows of only one program that is behind schedule. *Id.* at 18706. He was unaware of delay in purchasing point of sale terminals. Tr. 35/18708-09. Unexpected delays in the program were announced by the Service during Docket No. MC97-5, while this rate request was pending. *See* Docket No. MC97-5, Response of United States Postal Service to P.O. Information Request No. 1, January 13, 1998.

[2127] In light of this accounting data and his undocumented assertion that only one program is behind schedule, Porras' testimony concerning "other programs" suggests that he was not provided an accurate picture of where "other programs" spending stands. For example, he seems to testify that the Postal Service is only $50 million behind on "other programs." *Id.* at 18698 and 18710. This is inconsistent with the accounting data just discussed, and year-to-date spending on ADP Supplies and Services.

[2128] For the test year, the Postal Service's July 1997 filing projects spending of $721 million in ADP Supplies and Services. In March 1998, witness Porras' testimony projects an additional $298 million in spending for this account. *Id.* at 18598. Consequently, the Service is forecasting spending more than a billion dollars on ADP Supplies and Services. *Id.* at 18694.

[2129] Despite this ambitious spending schedule, financial data reported by the Postal Service indicates that only $56 million of this budgeted amount was spent through A/P 5 and $116 million was spent through A/P 7. *Id.* at 18696; Postal Service Reply Brief

at I-10. When faced with reports of actual spending on cross-examination, witness Porras was unable to explain the discrepancy between spending plans and reality. Tr. 35/18694-701.

[2130] The Service's arguments on brief further buttress the Commission's conclusion that the Service is continuing to spend significantly less than its rate case forecasts. The A/P 7 spending figure, cited on brief by the Postal Service, undercuts the Service's argument that the massive spending will occur by demonstrating that spending only averaged $30 million during accounting periods 6 and 7. Spending would need to average more than $100 million during the last six accounting periods in order to reach the original $721 million target set for ADP Supplies and Services.

[2131] The Postal Service's explanation, only unveiled in its reply brief, that it may be reporting the spending in another account is both unsettling and insufficient. Accurate accounting data provides the bedrock upon which the Commission designs postal rates and fees. Witness Porras was invited to explain or correct this problem when he testified, but he did not do so. Of course, statements of counsel on brief are not record evidence.

[2132] In any case, the Service's belated explanation also is at odds with the Service's own spending forecast of $1.28 billion for component 177. Patelunas Workpaper F at 590. Spending in component 177 has been $572 million through A/P 7, according to the Service; this is only 45 percent of the $1.28 billion estimated total spending for cost component 177 for the year. However, after 7/13 of the year, the level of reported spending in component 177 should be much higher if component 174 spending was mistakenly being placed in component 177, along with proper component 177 spending. Moreover, witness Porras' cross-examination does not suggest accounting errors; he simply seems to be indicating that a program's costs are spread among many cost components. *See* Tr. 35/18696.

[2133] The Service quotes at length from witness Porras' cross-examination to demonstrate that unprecedented spending will occur.

> In the past, I would have said to you, I don't think we can spend this money. Today, I cannot do that. I'm looking at a totally different organization today. We are doing what we said.

Id. at 18691.

> So, today my bottom line is the program managers are going to expend this money. We have the processes in place to let them do that. I think it's going to get done.

Id. at 18691-92.

> I mean we've got these things in place to get them done. I'm saying to you from my knowledge of what I have seen over the last couple of years, the processes are in place, that these can be spent.

Id. at 18736-37. *See also* Postal Service Reply Brief at I-16-I-17.

[2134] On the other hand, Porras made other statements suggesting that he is not so confident the funds will be spent.

> I cannot tell you whether or not — I just cannot tell you that, whether or not those program managers — they have said they are going to spend this money. I cannot tell you whether they are going to do it. We have got processes in place to assure they do what they said they were going to do.

Id. at 18736.

> I'm saying to you from my knowledge of what I have seen over the last couple of years, the processes that are in place, that these can be spent. I don't know at this point whether they will or not. They have told us, they have assured us that the programs are in place. Where they didn't feel comfortable, they told us that, and that's what you saw with that one program.

Id. at 18737.

> Now some of these program managers may not spend that money this year. I don't know that. But they're going to — it may carry over to next year. It's going to get spent.

Id. at 18608.

[2135] This does not persuade the Commission that he is confident that all the spending will actually occur in the test year, especially when Porras' testimony primarily relies upon "processes" that were geared up and in place in 1997, when the Service saw a significant spending shortfall on other programs, as detailed above by OCA. *See also* Tr. 35/18692-94.

[2136] Witness Porras also acknowledges the overestimation of spending which occurred in 1997. Tr. 35/18694. The Postal Service only spent a fraction of the budgeted amount for ADP Supplies and Services — $156 million of $426 million. *Ibid.* This forecasting error is particularly significant because witness Porras' contends that the Postal Service had "geared up" that year to spend the budgeted funds, yet the program managers did not spend the allocated funds.[5] *Id.* at 18693.

[2137] The Commission must also reject the argument that it does not matter when the money is spent because it will *eventually* be spent. Witness Porras suggested this under cross-examination and the Postal Service repeated the argument on brief. Tr. 35/18608; Postal Service Reply Brief at I-15, n.9.

[2138] This position is antithetical to the test year ratemaking process used by this, and most other, regulatory commissions. The Postal Service decides when to file a

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[5] The Commission notes that "Handbook F-6: Economic Value Added Financial Management and Pay for Performance," at 5, states bonuses are tied to EVA which "provides an incentive to minimize costs *and* capital employed." USPS-LR-H-258. *See also* Tr. 35/18694-96.

The operation of the Postal Service bonus system has not been explored on this record, and we do not base our decision to reject witness Porras' schedule of additional spending based upon the Postal Service's incentive-based compensation system. Nonetheless this might be a possible explanation for the Postal Service's persistent shortfalls in capital investment and its associated spending. Perhaps also the Postal Service's Five-Year Capital Investment Plan was simply too ambitious in projecting investment of $5.6 billion along with the associated "other programs" expense increase of over $2.5 billion for the test year. *See* 1997 Comprehensive Statement on Postal Operations at 81; USPS 1997 Annual Report at 42; USPS-T-9 at 14.

request for rate changes and has lattitude in the selection of the test year. *See* Rule 54(f)(2) (indicating that a test year must begin not more than 24 months from the date of filing). In this case, the Postal Service chose 1998 as the test year.[6]

[2139] A test year allows rates to be designed that will "provide sufficient revenues so that total estimated income … *will equal as nearly as practicable total estimated costs* of the Postal Service." *See* § 3621 (emphasis added).

[2140] The Board of Governors is responsible for developing Postal Service investment programs, and the Commission does not doubt that these programs will be effectuated. Postal Service Reply Brief at I-5-6. The Commission's complementary responsibility is to set rates that fairly recover the costs of these programs from mailers. Rates are set to recover projected expenditures in a test year, and only spending realistically expected to be incurred in the test year may be included in its revenue requirements forecasts.

[2141] The Postal Service contends, Reply Brief at I-14, that the Commission may not exclude expenses for planned programs, even if the Board has not yet approved those programs. That is not in issue here. The Commission does not exclude from the revenue requirement any program — it simply concludes that there is no credible evidence that the Postal Service will incur over $1 billion of ADP Supplies and Services expense in the test year.

[2142] In addition to the uncertainty surrounding the spending estimates, witness Porras himself doubts the fairness of accepting new estimates. "Updated information does not receive the thorough analysis and review by interested parties that the ratemaking process provides for original estimates. It seems unfair for intervenors to spend months evaluating the Postal Service's estimates only to have them changed after the fact." Tr. 35/18576.

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[6] As noted earlier, 1998 arguably is not a representative test year because it includes an unusually large amount of "other programs" expense. This is in part because a disproportionately large amount of investment spending was planned for 1998. See 1997 Comprehensive Statement on Postal Operations at 81. The Service's 5-year capital investment plan calls for $1.17 billion less investment in 1999 than in 1998.

[2143] This fairness argument is particularly persuasive when the Service changes estimates of spending entirely within its control. As the OCA notes, accepting Porras' new estimates of spending is quite different from replacing estimates of COLAs with actual COLAs: replacing estimates with actual numbers amounts to recognizing expenses that are being paid right now. The Service's argument on this issue is inapposite: Porras' increased "other programs" spending projections in his Exhibit E, Id at 18598, do not include non-discretionary items, such as workers' compensation and annuitant costs.

[2144] The Commission can not accept witness Porras' forecast that the Service requires additional funds when actual Postal Service spending and investment suggest that there is no need for additional revenue. A more comprehensive and better documented examination of the revenue requirement and "other programs" expense would be necessary to explain adequately why the Service is performing better than its forecasts, and why additional funds for "other programs" are necessary. A systematic review of this area would have been far more helpful and persuasive than witness Porras' presentation.

[2145] Hence, the Commission will not rely on witness Porras' estimates of increases in net "other programs" expenses for the test year contained in his Exhibit E. *Ibid.* The Commission is not suggesting that it does not believe that some new spending on the programs, such as the Year 2000 Software Program discussed in Porras' testimony, will not occur. Rather the Commission concludes that his forecast that total "other programs" spending will be $362 million more than the $2.5 billion increase the Postal Service originally estimated for "other programs" is not sufficiently supported and is unconvincing. Consequently, the Commission does not accept the projection of spending above and beyond what originally forecast by Postal Service witness Tayman.

[2146] ANM raises interesting arguments regarding the expensing and capitalizing of investments and the differing compliance requirements of GAAP and the Financial Accounting Standards Board. Joint Reply Brief of ANM, ALA and CRPA at 7-8; ANM Brief at 5-6. However, there is no way for the Commission to act on these arguments.

ANM has not identified any expenses that it believes should be capitalized or even suggested that certain investments be depreciated over longer periods. There simply is no evidence with regard to specific costs.

F. Miscellaneous Issues

[2147] *Updating Postal Service's Test Year Estimates for Known and Quantifiable Events.* When the Postal Service assembles its rate case, it estimates certain costs and inflation factors for the interim year and the test year. As almost a year passes between the time when it prepares its estimates and the Commission issues its opinion, more information becomes available. Often, estimates of inflation and employee compensation can be replaced by the actual amounts. For example, in its original filing the Postal Service estimated COLAs that it knew would be made to wages in August of 1997 and March 1998. The actual COLAs that have been used by the Postal Service to set wages are now known and could be used by the Commission to replace the Service's filing estimates. Tr. 35/18595. The Commission has substituted "actuals" such as these for estimates in past cases. *See* PRC Op. R94-1, para. 2026; PRC Op. R90-1, paras. 2007-12; PRC Op. R87-1, para. 2141; PRC Op. R84-1, paras.1188-90.

[2148] Witness Porras presents actual numbers for this case in his rebuttal testimony concerning 1997 results impacting the test year. Tr. 35/18581-86. Porras, as already discussed, argues *against* using his numbers. "In total, these changes have a relatively minor impact, and for that reason I would argue that there is no compelling reason to make the adjustments, particularly when the numerous problems associated with updating are considered." *Id.* at 18653. He cites concerns of fairness to the parties who spend months evaluating the Postal Service's estimates. *Id.* at 18576. The new numbers do not receive the same scrutiny as the original estimates, in Porras' view. *Ibid.* Finally, there is an increased possibility of error when estimates are updated. *Ibid.* at 18577.

[2149] In contrast to the Postal Service's concerns about updating with actual numbers, the participants appear to agree that recognizing actual events is appropriate. The OCA argues for acceptance of the known and certain items in witness Porras' testimony. "Most of the downward cost adjustments listed relate to specific adjustments in personnel costs required by law or by contract. Except for the error adjustment, the

adjustments relate to certain changes in various personnel or interest costs, all of which are tied directly or indirectly to the rate of inflation. The cost reductions are virtually certain to occur." OCA Brief (Second Section) at 30. OCA also accepts the validity of known and certain cost increases. "OCA does not object to certain upward adjustments to the revenue requirement proposed by the Postal Service." *Id.* at 32. DMA also supports updating estimates once they are known and certain, such as replacement of actual inflation rates for estimates. DMA Brief at 7. Moreover, the Postal Service does not appear adamantly opposed to this type of updating, as it did not attempt to rebut the suggestions made on brief that updating is proper.

[2150] The Commission will continue its established practice. In this case, lower COLAs in 1997 and 1998 than what were originally estimated will save the Postal Service $228.9 million in the test year. The Postal Service's rate of contribution to FERS is also lower than it originally anticipated, and this will yield costs lower by $102.3 million in the test year. Postal Service witness Porras provided all of these updated numbers for the test year. Tr. 35/18595..

Table 2-1
Test Year Known and Certain Revenue Requirement Changes

	(Millions)
COLA	(259.6)
Health Benefits	(24.8)
FERS	(102.4)
Transportation	(59.7)
Net Interest Expense	(86.9)
POD Workers Compensation	14.3
Depreciation Expense	15.0
All Other (Roll Forward Effects)	(7.0)
Total Revenue Requirement Change	(511.1)

[2151] The adjustment is shown in the following table. The figures in the table differs from witness Porras' estimates of known changes of test year accrued costs. This is because witness Porras includes a correction of a cost reduction program that was inadvertently omitted in the Postal Service's original filing. This correction, identified as a FY 97 volume variability adjustment, reduced the test year accrued costs by $55.3 million. Tr. 35/18595. The Commission has implemented his correction before including witness Porras' known and certain adjustments into the revenue requirement. The changes are detailed in Appendix D

[2152] *Flaw in Rollforward Model.* DMA witness Buc identifies what he describes as an "obvious flaw" in the cost reduction portion of the Postal Service's rollforward model. Tr. 28/15362-63. When clerks, mailhandlers and carriers' costs increase, the rollforward model typically increases supervisors' costs. This keeps the ratio between supervisor costs and the craft employees' costs constant. However, the Postal Service does not apply the same logic to its cost reduction programs, and does not reduce supervisors' costs when it projects a reduction in supervised craft employees. Witness Buc argues that for a consistent treatment of costs, the Postal Service should make the corresponding reduction in costs. The OCA also supports this adjustment. OCA Brief (Second Section) at 31. Buc calculates the proper reduction of supervision of mail processing costs as $31 million and the correct reduction of supervision of city delivery carrier costs as $20 million. *Id.* at 5.

[2153] The Postal Service opposes the adjustment. Witness Buc, "offered no evidence other than his opinion that supervisor costs were not considered by program managers when they calculated cost reduction savings and that they simply determined that no savings should be included." Postal Service Reply Brief at I-26. The Service points to Buc's statement that "'I do not know for a fact that Postal Service program managers did not consider adjustments in supervisor costs when they estimated the impact of cost reduction programs.'" *Id.* at I-26-I-27 (citing Tr. 28/15428). The Service claims Buc's opinion is "uninformed" and "speculation." *Id.* at 27. "The only fact [Buc]

has provided is that the supervisor ratio has changed. He has not, however, shown that this change is not valid." *Ibid.*

[2154] However, the Service never discusses why the supervisor ratio should change under cost reduction programs. *See* Postal Service Brief at 188; Postal Service Reply Brief at I-26-I-27. The Service offers no testimony bearing on the issue and just repeats the assertion that Buc incorrectly believes that program managers did not consider the effect on supervisors' costs. Postal Service Brief at 189; Postal Service Reply Brief at I-26. The Service seems to have no explanation for its failure to make a corresponding adjustment in supervisors' work hours when craft employees' work hours are reduced.

[2155] Buc's contention that supervisors' work hours and costs should go down when their managed employees' work hours and costs go down is both consistent with the technique the Postal Service has used in this case to project test year supervisor costs and essentially unrebutted. Consequently, the Commission has concluded that the it will make the adjustment suggested by witness Buc. In the absence of better record evidence, the Commission will assume a stable supervisor to craft employee ratio.

[2156] In correcting the Postal Service's oversight, witness Buc overlooked "other programs." These programs increase craft employee's work hours, and accordingly, the supervisors' work hours and costs for these programs should be increased. Witness Buc also only adjusted for the supervisors' work hours effect in 1998, but cost reduction and "other programs" in 1997 must be considered as well. *See* Tr. 28/15363.

[2157] The Commission calculates that mail processing costs decrease by $53 million and city carrier costs decrease by $46 million when all of the supervisors' cost decreases and increases are totaled. The total adjustment, a net decrease of approximately $100 million in test year costs includes the impact of cost reduction and "other programs" in 1997 and 1998.

III. COSTING

A. Mail Processing

[3001] *Introduction*. In all past proceedings the Postal Service has proposed, the parties have largely accepted and the Commission has relied upon an assumption that most mail processing costs are 100 percent volume-variable. Tr. 34/18217. As a consequence of this assumption, 95.6 percent of mail processing costs are attributable to the subclasses of mail and Special Services. *See* USPS LR-H-1 at 3.02. In this proceeding the Service proposes abandoning this assumption and, in its place, asks the Commission to base its estimates of the volume-variability of mail processing labor costs and other similar costs upon an econometric study performed for this purpose by Postal Service witness Bradley. *See* USPS-T-14. In general, witness Bradley's estimates indicate that approximately 76.4 percent of mail processing costs are volume-variable. *See* Exhibit USPS-14B at 2.

[3002] Adoption of witness Bradley's volume-variability estimates as proposed by the Service would reduce attributable costs and increase institutional costs during the base year by more than $3 billion, and by a comparable amount in the test year. This transfer occurs because a substantial component of the mail processing labor costs now treated as volume-variable would no longer be volume-variable. Such a large transfer between these cost pools is bound to influence the rates recommended by this Commission. Consequently, witness Bradley's econometric research and the changes in volume-variabilities resulting from it have been the subjects of a large share of the testimony heard by the Commission in this proceeding, including supporting testimony from MPA witness Higgins and highly critical testimony from UPS witness Neels and OCA witness Smith.

[3003] Postal Service rebuttal witness Christensen places the proposed change to the Commission's cost methodology in perspective as follows: "Since nearly a quarter of the Postal Service's Base Year 1996 costs are accrued in the mail processing component, it is highly desirable to use the best available technique to estimate marginal mail processing costs." Tr. 34/18217. Therefore, the Commission has reviewed all of this testimony with the greatest care.

[3004] Witness Bradley's testimony and workpapers describe clearly and in detail how he has combined elements of economic theory and econometric method to solve the practical problem of estimating elasticities to be applied within Postal Service witness Degen's proposed framework for calculating and attributing volume-variable mail processing costs. Witness Degen's methodology disaggregates mail processing costs into activity-specific cost pools to which are applied, first, witness Bradley's elasticities to obtain the components of the pools that are volume-variable, and, second, distribution keys for the activities to distribute the volume-variable components among the subclasses of mail and special services. This framework is described repeatedly in testimony by a number of Postal Service witnesses including Bradley (USPS-T-14 and USPS-RT-5), Degen (USPS-T-12, USPS-RT-6 and his response to P.O. Information Request No. 4), Christensen (USPS-RT-7) and Panzar (USPS-RT-13). The basic mathematics corresponds to calculations of volume-variability made in this and in previous dockets by the Commission. The Commission has accepted in principle witness Degen's general framework with some changes reflecting the suggestions of witnesses Stralberg and Cohen.

[3005] However, acceptance of the Service's activity-specific cost pools imposes no concurrent obligation to accept witness Bradley's elasticity estimates for them. The volume-variable components of these cost pools can be estimated with any values for elasticities the evidence supports, including elasticities of one in accordance with the established assumption that mail processing costs are 100 percent volume-variable. Postal Service witness Christensen's rebuttal testimony makes it clear that it is desirable from a theoretical standpoint that volume-variabilities and distribution keys match the

cost pools. Tr. 34/18221. However, witness Bradley's estimates are not the only estimates that match witness Degen's distribution keys and cost pools. Altogether in this proceeding several dozen sets of volume-variabilities have been estimated in ways that match witness Degen's cost pools.

[3006] The Commission has decided that it cannot rely upon a calculation of volume-variable mail processing costs that applies witness Bradley's elasticity estimates within witness Degen's framework. The established assumption that most mail processing costs are 100 percent volume-variable has not been proven to be incorrect by the evidence given by witness Bradley and others in this proceeding. Therefore, the Commission continues to regard most mail processing labor costs as approximately 100 percent volume-variable and has attributed these costs to the subclasses and special services accordingly.

[3007] The Commission finds four disqualifying defects in witness Bradley's estimates and their related application within witness Degen's framework. These are:

- Witness Bradley's elasticities are derived from a recommended model that limits the volume-variability of mail processing costs to those responses to volume changes that occur at most within a span of only eight weeks. If they are accepted by the Postal Service, the Commission's recommended rates may be expected to remain in effect until the conclusion of the next omnibus rate proceeding. In the past this span of time has been three to four years. Witness Bradley's models are specified such that they cannot measure responses of mail processing labor costs to changes in volume that take longer than eight weeks to occur. In his equations, processing time is related only to total piece handlings (TPHs) in the current accounting period and in the immediately preceding accounting period.

- Witness Bradley has been unable to overcome the problems he encounters using error-ridden samples extracted from two of the Postal Service's operating data systems (MODS and PIRS). Witness Bradley's "scrubs" of the MODS and PIRS data unacceptably affect his results because the scrubs are, at the same time, both excessive and ineffective. The scrubs are excessive because they remove

an extraordinary number of observations. Over 22 percent of the original usable observations are dropped. This massive deletion introduces selection biases that strongly affect his estimates. The scrubs are ineffective because they are not well-designed for their stated purpose, which is to remove erroneous and atypical observations. Erroneous observations for piece handlings left in the sample will tend to impart a downwards bias to the variabilities estimates.

- Witness Bradley's models must include control variables to capture important nonvolume effects. However, all of these control variables are treated as *not* volume-variable when he calculates his elasticities. Two of the control variables, the "manual ratio" and the "fixed effects" are actually volume-variable. The manual ratio is the ratio of manual to total piece handlings for sorting activities. It is volume-variable within the Bradley/Degen system virtually by definition. The fixed effects serve as proxies for average differences in the values of the regressors between facilities. These differences are due partly to facility size, floor space and equipment, all of which are likely to be volume-variable. Witness Bradley's volume variabilities omit the indirect effects of volume on mail processing labor costs transmitted through changes in the manual ratio and fixed effects.

- To apply witness Bradley's elasticities within witness Degen's framework obliges the Commission to accept a chain of new hypotheses regarding mail processing operations. Among the assumptions that are required by the Bradley/Degen system are that subclass piece handlings are proportional to subclass volumes, that average activity wage rates are invariant with respect to volume, that the number and size of processing facilities is not volume-variable, that elasticities computed at the sample mean apply to the base year and to the test year, that witness Bradley's elasticities can be liberally applied to a large number of other cost pools, and that the only differences between facilities that need to be modeled can be represented by fixed effects. While several of these new hypotheses may be acceptable, based on the evidence, most are unsupported except by conjecture, some appear to be incorrect, and one can be tested and rejected. The hypothesis that can be rejected is fundamental. The responses received from witnesses Neels, Higgins and Bradley to NOI No. 4 all show that

witness Bradley's fixed effects model is always statistically rejected in favor of a model that allows the slope coefficients to differ among mail processing facilities.

[3008] A variety of alternative econometric estimates of volume variability can be found in the testimony of witnesses Bradley, Neels and Higgins. These alternative estimates have been produced by making various major and minor changes in witness Bradley's recommended "fixed effects" model, in his data set, or in his method of estimation. These alternative estimates show variabilities of less than 100 percent when the differences in model specification are inconsequential. Others show volume-variabilities that are generally higher than those recommended by witness Bradley. Some show volume-variabilities that are typically above 100 percent.

[3009] The Commission finds that this evidence supports a finding that the defects in witness Bradley's research lead him to underestimate volume-variabilities for mail processing labor costs. When models are fit for data aggregated over longer periods of time, such as one year, or a cross-section, the volume-variabilities generally turn out to be substantially higher than witness Bradley's estimates. When witness Bradley's "fixed effects" model is refit to all of the usable data, including the 22 percent of the sample he removes by "scrubbing," the estimated volume-variabilities mostly go up by appreciable amounts. When one of the controls that witness Bradley incorrectly assumes are not volume variable, the fixed effects, is dropped from the model, the volume-variabilities all turn out to be approximately 100 percent. The failure of many of the assumptions required to place witness Bradley's variability estimates within witness Degen's framework would also lead to the conclusion that witness Bradley's estimates fail to represent all of the likely sources of volume-variability, particularly at the facility and system levels. The preponderance of the evidence presented in this proceeding supports the continued use of the established assumption that mail processing labor costs are 100 percent volume-variable.

1. Variability

a. Reasons for 100 Percent Volume-Variability

[3010] The Postal Service, on brief, characterizes as a "convenient assumption" the Commission's treatment of mail processing costs as 100 percent volume-variable, and other parties also seem to share the belief that 100 percent volume-variability is an assumption with no evidentiary support. *See* Periodicals Mailers Reply Brief at 6. This belief is a misconception. In Docket No. R71-1, the Commission considered empirical evidence, including a simple linear regression, of the relationship of clerk-mailhandler "manhours worked" to the "weighted volume of mail and special services." A plot of the data published in the volume of exhibits from that proceeding falls close to a line through the origin. The intercept of the linear regression was a small negative number, indicating that the volume-variability of mail processing manhours was greater than 100 percent. *See* Action of the Governors, U.S.P.S. in the Matter of Postal Rate and Fee Increases, 1971, Docket No. R71-1 at 4-121 to 4-129. Other information was cited in support of the finding that volume-variabilities exceeded 100 percent. "The Touche, Ross, Bailey, and Smart project uncovered numerous instances of increasing unit costs, in relating manhours to piece handlings at the operation level." PRC Op. R71-1 at 4-125. On the basis of the evidence presented in Docket No. R71-1 the Commission "classified" the costs of "mail processing and related activities" as "variable" and has regarded them as 100 percent volume-variable ever since. Up until June 1997, so did the Postal Service.

[3011] USPS LR-H-1 describes the Service's mail processing operations in terms that indicate volume-variabilities of 100 percent.

> *For Platform Operations* "changes in mail volume tend to cause proportional changes in the number of containers that must be handled. Accordingly, platform loading, unloading, and transfer costs are classified as variable."

> *For Collection and Preparation of Mail* "The time required to work individual pieces of mail depends on the number of pieces (i.e., mail volume) requiring work. Time spent on handling mail in bundles or containers – collecting mail, opening sacks or pouches, cutting bundles, or dumping hampers or containers of mail – is a function of the number of mail bundles or containers involved. The number handled is related to volume. Changes in the number of pieces that must be handled will change the number of bundles or containers handled. Therefore, the time spent on almost all labor activities related to collection and preparation varies with mail volume. The costs related to this time are classified as fully variable."
>
> *For Mail Processing and Distribution:* "The essential feature of mail processing is that each piece of mail, mail container, or unit of mail volume requires individual handling at each work center, regardless of the way in which the volume is spread among centers and over the time of day. Therefore, mail processing and distribution activities as a whole are considered fully variable with volume. Although the different volumes and shapes of mail handled cause individual work centers to operate with different productivity factors, each center necessarily makes a proportionate contribution to the overall flow of volume. Accordingly, mail processing and distribution costs are classified as fully variable."
>
> *For Activities Related to Mail Processing:* "Time for these activities tends to vary with the amount of mail processing time. The time required for moving empty equipment depends on the amount of equipment used, which is a function of all mail processing activities. Accordingly, the costs for break and clocking in and out time and for moving empty equipment, which are referred to as mail processing overhead, are classified as variable to the same degree as mail processing costs other than overhead."

See USPS LR-H-1 at 3-2 to 3-5.

[3012] Until it sponsored the testimony of witness Bradley in this proceeding, the Postal Service's view of its mail processing operations conformed to the opinion expressed by UPS witness Neels that "[c]ommon sense indicates that labor costs should be fully variable." Tr. 28/15591.

b. What the Econometric Evidence Shows

[3013] Econometrically regressing processing times on total piece handlings and a collection of controls without consideration of the underlying economic theory may yield a very inaccurate characterization of the true relationship of cost to volumes. On the other hand, specifying a cost model derived from economic theory without regard to the actual data it is attempting to explain is also likely to lead to inaccurate estimates of the true relationship. The Commission would prefer to rely upon a model that complies with economic theory, has been fit by accepted econometric methods *and* statistically explains all relevant data. Unfortunately, no such model for mail processing labor costs appears within the testimony of any witness in the current proceeding.

[3014] Table 1 *Comparison of Econometric Results* displays volume-variability estimates for six sorting activities at MODS facilities for 35 distinct variations of witness Bradley's recommended model. The sources for these alternative estimates of variabilities are the testimony of witness Bradley, UPS witness Neels and MPA witness Higgins. Witness Bradley's recommended model corresponds to the models designated B-1.1, B-2.6, N-1.1 and B-4.1. Witness Neels recommends that the Commission "stand by its traditional position and treat mail processing labor costs as 100 percent volume variable" but adds "[i]f the Commission does elect to adopt some version of Bradley's econometric analysis, I recommend adoption of his cross-sectional analysis as a starting point." This is shown as model N-1.3. *Ibid.* Witness Neels' low opinion of witness Bradley's research is shared by OCA witness Smith who, if forced to select a model, asserts that "the pooled regression approach is a better modeling of the data and that the data do not substantiate the fixed effects approach." Presumably, Smith would select one of the "pooled" regressions submitted by witness Bradley in response to P.O. Information Request No. 4. These are the models B-2.7 through B-2.12. Tr. 28/15841. Witness Higgins supports witness Bradley's selection of the fixed effects model but recommends one of his own models, the one designated H-1.2, "[s]hould the Commission not accept witness Bradley's estimates..." Tr. 29/16126. Several other

models may also be worth consideration, especially witness Bradley's model estimated on annual data, model B-1.4.

Table 3-1
Comparison of Econometric Results

Model ID		MODS Sort Activity					
		Manual Letters	Manual Flats	OCR	BCS	LSM	FSM
	Bradley Original Econometric Results [USPS-T-14]						
B-1.1	Fixed Effects Model for MODS Activities (Table 7)	79.7%	86.6%	78.6%	94.5%	90.5%	91.8%
B-1.2	From the Model Uncorrected for Serial Correlation (Table 13)	58.9%	62.4%	93.7%	100.6%	90.9%	99.7%
B-1.3	From Two-Way Panel Data Model (Table 14)	75.0%	73.1%	63.3%	83.0%	86.8%	79.7%
B-1.4	From the Model Estimated On Annual Data (Table 15)	73.2%	79.9%	97.5%	100.3%	94.7%	104.0%
B-1.5	From Estimating the Model on SPLY Data (Table 16)	52.3%	52.6%	75.9%	84.2%	88.7%	82.7%
	Bradley Response to POIR #4						
B-2.1	Fixed-Effects - TPH Alone - Uncorrected for Serial Correlation	62.9%	67.8%	88.9%	101.7%	80.3%	115.1%
B-2.2	Fixed-Effects - TPH and Lagged TPH - Uncorrected for Serial Correlation	61.9%	68.5%	90.6%	102.0%	80.2%	119.1%
B-2.3	Fixed-Effects - All Variables - Uncorrected for Serial Correlation (Also B1.2)	58.9%	62.4%	93.7%	100.6%	90.9%	99.7%
B-2.4	Fixed-Effects - TPH Alone - Corrected for Serial Correlation	74.4%	67.7%	56.3%	87.0%	84.6%	83.8%
B-2.5	Fixed-Effects - TPH and Lagged TPH - Corrected for Serial Correlation	75.7%	73.5%	72.0%	95.8%	85.8%	93.0%
B-2.6	Fixed-Effects - All Variables - Corrected for Serial Correlation (Also B-1.1)	79.7%	86.6%	78.6%	94.5%	90.5%	91.8%
B-2.7	Pooled - TPH Alone - Uncorrected for Serial Correlation	106.9%	110.4%	104.8%	106.5%	98.2%	102.9%
B-2.8	Pooled - TPH and Lagged TPH - Uncorrected for Serial Correlation	107.0%	110.6%	105.0%	106.8%	98.3%	103.1%
B-2.9	Pooled - All Variables - Uncorrected for Serial Correlation	107.9%	111.7%	109.3%	108.4%	104.8%	103.2%
B-2.10	Pooled - TPH Alone - Corrected for Serial Correlation	100.7%	101.4%	82.1%	98.0%	94.9%	97.3%
B-2.11	Pooled - TPH and Lagged TPH - Corrected for Serial Correlation	104.3%	106.3%	93.6%	102.9%	97.0%	100.3%
B-2.12	Pooled - All Variables - Corrected for Serial Correlation	106.3%	110.4%	102.6%	105.5%	103.0%	102.3%
	Neels Estimated Volume Variability Estimates [UPS-T-1]						
N-1.1	"Scrubbed" Data (Table 5, Same as Bradley Table 7)	80.0%	87.0%	79.0%	95.0%	91.0%	92.0%
N-1.2	All Usable Observations (Table 5)	84.0%	90.0%	83.0%	106.0%	97.0%	102.0%
N-1.3	Bradley's "Between" Model (Table 6)	106.0%	110.0%	111.0%	113.0%	105.0%	103.0%
N-1.4	Modified Version of Bradley's Cross Sectional (Table 1)	125.0%	131.0%	121.0%	132.0%	121.0%	116.0%
N-1.5	Bradley's Errors-in-Variables Methodology (Table A-1)	58.8%	69.7%	97.1%	100.4%	82.6%	113.6%
	Higgins Alternative Variability Estimates [MPA-NOI-1]						
H-1.1	Unweighted Mean Variability (Table 3)	51.1%	56.2%	67.0%	84.5%	80.5%	73.3%
H-1.2	Weighted Mean Variability (Table 3)	46.2%	49.1%	73.6%	79.5%	80.9%	73.3%
	Neels Response to NOI #4 [UPS-ST-1]						
N-2.1	Range of Facility-Specific Volume Variability Percentages (Table 2)	102.8%	81.0%	82.1%	91.7%	93.1%	93.1%
	Bradley Statement on NOI #4						
B-3.1	Site by Site (Table 2)	52.4%	52.3%	70.7%		83.2%	
B-3.2	Fixed Effects (Table 2)	72.8%	76.3%	76.8%		91.3%	
B-3.3	Pooled (Table 2)	103.0%	107.1%	97.8%		102.4%	
	Bradley Rebuttal Testimony [USPS-RT-5]						
B-4.1	39 Accounting Period Scrub (Table 1, Same as Bradley Table 7)	79.7%	86.6%	78.6%	94.5%	90.5%	91.8%
B-4.2	26 Accounting Period Scrub (Table 1)	79.7%	89.0%	79.9%	94.4%	90.5%	91.9%
B-4.3	Fixed Effects Beta (Table 3)	62.7%	69.7%				
B-4.4	13 Period Difference Beta (Table 3)	52.2%	64.1%				
	Bradley Rebuttal Testimony [USPS-RT-5]	**Mail Processing Labor**					
B-4.6	From a Cross-Sectional Analysis - No Capital Variables (Table 4)		120.0%				
B-4.7	From a Cross-Sectional Analysis - Adding Sq. Ft. and Age (Table 4)		74.3%				
B-4.8	From a Cross-Sectional Analysis - Add Sq. Ft., Age and Floors (Table 4)		76.1%				

[3015] Witnesses Neels and Smith prefer the “cross-sectional” and “pooled” models because they believe that these models will suffer less from the defects in model formulation that they find in witness Bradley’s recommended model and suffer less from the difficulties witness Bradley encounters with a problematic data set. According to witness Neels, the cross-sectional model “is better able to provide estimates of long-run volume variability, and it is less subject to downward bias from errors in the measurement of volume.” Witness Neels refits the cross-sectional model to all of the data, including the observations that witness Bradley deletes with his several scrubs of the data set. Tr. 28/15591-92. These models usually exhibit volume variabilities that are well above 100 percent.

[3016] Witness Smith’s preference for the “pooled” models derives from his belief that each fixed effect in witness Bradley’s model “relates to a short-run, ‘monthly’ facility specific cost relationship.” *Id.* at 15840. He believes that one of the “pooled” models will better represent the “expansion path reflecting expansion or contraction of the scale of the facility in the foreseeable future....” *Id.* at 15841. He further states: “I conclude that a pooled regression approach is more consistent with the underlying form of the data and the longer-run time period over which the rates will be in effect.” *Id.* at 15823. The pooled models all exhibit volume variabilities that are close to 100 percent for most activities.

[3017] Witness Bradley’s defense of his recommended model rests primarily on formal statistical tests showing that the pooled model and a random effects model may be rejected in favor of his fixed effects model. Witness Higgins continues the model development and testing along these lines to show that “the data do not support the contention that the volume variability of mail processing labor in any of the cost pools is precisely the same at all facilities....” Thus witness Higgins’ tests lead him to reject all of the models in Table 1 except his own. Tr. 29/16124-25. The variabilities witness Higgins derives from his estimates are somewhat lower than those from witness Bradley’s recommended model. Witnesses Bradley and Neels do similar tests and reach similar conclusions. *See* USPS-ST-55 and UPS-ST-1.

[3018] In the Commission's view all of the estimates of mail processing variability in Table 1 are derived from models with disqualifying defects. The models proposed by witnesses Bradley and Higgins are capable of describing variability in processing costs only over the short period of eight weeks. At the other extreme, witness Neels' cross-sectional models N-1.3 and N-1.4 are also inappropriate but for the opposite reason. The cross-section sample combines observations taken over periods of eight or nine years and, presumably, reflect volume effects that may take as long to occur. Strictly speaking, these models are still short run rather than long run because even over this period of time there are capital inputs to postal processing operations that cannot be considered to be fully variable.

[3019] The appropriate horizon for the Commission's work should reflect the period of time that the Commission's recommended rates would remain in effect if accepted by the Postal Service Board of Governors. But none of the parties has taken the trouble to fit equations specifically to represent volume-variability over this span of time. An inspection of the volume variabilities in Table 1 indicates that they increase with the length of time spanned. The lowest variabilities correspond to witness Bradley and Higgins' eight-week models. The highest variabilities are exhibited by witness Neel's nine-year cross-sectional model. A model fit to annual data, B-1.4, has variabilities close to 100 percent for mechanized and automated sorting but much lower variabilities for manual sorting. All of these results suggest that a three-year model would exhibit somewhat higher variabilities than the model fit to annual data.

[3020] A comparison of the variabilities from the pooled and the fixed effects models produces a similar conclusion with respect to the fixed effects. Witness Bradley's fixed effects reflect differences between the capital, capacity and size of processing facilities that are volume-variable at the system level over a span of three to four years. The variabilities for models B-4.6, B-4.7 an B-4.8, derived from witness Bradley's rebuttal testimony, show that the fixed effects are associated with square feet, age and number of floors at the facilities. Of these, only age is nonvolume variable. Consequently, his fixed effects cannot be regarded as nonvolume variable controls.

[3021] The pooled models are identical to the fixed effects models except that the fixed effects dummies have been dropped and the models have a common intercept for all facilities. Most of the volume variabilities for the pooled models are around 100 percent. Dropping the fixed effects draws the volume variabilities toward the value assumed by the Commission. But dropping the fixed effects leaves the pooled models without a set of controls to capture effectively the nonvolume variable differences, such as age between the processing facilities. Such differences are bound to exist for all of the reasons given by witness Bradley in his testimony. *See* USPS-T-14 at 39-40. Without effective controls for facility-specific differences, the pooled models are inferior as explanations of the information in the sample. The Commission suspects that if the fixed effects were replaced by a non-volume variable set of controls, the estimated variabilities would approach 100 percent, as with the pooled models.

[3022] The cross section models favored by witness Neels also omit any controls for site-specific effects. So they suffer from the same defects as the pooled models in this respect.

[3023] The variability estimates from the testimony of witness Neels and the rebuttal testimony of witness Bradley provide the Commission with some limited insight into the effects of witness Bradley's scrubbing practices. The only difference between the models labeled N-1.1 and N-1.2 is that the first was fit to witness Bradley's scrubbed sample, while the second was fit to "all usable observations" by witness Neels. This is also the only difference between models N-1.3 and N-1.4. One of the purposes of witness Bradley's scrubs is to remove data with bad or atypical observations for piece handlings. When such observations are removed, the tendency should be to reduce an attenuation (errors-in-variables) bias in the variabilities estimates. Although, when more than one variable is involved, as is the case here, it is not always possible to determine the direction of the bias *a priori*. Nevertheless, witness Bradley's variability estimates (models N-1.1 and N-1.3 fit to the scrubbed sample) should exhibit a general tendency to be higher than witness Neels' comparable variabilities (models N-1.2 and N-1.4 fit to all usable observations). But it is the exact opposite that has actually occurred. Estimates

from the scrubbed sample are uniformly lower than those from the unscrubbed sample. In fact, scrubbing the sample typically reduces the estimated variabilities by 10 to 15 percent. From this the Commission concludes that witness Bradley's scrubs are the source of a selection bias that depresses his estimates of volume variability.

[3024] The piece handling data for manual activities is more likely to contain erroneous observations than the data for mechanized and automated activities because they are derived from weights and container counts using conversion factors. Witness Bradley is aware of the problem. "In the mail processing analysis, measurement error is of particular concern for the manual letter and flat operations, in which the mail is weighed to produce volume counts." USPS-T-14 at 83. However, his scrubs of the data set do not identify and remove observations with this error. In his direct testimony he fits two models with simple specifications and uses the estimates to derive "errors-in-variables" coefficients for piece handlings that will suggest the amount of attenuation in his estimates. His conclusion is "that measurement error in manual letter and flat piece handlings volumes is not a critical problem for the ... elasticities for those activities." *Id.* at 83-84 (footnote omitted). However, witness Bradley's analysis is flawed and cannot be relied upon by the Commission. For several activities witness Bradley's analysis implies that the measurement error variance of piece handlings is negative, a mathematically impossible result. *See* UPS-T-1 Appendix A.

[3025] A desirable property of econometric estimates used by the Commission is that they be stable over the sample and robust with respect to the model specification. "Stable over the sample" means that reasonable partitions of the sample (i.e., large versus small facilities, new versus old, urban versus rural, recent versus earlier observations, etc.) do not yield statistically significant differences in the estimates. "Robust" means that minor and plausible modifications to the model do not cause major changes in the results relied upon by the Commission. To ascertain if a recommended model is stable over the sample, the model is refit for reasonable partitions and the appropriate tests, such as the Chow test, are applied. For robustness, the obvious check is to examine the estimates within the context provided by estimates of models

incorporating the kind of minor and plausible changes that should not cause major changes in results. The variability estimates in Table 1 do not provide an adequate basis for a judgment that the estimates derived from any of the models are stable and robust.

[3026] Witness Bradley was remarkably incurious about the stability and robustness of the estimates for his recommended model. From DMA/USPS-T14-52: "Did you experiment with inclusion of a time-trend interaction terms in your allied activities regressions?" Response: "No." From DMA/USPS-T14-53: "(D)id you experiment with any specifications that omitted lagged piece handlings, the manual ratio or both?" Response: "No." From DMA/USPS-T14-54: "Did you experiment with any specifications that used a functional form other than the translog?" Response: "No." "Did you run any mail processing labor cost (i.e., work hours) variability regressions using aggregate time series data on hours and piece handlings rather than the panel data…?" Response: "With the exception of the Registry activity, I did not." Tr. 11/5314-15. "Did you experiment with additional lag terms (either higher-order lags in TPH or lags in MANR)…? Response: "... I did not try longer lags." *Id.* at 5275. Referring to the segmented autonomous trend in the models, "Have you performed any sensitivity analyses to test whether any of your results are sensitive to the presence, or the precise location, of the breakpoint?" Response: "... I did not pursue any sensitivity analyses of alternative breaks." *Id.* at 5277-78. "Was an attempt made to complete the analysis without the continuity, outlier, and allied scrubs, in order to determine the impact of deleting such data?" Response: "Once I became aware of potential reporting issues associated with the MODS data, I decided that we should scrub the data. Following that decision, I worked only with the scrubbed data." *Id.* at 5384. "Please confirm that … the true model, if not yours, could reveal volume variabilities to be higher, even approaching 100% volume variability." Response: "I confirm that the 'true' model, if not mine, could produce either higher or lower variabilities." *Id.* at 5411-12.

[3027] When Chairman Gleiman asked witness Neels "are any of the econometric results shown in the table robust and stable?" (The table viewed by witness Neels included all of the results shown in Table 3-1, *supra*; except those from N-2.1 down.) He

responded, “Not in my opinion.” Tr. 28/15786. This is also the finding of the Commission, at least to the extent that the rather meager collection of results offered in evidence in this proceeding will support any finding at all. Assumed volume variability estimates of 100 percent seem to be entirely within the range of estimates that might result from minor and plausible modifications to witness Bradley’s model. None of the results shown in Table 1 involve partitions of the sample based on (for example) size, age or location of the facilities, so it is impossible to make any judgment on the stability of any results over any subsample.

[3028] Choosing among the volume variability estimates shown in Table 1 does not appear to the Commission to be materially different from assuming a value within the bounds that these estimates suggest. Volume variabilities of 100 percent are well within the bounds of estimates that the Commission might choose if it could select a model and estimates that correctly reflected (1) the number of years spanned by the time period that the Commission’s recommended rates would be in effect, (2) controls that the Commission would regard as nonvolume variable over this time period, (3) a data set comparatively free of errors in measurement in total piece handlings, and, (4) a data set without selection biases introduced by excessive scrubbing.

c. Commission Findings on Witness Bradley’s Variabilities

[3029] Witness Bradley plainly believes that his econometric estimates prove that the assumption that mail processing labor cost are 100 percent volume-variable is wrong: “The most general result that I find is that the estimated variabilities are less than one. I find very little support for the Postal Service’s old assumption of proportionality between costs and volume.” USPS-T-14 at 55. Witness Bradley appears to reach this conclusion by performing a simple statistical test on the estimated first-order coefficients for total piece handlings. All of witness Bradley’s models employ translog functions and are fit to mean-centered data. As he says “[i]n a mean-centered equation, the effect of

any explanatory variable on the dependent variable is captured by the first order term for that explanatory variable." *Id.* at 52.

[3030] When one applies a simple t-test using witness Bradley's preferred models, the null hypothesis, that the first-order coefficient for piece-handlings is equal to one, usually can be rejected with a high degree of confidence. One way to apply the test is by computing confidence intervals as described by witness Bradley in a footnote. "The precision of estimation can be expressed by the size of the confidence interval for the estimated coefficient. The smaller the standard error, the more precise the estimate. For example, the coefficient on piece handlings in the manual letters equation is 0.772 with a standard error of 0.00653. This provides a 99 percent confidence interval of 0.755 to 0.788." *Id.* at 55. The null hypothesis fails because the value of one is not covered by the confidence interval.

[3031]Unfortunately, this test is not quite right for the null hypothesis that volume-variability is equal to one. The coefficient for lagged piece-handlings is also included in witness Bradley's elasticity estimates "[b]ecause the Postal Service measure of volume variability is the response in cost to a sustained increase in volume...." *Ibid.* A correct test is a t-test of a linear hypothesis of the kind described by Judge *et al.* in *The Theory and Practice of Econometrics*, 2nd ed. at 22-24. The Commission cannot find any place in the testimony, workpapers or library references of witness Bradley where this test or any other correct statistical test is actually performed, or even described, for the sum of the coefficients for lagged and unlagged piece-handlings. Even more coefficients would be involved in the linear hypothesis if volume elasticities were estimated at values of the regressors different from the sample means or if the linear model included piece-handlings lagged more than a single accounting period. In fact, the confidence interval test used by witness Bradley demonstrates only that processing time in a single accounting period is less than 100 percent volume-variable with respect to changes in volume during the same accounting period. Since postal accounting periods are only four weeks long, this result is not too surprising.

[3032] Even if witness Bradley had provided formally correct tests, the Commission might have had difficulty relying upon them. The validity of classical statistical tests performed on linear regression coefficients depends upon several conditions. These are that the linear model has been correctly specified, that an appropriate econometric method has been applied to estimate the coefficients, that the data used to make the fit are a representative sample of the population, and that the explanatory variables have been observed without error.

[3033] In practice econometricians apply the classical statistical tests even when models, methods and samples only approximately satisfy these assumptions. Likewise, the Commission would be willing to accept and to rely upon the tests if witness Bradley's testimony satisfied common and accepted standards for econometric practice. However, it is the Commission's opinion that it does not.

d. Overall Opinion of Witness Bradley's Model, Data and Econometrics

[3034] A complete analysis of the testimony relating to witness Bradley's mail processing models is given in a technical Appendix. This section summarizes the defects that the Commission regards as disqualifying.

(1) Eight-Week Time Span is Too Short to Capture Effects That Are Volume-Variable Over the Time Span of a Postal Rate Cycle

[3035] The Commission's understanding of the time period that is appropriate for volume-variable cost analyses is that the volume-variability of costs should reflect the length of time that the Commission's recommended rates would be expected to be in effect. This position is consistent with the testimony of Postal Service witnesses Baumol and Panzar in Docket Nos. R87-1 and R90-1. *See* Response of witness Bradley to POIR No. 4, Question 1. The Commission was advised to adopt the position that marginal costs should be "actual" marginal costs as they arise over the span of time in which a set of rates are in force. This span of time is the length of a rate cycle, which

historically has been approximately three years. Witness Bradley is correct when he asserts that this position corresponds to the economic definition of “short run” rather than “long run” cost. The usual economic definition of long run costs is that they are the costs that arise when all inputs are variable. If some inputs are variable, but others are not, then costs are short run. However, there are many flavors of short run depending upon what inputs can be varied over the length of time considered. Witness Bradley’s operational definition given in his response to P.O. Information Request No. 4 is consistent with the Commission’s view of the correct time period for postal cost studies. “One should attempt to base prices on the marginal costs that will actually be incurred by the firm to serve a sustained increase in volume over the time period during which the prices will be in effect.” Tr. 11/5417-18.

[3036] However, witness Bradley is simply wrong when he claims that “(t)hose are the costs measured by my econometric analysis.” Tr. 33/17904. Both OCA witness Smith and UPS witness Neels have pointed in testimony to the features of witness Bradley’s recommended “fixed-effects” model and his data that make it improbable that his elasticity estimates measure marginal costs beyond a short period of time.

[3037] First, witness Smith: “[t]he data span at least 39 time periods; however, most of witness Bradley’s comments and analyses suggest that he is looking at essentially ‘monthly’ or, more precisely, four-week periods.” Tr. 28/15835-36 (footnote omitted). Witness Smith describes witness Bradley’s estimated equations as “monthly facility specific cost relationships,” and concludes that “the appropriate mail processing cost to measure as volumes increase or decrease is the longer-run cost — which witness Bradley has not measured.” Witness Smith specifies the “longer-run” as “approximately a year”. *Id.* at 15824 and 15836.

[3038] Witness Neels sees the same problems: “[t]hose models relate mail processing labor hours in a four-week accounting period to the number of piece handlings in that same period and in the previous period. Because these models look back only a single accounting period, they are not capable of detecting or accounting for changes that take place over longer periods of time.” Tr. 28/15625. Witness Neels

states that the Commission is required to attribute costs that are variable "over periods longer than a year. The eight week adjustment period provided for in Bradley's fixed effects models falls well short of this threshold." *Id.* at 15626 (footnote omitted). The Commission agrees with this appraisal of witness Bradley's model. The elasticities he derives from them are not estimates of volume-variability for the period of time the recommended rates would be in effect.

[3039] Witness Bradley's model lacks a firm basis in economic theory. He characterizes his equations as "cost equations" rather than "cost functions." The only explicit assumption he makes is that the Postal Service follows a stable operating plan as described by Postal Service witness Panzar. *See* USPS-T-11 at 2-4. If the operating plan determines input choices for processing all the mail volume received during a postal rate cycle, then input and volume data on an accounting period basis will yield a relationship between mail volume and costs that is inconsistent with the operating plan. To make this example concrete, suppose for simplicity that the Postal Service's operating plan is to choose all inputs to minimize the total costs of processing all the mail volume within a given rate cycle. Estimating the cost/volume relationship using data on an accounting period basis will yield a relationship between costs and volume that is not reflective of the Postal Service's operating plan because input choices that minimize the total cost of producing all of the mail volume for a rate cycle will not, in general, lead to accounting period-level input choices that minimize the total costs of processing all of the mail received within that accounting period. Rate cycle pricing leads to more excess capacity to cover peaks over the cycle and to lower volume variabilities over accounting periods.

(2) The MODS and PIRS Samples Are Dirty but Witness Bradley's Scrubs Are Excessive and Ineffective

[3040] A data sample that is used to fit an econometric model should have the following qualities. These are, first, that the data set needs to include measurements of all of the important variables that are nominated for the model by economic theory, and,

second, that the measurements of the variables to be used as explanatory terms in the estimated model must be error-free. The consequences that follow from using a sample notably lacking one or the other of these qualities can be severe. When fit to the sample, the model's estimated coefficients may be biased and inconsistent. Tr. 11/5391 and USPS-T-14 at 80. "Biased" means that the estimated coefficients are expected to be different from those of the true relationship. "Inconsistent" means, roughly, that one can not eliminate the bias even by making the sample very large. Econometricians do not have very effective tools for identifying and correcting biases and inconsistencies caused by either "omitted variables" or "errors-in-variables" unless the true error process is known, which is rarely the case.

[3041] For processing activities at Management Operating Data System (MODS) facilities, witness Bradley uses operational data extracted from the Postal Service's MODS data base from 1988 through 1996. For Bulk Mail Centers (BMCs), he uses similar data from the Productivity Information Reporting System (PIRS). Neither of these systems was designed to yield data samples that meet econometric standards. Not surprisingly, neither does. Tr. 11/5284. Econometricians are accustomed to using data as they find it; however, the MODS and PIRS data are far below the common standard.

[3042] The MODS and PIRS data sets do not include all of the variables nominated by the relevant economic theory. These systems report only piece handlings and processing times by activity, facility and accounting period. Consequently, each observation in witness Bradley's samples is limited to the identity of the activity, the four-week accounting period, the identity of the MODS facility or BMC making the report, total piece handlings (or first piece handlings, if witness Bradley had chosen to use them), and work hours. This data set plainly does not include all of the variables suggested by the underlying economic theory of production and cost. Notably missing are wage rates and, since the cost functions are short-run, information about the factors that are fixed in the short run.

[3043] Witnesses Smith and Neels are both highly critical of witness Bradley for failing to follow the relevant economic theory when specifying the equations he fits to the

MODS and PIRS data. Tr. 28/15825-31 and 15994-600. Witness Bradley's data set might have been augmented with information from other sources that could be matched to the MODS and PIRS observations by facility or by accounting period. However, witness Bradley made no attempt to do this until he prepared his rebuttal testimony. When asked by the DMA to "describe all characteristics and information that the Postal Service considered essential when deciding on a data set to calculate the volume variability of mail processing labor costs...," witness Bradley replies, "I would say that the essential characteristics were having data available on hours and piece handlings (the cost driver), and having sufficient data to permit econometric estimation of the variabilities". Tr. 11/5302, 304. In the Commission's opinion witness Bradley's data sets do not include a sufficient set of explanatory variables to properly specify cost functions or, more precisely, functions describing the Postal Service's derived demand for mail processing labor time.

[3044] The MODS and PIRS data are apparently quite dirty in ways that may seriously affect witness Bradley's elasticity estimates. If there is measurement error in piece handlings, the estimates will tend to *understate* the true volume variability of mail processing costs. Tr. 28/15604-605. Witness Bradley's own estimates of variabilities for purchased transportation illustrate this effect. When just a "small number of unusual observations" are eliminated, all of the volume variabilities increase, sometimes substantially. *Id.* at 15706. Witness Neels points out that "the U.S. Postal Inspection Service found large variances between the piece handling figures contained in the MODS system and actual piece counts." The piece-handling statistics for manual activities are particularly suspect because these statistics are estimates that depend upon "inadequate conversion factors" to derive piece counts from numbers of trays and sacks or pounds of mail. *Id.* at 15601 (footnotes omitted). There is also internal evidence that the data are dirty. Upon examining the data witness Bradley discovered many observations that implied physically impossible levels of productivity. Witness Neels examination found even more likely errors. "There are, for example, hundreds of instances in which a site reports piece handlings for a specific activity for only a single

period out of the nine years covered by Bradley's dataset." And, "(t)here are also numerous reporting gaps in Bradley's datasets." "Often an activity will 'disappear' at a site for a single accounting period or for a number of accounting periods, only to reappear at a later date." *Id.* at 15602-603.

[3045] Witness Bradley attempts to eliminate erroneous and unrepresentative observations in the MODS and PIRS data by "scrubbing." His scrubbing eliminates (1) "ramping up," all of the observations for an activity at a facility that fall below a threshold level, (2) unusual productivities, all of the observations in the one percent tails of the distribution of productivities for the activity, and (3) nonsequential observations, all observations that are not part of a continuous sequence of at least 39 (or 26) observations for the activity at the facility, and all those not part of the most recent continuous sequence. The amount of data that is removed is extraordinary. *Id.* at 15611. More than 22 percent of the original sample is discarded! This scrubbing has been severely criticized by UPS witness Neels who points out to the Commission, first, that most of the scrubbing cannot be justified as an attempt to remove erroneous observations; second, that removing even erroneous data from a sample without investigating for cause is not representative of the best econometric practice; third, that ramping up, running at levels below capacities and occasionally shutting down an activity are perfectly normal and common aspects of mail processing; and fourth, that deleting so much data materially affects the estimates. *Id.* at 15609-619.

[3046] The Commission views witness Bradley's scrubbing as ineffective. Therefore, his elasticities are derived from estimates of the first-order coefficients for total piece handlings that include an unknown errors-in-variables bias. The Commission views witness Bradley's scrubbing as excessive. His estimates of mail processing costs are analogous to estimates of the cost of air transportation fit to data omitting takeoffs and landings. It is evident from comparisons of estimates derived from scrubbed and unscrubbed samples that his scrubbing introduces a substantial selection bias that tends to depress his volume-variabilities.

(3) Witness Bradley's Controls Are Inadequate and Volume-Variable Contrary to His Assumptions

[3047] In general, the MODS and PIRS data do not include enough information to permit witness Bradley to specify cost equations with proper controls for nonvolume effects. This has been pointed out most clearly in the testimony of OCA witness Smith. *Id.* at 15850-52. The controls that are needed are variables that explain costs in ways that are statistically effective and accord with economic theory, but are not themselves volume-variable over the time spanned by the cost equations. When such a set of controls are present in the equation, volume effects will be correctly separated from nonvolume effects when the equations are fit to the data. Then, the volume elasticity can be extracted from the estimates under the assumption that the controls are fixed, as witness Bradley does when he fits his equations to mean-centered observations and then adds the first-order coefficients for piece handlings and lagged piece handlings.

[3048] The controls that commonly appear in witness Bradley's cost equations are (1) for MODS direct activities a set of 12 seasonal dummy variables for the accounting periods, and for MODS allied and BMC activities, Christmas and summer seasonal dummies, (2) separate time trends for the periods 1988-92 and 1993-96, (3) for MODS direct and BMC activities, the "manual ratio" which is defined as the ratio of manual letter (or flats) piece handlings to the sum of manual, mechanized and automated letter (or flats) piece handlings, and (4) facility-specific "fixed effects," meaning that the cost equation is fit with a different intercept for each facility.

[3049] The first difficulty with this set of controls is that witness Bradley has made no real effort to specify models that correspond to the cost functions of economic theory. The models omit variables to represent wages by accounting period, facility or activity. Wage data at any of these levels is absent from witness Bradley's sample. Any economic model of the relationship of cost to volume will include wage rates and other factor prices as variables. Even witness Panzar's formalism, in which costs are determined by nothing more concrete than the Postal Service's "operating plan," relates the operating plan and processing costs to wages. *See* USPS-T-11 at 14-16. The

operating plan is assumed to be stable with respect to changes in volume, wages, postal rates, and the economic environment generally. UPS witness Neels points out several specific ways that changes in average wage rates and processing volumes are related under the assumption that the negotiated wage schedule is fixed. Tr. 28/15594-97. It also appears to the Commission that as postal employees are hired and released in response to changes in volume, the average wage level and processing costs will be affected whenever the hired and released employees work for wages that differ from the average.

[3050] The second difficulty is that witness Bradley's cost equations also fail to include measures of capital as noted by witness Smith. *Id.* at 15828-29. Measures of capital are appropriate in a short term cost equation if capital is not completely volume-variable over the time span of the equation. Witness Bradley's eight-week time spans do not allow much time for volume-induced changes in processing equipment or facility space to be reflected in processing costs. Therefore, witness Bradley's data should have included measures of processing capital at the facilities as controls. A limited amount of capital data was available at the facility level, but witness Bradley failed to exploit it until his rebuttal testimony. Tr. 33/17908-913. Typically, witness Bradley's models rely entirely upon the manual ratio and fixed effects to control for all differences across facilities. If such differences change over time in the sample, these changes cannot be represented by the fixed effects.

[3051] The third difficulty is related to the second. Witness Bradley's controls are all dummies and trends. That is, none of them are direct and unambiguous measurements of a hypothesized influence on mail processing labor. Instead, they are proxies that are expected to represent influences such as technological change, local conditions and capital investment that have not been measured and are not included as variables in witness Bradley's data sets. The difficulty with dummies and trends used in this manner is that it is often impossible to reconcile the estimated coefficient for the proxy variable with any of the influences the proxy is supposed to represent. This problem arises whenever the parties try to make sense of the estimated coefficients for

witness Bradley's controls. For example, witness Neels derives the segmented trends indicated by witness Bradley's estimates and finds that they do not fit any reasonable pattern of technological change. Tr. 28/15620-25. The Commission believes that similar problems would arise with witness Bradley's estimates of the fixed effects. These coefficients are unlikely to exhibit patterns of values that correspond sensibly to the hypotheses offered to explain them. Witness Bradley refused to supply estimates of the fixed effects for his recommended model in response to an information request from the Commission's Presiding Officer. Tr. 19E/9671-9755.

[3052] The last and most serious difficulty with witness Bradley's set of controls is that the two that are the most important are likely to be volume-variable. These are the "manual ratio" and the "fixed effects". UPS witness Neels has given testimony that both are volume-variable. Tr. 28/15795-97. The manual ratio is calculated from piece handlings. *See* USPS-T-14 at 16-17. It can be expected to change with volume as capacity limits are reached on a facility's automated and mechanized equipment. It would also change if the qualitative aspects of the mailstream making it suitable for mechanized and automated processing change with volume, or if facilities tend to become more automated and mechanized as the size of the mailstream they process increases. Given witness Degen's distribution keys, the manual ratio will change if the mix of mail by subclass changes.

[3053] UPS witness Neels has stated that the fixed effects coefficients and volumes may be related because of size: "If you have large and systematic differences between facilities in size such that the variation over time in volumes for a facility is small in relation to the level, it wouldn't surprise me if much of the level effect went into the fixed effects coefficient." Tr. 28/15796. And, "(i)f a relationship can be established between volume and the fixed effects coefficients, then I think that indirect effect should also be incorporated into the overall relationship between volume and cost." *Ibid.* Also, the testimony of OCA witness Smith includes a demonstration of how the expansion path of a firm may take the firm through a succession of short run cost functions with different fixed effects. A series of crude plots of witness Bradley's data often suggest, but do not

prove, that postal mail processing facilities have such expansion paths. *Id.* at 15842-49 and 15878-96.

[3054] Witness Bradley's own testimony shows that he has incorrectly assumed that none of his controls are volume-variable. "The seasonal *dummies do not include volumetric effects*." Tr. 11/5336 (emphasis added). "If a trend term was not included, the estimation of the volume variability would be confounded with the effects of the *autonomous* trend." *Id.* at 5337 (emphasis added). "Because the manual ratio is the percentage of volume sorted manually, *it is not affected by volume*, but by the way that the volume is sorted." *Id.* at 5575 (emphasis added). "(T)he fixed effects method includes a set of site-specific dummy variables that are used to control *for non-volume site-specific effects*." *Id.* at 5316-17 (emphasis added). Consequently, witness Bradley's volume elasticities do not include any part of the volume-variable effects on processing cost that enter indirectly through the volume variability of the manual ratio and the fixed effects.

(4) The Bradley-Degen Framework Has Untested Assumptions, Some of Which May Be Wrong

[3055] Finally, the Commission finds that using witness Bradley's elasticities to estimate the volume-variable mail processing costs that are attributed as described by Postal Service witnesses Degen and others would require acceptance of a chain of assumptions that are mostly untested, and in several cases are probably wrong. One of these assumptions can be tested statistically and rejected. The Commission's rejection of witness Bradley's elasticities for other reasons makes moot a finding on the specific issues raised by the Postal Service's use of these assumptions. However, the Commission believes that a finding in favor of the positions taken by Postal Service witnesses in every instance would have been unlikely given the evidence that was presented in this Proceeding. The assumptions are:

- Total piece handlings for a mail processing activity, the cost "driver" for the activity's labor costs, are proportional to subclass volumes as they are applied within witness Degen's framework. This assumes, among other things, that the proportions are not themselves volume variable and that they do not change for other reasons at least between the base year and the test year. The mathematical role played by this assumption of proportionality is described at length by witness Degen in his Response to P.O. Information Request No. 4. Tr. 12/6598-604. The assumption also allows witness Bradley to use piece handlings as a proxy for volumes in his equations. The Commission provisionally accepts this assumption as a reasonable approximation but believes that the Postal Service has not yet provided sufficient evidence to conclusively support it.

- The proportion of TPH contributed by each subclass to the volume-variable component of witness Degen's cost pools can be derived from the proportion of In-Office Cost System (IOCS) tally dollars for the subclass. In prior proceedings IOCS tallies were used to derive distribution keys for only four broadly defined mail processing functions: "outgoing," "incoming," "transit" and "other." See USPS-T-12 at 4. For R97-1 the number of functions has increased by an order of magnitude due to the use of the MODS and PIRS cost pools. See USPS-T-12 Table 5 at 17-23. So the new assumption entailed by witness Degen's use of IOCS tallies is that these tallies continue to serve adequately as proxies for determining the subclass distribution proportions when costs are much more finely divided.

- Average postal wage rates do not change in response to sustained changes in postal volumes. Witness Bradley states "When volume changes, however, Postal Service wage rates do not respond to those changes in volume ... Because wages do not change in response to variations in volume, they are not part of the variation in cost associated with variations in volume." Tr. 11/5273. This assumption has been questioned by UPS witness Neels who argues that both the schedule of wages and the mix of "types of hours" may change systematically with volumes. Tr. 28/15594-97. On a more fundamental level, when volume grows such that the Postal Service hires new personnel beyond the numbers needed to

replace attrition, there is no evidence on the record to support an hypothesis that these net new personnel are hired at the average wage.

- Mail processing time at each activity, except allied activities, is unaffected by piece-handlings at other activities. Witness Bradley even assumes that such cross-activity effects cannot be transmitted through changes in the manual ratio, since he assumes that the manual ratio is not volume-variable. As witness Smith says: "It is clear that a variety of automated, technologically sophisticated activities are interwoven to support the timely processing of mail." *Id.* at 15852. Most of witness Bradley's models do not allow for this kind of connectedness between activities. However, it is interdependence in the form of economies of scope that explains why many different mail processing activities usually take place at each facility.

- The number of mail processing facilities and the capacity of the existing ones is not volume-variable. According to witness Degen "(n)early all volume growth is absorbed by existing facilities. Incremental workloads are too small to justify redefining service areas and building new facilities to serve them." Tr. 36/19366. Except for this testimony on rebuttal, Postal Service witnesses seem to have entirely overlooked the possibility that the mail processing system may expand and contract in various ways in response to volume changes. Witness Neels has testified that he "would expect the number of facilities to vary with volume." This would occur as production facilities exceeded their "most efficient level of activity." If the Service responded to volume increases entirely by replicating facilities "you'd expect costs to vary linearly with the number of facilities or directly with 100 percent variability." Tr. 28/15791-92 and 15802-803. A 100 percent variability might also result from simple expansion of the square footage of existing facilities.

- Witness Bradley derives elasticities at the mean of his sample. These are then applied to cost pools for the base year and the test year. "[T]o facilitate the calculation of the cost elasticity, each of the variables is mean centered. Under this transformation, the cost elasticity or variability is just the first order term on TPH." See USPS-T-14 at 36. The MODS dataset includes observations taken over a nine-year interval from 1988 to 1996. The PIRS dataset encompasses

only a slightly shorter period of time. The base year and test year are FY 1997 and 1998 respectively. The manual ratio at the mean of witness Bradley's sample reflects the degree of automation in mail processing that prevailed sometime during 1993. The mean values for the two segments of witness Bradley's trends do not correspond to a single point in time, much less a point of time in the base or test year. Mean centering may not be the most appropriate way to estimate volume variabilities from witness Bradley's fitted models for the purpose of setting rates over a future rate cycle.

- "For those cost pools without recorded workload measures, the best information available for approximating their variability is an estimated variability from a similar activity." *Id.* at 86-90. On the basis of this best available information assumption witness Bradley assigns elasticities from among those he has estimated for MODS facilities to a collection of "Mail Processing Activities Without TPH" and "Customer Service Activities." An "hours-weighted average of all the econometrically estimated variabilities" is assigned to "General Support Activities" and "Non-MODS Activities." Other Service witnesses have continued in this vein to apply witness Bradley's variabilities to associated MODS cost pools for processing equipment maintenance labor, parts and supplies and depreciation.

- The slope coefficients in witness Bradley's translog equations are the same at every facility. "The restriction of estimating a single slope coefficient from each econometric model accomplishes the goal" of "construction of a single variability for that cost pool." Tr. 11/5287. Also "[S]eparate slope coefficients could be estimated for each site, but those many estimated coefficients would have to be combined in some way. There is no single correct way to combine these coefficients…." *Ibid.* In Notice of Inquiry No. 4 the Commission asked the parties "to evaluate whether this restriction can be supported statistically." MPA witness Higgins provided F tests of the restriction for eleven MODS activities. In every case the null hypothesis that the slope coefficients are the same at all facilities is rejected. Tr. 29/16123. Witnesses Neels and Bradley conduct similar tests and reached the same conclusion. Tr. 28/15642-49 and 16070-94.

- Mean centering implicitly evaluates witness Bradley's equations at the same mean values for all facilities (except for the fixed effects). In fact when variabilities are evaluated separately for each site at the means for the sites, the result is a distribution of site-specific variabilities. Witness Bradley displays the distribution for manual letter processing in Attachment 4 to his response to POIR No. 7. Attachment 3 to his response compares his mean-centered elasticity estimates to the means of these site-specific elasticities for eleven processing activities. Although the results are generally not too different, a proper statistical test of the hypothesis that the mean-centered value is equal to the mean of the site-specific estimates would usually result in rejection.

[3056] The volume variabilities derived from the estimated equations shown in Table 3-1 may not represent all of the volume variability of mail processing costs within processing facilities or at the system level if any of the untested assumptions made by witnesses Bradley and Degen to apply these volume variabilities are incorrect. For example, within the facilities witness Bradley's estimates omit all indirect effects of volume on processing time transmitted through changes in the manual ratio and fixed effects. At the system level witness Bradley's variabilities do not include the effects on processing time of expansions in either the number of facilities or the sizes of existing facilities. Most of these omissions would add to the variabilities estimated by witness Bradley. Therefore, the Commission continues to use volume variabilities of 100 percent for mail processing labor costs.

2. Distribution

a. Apportioning Segment 3 Costs to Components

[3057] Cost Segment 3 payroll costs are the clerk and mailhandler labor costs in CAG A-J offices. These costs exceeded $16.5 billion in the 1996 base year, $13.2 billion of which was associated with mail processing. USPS-T-5, Exh. 5A at 22. Under the current method of analyzing subclass responsibility for those costs, time spent by

clerks and mailhandlers performing their various activities is sampled by the In Office Cost System (IOCS). At random instants in time, data collectors identify the activity that a particular clerk or mailhandler is engaged in, and, if applicable, the subclass or special service of mail with which the sampled activity can be associated. The result is a sample tally. Under the established method, Cost Segment 3 costs are apportioned to the mail processing component (3.1), the window service component (3.2), or the administration component (3.3) based on their relative share of IOCS tallies.

[3058] In this docket, the Postal Service proposes to continue to use the IOCS to apportion Cost Segment 3 costs to its three components for BMC and non-MODS offices. For MODS offices, where almost 78 percent of total mail processing costs are incurred, the Postal Service proposes to apportion Segment 3 payroll costs to mail processing, window service, and administrative costs according to the MODS operation into which employees are clocked. This proposed method would shift to the mail processing component, $683 million of costs that under the established method would be apportioned to the administrative component, and $107 million of costs that under the established method would be apportioned to the window service component. Tr. 12/6590-95. These shifts occur primarily because MODS operation codes categorize certain activities differently than IOCS activity codes. For example, some costs of administration of mail processing labor are considered administration under IOCS but considered mail processing under MODS. Another source of the shift is misclocking by employees. For example, an employee clocked into mail processing might fill in temporarily at the window and return to mail processing, without bothering to reclock. These proposed redefinitions of mail processing, administration, and window service components are incidental to the Postal Service's main purpose for organizing mail processing labor costs into operation-specific pools. That purpose is to identify cost pools each of which has a homogenous response to a specific cost driver so that its variability can be separately estimated. *See* Tr. 10/4933.

[3059] United Parcel Service (UPS) proposes that the established method for apportioning Segment 3 accrued costs among the administration, window service, and

mail processing components be restored. Its primary purpose is to restore the established volume variability assumptions that attach to these respective components, including the assumption that most mail processing labor costs are 100 percent volume variable. To accomplish this, UPS uses IOCS activity code tallies to identify the accrued mail processing costs that the established method would have considered administration or window service, and restores that classification to them. *See* Response of UPS to Presiding Officer's Information Request Nos. 11 (Tr. 26/14183-89) and 16 (Tr. 36/ 19487-90).

b. Distributing Mail Processing Labor Costs to Subclasses

[3060] The Commission's recommended attribution of volume variable Segment 3 clerk and mail handler costs is compared with the four comprehensive methods that were proposed or demonstrated on this record. The results are compared in Table 3-2. Where the variability assumptions are the same, the differences in results are caused by differences in the methods of distributing mail processing labor costs. These differences and their supporting rationale are described below.

Table 3-2
Segment 3 Alternative Distributions of Clerk and Mailhandler Labor Costs

	Base Year 1996									
	DISTRIBUTIONS WITH USPS VARIABILITIES				DISTRIBUTIONS WITH 100% MAIL PROCESSING VARIABILITIES					
	USPS Method [a]		Time Warner Method [a]		R94-1 Method [b]		UPS Method [c]		PRC Recommended [d]	
	($1,000)	%	($1,000)	%	($1,000)	%	($1,000)	%	($1,000)	%
First-Class Mail										
Letters & Parcels	5,566,303	47.5%	5,819,232	49.6%	7,057,955	49.3%	6,580,438	46.2%	6,735,420	47.2%
Presort Letters & Parcels	1,194,689	10.2%	1,187,543	10.1%	1,442,451	10.1%	1,410,425	9.9%	1,414,722	9.9%
Single Piece Cards	183,379	1.6%	209,909	1.8%	250,793	1.8%	218,674	1.5%	232,968	1.6%
Presort Prv Prcls	41,349	0.4%	53,484	0.5%	56,273	0.4%	49,418	0.3%	52,119	0.4%
Total First	6,985,720	59.6%	720,168	6.1%	8,807,472	61.6%	8,258,956	58.0%	8,435,229	59.2%
Priority Mail	540,853	4.6%	389,435	3.3%	554,312	3.9%	757,182	5.3%	668,597	4.7%
Express Mail	112,436	1.0%	130,227	1.1%	192,690	1.3%	164,696	1.2%	175,336	1.2%
Mailgrams	88	0.0%	130	0.0%	141	0.0%	111	0.0%	130	0.0%
Second Class Mail										
Within County	17,388	0.1%	16,842	0.1%	19,880	0.1%	21,358	0.1%	20,852	0.1%
Outside County										
Reg. Rate Pub	496,960	4.2%	416,821	3.6%	521,980	3.6%	615,960	4.3%	568,128	4.0%
Nonprofit Pub	88,934	0.8%	79,432	0.7%	97,465	0.7%	110,437	0.8%	104,231	0.7%
Classroom Pub	6,005	0.1%	4,184	0.0%	5,347	0.0%	7,942	0.1%	6,219	0.0%
Total Second	609,287	5.2%	517,280	4.4%	644,672	4.5%	755,697	5.3%	699,430	4.9%
Third Class Mail										
Single Piece Rate	82,069	0.7%	82,983	0.7%	101,342	0.7%	102,008	0.7%	105,172	0.7%
Bulk Rate-Reg										
Car Presort	305,921	2.6%	279,284	2.4%	335,647	2.3%	389,801	2.7%	374,824	2.6%
Other	1,605,824	13.7%	153,937	1.3%	1,821,325	12.7%	1,962,202	13.8%	1,954,861	13.7%
Total Regular	1,911,745	16.3%	1,817,221	15.5%	2,156,972	15.1%	2,352,003	16.5%	2,329,685	16.3%
Bulk Rate-Nonprofit										
Car Presort	32,442	0.3%	27,540	0.2%	34,724	0.2%	40,077	0.3%	39,676	0.3%
Other	385,597	3.3%	385,035	3.3%	442,580	3.1%	457,133	3.2%	463,954	3.3%
Total Nonprofit	418,039	3.6%	412,576	3.5%	477,304	3.3%	497,210	3.5%	503,630	3.5%
Total Third	2,411,853	20.6%	2,312,780	19.7%	2,735,618	19.1%	2,951,221	20.7%	2,938,487	20.6%
Fourth Class Mail										
Parcel Zone Rate	168,661	1.4%	142,337	1.2%	192,577	1.3%	241,799	1.7%	220,735	1.5%
Bound Prnt Matter	76,322	0.7%	71,571	0.6%	90,143	0.6%	105,726	0.7%	100,960	0.7%
Spc 4th-Cl. Rate	72,257	0.6%	77,549	0.7%	95,741	0.7%	100,753	0.7%	103,205	0.7%
Library Rate	16,453	0.1%	16,367	0.1%	20,760	0.1%	23,279	0.2%	23,213	0.2%
Total Fourth	333,693	2.8%	307,825	2.6%	399,221	2.8%	471,556	3.3%	448,113	3.1%
US Postal Service	112,772	1.0%	127,977	1.1%	147,928	1.0%	141,000	1.0%	143,344	1.0%
Free Mail -- Blind & Hndc & Servicemen	11,042	0.1%	9,857	0.1%	13,032	0.1%	14,851	0.1%	13,981	0.1%
International Mail	252,743	2.2%	256,537	2.2%	326,727	2.3%	311,608	2.2%	315,392	2.2%
TOTAL ALL MAIL	11,370,487	97.0%	11,322,216	96.4%	13,821,813	96.6%	13,826,878	97.1%	13,838,039	97.1%
Special Services										
Total Special Services	353,220	3.0%	418,425	3.6%	485,846	3.4%	418,582	2.9%	418,677	2.9%
Total Volume Variable	11,723,707	100.0%	11,740,642	100.0%	14,307,659	100.0%	14,245,460	100.0%	14,256,716	100.0%

[a] Tw-T-1, Exhibit 3, P1, Revised 2/20/98
[c] UPS-Sellick-WP-R1 revised

[b] Cost segments and Components, Fiscal Year, page 21-22.
[d] PRC LR-19

(1) Established Method

[3061] Under the established method for attributing mail processing costs, it is assumed that most mail processing activities vary proportionately with volume. Completing the causal connection with subclasses, therefore, depends on the method chosen to distribute mail processing costs to subclasses. The established method distributes mail processing costs to subclasses in proportion to each subclass's share of weighted IOCS mail processing tallies, which reflect each subclass's share of total processing time.

[3062] The IOCS sampling system is stratified by Cost Ascertainment Group (CAG), which ranks mail processing facilities according to the amount of revenue they generate, and by craft (clerk, mailhandler, etc.). [7] Tallies within each CAG and craft are assigned a dollar value that is weighted by the proportion of Segment 3 costs that are accrued within that particular CAG and craft.

[3063] For almost half of the cost-weighted tallies, the sampled activity can be directly associated with a specific subclass of mail.[8] This direct association can be made in several ways: the employee might be observed handling an individual piece, an "item" (bundle, tray, pallet), or a "container" (a wheeled container) of only that subclass; he might be observed handling an item that is subject to the "top piece rule" where that subclass is the top piece; or he might be observed handling an item whose subclass content is then counted and found to include a certain proportion of that subclass. For the remaining half of the IOCS tallies, the sampled activity could not be directly associated with a specific subclass of mail. This could be because the sampled employee was observed handling an "item" or a "container" whose subclass content the data collector did not identify or count, or verified was empty. These tallies are

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[7] Generally, for any sample size, valid stratification produces more accurate estimates by dividing the population into subgroups that are internally more homogenous. (George W. Snedecor & William G. Cochran, Statistical Methods 434, 1982 (7th ed.), page 434.

[8] USPS-T-12, Table 2, at 13.

considered to be “mixed mail” tallies. It would also be true if the sampled employee was observed to be “not handling” mail, for example, because he was on break.

[3064] Under the established distribution method, mixed mail tallies account for about one tenth of all mail processing costs. They are distributed to subclasses in the same proportion as direct tally costs. This distribution to subclasses is done within CAG, craft, and basic function. All tallies are partitioned by basic mail processing function (outgoing, incoming, transit, and other) before mixed mail tally costs are in proportion to direct tally costs. This allows the mixed mail tally costs to reflect the different subclass profiles and workload content that the basic functions exhibit. For example, the cost for a mixed flat outgoing tally is distributed to classes and subclasses based on all direct flat tally costs in the outgoing mail processing operation. If a subclass generates half of those direct tallies, it will be assigned half of the cost of a mixed flat tally.[9]

[3065] “Not handling” costs (e.g., breaks/personal needs, clocking in and out, moving unidentified empty equipment) are about 43 percent of total mail processing costs in FY 1996. Tr. 28/15383 (Buc). Under the established method, most not handling costs are assumed to be 100 percent variable with volume, and are distributed to subclasses in proportion to the distribution of all other mail processing costs. Some platform acceptance costs are considered fixed costs and treated as institutional.

(2) Postal Service’s Proposed Distribution Method

[3066] The Postal Service presents its proposed method for distributing variable mail processing labor costs as a response to several criticisms of the established method made in the past. In the past, parties have noted the steady increase in the proportion of overall tallies that are “not handling” tallies, asserted that this reflects underused labor made surplus by the automation program, and concluded that such costs should not be attributed to certain subclasses. Implicit in this argument, according to the Postal

[9] Using IOCS tallies in this way assumes that the random instants in time when the tallies are taken are representative of all instants in time, and that the cost of processing a subclass is directly proportional to time spent processing that subclass.

Service, is an assertion that mail processing overhead is less than 100 percent volume variable, contrary to the established assumption. *See* USPS-T-12 at 5, and Tr. 34/18218, 18227. The Postal Service also notes that in the past parties have argued that using a small and declining relative share of direct tallies as a proxy distribution (or "key") for distributing mixed mail and "not handling" tallies risks biased distributions to subclasses. Tr. 36/19322-23, 19330-33.

[3067] The Postal Service purports to address these problems by dividing Segment 3 payroll costs not into four basic processing functions as the established method does, but into 46 separate pools. The 46 cost pools include 39 at MODS offices, six at BMCs, and one for non-MODS offices (which is disaggregated into four groups by basic function).

[3068] Each MODS and BMC pool is associated with a specific mail processing activity or machinery type. Examples of the MODS cost pools are OCR, BCS, FSM, manual letters, and manual flats operations. This division is based on Management Operating Data System (MODS) data that records the hours that employees spend clocked into sets of specific mail processing operations, each defined by a specific Labor Distribution Code (LDC) and set of MODS codes.[10] One purpose of this innovation was to enable the Postal Service to develop an econometric model of the variability of labor costs with volume for each pool. These models assume that labor hours in each MODS pool exhibit a homogenous response to volume changes within the pool. Within each pool, labor hours are assumed to be a suitable proxy for labor costs, and Total Piece Handlings (TPH) are assumed to be a suitable cost driver. Where MODS pools do not have a TPH or other pool-specific workload measure, proxy variabilities from related pools are used.

[3069] MODS offices within the IOCS sampling system consist primarily of large mail processing facilities. They account for about 78 percent of mail processing costs. For Bulk Mail Centers (BMCs), the Postal Service divides payroll costs into an analogous

[10] A more complete description of MODS is provided in USPS-T-4.

but much simpler set of operation-specific pools.[11] For non-MODS offices, the Postal Service proposes to continue dividing payroll costs into the four basic mail processing functions. See USPS-T-12 at 5-7. The average overall variability for the MODS pools is applied to the non-MODS costs.

[3070] The Postal Service econometrically estimates the volume variability of mail processing labor. The results ranges from 15.3 percent for several small specialized pools to 100 percent for the Remote Barcoding System pool. They average 76.4 percent across the MODS pools. *Id.* at 15, table 4.

[3071] The Postal Service proposes to distribute the variable costs for each pool to subclasses on the basis of IOCS tallies associated with each pool, as is done using larger pools under the established method. Unlike the established method, the Postal Service's proposed distribution method ignores the CAG structure of the IOCS sample, and the basic function with which each tally is associated. Instead it assigns all IOCS tallies to specific MODS pools. In each pool, the Postal Service associates a portion of each tally directly, or by inference, with a specific subclass of mail. The distributed tallies in each pool are then assigned a dollar value.[12] The Postal Service argues that in each MODS pool, the total amount of variable tally dollars distributed in this manner to a subclass of mail is the equivalent of subclass marginal cost.

[3072] For non-MODS offices, the cost pool is the basic function. For BMCs, tally assignments to pools are those used initially to divide payroll costs into pools. For MODS offices, an IOCS tally is assigned to a MODS pool according to the tally's MODS operation code. Where the MODS operation code conflicts with the IOCS data collector's description of the operation involved (in IOCS Questions 18 and 19), the MODS code overrides the IOCS description. As a result, the Postal Service's proposed

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[11] BMC pools are based on the operation indicated in Questions 18 and 19 of the IOCS report. Workload measures corresponding to these pools are obtained from the Productivity Information Reporting System (PIRS).

[12] An adjustment factor must be applied to each tally dollar to reconcile the tally dollar total in each pool with accrued payroll dollars for that pool. See USPS-LR-304. (Postal Service Response to DMA/USPS-T-12-13b). Each tally dollar is then multiplied by a fraction to reflect its variability with TPH.

method shifts about $790 million of payroll costs that are associated with administration and window service under the established method, to mail processing. When the Postal Service shifts these costs to mail processing, their volume variability is determined by the MODS pool to which they are assigned.

[3073] Within each MODS pool, the Postal Service proposes to distribute the variable mail processing costs associated with direct tallies to subclasses in proportion to the subclass composition of the direct tallies. It distributes variable mixed mail costs to subclasses in proportion to the direct tally distribution, by item type and container type. It distributes "not handling" costs to subclasses in proportion to the combined distribution of direct and mixed mail costs. The Postal Service argues that the causal link between these IOCS "direct," "mixed," and "not handling" tally dollars in a given pool and individual subclass volumes is provided by witness Bradley's estimate of the variability of those dollars with piece handlings in that pool. It argues that this causal inference is as clear for mixed mail and not handling costs in a given pool as it is for direct costs. Postal Service Reply Brief at III-61, III-73.

(a) Direct Tally Costs

[3074] Direct tally costs comprised approximately 46 percent of total variable weighted tally costs in the base year.[13] The Postal Service proposes to distribute the costs associated with direct tallies within cost pools to subclasses in the same general manner as under the established method. The major difference is that it proposes to distribute direct tally costs within pools that are disaggregated to highly specific mail processing operations and equipment type.

[3075] Both methods distribute the cost that direct tallies represent to the subclass of mail that the IOCS data collector observed the employee handle or that the data collector counted after it was handled.

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[13] Calculated from USPS LR-H-23.

(b) Mixed Mail Tally Costs

[3076] Mixed mail costs as currently defined are approximately 11 percent of mail processing costs.[14] The Postal Service proposes to distribute these costs to subclasses using a three-step process. Within each pool, the Postal Service distributes costs for mixed items to subclasses in proportion to direct tally costs of the same item type. This proxy distribution procedure assumes that the subclass composition of mixed items is the same as the subclass composition of direct items of the same item type and cost pool.[15] For example, if ten percent of direct tallies where an employee is observed handling a flat tray and is clocked into a Letter Sorting Machine MODS operation are assigned to a subclass, the Postal Service assigns to that subclass ten percent of the costs of mixed mail tallies where the employee was handling a flat tray and was clocked into a Letter Sorting Machine MODS operation.[16]

[3077] The Postal Service also distributes the costs for identified mixed containers. Identified mixed containers are containers where the IOCS data collector observes the employee handling a container of nonidentical mail and estimates what percentage of the filled space within the container is occupied by specific types of items and loose shapes of mail. The Postal Service uses these percentages to prorate the variable identified container tally cost to the various item types and loose shapes observed there.

[3078] This procedure assumes that the subclass content of items in identified mixed containers by item type and cost pool is the same as the subclass cost distribution of items outside of containers by item type and cost pool. It also assumes that the

[14] Witness Degen has redefined mixed mail and mixed mail tallies. His definition of mixed mail shifts the activity of moving empty items or containers from overhead (now termed “not-handling” mail) to mixed mail. Expanding the definition of mixed mail in this manner would increase its proportion of total tally dollars from about 11 percent to 22 percent. Tr. 28/15369-70.

[15] Mixed item tallies occur when an employee is observed handling either 1) an item containing nonidentical mail whose contents are not counted and the top piece rule is not applied, or 2) an empty item of a determined type that was observed to be empty.

[16] When there were no direct tallies for a specific item type (e.g., letter tray) within a cost pool, witness Degen used direct volume-variable tally costs for the item type across all cost pools within the facility type (e.g., MODS 1 and 2 facilities) as his distribution key.

subclass composition of loose shapes inside identified mixed containers by cost pool is the same as the subclass composition of loose shapes outside of these containers by cost pool. For example, if letter trays occupy 25 percent of the filled space within a container, the Postal Service assigns 25 percent of the cost of that container to subclasses in proportion to the subclass composition of direct tally letter trays within that cost pool.

[3079] After distributing the costs for identified mixed containers, the Postal Service distributes the costs for unidentified and empty mixed containers.[17] These are containers whose type was determined, but no information concerning the contents was collected. The Postal Service assumes that the subclass distribution of their contents is the same as the subclass cost distribution of identical and identified containers of the same container type in the same cost pool.

(c) Not Handling Mail Tally Costs

[3080] The Postal Service defines tallies that are not “direct” or “mixed mail” as “not handling” tallies. As currently defined, they account for approximately 43 percent of total weighted tally costs (27 percent under the narrower definition proposed by the Postal Service). Tr.28/15383. The Postal Service distributes the volume-variable portion of these costs to subclasses in proportion to the distribution of all other mail processing costs (direct and mixed mail) within each cost pool.[18] This procedure assumes that not-handling costs in each of the 46 cost pools are directly proportional to the direct and distributed mixed mail costs within each cost pool. In explaining how its proposed method of attributing mail processing costs addresses the issue of how to determine subclass responsibility for the increasing proportion of “not handling” costs, the Postal Service notes that its proposed method does not include not handling tallies in its

[17] These are tallies where the data collector observed the employee handling a container of a determined type that 1) contained non-identical mail that the data collector did not identify, or 2) contained no mail.

distribution keys. It argues that in contrast to the established method, not handling tallies play no role in determining the size of the cost pools that it proposes to use. Tr. 36/19321.

(3) Distribution Methods Proposed by Presort Mailers

[3081] The Magazine Publishers Association (MPA), Time Warner Inc., and Direct Marketing Association (DMA),[19] propose that mail processing labor costs be distributed to subclasses by methods that preserve the Postal Service's variability percentages for each cost pool but distribute those costs to subclasses using keys that cross MODS pool boundaries. While Dow Jones, Inc. does not propose a specific distribution, it supports the rationale underlying the use of cross-pool keys. The presort mailers contend that the pool-specific variabilities that Postal Service witness Bradley estimates do not require pool-specific distributions to subclasses to yield valid marginal costs. As long as the correct variability percentage is applied to each tally, they argue, they are free to distribute costs to subclasses across cost pools. *Id.* at 14050.

[3082] In order to reduce the risks of bias and imprecision that they perceive in the Postal Service's elaborately stratified distribution procedure, the presort mailers propose

[18] There are several exceptions to the Postal Service's method for distributing mixed mail and not-handling mail costs to subclasses or special service:

For the MODS Platform cost pool, all MODS Allied labor cost pools are used to distribute mixed items in containers to subclass/special service.

- For the MODS 1MISC and 1Support cost pools, all function 1 cost pools are used to distribute not-handling mail costs to subclass/special service.

For the MODS 1EEQPT (Empty Equipment) cost pool, all MODS mail processing cost pools are used to distribute not-handling mail costs to subclass/special service.

For the MODS LDC48 0TH cost pool, all MODS function 4 cost pools are used to distribute not handling mail costs to subclass/special service.

- For the BMC Platform cost pool, all BMC cost pools are used to distribute mixed item costs to subclass/special service.
- For non-MODS cost pools, activity codes 6XXX (except 6521-23) are distributed by IOCS operation code.
- For several cost pools, not-handling mail costs are assigned to subclasses of mail but not types of special services.

[19] In this section, for ease of reference, these parties will be referred to as "the presort mailers." This group does not include all of the parties that represent the interests of presort mailers.

alternative distribution procedures that employ the much broader and simpler distribution keys of CAG, craft, and basic function that are used in the established method. The alternative methods proposed by the presort mailers differ in their details, but share the following characteristics.

[3083] The presort mailers propose distributions that start with the same accrued costs for the mail processing component of Segment 3 that the Postal Service uses. They use IOCS tallies to distribute costs separately by facility type (MODS, BMC, and non-MODS facilities) as the Postal Service proposes. Instead of activity-specific MODS pools, they would distribute mail processing costs by what is essentially the established method. *Id.* at 14078-80. They propose to distribute the mixed mail and not handling costs that can be related to specific shapes (letters/cards, flats, IPPs/parcels) on directs costs associated with the corresponding shapes. They propose to distribute all other mixed mail and not handling costs, including empty item and container costs, on all direct mail costs, by CAG, and basic function. Tr. 26/13819, Tr. 26/14056-57, Tr. 28/15385-86.[20]

[3084] These mailers contend that the Postal Service misclassifies certain not handling costs related to window service and administration/support as mail processing costs They propose to apply the traditional window service and administration/support distribution keys to these costs. They also contend that certain not handling costs are related to specific subclasses and special services, such as Express Mail, Registry, and Post Office Boxes, and to specific activities, such as central mail markup. They propose distributing those costs to those subclasses, services, or activities. Tr. 26/13819, Tr. 26/14056-57, Tr. 26/14132.

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[20] This is DMA's preferred alternative. If the Commission adopts the Postal Service's proposed distribution, DMA proposes the Commission make the following modification of it:

(1) distribute all direct tally dollars to the appropriate subclass
(2) use the resulting proportions to distribute all mixed mail tally dollars
(3) use the same proportions to distribute all not handling tally dollars.

Tr. 28/15385.

(a) Rationale for Presort Mailers' Alternative Distributions

[3085] Periodicals and Standard A (advertising) mail is presorted mail. These mailers endorse the Postal Service's analysis of the volume variability of mail processing labor costs and its conclusion that its average variability is about 76 percent. These mailers, however, are adamantly opposed to the Postal Service's proposed distribution method. They have two major criticisms.

[3086] First, they recognize that using a distribution key to distribute costs to subclasses of mail assumes that the cost driver selected for the cost pool being analyzed is the cause of the costs associated with the distribution key. These mailers question the Postal Service's assumption that the subclass tallies found in a given MODS pool are caused only by the cost driver that the Postal Service has selected for that pool. They contend that the Postal Service's MODS pools are too narrowly defined because they ignore the causal relationships between pools.

[3087] Second, they argue that the costs in a given cost pool whose subclass distribution is known (the distributions of identical mail, and counted mixed mail tally dollars) are biased proxies for the subclass distribution of costs that are unknown (the distributions of uncounted mixed mail and "not handling" tally dollars). They point out that the subclass distributions for a majority of mail processing costs are unknown. They argue that the multi-layered proxies that the Postal Service proposes to substitute for unknown subclass distributions require elaborate assumptions about their relationship to the known distributions that have not been tested. They argue that the proposed proxy distributions suffer from selection bias and assumption bias, as well as unacceptably large sampling error.

(1) Selection bias

[3088] About one tenth of mail processing labor costs are associated with "items" (a piece, bundles, tray, sack, pallet, etc.). IOCS data collectors are supposed to record items as either identical, top-piece rule, or counted items. Less than 10 percent of item

costs are eligible for counting. Of those, the Postal Service manages to count about 38 percent, according to Time Warner witness Stralberg, Tr. 26/13829, or 52 percent according to UPS witness Sellick, Tr. 36/19480. The Postal Service distributes the items that remain uncounted on the subclass distribution of the combination of direct and counted items of the same item type, within each MODS pool.

[3089] The presort mailers complain that the Postal Service has not conducted any studies to determine the extent to which the subclass composition of uncounted items matches that of counted items. They contend that there are too few IOCS data collectors to count all items that are supposed to be counted. Therefore, they argue, data collectors tend to select items that are easy to count, because the item contains relatively few, large pieces, such as items containing periodicals and parcels. They also argue that data collectors tend to select non-preferential mail items to count, since, if they try to count them, they are less likely to prevent such mail from meeting a critical dispatch.

[3090] The presort mailers emphasize that in Docket No. R94-1, the Commission rejected a proposal to distribute uncounted items on the subclass composition of counted items because it had concluded that the selection of items to count was not random. Tr. 26/13831-32 (Stralberg), Tr. 26/14047-48 (Cohen), Tr. 28/15523-24 (Shew). They argue that this selection bias remains despite the Postal Service's proposed stratification of distribution keys by MODS pool and item type. They show, for example, that trays and sacks that contain parcels and magazines make up the large majority of the item types that are counted, and argue that parcels and magazines are unlikely to be the majority of mail in those item types. They also argue that while some MODS pools process more non-pref and presorted mail than others, such correlations are far from perfect, and the opportunity remains in many pools to select the subclasses of mail that are easier to count. Tr. 26/13831, DMA Brief at 22-23.

[3091] Finally, the presort mailers argue that there is a selection bias against periodical mail which mostly travels though the system as bundles on pallets. Pallets can contain bundles, trays, or sacks. The presort mailers allege that trays and sacks on pallets are more difficult to count than bundles, and therefore bundles are most likely to

be counted. Because pallets are arbitrarily treated as items rather than containers, they argue, palletized bundles all of one subclass can be recorded as direct items, where bundles in other large containers are not examined for subclass content. The result, they allege is a disproportionate number of direct tallies recorded for Periodicals. Tr. 26/13837-39 (Stralberg).

(b) Assumption Bias

[3092] The presort mailers have responded to the complex distribution scheme that the Postal Service proposes in this docket by alleging that it incorporates an elaborate set of assumption biases. The principal bias that it introduces, according to the presort mailers, is the assumption that the subclass composition of mixed mail and not handling costs within a given MODS pool is the same as the direct costs in that pool. Presort mailers argue that because subclasses are prepared differently and processed differently, the subclass composition of direct tallies within a given MODS pool would be expected to differ substantially from that of mixed mail tallies, even within the same item and container types. They allege that restricting the distribution of costs to subclasses within a given MODS pool is biased when the causes of those costs cut across MODS pools. They also argue that within a given MODS pool, the subclass responsibility for not handling tallies, if it were modeled, would be found to be broader (to encompass a broader set of pools) than the subclass responsibility for direct and mixed mail.

[3093] Presort mailers argue that the established distribution method rests on more plausible assumptions. It assumes that the subclass composition of mixed mail of a specific shape and basic function is similar to that of direct mail of the same shape and basic function. They argue, for example, that Function 2 (incoming mail processing) is highly correlated with presorted mail. They also argue that shape is highly correlated with subclass. Tr. 36/19245 (Cohen), Tr. 26/13840 (Stralberg), DMA Brief at 24. *See* also, USPS-LR-145.

[3094] *MODS pool costs are not caused in isolation*. In arguing that costs in a given MODS pool are not caused exclusively by the subclasses tallied at that cost pool, and therefore should not be distributed exclusively to those subclasses, the presort mailers focus on the MODS pools devoted to allied operations. Allied labor costs, they argue, are a composite of functions. To model them accurately, they contend, it is necessary to distinguish between activities that serve the letter, flat, and parcel sorting operations, and activities that serve "direct" mail that, due to presortation, bypasses piece sorting operations. Tr. 36/19285. They argue that Postal Service witness Bradley recognizes that allied activities support piece sorting operations in other MODS pools, which is why he uses an index of piece handlings at those related pools as his cost driver in allied pools. As an example, they argue, witness Bradley recognizes that the BMC platform pool has two primary functions — cross docking mail not processed in that facility, and handling mail that is processed there. Witness Bradley uses cross-docked pallets as the cost driver for the first function, and Total Equivalent Pieces (TEP) as the cost driver for the second function. This, they say, illustrates why a portion of mixed mail and not handling costs at allied operations must be distributed in proportion to the direct costs in the piece-sorting operations that they support.

[3095] The presort mailers contend that the Postal Service's distribution method is inconsistent with its causation analysis for allied pools, because its distribution of allied costs (on within pool "direct" tallies) reflects the effects only of the within-pool cost driver.[21] This, they argue, strongly biases the results against presorted mail. They argue that mail that bypasses piece distribution at a MODS facility also incurs relatively little handling at allied operations. But, because presorted mail produces mostly "direct" tallies, distributing all costs in an allied pool on its direct tallies, as the Postal Service

[21] Time Warner witness Stralberg purports to illustrate this inconsistency by calculating the cross-pool contributions to marginal costs implied by witness Bradley's model of the platform MODS pool. Aggregating the coefficients of witness Bradley's composite cost driver, he calculates that the implied marginal cost contribution from the letter distribution pools is 3.5 times the implied contribution from the flats distribution pools. He notes that witness Degen's distribution keys distribute only 1.47 times as much marginal platform cost to letters as to flats. Tr. 36/19282-83.

proposes, would burden presorted mail with most of the mixed mail and not handling costs at allied operations. *Ibid.* They estimate the resulting overattribution of allied costs to presort mail to be as much as 60 percent, or $700 million. *Id.* at 19228-30. They argue that, at a minimum, the Commission must correct witness Degen's proposed distribution by distributing allied mixed-mail and not-handling costs to subclass based on tallies across all distribution operations and allied operations, rather than tallies solely in the same allied cost pool. Presort Mailers Reply Brief at 12-13.

[3096] *Other forms of assumption bias*. The presort mailers also argue that the Postal Service's proposed distribution method suffers from other forms of assumption bias. These include the assumptions that the subclass composition of

- direct items (including counted items) mirrors that of uncounted and empty items in a particular item type and cost pool

- direct items (including individually handled pieces outside of containers) mirrors that of items and loose shapes in containers

- identical and identified containers mirrors that of unidentified and empty containers in a particular container type and cost pool

[3097] *Mixed items differ from direct items.* The presort mailers argue that it is unlikely that the subclass content of uncounted mixed mail items is the same as the subclass distribution of direct item costs. Identical items, they contend, are likely to be periodicals and Standard A mail, which remain packaged as identical items through much of their processing, and therefore are easy to identify as a direct item tally. Mixed items, they argue, consist of a broad range of subclasses because they are collection mail or mail that the Postal Service has already sorted at least once. They demonstrate that the subclass composition of identical items differs drastically from that of counted mixed mail items. They show that the Periodicals and Standard A subclasses, which are typically presorted, receive over 80 percent of identical item costs, but less than a third of counted mixed mail costs. Because presorted mail is over-represented in both identical

and counted item tallies, they argue, the combination ("direct" mail) is likely to differ substantially from uncounted mixed mail, which consists primarily of collection mail and other mail packaged by the Postal Service. Tr. 26/13830-31, 13866 (Stralberg), Tr. 26/14047-49 (Cohen).[22]

[3098] *Items types (including loose shapes) in containers differ from those outside of containers*. The presort mailers criticize the Postal Service for collecting no direct information about the subclass composition of mixed container tallies. They argue that the mixed container information that the Postal Service collects (such as the item composition of containers) is too subjective and unreliable to be used. Tr. 26/13833-35.

[3099] They challenge the assumption that the subclass composition of mixed items in containers resembles that of direct items out of containers. For example, they argue, the Postal Service's method assumes that in a given MODS pool, loose letters appear in similar proportions in and out of containers. They argue that in allied operations, both collection mail and presorted mail are likely to be handled as loose mail outside of containers, but that presorted mail is very unlikely to be found as loose mail in containers because that would destroy its presortation. What little individual piece handlings of presorted mail occurs at allied operations, they argue, is incidental, such as handling of pieces from accidentally broken bundles. They contend that distributing mixed container costs on the few, anomalous individual piece handlings within that allied pool burdens subclasses that have little to do with mixed container costs. Tr. 26/14049-50, 14124 (Cohen), Tr. 26/13836 (Stralberg). The presort mailers show that in platform and opening units loose letters, loose flats, bundles, and trays appear in very different proportions in and out of containers, which implies that the respective subclass distributions do not correspond well either. Tr. 26/13835-36 (Stralberg). They argue that

[22] The presort mailers note that identical items subject to the top piece rule are no more likely to get a direct tally than other top piece rule items, and do not suffer from counting bias, at least not to the same degree as non-top piece rule items. Therefore, they argue, the distribution of top piece rule items only would be a less biased proxy for distributing uncounted mixed mail item tallies. Tr. 26/13832 (Stralberg) and Tr. 36/19297.

this bias can be ameliorated by distributing mixed container costs across MODS pools. *Id.* at 13837.

[3100] *Empty item types differ from filled item types*. With regard to empty items, presort mailers argue that assuming that their cost distribution mirrors the cost distribution of filled items by type is almost certainly false. This procedure, they argue, assumes that the path that an empty item takes back to the mailer goes through the same sequence of operations that the filled item did. They demonstrate that this assumption is often false, since for 50 of the 238 combinations of item type and cost pool, items are observed only when empty. *Id.* at 13834.

[3101] *Empty containers*. The presort mailers argue that because the Postal Service distributes empty container costs on the basis of combined direct and mixed mail costs, all of the biases that infect its distribution keys for direct and mixed mail, infect those for empty container costs. *Id.* at 13838.

(c) "Not Handling" Costs

[3102] For the reasons described above, the presort mailers contend that the causal connection between the variable costs in a given MODS pool and the subclasses assigned the mixed mail tallies in that pool is, at best, unclear. They argue that the connection between the variable costs in a given MODS pool and the subclasses assigned the not handling tallies in that pool, however, is simply arbitrary. This is because, in their opinion, there is no pool-specific cost driver for not handling tallies. They contend that partitioning not handling tallies into narrowly-defined MODS pools simply shows where workers were clocked when they were not handling mail. *Id.* at 13823 (Stralberg). They argue that neither the IOCS nor MODS activity codes are capable of showing why a not handling tally occurred. According to the presort mailers, identifying the subclasses responsible for not handling tallies requires a model of management's staffing strategies. If, for example, management builds reserve capacity into the manual letter MODS pool so that it can serve as a backstop for high priority

automated letter processing, the effect that this strategy would have on not handling costs tallies in the manual letter sorting MODS pool should be modeled.
Tr. 26/13966-67.

[3103] The presort mailers contend that subclass responsibility for not handling tallies cannot be determined without analyzing the diverse activities that are collectively labeled "not handling." They list the major ones as follows:

- class and activity-specific not handling costs
- shape-related not-handling (not handling tallies with IOCS activity codes 5610-5700, which are used at operations that process predominantly one shape of mail)
- not handling associated with special services
- general overhead (breaks/personal needs, clocking in and out, moving empty equipment, and mixed all-shapes tallies)

Id. at 13958.

[3104] *Class and activity-specific not handling*. The presort mailers argue that the Postal Service's proposed pool-by-pool distribution of not handling costs ignores more specific and reliable information about the cause of not handling costs. For example, some not handling tallies are associated with specific classes of mail, such as Express Mail, but are distributed by a pool-wide key. They claim to identify many IOCS not handling costs that the Postal Service distributes by pool-wide keys even though they have more specific and reliable keys relating them to window service or administration/support activities. They claim to identify over $800 million in such not handling costs, and to redistribute them accordingly. *Id.* at 13847-48.

[3105] *Shape-specific not handling*. The presort mailers propose to distribute not handling costs associated with shape-specific IOCS tallies (those with IOCS activity codes 5610-5700) in proportion to the direct costs of the corresponding shape, without

regard to cost pools. *Id.* at 13849. The presort mailers complain that the Postal Service's proposed pool-by-pool distribution treats all not handling costs alike. Ignoring the available shape information, they argue, yields anomalous results. For example, letter-shape related not handling costs are often distributed on the basis of non-letter related keys.

[3106] *Not handling specific to special services*. The presort mailers argue the Postal Service proposes to avoid distributing not handling costs to special services in MODS offices, even though there are direct IOCS tallies associated with special services in almost all MODS pools. Even not handling costs that have activity codes that are specifically related to special services, such as P.O Boxes, Money Order, Special Delivery, and Registry are not distributed to those services. The presort mailers distribute not handling costs associated with specific special services to those services. *Id.* at 13850-51.

[3107] *General overhead not handling*. In the past, according to the presort mailers, the last group of not handling activities described above was considered to be systemwide overhead, and were appropriately distributed to subclasses in proportion to all other mail processing costs. They advocate retaining the established view and the established distribution. *Id.* at 13850. They argue that the Postal Service's proposal to now distribute them to narrow operation-specific pools assumes that the amount of break time taken while clocked into a specific operation is a function of piece handlings only in that operation. It is equally plausible, they argue, that employees take breaks at standard intervals throughout the day, in which case these not handling costs should continue to be regarded as general overhead and distributed over broad activity groups, or take breaks between operations, in which case not handling costs would have to be apportioned to the operations responsible. Tr. 26/13956-58, DMA Brief at 34.

[3108] Dow Jones, Inc. witness Shew makes a related argument. He reasons that if labor is as freely transferable among pools as the Postal Service claims, and overhead tallies reflect reserve capacity needed to handle facility-wide peak loads, the distribution

of overhead tally costs should be broad enough to reflect the facility-wide effects of workload peaks. Tr. 28/15525.

[3109] Perhaps a more important factor undermining the causal connection between volume and "not handlings" within a MODS pool, according to the presort mailers, is the implication that a substantial portion of not handling tallies reflect the effects of inefficiency, rather than volume. Presort mailers argue that to a substantial extent, overhead tallies reflect inefficiency rather than the effects of volume. Tr. 26/14055, 58 (Cohen). They consider it inexplicable that overhead costs as a percentage of all other mail processing costs have grown from 14.2 percent in FY 1980 to 23 percent in FY 1989, and to 31.5 percent in FY 1996. Tr. 26/13841; PRC Op. R94-1, para. 3023. The presort mailers argue that the evidence that these not handling costs do not represent productive time is that their rapid rise coincides historically with the implementation of automated mail processing, which began in FY 1986. Tr.26/13842 (Stralberg).

[3110] The presort mailers note that the explanation for the rising share of not handlings costs given by the Postal Service prior to this docket was that they reflect an increasing need for employees to monitor the new machines, rather than touch mail. They argue that this explanation is inconsistent with the distribution pattern of not handling costs. They claim that most not handling costs, and most of the increase in not handling costs, occur at non-automated operations. *Id.* at 13960. They show that not handling costs are a much higher percentage of total costs in MODS pools in which productivity is not measured (essentially the MODS pools for allied operations). *Id.* at 13843 (Stralberg), 14051 (Cohen). The implication that not handling costs reflect inefficiency is supported by the Postal Inspection Service report that found that managers have an incentive to shift temporarily idled employees from piece-sorting operations where productivity data are gathered to allied operations where such data are not gathered, and to have employees clock initially into allied operations until it is determined that they are needed elsewhere. The presort mailers note that since their mail is processed primarily at allied operations, their mail is assigned most of the cost at

those operations. Therefore, they complain, they are unfairly held responsible for the extra not handling costs incurred there by underused employees that are harbored at allied operations when they are not needed elsewhere. *Ibid.*

[3111] The presort mailers also assert that the general rise in the proportion of not handling costs coincides historically with a general decline in piece handling productivity at almost all letter and flat sorting operations from FY 1988 to FY1996. This, they argue also supports the implication that while automation has increased overall piece sorting productivity, this increase has been partially offset by lower productivity at many individual processing operations. The offsetting reductions in productivity, they argue, manifest themselves as a concurrent increase in the proportion of not handling costs. They argue that the disproportionate increases in the “mixed all-shapes” costs, and the costs of “not handling” empty equipment provide particularly strong inferences that increased proportions of not handling costs reflect increases in non-productive time. *Id.* at 13844 (Stralberg citing Tr. 11/5565); Tr. 26/14061-62 (Cohen).

[3112] The presort mailers argue that the Postal Service has not demonstrated a causal connection between the portion of mixed mail and not handling costs that represent overhead to the piece handlings performed in specific MODS pools. Therefore, they argue, distributing those variable overhead costs to the subclasses receiving direct IOCS tallies in that pool would be arbitrary. The presort mailers argue that their proposed alternative distribution procedure has several advantages for not handling costs. Because it uses broad distribution keys based on CAG, craft, and basic function, they argue, it avoids issues concerning why an employee was observed at a particular operation, and the degree to which specific operations are interrelated, because employees do not shuttle between CAGs or facilities during a shift. They argue that where subclass responsibility for mixed mail and not handling costs are unclear at the MODS pool level, it is better to distribute these costs to subclasses in proportion to their share of the entire workload during a shift (basic function). Tr. 26/14055 (Cohen).

(d) Institutionalizing Mixed Mail and Not Handling Costs

[3113] The presort mailers characterize the rate of growth in the general overhead component of mixed mail and not handling costs as "alarming." Because there is no satisfactory explanation for such growth, they argue, at least a portion of these costs should be assumed to be the result of inefficiency rather than of increased volume. They argue that the Commission should treat a portion of the $2.7 billion in overhead costs that the Postal Service considers to be volume variable as institutional cost. *Id.* at 14057-62 (Cohen).

[3114] The presort mailers argue that there are circumstances under which it is better to treat volume variable costs as institutional rather than arbitrarily distribute them to subclasses. They argue if an employee were made surplus in a facility as a result of automation and were then detailed to a non-automated processing operation where he was not needed, the wage cost of that employee should be treated as institutional. They assert that Postal Service witness Degen has acknowledged that institutional treatment would be appropriate under this circumstance. *Id.* at 140159, 14061 (Cohen).

[3115] MPA witness Cohen concedes the difficulty in identifying a specific portion of overhead that should be considered to result from inefficiency, but offers several alternative estimates. She notes that a 1994 benchmarking study performed for the Postal Service by Christensen Associates estimates that if the productivity of the top 25 percent of mail processing facilities were achieved by the remaining 75 percent, it would reduce mail processing costs by 20-25 percent. Witness Cohen concludes that applying the more conservative 20 percent figure to the mixed mail and not handling portion of mail processing costs would imply that about $1 billion in mail processing costs could be inferred to be the result of inefficiency. *Id.* at 4061. Witness Cohen also calculates what the effect on mail processing costs would be if the productivity levels experienced in FY 1988 were applied to FY 1996 on an operation-by-operation basis. She estimates that this would reduce variable mail processing costs in FY 1996 by about $900 million. She argues that the mixed mail and not handling portion of that reduction would be $450

million. *Ibid.* Finally, she argues that the not handling costs associated with the mixed all-shapes and the moving empty equipment activity codes (about $1.05 billion) reflect inefficiency "almost by definition." *Ibid.* Witness Cohen prefers to use the $1 billion estimate that she infers from the Christensen Associates study as the measure of variable mail processing labor costs that should be treated as institutional. She revises her proposed distribution of variable mail processing costs accordingly in Exhibit MPA-2 F.

(4) Distribution Method Proposed by UPS

[3116] UPS argues that Postal Service witness Bradley's mail processing variability analysis should be rejected and that the Commission should adhere to the established assumption that most mail processing labor costs are 100 percent volume variable. It argues, however, that the validity of Postal Service witness Degen's proposed distribution of mail processing costs is independent of the particular piece handling variabilities estimated by witness Bradley. UPS witness Sellick argues that witness Degen's distribution of mixed mail and not handling costs within MODS pools has two distinct advantages over the established method: it links those costs with the operational characteristics of mail processing, and it incorporates the available information on the contents of items and containers more completely into the distribution of mixed mail costs. Tr. 26/14163. Witness Sellick contends that neither of these advantages of witness Degen's method depend on the particular variability estimates provided by witness Bradley, and neither are affected by the defects in witness Bradley's TPH data. *Id.* at 14171.

[3117] In his direct testimony, witness Sellick estimated attributable mail processing labor costs under the established assumption that most of mail processing labor costs are 100 percent volume variable. He did this by identifying those costs that are considered mail processing under witness Degen's proposed method but window service and administrative under the established method. He transferred those costs back to the

window service and administrative components to which they belong under the established method, and adjusted their variability consistent with their status as window service or administrative support costs. He also adjusted the variability of the portion of platform costs that is considered fixed under the established method.[23] He then applied witness Degen's method of distributing IOCS tally dollars within MODS pools, by item and container type.

[3118] In defending witness Degen's proposed distribution method, witness Sellick argues that stratifying IOCS tally costs by MODS pools better ties subclass processing costs to the operations and machine types that drive those costs, than do the established stratifications by CAG, craft and basic function. For example, he argues, witness Degen's method assumes that the subclass shares of mixed mail costs found at the OCR operation resemble those found in direct mail only in the OCR operation. Witness Sellick argues that this assumption is more reasonable than the established assumption that they resemble the subclass distributions of direct mail costs at both OCR and non-OCR operations.

[3119] Witness Sellick regards associating not handling costs with particular operations and machine types as a particularly significant improvement in tracing the subclass responsibility for those costs. *Id.* at 14167. For example, he argues, there is a need to differentiate the distribution of not handling costs associated with moving empty equipment by equipment type because some subclasses are more dependent on containerization and related handling equipment than others. He also postulates a relationship between the increased use of automation and the likely demand for increases in break time. *Id.* at 14168-69.

[3120] Witness Sellick argues that stratifying costs and distributions by item type and container type captures the correlation of those strata with subclass. He notes that in Docket No. R94-1, the presort mailers demonstrated the likelihood that there is a

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[23] *See* Tr. 26/14173 and UPS-Sellick-WP-1-A2, pages 3-4. Witness Sellick performed a more complete adjustment of these costs in response to P.O. Information Request Nos. 11 and 16. *See* UPS-Sellick-WP-2-A.

selection bias in the way mixed mail is counted by showing that uncounted mail was statistically significantly different from counted mail with respect to the processing operations and the item types in which it was found, and that these characteristics were correlated with subclass. In this docket, he argues, the Postal Service has reduced the likelihood of selection bias by stratifying IOCS tallies by these characteristics, and by container type. Tr. 26/14169-70.

[3121] Witness Sellick also attempts to rebut the presort mailers allegations that counted mixed mail is a biased distribution key for uncounted mixed mail. He asserts that the percent of mail eligible for counting that has been counted has increased to 52 percent from 27 percent in Docket No. R94-1. When he applied the same statistical tests that the presort mailers used in R94-1, to the expanded set of counted data in this docket, he concluded that there is no statistically significant difference between counted and uncounted mixed mail with respect to most of the characteristics that the presort mailers examined in R94-1. Tr. 36/19481-82.

(5) Postal Service Distribution Under Established Variability Assumptions

[3122] In response to a discovery request by the OCA, the Postal Service provided an estimate of attributable mail processing labor costs under the established assumption that most of those costs are 100 percent variable with volume. Instead of removing costs related to window service and administrative support from the mail processing component, as witness Sellick had done, the Postal Service left them in mail processing, but adjusted their variability to reflect the variability of the window service or the administrative component, as appropriate. The Postal Service then distributed the resulting variable mail processing costs using the method proposed by witness Degen. *See* PRC Order No. 1203 (December 9, 1997), and USPS-LR-H-315.

(6) Distribution Method Proposed by RIAA *et al*.

[3123] Witness Andrew, on behalf of the Recording Industry Association of America and Advertising Mail Marketing Association (RIAA, *et al.*), asserts that the use of an average variability for non-MODS offices does not allow the distribution key to be properly weighted to reflect the variabilities of individual cost pools. According to witness Andrew, the resulting distribution of volume variable costs by shape for each subclass and the subsequent calculation of cost differences between flat and letter costs per piece is meaningless. Tr. 22/11661-62.

[3124] To remedy the problem, witness Andrew proposes to accept the Services distribution of volume variable costs to subclasses for non-MODS offices, but to redistribute those costs to shape on the basis of piece volumes. He does this by aggregating the volume variable costs by subclass, then redistributing those costs on the basis of piece volume by letter, flat, and parcel shapes, and then adding the results. The impact is to drop the difference between parcels and flats from 23.41 cents per piece under the Service's proposal to 21.08; a difference of 2.33 cents. *Id.* at 11663.

[3125] Witness Degen rebuts witness Andrew's claim that the use of an average variability for the non-MODS office is flawed. He cites a calculation by witness Bradley in which a partition of non-MODS costs into subgroups by sorting activity based on IOCS tallies results in an average variability of 77.9 percent. Tr. 11/5359-60. Witness Degen then distributes these non-MODS costs by subgroups and notes that the result is not very different from the Postal Service's proposed distribution. From this, witness Degen concludes that the criticisms of witness Andrew are inconsequential, even if they may have theoretical validity. Tr. 36/19360-62. On brief, the Service presents additional calculations showing that witness Andrew's proposed distributions imply variabilities that are too low to be believed for flats (57 percent), and for parcels (26 percent). Postal Service Brief at V-165.

[3126] The Postal Service notes that distributing costs in proportion to piece volume assumes that each shape has the same unit cost within non-MODS offices. To illustrate

where this assumption fails, the Service points out that in non-MODS offices, some flats are received already sorted to carrier route, while others require such sorting. In contrast, all parcels in non-MODS offices require a carrier route sort. *Ibid.*

[3127] The Postal Service validly argues that it is not reasonable to assume that parcels and flats have the same unit processing costs in non-MODS offices. The magnitude of the problem does not warrant discarding the IOCS information that shows that processing costs differ by shape and replacing it with the dubious assumption that all pieces incur costs equally.

c. Postal Service Rebuttal

[3128] The Postal Service's rebuttal witnesses note that both the presort mailers and UPS advocate a decoupling of witness Bradley's variability analysis and witness Degen's distribution method for mail processing labor costs — one so that witness Bradley's variabilities can be rejected, the other so that witness Degen's distributions can be rejected. The Postal Service's witnesses argue that in order to calculate economically meaningful marginal costs, witness Bradley's variability analysis and witness Degen's distribution method cannot be separated. Tr. 34/18223; Tr. 36/19319-20. They assert that the established IOCS/LIOCATT-based method for distributing mail processing costs distributes variable costs to subclasses outside the MODS pool in which variability was determined. They argue that this blurs the relationships between MODS-pool cost drivers and mail processing costs estimated by witness Bradley, and departs from economically meaningful marginal cost. Tr. 34/18219-23.

[3129] To obtain economically meaningful marginal costs, the Postal Service insists, distribution keys must be selected that provide estimates of the variabilities of mail volumes with respect to the cost drivers used. By urging that the link between witness Bradley's within-pool cost drivers and within-pool distribution keys be severed, the Postal Service argues, the presort mailers violate the theory set forth by witness

Panzar linking unit volume variable costs and economic marginal costs. Tr. 34/18221-23.

[3130] Witness Christensen, somewhat vaguely, also argues that UPS witness Sellick may not consistently employ witness Degen's distribution methods at the same time that UPS witness Neels challenges witness Bradley's "analytical framework." *Id.* at 18224.

[3131] Witness Christensen responds to the presort mailer's argument that cross-pool distribution keys are needed to distribute the costs of interrelated MODS pools such as automated and manual letters. He argues that if such interrelationships exist, they should be explicitly modeled. He argues that the proper modeling approach is to maintain the MODS pool distinctions, add cost drivers from related pools to the pool being modeled, weight the relative effects of the cost drivers, and develop a properly weighted distribution key for all within-pool IOCS tallies — direct, as well as mixed, and not handling. He argues that the presort mailers' distribution is not a valid method for taking cross-pool relationships into account. He complains that it assumes no cross-operation causality relationships for "direct" costs because it assigns them straight to the subclass indicated by the IOCS, while it "indiscriminately applies cross-operation distributions" for mixed mail and not handling costs. *Id.* at 18225. With respect to allied MODS pools, witness Christensen acknowledges that witness Bradley models their variability using as a proxy cost driver an index of cost drivers from the MODS distribution operations that the allied MODS pools support. He appears to concede that this implies cross-pool causality, but argues that "taking the … cost driver literally for distribution purposes would understate the costs of presorted mail categories by ignoring their contribution to workload in allied operations." *Id.* at 18226. He describes witness Degen's distribution of allied pool costs, somewhat opaquely, as "a hybrid of the distribution key method and the "piggyback" method," citing USPS-LR-H-1, Appendix H.

[3132] Witness Christiansen denies that the problems alleged by the presort mailers with witness Degen's distribution keys create any ambiguity in the causal link between witness Bradley's cost drivers and subclass volumes. Because witness

Bradley's variability estimates definitively establish causation for all costs within a given MODS pool, he argues, there are no grounds for treating any variable mail processing costs as institutional. Nor, he contends, are there grounds for departing from witness Degen's within-pool distribution keys, since IOCS tallies by themselves cannot establish volume variability. Tr. 34/18227-28.

[3133] DMA witness Buc shows that the Postal Service's overall productivity is low relative to the manufacturing sector of the economy. From this witness Buc infers that mail processing productivity is inefficient. Witness Christensen argues that overall Postal Service productivity is more validly compared with total private nonfarm business multifactor productivity. He concludes that the growth rate in the Postal Service's Total Factor Productivity is "similar" to nonfarm multifactor productivity, and therefore does not support an inference of inefficiency. *Id.* at 18230-31.

[3134] On rebuttal, witness Degen addresses the presort mailers' allegation that the growth in mixed mail and not handling costs reflects growth in excess labor capacity in mail processing operations, most likely from automation refugees. He argues that any excess labor capacity would already be reflected in the degree to which witness Bradley's variability estimates are less than 100 percent. To institutionalize any additional mail processing labor costs, he argues, would be double counting. Tr. 36/19323, 19340.

[3135] Witness Degen argues that the presort mailers are misinterpreting the growth in mixed mail and not handling tallies as evidence of inefficiency. He argues that part of the growth in not handling tallies came about in FY 1992 when data collectors were instructed not to ask employees to pick up mail if they were observed at a time that they were not handling mail. He purports to show graphically that this change in instructions caused a pronounced spurt in the growth of not handling tallies. *Id.* at 19321-22. He argues that mixed mail and not handling time is predominantly productive time that varies from MODS pool to MODS pool because the nature of the operation affects its proportion of not handling time. (As he explains it, the more movement of mail

an operation involves, the more empty backhaul it will involve, and therefore the more not handling cost it will incur). *Id.* at 19338-42.

[3136] Witness Degen argues that the growth in not handling costs reflects the growth of centralized, automated, and containerized mail processing, rather than increasing inefficiency. *Id.* at 19321. He also asserts that growth trends in not handling costs refute the presort mailers' automation refugee theory. He asserts that since 1986, when the automation program began, not handling costs in allied operations have grown about 50 percent, while they have tripled in non-allied operations. *Id.* at 19343-44. Postal Service witness Steele, purporting to provide the plant manager's perspective on the automation refugee theory, insists that management policy is to intensely manage staffing at allied operations to squeeze out any excess capacity there. Tr. 33/17843-55.

[3137] Witness Degen responds to the presort mailers' charge that his distribution method rests on untested assumptions. He contends that his basic assumption is the same as under the established method, namely, that the subclass distribution of costs that are unknown are the same as the subclass distributions of costs that are known. He contends that his distribution method, which uses highly specific operation-, item-, and container-defined cost pools, is an improvement over the established method. He argues that because operation, item type, and container type can have strong subclass associations, distributing mixed mail and not handling costs in those pools only to the subclasses detected there necessarily yields less biased distributions. Tr. 36/19326-27.

[3138] Witness Degen asserts that operational experience confirms that confining cost distributions within specific operations reduces bias. Like the presort mailers, he argues the likelihood of biased distributions is greatest in allied operations. He argues that IOCS data collection procedures are biased against non-presorted mail. Because non-presorted mail is more likely to be observed being handled as an individual piece, and presorted mail is more likely to be observed being handled in an item or container, he argues, non-presorted mail is more likely to generate a direct tally. Since the costs of mixed mail and not handling are distributed on direct tallies, he argues, a disproportionate amount of those costs will be distributed to non-presorted mail under

the broad keys used in the established method. Because distribution operations primarily handle individual pieces, and allied operations primarily handle items or containers, he reasons, presorted subclasses will escape identification to the extent that they bypass distribution operations in a facility. To correct this bias, he argues, it is necessary to distribute all costs within a given allied operation to the direct tallies recorded in that operation.

[3139] According to witness Degen, neither circumstantial evidence nor operational experience would suggest that direct tallies suffer from either counting or selection bias. He asserts that most mixed mail tallies occur when the data collector observes an employee not handling mail at a particular operation. Because such tallies are unrelated to any particular mail, he argues, there is little opportunity for a data collector to select or count mail in a biased way. *Id.* at 19329. Witness Degen also argues that the issue isn't whether counting or selection bias exists, but whether they are increased or reduced by confining distributions to MODS pools, item-type, and container-type. He argues that they are reduced. He notes that the presort mailers advocate that mixed mail tallies associated with a particular shape be distributed on direct tallies of the same shape, on the assumption that shape correlates with subclass. He argues that confining distributions to specific operation-based merely strengthens the subclass correlation that shape-based distributions would capture, even if the correlation of operation with subclass isn't perfect. *Id.* at 19330-31. Witness Degen purports to illustrate this point by showing the distribution of costs for the allied pool "1Canc MPP" where cancellation and pref mail preparation is performed. He shows that the broad distribution key that the presort mailers would apply based on basic function would distribute a substantial share of these costs to non-pref mail, even though there is no reason for non-pref mail to be processed in this pool.

d. Commission Analysis

(1) Summary of the Commission's Findings and Conclusions

[3140] For reasons explained in the Commission's discussion of mail processing variability, the Commission has decided to adhere to the established assumption that most mail processing costs are 100 percent variable with volume. Before applying these variabilities, it is first necessary to apportion Segment 3 costs according to the established method. The Commission does this in the manner demonstrated by UPS witness Sellick.

[3141] The Commission must also consider whether it is consistent to adhere to the established variability assumption and yet adopt the Postal Service's proposal to distribute variable mail processing costs within operation-specific MODS pools. The Postal Service insists that the distribution method and the variability analysis must be consistent if a meaningful causal connection is to be maintained between subclass volumes and the costs that they cause. The Postal Service argues that to maintain the causal link, 1) costs must be organized into pools of related processing activities that have a shared response to a common workload or "cost driver," and 2) variable costs must be distributed in proportion to the IOCS tallies in each pool in order link subclass volumes to the workload or costs that they "drive."

[3142] In the previous section, the Commission explained why it concludes that its established assumption of 100 percent variability is a more reliable estimate of variable costs than the Postal Service's flawed econometric estimates. In this section, the Commission concludes that, in general, MODS pools are valid groupings of operations around common workload or "cost drivers." Therefore, distributing variable MODS pool costs, as the Commission estimates them, in proportion to the subclass volumes processed within each pool, as inferred from IOCS tallies, associates subclass volumes with the costs they cause at least as meaningfully as if the Postal Service's variability estimates were used. For these reasons, the Commission adopts the Postal Service proposal to partition mail processing costs into operation-specific MODS pools.

[3143] In general, the Commission adopts the basic Postal Service/UPS proposal to organize mail processing costs into operation-specific pools and distribute costs in each pool to the subclasses that appear there. It believes that this is an improvement over the established method because it clarifies the relationship between variable costs and the subclasses that are responsible for those costs. But there is an important exception. The Postal Service has not shown that the direct IOCS tallies in allied pools reliably reflect the ambiguous workload measures or “cost drivers” in the allied pools. Because some allied functions are internal to each allied pool, while others primarily support other pools, the Commission concludes that a combination of IOCS direct tallies from within each allied pool and the IOCS direct tallies across all pools will provide a better indication of the subclasses responsible for the various kinds of allied workload.

[3144] Having concluded that stratifying cost distributions by MODS pool generally clarifies subclass cost responsibility, the Commission must consider whether further stratifying within-pool distribution keys by item type and container type reduces bias in direct tallies, as the Postal Service and UPS claim, or increases it, as the presort mailers claim. The additional stratifications proposed by the Postal Service, in general, are sensible criteria for distributing mail processing costs. MODS operation, item type, and container type tend to have strong shape associations, and therefore distinct subclass associations. For this reason, these additional stratifications should generally reduce bias in direct tallies when they are used as proxies for the distribution of mixed mail and not handling costs. Accordingly, the Commission applies these additional stratifications when it distributes costs within MODS pools on direct tallies within those pools.

[3145] Although the Commission includes these additional strata in its distribution keys, it recognizes that their correlations with subclass are imperfect, and the opportunities for bias remain. The Commission concludes that as long as a substantial portion of mixed mail is uncounted, the potential for significant selection bias against mail that is presorted, non-preferential, or bulky in shape remains. It also concludes that the potential for significant assumption bias remains. For this reason, the Commission urges

that the Postal Service test the degree of bias that remains by selective audits of sampled facilities.

[3146] The Commission concludes that the risk of both selection bias and assumption bias is greatest in the allied pools. This is because allied pools process all shapes and types of mail, and allied pools are where most mail is handled in bulk and its subclass identity is obscured. An additional reason for using a broader distribution key for allied mixed mail is that direct tallies are typically a small portion of total tallies in each allied pool, which magnifies the effect of any bias in the direct tallies within the pool. The Commission concludes that distributing mixed mail in allied operations in proportion to direct tallies in all pools is needed in order to reduce these risks.

[3147] In Table 3-2, the results of the Commission's recommended distribution of Segment 3 variable labor costs are compared with those that would result from the established distribution method as well as those proposed by the Postal Service, Time Warner, and UPS. A direct comparison cannot be made between proposed distributions that assume different levels of variability. For the distribution methods that assume 100 percent variability, however, it can be seen that the results of the Commission's recommended distribution fall about midway between the highly stratified distributions proposed by UPS, and the results of using the broad distributions keys applied by the established method, and advocated by Time Warner and other presort mailers.

[3148] The presort mailers argue that the rapid growth in mixed mail and not handling costs reflects automation refugees or other inefficiencies associated with automation. The Commission finds that the circumstantial evidence for this inference is inconclusive, but warrants systematic investigation. It makes a similar finding with respect to the rising unit processing costs of Periodical mail.

(2) The Commission Adopts the Established Apportionment of Segment 3 Costs to Its Components

[3149] To develop Segment 3 attributable costs, it is necessary for the Commission to decide how Segment 3 accrued costs should be apportioned among the mail

processing, administrative, and window service components. The variability of Segment 3 costs depends on whether a specific cost element is categorized as administrative, window service, or mail processing, before its variability is evaluated. For this reason, adhering to the established variability assumption for mail processing costs requires adherence to the established apportionment of Segment 3 costs among its components, based on IOCS activity codes. Accepting witness Bradley's MODS pool variabilities, as the Postal Service and the presort mailers propose, requires accepting the reapportionment of Segment 3 costs that is implied by organizing Segment 3 activities by MODS codes. UPS, which endorses the established 100 percent variability assumption, accepts the established apportionment implied by IOCS activity codes. UPS witness Sellick identifies those IOCS tallies that the Postal Service subsequently reclassified as mail processing using MODS codes, and restores them to the administrative and window service components to determine their variability on that basis, consistent with the established method.

[3150] Because the Commission has decided to adhere to the established assumption that most mail processing labor costs are 100 percent volume variable, it also apportions Segment 3 clerk and mail handler costs to its mail processing, window service, and administrative components according to the established criteria, as demonstrated by witness Sellick in his responses to Presiding Officer's Information Request Nos. 11 and 16. Given its decision to adhere to the established apportionment of Segment 3 costs to its components, and the established assumption that most mail processing costs are 100 percent volume variable, the Commission next must decide what distribution approach best implements those decisions.

(3) Ability of Alternative Distributions to Estimate Subclass Marginal Cost

(a) The Postal Service/UPS Distributions Can be Interpreted as Subclass Marginal Cost Under the Established Variability Assumption

[3151] The Postal Service insists that to obtain an economically meaningful estimate of the marginal costs of mail processing labor, an empirical estimate of the variability of those costs with respect to an appropriate cost driver, such as witness Bradley's Total Piece Handlings, must be provided. Distribution keys must then be selected that link the variability of the cost driver to subclass volumes. It emphasizes that witness Bradley provides the only empirical estimate of cost driver variability on this record. The Postal Service argues that both UPS and the presort mailers violate the theory set forth by witness Panzar linking unit volume variable costs and economic marginal costs because they do not maintain the link between witness Bradley's within-pool cost drivers and within-pool distribution keys. Tr. 34/18221-23.

[3152] In the previous section, the Commission concluded that the econometric models of piece handling variability provided by witness Bradley provide a less reliable estimate of mail processing volume variability than the established assumption that most mail processing costs vary proportionately with volume. The Commission concluded that equally valid variations of witness Bradley's models provide results that indicate that overall variability of mail processing labor with piece handlings is as likely to be above 100 percent as below. The Commission concluded that a reliable econometric estimate would require different models that more adequately accounted for the influence on labor costs of volume-related factors in addition to piece handlings. For this reason, the Commission decided to adhere to its long-established assumption that mail processing labor costs vary in proportion to volume.

[3153] Given that the established proportionality assumption is the best estimate of the volume variability of mail processing labor, the question remains whether the causal link that must be inferred between these variable mail processing costs and subclass

volumes is affected by the manner in which cost pools are defined and their costs are distributed to subclasses. The Commission concludes that it is.

[3154] Postal Service witness Christensen concedes that a rather involved sequence of assumptions is necessary to support the Postal Service's conclusion that witness Bradley's variabilities coupled with witness Degen's method of distribution yields economically meaningful marginal costs.[24]

[3155] According to witness Christensen, the key assumptions that allow witness Degen's distributions to be interpreted as marginal costs are that IOCS tallies are the equivalent of the "productivity-weighted subclass distribution of TPH" and that subclass TPH is a fixed proportion of subclass volume. These assumptions have not been empirically investigated by the Postal Service and are substantial oversimplifications of the real relationships posited here.[25] The established 100 percent variability assumption does not explicitly assume that TPH in a given MODS pool is the cost driver for that pool.

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[24] Because witness Bradley estimates the elasticity of workhours with respect to Total Piece Handling (TPH) in each MODS pool, the subclass distribution of TPH is the theoretically appropriate distribution key. Witness Christensen acknowledges, however, that the Postal Service does not know the subclass distribution of TPH. It uses the subclass distribution of IOCS tallies, which indicate the proportion of time spent handling mail of various subclasses at MODS operations, as a proxy for the correct distribution key. Witness Christensen argues that within a MODS pool, the total amount of variable tally dollars distributed by this key to a subclass of mail is the equivalent of subclass marginal cost for that MODS operation. Tr. 34/18219-21.

Witness Christensen concedes that subclass tally dollars will equal subclass marginal cost for a given MODS pool only if an intricate sequence of untested assumptions hold. The subclass distribution of processing time reflected in IOCS tallies, he argues, may be assumed to be equal to the productivity-weighted subclass distribution of TPH. Then, he argues, by the chain rule of calculus, the elasticity of MODS pool cost with respect to subclass TPH can be multiplied by the elasticity of subclass TPH with respect to subclass volume to yield subclass volume variable (marginal) cost for that MODS pool.

Witness Christensen recognizes that the Postal Service has not estimated the elasticity of subclass TPH with respect to subclass volume. He asserts, however, that one may assume that subclass TPH in a MODS pool is a fixed proportion of subclass piece volume, at least over a period as short as one year. Witness Degen concedes that there are many reasons for believing that the proportion changes over time. But he argues that it is approximately fixed within the base year, and therefore one may assume that the elasticity of subclass TPH with respect to subclass is one. Tr. 12/6603. Subclass distribution keys may be constructed at the MODS pool level, witness Christensen argues, because unit volume variable costs may be aggregated to overall total marginal cost for a given service. Tr. 34/18221-23.

[25] The Postal Service asserts that accepting this pair of rather loose assumptions has the effect of curing TPH of any bias or instability that there might be in its relationship with subclass volume.

Under the established variability assumption, IOCS tallies might be assumed to be the equivalent of the productivity-weighted subclass distribution of TPH, as the Postal Service chooses to assume in its variability analysis. It would be equally reasonable for the Commission to assume that IOCS tallies are the equivalent of the workload-weighted subclass distribution of pieces. Whether viewed as the equivalent of appropriately weighted piece handlings, or appropriately weighted pieces, it is necessary to further assume that IOCS tallies are proportional to subclass volume, if the result is to be interpreted as subclass marginal cost.

(b) It is Difficult to Interpret the Presort Mailers' Distributions as Subclass Marginal Costs Under Their Variability Assumptions

[3156] An important consequence of the 100 percent variability assumption is that it allows mixed-mail costs to be distributed within MODS pools or across MODS pools, as the facts warrant, and still be interpreted as subclass marginal costs. If, as the presort mailers argue, mail processing cost variability differs across MODS pools, mixed mail costs cannot be distributed across MODS pools as the presort mailers propose without distorting the distributions in a way that destroys the necessary link between the MODS pool-defined cost driver and subclass volume. The reasons become evident when the distribution process is examined.

[3157] "Direct" costs consist of variability-weighted tally dollars that are directly associated with specific subclasses. Because they are already associated with particular subclasses, it is immaterial in what order subclass tally dollars are aggregated (e.g., individually, by MODS pool, or by groups of MODS pools). The subclass distributions of mixed mail and not handling tally dollars, however, are unknown. The task is to determine whether direct costs within the same MODS pool, or direct costs across some set of MODS pools, provides a more accurate image of the subclass composition of the mixed mail costs. If, as the presort mailers contend, the subclass composition of direct costs in a set of related MODS pools provide a truer image of the

subclass composition of mixed mail costs in the principal MODS pool, that image will be distorted if the direct costs in the related MODS pools have been adjusted by an array of distinct variability factors. Cross-pool distributions do not suffer from this distortion if all MODS pools are considered to be 100 percent volume variable.

[3158] Following UPS witness Sellick, the Commission applies the established variability assumption to accrued mail processing costs and distributes mixed mail and not handling costs on direct costs within MODS pools, by item type, and container type. The Commission's assumption that most of the costs in each MODS pool are 100 percent variable is as reasonable as the variability assumptions used by witness Degen. The Commission is as free as witness Christensen to assume that IOCS tallies represent appropriately weighted subclass distributions of total piece handlings in each pool, and as free as witness Christensen to assume that there is a fixed proportion between IOCS tallies associated with a subclass and pieces of that subclass. It is therefore as reasonable to interpret the Commission's distributions as subclass marginal cost as it is to interpret witness Degen's distributions that way.

[3159] Time Warner witness Stralberg, and MPA witness Cohen apply witness Bradley's variability estimates to accrued mail processing costs in each MODS pool, but distribute mixed mail and not handling costs on direct costs within CAG and basic function, essentially following the established method. Because their distribution key for mixed mail and not handling costs is a set of direct tally costs that cuts across a broad group of MODS pools, the connection between subclass volumes (whose distribution is inferred from IOC tallies) and the workload or "cost driver" in any particular MODS pool is remote. In addition, in a given MODS pool, this distribution key is presumed by the presort mailers to be the "mirror image" of the subclass distribution of mixed mail costs. This "mirror image," however, is distorted because the direct tally costs incorporated in it have already been substantially reweighted to reflect the distinct variability of the MODS pool they came from. This puts further distance between witness Bradley's cost drivers in individual MODS pools and subclass volumes in those pools. It is therefore more difficult to interpret the results of the distribution proposed by the presort mailers as

subclass marginal costs. Their proposed distribution method conflicts with their endorsement of the individual MODS pool variabilities estimated by witness Bradley. USPS-RT-6 at 2.

(4) Organizing Processing Costs by Specific MODS Operations Clarifies Subclass Cost Responsibility

[3160] The Commission adopts the Postal Service's proposal to organize mail processing costs in operation-specific MODS pools because it finds that they are, in general, valid groupings of processing operations around common workload or "cost drivers." Previously, in its discussion of mail processing variability, the Commission explained why it concludes that its established assumption that most mail processing labor costs vary in proportion to volume is a more accurate estimate of volume variable costs than the Postal Service's flawed econometric estimates. Therefore, distributing variable MODS pool costs, as the Commission estimates them, in proportion to the subclass volumes processed within each pool, as inferred from IOCS tallies, more accurately associates those variable costs with the subclass volumes that cause them. For this reason, distributing variable mail processing costs to subclasses in proportion to their IOCS tallies within operation-specific MODS pools is an improvement over the established distribution by basic function.

(5) Stratifying Distributions by MODS Pool, Item Type and Container Type Generally Reduces Bias

[3161] Under the established distribution method, after IOCS tally dollars are weighted by CAG and craft, they are organized by basic mail processing function (outgoing, incoming, transit, etc.) There is general agreement that direct IOCS tallies remain a biased key for distributing mixed mail and not handling costs under the established method, although the preponderant direction of the bias (in favor of or against presorted mail) remains in dispute. Under the method proposed by the Postal

Service and UPS, weighted tally dollars are organized by highly specific MODS pools, and further stratified by item type and container type. The question is whether the more detailed stratification proposed by witnesses Degen and Sellick is likely to increase or reduce that bias.

[3162] The Commission agrees with witnesses Degen, USPS-T-12 at 6-10, and Sellick, Tr. 26/14163, that stratifying IOCS tally costs by MODS pools better ties subclass processing costs to the operations that are likely to drive those costs, than do the established stratifications by CAG and basic function. It is reasonable to assume that the subclass shares of mixed mail costs incurred at a given operation will bear a closer resemblance to those found in the direct mail costs only at that operation than at a group of operations, unless the direct handlings are only incidentally related to the cost driver in that pool.

[3163] The Commission recognizes that distributing mixed mail and not handling costs within a specific MODS pool is likely to oversimplify causation, because it assumes that there is no interdependence among pools. The Postal Service admits, for example, that the workload in the automated letter sorting MODS pool affects the workload in the manual letter sorting MODS pool, where rejects and overflow from the automation pool are processed. (USPS-T-14 at 15-17). It also admits that much of the workload in allied pools is closely related to the workload in the distribution operations that they support. *Id.* at 18. Still, the effect of the within-pool cost driver is likely to be dominant, except, perhaps, in allied pools.

[3164] The Commission agrees with witness Sellick that associating not handling costs with particular operations is an improvement in tracing the subclass responsibility for those costs. Tr. 26/14167-69. For example, it is plausible that the workload in a given cost pool determines its staffing level, which, in turn, determines the amount of general overhead required (break time, clocking time, and personal needs).

[3165] The Commission agrees with witnesses Degen and Sellick that stratifying cost distributions by item type and container type is likely to reduce bias in the established IOCS distribution keys because it captures the correlation of those strata

with subclass. Tr. 36/36/19330-32 (Degen); Tr. 36/19477-82 (Sellick). Witness Sellick notes that in Docket No. R94-1, the presort mailers demonstrated the likelihood that there is a selection bias in the way mixed mail is counted by showing that uncounted mail was statistically significantly different from counted mail with respect to the processing operations and the item types in which it was found, and asserted that these characteristics were correlated with subclass. In this docket, witness Sellick argues, the Postal Service has reduced the likelihood of selection bias by stratifying IOCS tallies by essentially the same characteristics, as well as by container type. Tr. 26/14169-70.

[3166] Witness Sellick undermines the presort mailers' argument that counted mixed mail is a biased distribution key for uncounted mixed mail. He shows that the percent of mail eligible for counting that has been counted has increased from 27 percent in Docket No. R94-1 to 52 percent in this docket. Applying the same statistical tests that the presort mailers used in R94-1 to the expanded set of counted data in this docket, he demonstrates that there is no longer a statistically significant difference between counted and uncounted mixed mail with respect to most of the characteristics that the presort mailers examined in R94-1. Tr. 36/19481-82 (Sellick). This implies that the bias involved in distributing uncounted mixed mail costs on counted mixed mail costs has been reduced.

(6) The Stratifications Adopted by the Commission May Not Eliminate Bias

(a) The Potential for Selection Bias Remains

[3167] The potential for significant selection bias remains despite the highly stratified distributions proposed by witness Degen and Sellick. In Docket No. R94-1, the Commission rejected a proposal to distribute uncounted items on the subclass composition of counted items because it had concluded that the selection of items to count was not random. Tr. 26/13831-32 (Stralberg); Tr. 26/14047-48 (Cohen); Tr. 28/15523-24 (Shew). The Commission found it plausible that understaffed IOCS

data collectors select items that are easy to count, because the item contains relatively few, large pieces, such as items containing periodicals and parcels. It also found it plausible that data collectors tend to select non-preferential mail items to count, because counting them is less likely to prevent such mail from meeting a critical dispatch. The proportion of eligible items that has been counted is higher in the base year in this docket, and this form of potential selection bias appears to have been reduced. The potential problem continues to be significant, however, because the opportunity and the incentive to count the easiest items remains.

[3168] The fact that trays and sacks that contain parcels and magazines still make up the large majority of the item types that are counted, even though they are unlikely to be the majority of mail in those item types overall, implies that some selection bias may occur in distributions stratified by MODS pool, and item type. While some MODS pools process mail that is predominantly non-preferential, or flat or parcel shaped, such correlations are far from perfect. The opportunity remains in many pools to select the subclasses of mail that are easier to count. Tr. 26/13831 (Stralberg); DMA Brief at 22-23. In addition, bundles on pallets are examined for subclass content, while bundles in containers are not. This is because pallets are considered “items,” while containers are not. This distinction appears to be arbitrary, and may lead to a disproportionately high rate of identical item tallies for periodicals, which typically appear as bundles on pallets. Tr. 26/13837-39 (Stralberg).

(b) The Potential for Significant Assumption Bias Remains

[3169] The potential for significant assumption bias also remains despite the highly stratified distributions proposed by witnesses Degen and Sellick and adopted by the Commission. The basic assumption that the subclass composition of mixed mail and not handling costs within a given MODS pool mirrors the direct costs in that pool is most questionable in the allied pools. This is because allied pools tend to be composites of a number of distinct functions. Generally, the predominant allied function is to prepare

mail for, and transfer mail to, the direct distribution pools in a facility. Another distinct function is to process mail that bypasses distribution operations and forward it to another facility. Tr. 36/19225-26 (Cohen citing witness Bradley).

[3170] *Potential bias against presorted mail in allied pools*. To model allied pools accurately, it is necessary to identify distinct cost drivers for each of the multiple allied functions described above. Witness Bradley explains this need to model multiple functions with multiple cost drivers in describing the BMC platform operation. USPS-T-14 at 20-21. The same need applies to most allied MODS pools. To distribute allied costs to subclasses accurately, there must be some assurance that the direct mail costs in a given allied pool fairly reflect the effects of both the distribution support function and the bypass processing function. *See* Tr. 36/19285; Presort Mailers Brief at 12-13. Witness Degen has not provided this assurance. The cost driver that reflects the distribution support function in the allied MODS pools is an index of TPH at the various distribution MODS pools developed by witness Bradley. Witness Degen, however has not provided a satisfactory way to relate the direct tally costs within a given allied pool to the Bradley cost driver, which measures the workload in the supported distribution pools.

[3171] Witness Degen himself explains why the subclass distribution of direct mail costs in allied pools is not likely to be a fair reflection of the subclasses that will receive subsequent piece sorting in the MODS distribution pools. He recognizes that the IOCS tally system is biased because it relies on direct tallies to distribute tallies whose subclass distributions are unknown. He explains that mail that receives an individual piece distribution typically receives a direct tally, but mail traveling through the system in bulk without being broken down for piece distribution typically does not (presumably because it is typically observed in mixed items or containers rather than in identical items or containers). For this reason, mail in allied pools that is prepared for, and moved to, the piece-distribution MODS pools typically does not receive a direct tally until it reaches those distribution pools. Tr. 36/19353. If this is true, the subclass composition of direct costs in allied pools provides a less accurate picture of the subclasses that are

subsequently piece sorted in the distribution MODS pools than the subclass composition of direct costs in the distribution pools themselves.

[3172] The presort mailers agree that mail that receives an individual piece distribution is likely to receive a direct tally and that mail that travels in bulk in mixed items and containers is not. What witness Degen overlooks, they argue, is that presorted mail typically travels through allied pools in bulk in *identical* (or easily counted) items or containers. For that reason, they argue, presorted mail is much more likely than other mail to receive a direct tally in allied pools, even though it less likely than other mail to receive a subsequent piece distribution. Tr. 36/19285. This, they say, is why presorted mail makes up most of the direct tallies in allied pools,[26] and why these tallies provide a poor picture of the subclasses in allied pools that are subsequently piece sorted in the distribution pools. For these reasons, the presort mailers argue, the distribution key in allied operations should reflect the subclass composition of the direct costs in the distribution pools. Presort Mailers Reply Brief at 12-13. The Commission concludes that this argument is valid.

[3173] *Potential bias in allied pools in favor of presorted mail.* The sources of bias described above have another distinct effect. Presorted mail receives most of its processing in allied, rather than in distribution pools. It is also more likely than other mail to bypass the distribution pools altogether. To the extent that it is bypass mail that is observed by the data collector in mixed rather than in direct items and containers, it is likely to avoid responsibility for the cost of its allied processing. According to witness Degen, a major benefit of distributing mixed mail costs on the direct costs within the same MODS pool is that it forces presort mail to accept responsibility for its mixed mail costs in allied pools. Tr. 36/19353. What witness Degen overlooks is that the relationship between the direct tally costs in allied pools and the bypass processing function is tenuous, at best. In witness Bradley's models of the allied MODS pools there is no cost driver for the bypass processing function. As a result, there is no way for the

[26] This inference is supported by the fact that Periodicals and Standard A receive over 80 percent of all direct item costs in all pools. Tr. 26/13840 (Stralberg).

Postal Service to know whether the direct costs in a given allied pool provide an accurate picture of the subclasses that receive this kind of processing.[27] Witness Cohen recognizes the need for bypass mail to be held responsible for the processing costs that it incurs within allied pools. That is why she agrees, at least in principle, that allied mixed mail costs should be distributed in proportion to a combination of direct costs taken both from within the allied pool and across the distribution MODS pools. *Id.* at 19269.

[3174] *Greater risk of sample error in allied pools.* The risk that witness Degen's distribution keys for allied pools suffer from the biases described above is magnified by the fact that direct costs are a small minority of the total costs in most allied pools. For example, 10 percent of the costs in the platform MODS pool are direct, while 90 percent are mixed and not handling costs. All else being equal, the risk that a 10 percent sample misrepresents the whole is much greater than the risk that a 75 percent sample misrepresents the whole.

(7) Using Cross-Pool Tallies to Distribute Mixed Mail Costs in Allied Pools is an Interim Solution

[3175] The Commission's conclusion that the adopted stratifications reduce bias is tentative, and requires further study. On balance, the Postal Service's proposed changes to its method for distributing mail processing labor costs appear to have reduced the risk of biased distributions. The Postal Service has reduced the proportion of eligible mixed mail that it fails to count. This reduces the potential influence of selection bias. It has stratified its distribution by MODS pool, item type, and container

[27] Witness Stralberg provides a convincing example of why the subclass composition of direct costs in particular strata in allied pools is unlikely to provide an accurate picture of the subclasses processed as bypass mail. The Degen approach distributes the costs of loose letters in containers in proportion to the costs of direct letters out of containers. Witness Stralberg argues that in the allied pools, both collection mail and presorted mail appear as loose mail outside of containers, but that presorted mail rarely appears loose in containers because that would destroy its presortation. The individual piece handlings of presorted mail that occur at allied operations, he argues, are anomalous, resulting only from such things as accidentally broken bundles. For that reason, he argues, they provide a poor picture of the presorted subclass content of mixed containers in allied pools. Tr. 26/13836 (Stralberg); Tr. 26/14049-50 (Degen), Tr. 14124 (Cohen).

type, which are likely to be correlated with subclass. For MODS pools that are reasonably self-contained, this approach is likely to reduce the risk of bias. Even there, however, the Commission's conclusion that the potential for bias has been reduced is tentative.

[3176] Dow Jones witness Shew points out that it is not enough to compare the size of the bias in the Postal Service's proposed distribution method with that in the established method. He argues that the degree to which biases in the distribution keys offset each other is also an important consideration. It is possible that distributing mixed mail and not handling costs by basic function allows biases to effectively cancel each other.[28] For this reason, witness Shew argues, the fact that MODS pools might be correlated with subclass doesn't necessarily mean that a distribution based on MODS pools is less biased. He also points out that if witness Degen's highly stratified distribution produces less bias, but the bias is more systematic, it is not necessarily an improvement over the established method. Tr. 28/15556.

[3177] For the allied MODS pools, the Postal Service has not solved the problem of identifying direct costs that accurately reflect subclass responsibility for either their distribution support functions or bypass processing functions. The net effect of these two forms of bias is uncertain, but the potential bias is very large. Witness Cohen has demonstrated that whether allied mixed mail costs are distributed only on allied direct costs, or on all direct costs, has an enormous impact on Periodical, Priority, and Standard B mail. Tr. 36/19229.

[3178] The Degen/Sellick method should be modified to ameliorate these potentially large biases, and the uncertainty that comes from using a small number of within-pool direct tallies as distribution keys. That is why the Commission concludes that mixed mail costs in a given allied MODS pool should be distributed in proportion to the direct costs across all MODS pools, and that not handling costs in a given allied pool

[28] Witness Cohen supports this inference when she demonstrates that her overall subclass distribution of mixed mail costs by basic function is very close to the overall subclass distribution of direct costs. Tr. 26/14092.

should be distributed on the combination of its direct costs and its redistributed mixed mail costs. It does so on the understanding that this is an interim solution to the lack of data on the true subclass distribution of mixed mail and not handling costs.

[3179] The Commission agrees with witness Shew that the assumption that uncounted mixed mail costs have the same subclass distribution as direct mail costs is one that could be tested, if not systemwide, at least by spot sampling. Tr. 28/15527-28. It would appear that an approach similar to the one that the Postal Inspection Service used to audit MODS data could be used to audit IOCS distribution keys. Under that approach, a small number of offices could be selected for an audit and an adequate audit team provided to count all eligible mixed mail items at the selected facility. The Postal Service should also consider collecting information that identifies the presence of mail of particular shapes and subclasses in containers, even if it is not counted. It is also clear that better models of cost responsibility for allied operations are urgently needed.

(8) Institutionalizing “Inefficient” Mail Processing Costs

[3180] The presort mailers characterize the rate of growth in the general overhead component of mixed mail and not handling costs as “alarming.” Because there is no satisfactory explanation for such growth, they argue, at least a portion of these costs should be assumed to be the result of inefficiency rather than of increased volume. They argue that the Commission should treat a portion of the $2.7 billion in overhead costs that the Postal service considers to be volume variable as institutional cost. Tr. 26/14057-62 (Cohen).

[3181] The presort mailers argue that if an employee were made surplus in a facility as a result of automation and were then detailed to a non-automated processing operation where he was not needed, the wage cost of that employee should be treated as institutional. They assert that Postal Service witness Degen has acknowledged that institutional treatment would be appropriate under this circumstance. *Id.* at 14059, 14061. The presort mailers assert that this scenario explains the rapid rise in the

proportion of mail processing costs that are overhead, and the reduced productivity in the allied operations whose costs are distributed disproportionately to presorted mail. They speculate that when employees are not needed at automated operations, they are diligently clocked out of those operations and sent to allied operations, where they temporarily "hide" from the direct scrutiny of management productivity tracking programs until they are needed again.

[3182] In support of this theory, the presort mailers claim that most not handling tallies, and most of the increase in not handling tallies, occur at non-automated operations. Tr. 26/13960. They show that not handling tallies are a much higher percentage of total tallies in MODS pools in which productivity is not measured (essentially the MODS pools for allied operations). Tr. 26/13843 (Stralberg); Tr. 26/14051 (Cohen). They note that Postal Inspection Service reports have found that managers have an incentive to shift temporarily idled employees from piece-sorting operations where productivity data is gathered to allied operations where such data is not gathered, and to have employees clock initially into allied operations until it is determined that they are needed elsewhere. *Ibid.*

[3183] MPA witness Cohen concedes the difficulty in identifying a specific portion of overhead that should be considered to result from inefficiency, but offers several alternative estimates. She notes that a 1994 benchmarking study performed for the Postal Service by Christensen Associates estimates that if the productivity of the top 25 percent of mail processing facilities were achieved by the remaining 75 percent, it would reduce mail processing costs by 20 percent, or $1.0 billion. She notes that if the productivity levels experienced in FY 1988 were applied to FY 1996 on an operation-by-operation basis, this would reduce variable mail processing costs in FY 1996 by about $900 million. She argues that the mixed mail and not handling portion of that reduction would be $450 million. *Id.* Finally, she argues that the not handling cost associated with the mixed all-shapes and the moving empty equipment activity codes (about $1.05 billion) reflect inefficiency "almost by definition." *Id.* Witness Cohen prefers to use the $1 billion estimate that she infers from the Christensen Associates study as

the measure of variable mail processing labor costs that should be treated as institutional. She revises her proposed distribution of variable mail processing costs accordingly in Exhibit MPA-2 F.

[3184] Postal Service witness Steele's description of management policy regarding allied operations is diametrically opposed to the actual management practices described by the Postal Inspection Service. He insists that management policy is to intensely manage staffing at allied operations to squeeze out any excess capacity there. Tr. 33/17843-55.

[3185] Witness Degen argues that the growth in not handling costs has legitimate explanations. He contends that part of the growth in not handling tallies came about in FY 1992 when data collectors were instructed not to ask employees to pick up mail if they were observed at a time that they were not handling mail. Tr. 36/19321-22. He also asserts that since 1986, when the automation program began, not handling costs in allied operations have grown about 50 percent, while they have tripled in non-allied operations, refuting the theory that these costs are the result of refugees harbored at allied operations. *Id.* at 19343-44. Witness Degen argues that mixed mail and not handling time is predominantly productive time. Their growth, he argues, reflects the growth of centralized, automated, and containerized mail processing, rather than increasing inefficiency. *Id.* at 19321, 19338-42.

[3186] Witness Degen's explanation of the reasons for the growth of not handling time are not fully satisfactory. His assertion that witness Bradley's mail processing variability analysis provides all the causal information necessary to attribute not handling costs is not persuasive. The MODS pools where witness Bradley's estimated variabilities are relatively low are not consistently those with high ratios of not handling costs. *See id.* at 19342.

[3187] Witness Stralberg argues that the various components of not handling costs should be analyzed individually, and that the IOCS data would allow them to be tracked in more detail than the Postal Service apparently attempts. Witness Stralberg is probably correct that understanding the unsettling trends in not handling costs will

require a model that relates them to the staffing strategies pursued by management. Witness Shew supports this suggestion, commenting that if there is a management strategy to staff operations with some reserve capacity to handle various kinds of peak loads, the effects of that strategy should be modeled and related to the way that costs are attributed to subclasses. Tr. 28/15525-26. The Postal Inspection Service reports strongly suggest that the official management staffing strategy described by witness Steele is not the full story. The Commission urges the Postal Service to make a more systematic inquiry into the causes of rising not handling costs, as these witnesses suggest.

[3188] Even though the Postal Service's explanations of the growth of not handling costs are not fully satisfactory, the circumstantial evidence is not sufficiently strong to allow the Commission to institutionalize a portion of variable mail processing costs. The indirect evidence for excess staffing in allied operations that is available does not line up consistently with the presort mailers' automation refugee theory. If it did, the difficulty in quantifying the portion of variable processing costs that are the result of this form of inefficiency remains a formidable obstacle to institutionalizing them.

(9) Growth in the Unit Costs of Periodicals

[3189] The Periodicals mailers as a group have questioned recent trends in Periodicals costs. *See* especially MPA witness Little, Tr. 27/14543-47. They reference numerous occasions in the past, when similar issues have been raised, including an unsuccessful attempt by the Commission to look into the matter in Docket No. RM92-2.[29] *See* Tr. 26/14029-39 (Cohen). Central to the presentation made by these intervenors is a graph of various costs, by year, since Fiscal Year 1986, presented by witness Little. The graph shows that Periodicals costs have grown much more rapidly than clerk and mailhandler wage rates, as well as more rapidly than the costs of certain other

[29] The lack of success was due largely if not entirely to the refusal of the Service to cooperate with the inquiry.

subclasses, including Standard A and First Class. Witness Cohen argues that these results are tied to the phenomenon of “automation refuges” and to the growth in mixed mail and not-handling tallies.

[3190] Witness Cohen and others argue that Periodicals mailers have made investments over this time that would be expected to reduce the cost of the mailstream, including changes in mail preparation, additional presorting, additional drop shipping, additional barcoding, and improved addresses. They also refer to the expected benefits from automation investments made by the Service. They argue that these changes should have kept the increase in costs for Periodicals below the average increase in wages.

[3191] Though not developed in depth, the Commission finds the argument that additional worksharing should have reduced costs has some plausibility. It must be noted, however, that increased worksharing has taken place in virtually all classes of mail, so it is difficult to say which subclasses should exhibit the larger effects. For letter-shaped mail, the cost effects of automation may well have been larger and more pronounced than for flat mail. For this reason, the Commission does not find it particularly surprising that the cost trend for First Class is below that of Periodicals.

[3192] On rebuttal, witness Degen demonstrates that the unfavorable Periodical cost trends are moderated considerably when a different year is used as the baseline. Using Fiscal Year 1989, which was the base year for Docket No. R90-1, he shows that Periodicals costs do not appear to be substantially out of line with trends in wages. *See* Tr. 36/19344-49.

[3193] Witness Degen also argues that mailers have taken advantage of relaxed pallet preparation requirements in recent years, and that this may have increased the costs of Periodicals. His analysis, however, did not include consideration of many other possible mailer changes that could have been analyzed from routine billing determinant data for Periodicals. He agreed that he “had not studied the issue sufficiently to offer a comprehensive plan for a meaningful analysis.” *Id.* at 19352.

[3194] The effect of selecting different baseline years for comparing the unit cost trends for Periodicals with trends in wages, and in the costs of other mail, leaves the extent of the problem faced by Periodicals mailers somewhat unclear. These issues are important. The analysis presented thus far by the Service is incomplete, not well developed or examined, and may be selective. For this reason, the Commission welcomes the cooperative inquiry into the costs of Periodicals mail that is planned by the Postal Service and the industry.

(10) Data Issues

[3195] *Data thinness*. MPA witness Cohen and DMA witness Buc assert that the elaborately stratified distribution keys proposed by the Postal Service result in 1,540 possible distributing sets for 21,000 direct tallies, compared to 960 possible distributing sets for 90,000 direct tallies in the established IOCS/LIOCATT distribution method. DMA Brief at 25, n.16. They contend that this results in unacceptably large coefficients of variation for mixed mail cost distributions. For example, they contend that 30 percent of the distributing sets that the Postal Service uses for uncounted and empty mixed items (representing 10 percent of those costs) are distributed on five or fewer tallies They argue that the distributing sets for mixed containers show data thinness problems of a similar magnitude for mixed container costs. Tr. 26/14052-53 (Cohen); Tr. 28/15371-72 (Buc).

[3196] Because of this data thinness, they argue, 70 percent of the sets of subclass costs which make up the Postal Service's distribution keys have coefficients of variation (a measure of relative sampling error) greater than 50 percent. Because such keys are not statistically significantly different from zero, they argue, they are not a suitable basis for distributing mail processing costs. Tr. 26/14053, 14119 (Cohen); Tr. 28/15382 (Buc).

[3197] The Postal Service responds by arguing that the increase in the number of partitions of the IOCS data before development of distribution keys, because they are correlated with subclass, strengthen subclass associations and reduce bias, even when

shape is not identified. Tr. 36/19330-31. Witness Degen notes that in cost attribution, reducing bias nearly always takes priority over efficiency concerns. Postal Service Brief at III-105.

[3198] In order to refute the concerns about efficiency, witness Bradley uses bootstrapping techniques to estimate coefficients of variation (CVs)for the mail processing cost estimates for both the new method and the established LIOCATT-based method. The Postal Service argues that the CVs from the new method are only marginally higher, and demonstrate that they reduce bias without significantly reducing efficiency. Tr. 36/19336.

[3199] The Postal Service also points out that while witness Degen's method may increase the number of instances in which the distribution of mixed mail tallies is based on less than five direct tallies, the total amount of costs distributed on this basis is small. *Id.* at 19335.

[3200] The Commission agrees that, on balance, the additional stratifications proposed by witness Degen are likely to reduce bias compared to the established distribution keys, without a significant loss of efficiency. The thinness of the data remains a legitimate concern, and ways of reducing the problem should continue to be investigated. For instance, the benefits of broadening a distribution key when fewer than five direct tallies are available should be explored. For allied pool costs, the Commission has attempted to mitigate the problem by distributing mixed mail costs on the basis of direct tallies from all pools and not just the minority of direct tallies within a given allied pool.

[3201] *Misclocking*. The Postal Service's proposed distribution method uses IOCS direct costs in the MODS pool in which an employee is clocked to distribute uncounted mixed mail and not handling costs. Employees, however, are not always clocked into the MODS pool in which they are working. The presort mailers argue that the extent of misclocking is substantial. They cite a Postal Inspection Service report that concluded that in the facilities examined, employees often did not clock into their actual MODS operation number after receiving their work assignments, but "used any timeclock and

operation number that was convenient. In order to get 'on the clock' as soon as possible, employees used the first timeclock they came to when beginning their tour and returning from lunch." DMA Brief at 29 (citing USPS-LR-H-236 at 19); *see* Tr. 26/13916-17; Tr. 26/14052; Tr. 28/15377. The presort mailers contend that misclocking is revealed by inappropriate tallies showing, for example, that window service or administrative costs were being distributed using mail processing distribution keys. Tr. 29/13847-48; Tr. 26/14120; Tr. 28/15377-78. They note that misclocking distributes the cost of one MODS operation to subclasses handled in another MODS operation. They argue that this problem does not affect distributions under the established IOCS/LIOCATT distribution method. DMA Brief at 30.

[3202] The Postal Service argues that the Inspection Service reports do not have general applicability, since they did not randomly sample facilities to audit. Witness Degen speculates that a substantial portion of the reported misclocking probably occurred between operations within a MODS pool, which would not affect the distribution results. Postal Service witness Steele argues that misclocking is likely to be rare, because supervisors have financial incentives to correct any clocking errors between operations pool that might negatively affect productivity measured in their operations. Tr. 18/8330-31.

[3203] The Commission recognizes that the misclocking reported by the Postal Inspection Service is a potentially serious source of bias for cost distributions, particularly for allied pools. Managers have an incentive to accurately clock the operations for which they are responsible, which is likely to limit the incidence of misclocking across management areas. A more systematic survey of this problem is warranted.

[3204] *Tally reweighting*. Because the MODS system was not designed to relate costs of operations to subclasses, the Postal Service uses IOCS tallies to distribute MODS pool costs to subclasses. Because the accrued costs for a given MODS pool do not equal the sum of all IOCS tally costs within a MODS pool, the IOCS tally costs must be reweighted to conform to the accrued costs derived from the MODS data. Witness Buc contends that the need for tally reweighting arises not from intrinsic wage

differences among the MODS pools as the Postal Service claims, but from misclocking and sample error. Tr. 28/15377; DMA Brief at 31. He notes that tally reweighting of over 10 percent is required in almost half of the MODS pools. Witness Buc argues that reweighting produces inaccurate cost distributions because it causes the cost for two IOCS tallies for the same activity taken within the same CAG and craft to differ depending on the operation into which the employee is clocked, rather than reflecting "actual cost differences." Tr. 28/15376.

[3205] In rebuttal, the Postal Service emphasizes that mail processing wages vary across Labor Distribution Codes (LDCs), but that the current LIOCATT does not take this into account. It argues that this causes a bias in the current method which its proposed method eliminates. Additionally, the Service asserts that the proportions for distributing the payroll costs come from the IOCS data and are "obviously unaffected" by the reweighting. Postal Service Reply Brief at III-84.

[3206] The Postal Service rejects witness Buc's argument that the need to reweight tallies is due to misclocking and sampling errors. It discounts DMA's inference of a misclocking problem from the way that IOCS tallies are associated with cost pools. It argues that any discrepancy due to sampling error is not a problem introduced by the new system, since sampling is part of the existing IOCS. The new system is claimed to be an improvement, since it reduces dependence on quantities that are known to have sampling error. *Id.* at III-87.

[3207] The Commission believes that estimated costs should reflect wages actually paid to the greatest extent possible. If a particular subclass of mail uses mail processing operations with lower-than-average wage rates, then the subclass should receive the benefit of the lower wages in the calculation of attributable costs. The reweighting proposed by the Postal Service is a necessary step if the distribution key derived from the IOCS tallies is to be applied to payroll system costs. While potential misclocking, and sample error in the IOCS data remain, they are counterbalanced by the likely reduction in bias that results from the use of implicit average wages in the LIOCATT. The

Commission does not agree that the reweighting is a grounds for rejecting the distribution method proposed by the Service.

(11) Detailed Description of the Commission's Recommended Distribution

[3208] The Commission follows witness Sellick's proposed distribution of Segment 3 volume variable costs to subclasses for all cost pools except for the following:

- For offices with MODS, nine cost pools: Platform; Pouching Operations; Opening Unit - Preferred Mail; Opening Unit - Bulk Business Mail; Mechanized Sort - Sacks Outside; Manual Sort - Sacks Outside; Bulk Presort; Cancellation and Mail Preparation; and Air Contract DCS; and Incoming.

- For BMCS, two cost pools: Platform and "Other."

[3209] Witness Degen in LR-146, JCL and Program Listings at 19, refers to these nine MODS pools as "all allied pools". Following this pattern all eleven of these pools are referred to here as "allied pools." For the remainder of the cost pools, the Commission uses labor costs exactly as calculated by witness Sellick.

[3210] There are three types of costs to be distributed. As defined by witness Degen they are costs associated with: direct tallies, which are directly associated with a particular class or subclass; mixed tallies, for which the subclass association is unknown, but the type of item or container being handled is known; and not handling tallies.

[3211] In all pools, including the above listed allied pools, the Commission distributes the direct and not-handling-mail costs in the manner proposed by witness Sellick. The direct tallies are used to distribute costs within each cost pool. Not-handling-mail costs are also distributed within each pool, but in proportion to the combination of the direct tallies from that pool and the distribution of mixed mail costs developed for that pool.

[3212] Witness Sellick generally distributes mixed mail costs for each pool on the basis of the direct tallies in that pool, by item and container type. Two exceptions are: (1) when there are no direct tallies available of the same item and container type on which to base a distribution and (2) when the tallies are from MODS offices for items in containers in the platform pool operation. For the first exception, when no direct allies are available in the pool, witness Sellick distributes costs on the basis of direct tallies across all pools. For the items in containers on the platform, a special distribution key is created that uses direct tallies from the nine MODS office allied pools listed above.

[3213] In allied operations, the Commission recommends that direct costs and not handling costs be distributed in proportion to the IOCS tallies within each pool, as the established method does. With respect to allied mixed mail costs, however, the Commission recommends that they be distributed in proportion to the direct costs in all pools. For MODS offices, allied mixed mail costs are distributed in proportion to all MODS direct costs. For BMCs, mixed mail costs analogous to allied costs are distributed in proportion to all BMC direct costs.

[3214] The purpose of distributing allied mixed mail costs in proportion to the direct costs in all pools is to reduce the risk of the various forms of selection and assumption bias that remain in the Sellick method. For reasons described earlier, the Commission concludes that the risk of these forms of bias is higher in the allied pools than in pools generally. Distributing allied mixed mail costs in proportion to direct costs in all pools also reduces the risk that biases in allied direct tallies will be magnified by the greater risk of sampling error due to the relatively small proportion of direct tallies found in allied pools.

[3215] The Commission's modification of the Sellick method by using an all-pool direct tally key to distribute allied mixed mail costs is similar to that proposed by witness Buc. He distributes all non-direct tally costs on the basis of direct tallies in all pools. The Commission's all-pool direct tally key is also similar to the approach that witness Sellick applies to certain mixed mail cost strata where there are no direct tallies within a MODS pool to provide a distribution key. The Commission applies its all-pool direct tally key to

a narrower set of mixed mail costs than witness Buc, but a wider set of mixed mail costs than does witness Sellick.

[3216] In applying its all-pool mixed mail key to allied mixed mail costs, the Commission stratifies direct tallies by mail shape to the extent that shape information is available. With respect to shape stratification, the Commission's modification applies the approach established in Docket No. R94-1, and the approach proposed by witnesses Stralberg and Cohen.

[3217] Within a given allied pool, the Commission distributes not handling costs in proportion to the combination of that pool's direct tallies and the Commission's all-pool direct tally key for mixed mail costs. Given the Commission's conclusion that each allied pool has bypass processing functions that are performed within the pool, and support functions that cross pool boundaries, the Commission concludes that combining within-pool direct tallies with its all-pool direct tally mixed mail key yields a key that is more likely to be a balanced representation of the subclasses responsible for the not handling costs arising from both allied functions.

[3218] The Commission's method for distributing allied pool costs involves three major steps. Within each of these three major steps, several subordinate distribution steps are taken to apply the available shape information in conformity with the established method. For example, mixed tally costs for which the shape is known are distributed on the basis of all direct tallies for the same shape from all pools. This requires three separate distributions corresponding to letters, flats and parcels. A fourth distribution is required for the mixed tallies that do not have a shape identified. Once the distributions of the direct, mixed and not handling costs are developed, the results are added. The distributed costs are then adjusted proportionately so that the total distributed costs for the pool match the total pool costs calculated by witness Sellick. This is same adjustment that witness Sellick makes so that distributed costs from the IOCS tallies equal the total dollars for the Service's payroll accounting systems. These adjusted distributions are the direct mail processing labor costs by subclass that are carried forward into the other cost analyses of this docket.

[3219] The SAS programs presented by witness Sellick are used to output, in spreadsheet form, the direct tallies for each allied pool, by shape and subclass. For a small number of direct tallies associated with Express, Priority and international mail, the shape is not recorded. These tallies are distributed to the letter, flat and parcel costs within the subclass in proportion to the distribution of tallies for which the shape is recorded. The sum of the resulting tallies for each shape and subclass form the distribution of direct tallies for each pool.

[3220] There are also a number of direct tallies for which a class of mail is known but the subclass is not known. These have the IOCS identifiers 5300 through 5461, and are identified in LR-H-1 as Mixed Mail Codes: Mail Classes and Combinations of Mail Classes. LR-H-1 at p. B-12. The Commission uses the instructions in LR-H-1, Exhibit E, to distribute these tallies to subclasses.

[3221] The Commission modifies witness Sellick's SAS programs in UPS LR-8 and 9 to separate mixed mail costs into the categories of letter, flat, parcel, and "shape unknown," for each allied pool. The "shape unknown" category includes tallies identified as all shapes, empty equipment, or as having no shape designation. The direct tallies from all pools are used as the basis for distributing mixed mail costs to subclasses. The distribution key for letters is developed with the direct tallies from all pools that can be associated with a letter shape. The percentage of costs associated with each subclass is calculated and multiplied by total mixed mail letter costs to obtain the distributed mixed letter-shape costs. The flat and parcel mixed-shape costs are calculated in the same manner. The direct tallies from all pools are also used to calculate the percentage of costs that accumulate in each shape/subclass combination. To obtain the distribution of these costs, these percentages are then multiplied by the sum of the costs from mixed mail with unknown shape for each allied pool. The sum of the distributions from known and unknown shape tallies constitutes the distribution of the mixed mail costs.

[3222] For each of the allied pools, the sum of the distributed direct and mixed mail costs are added to create the distribution key for not handling costs. The not handling costs for which the letter, flat, or parcel shape is identified are distributed on the sum of

the direct and mixed mail distributions for the respective shapes. The not handling costs for which shape is not identified are distributed on the basis of the combination of direct and mixed letter, flat, and parcel, direct and mixed costs. Direct, mixed, and not handling costs are then added for each allied pool to obtain the distribution of the IOCS tally costs. The distributions of the tally costs are proportionally adjusted so that the sum of the distributed costs will equal the total costs from the payroll accounting system for each cost pool.

[3223] Total costs to be distributed are obtained by applying witness Sellick's SAS programs, with some minor modifications. Witness Sellick's SAS programs are used to distribute the direct tallies. The distribution of the total mixed and not-handling is accomplished with Excel spreadsheets. Each step in the distribution process summarized here is presented in detail in PRC LR-4, along with the spreadsheet calculations and SAS programs.

[3224] The Commission's distribution of mail processing labor costs is the sum of the distribution for the allied pools by the process described above and for the non-allied pools, following witness Sellick's approach.

B. Carrier Costs

1. Preliminary Issues

[3225] The presentations in this docket have led to significant progress in the analysis of city delivery carrier street time costs, particularly with respect to motorized letter route costs and coverage-related load time costs. It has been difficult, however, to translate this progress into more accurate attributable costs, because the basic data on which city delivery carrier cost attribution must rely come largely from obsolete special studies that no longer conform to current delivery operations or the current state of analysis.

[3226] The Street Time Sampling (STS) survey is a tally-based work-sampling system similar to the IOCS. It was conducted in 1986, and has been used in all rate cases since then to apportion city delivery carrier street time among its basic functions. Its proportions applied to base year payroll costs determine the relative size of runtime, load time, travel time, and street support time. There is a substantial inconsistency between the base year accrued costs of the basic components of carrier street time implied by the STS data and the base year accrued costs of the same components implied by the models that the Postal Service uses to determine attributable access, route, and load time costs in this docket.

[3227] For example, Postal Service witness Nelson's proposed method for estimating the volume variability of the motorized portion of letter routes gives rise to a substantial inconsistency between the established model of variable runtime and STS-derived accrued runtime costs. As explained in more detail in section 4, the established method of estimating attributable access and route time costs begins with total STS-derived accrued runtime costs. Under the established method, the portion of accrued runtime costs that varies with stops (access time) and the portion that does not (route time) is obtained by applying a stops variability factor estimated from a regression that uses data from the Curbline and Foot Access Test (CAT/FAT). The CAT/FAT

experiment, last conducted in 1989, simulates how all runtime, including drive time, responds to different levels of stop coverage. To facilitate witness Nelson's analysis of the variability of the motorized portion of letter routes in this docket, the Postal Service subtracts from total accrued runtime the $501.3 million associated with driving time before it multiplies runtime by the CAT/FAT stop variability factors to obtain access time and route time.

[3228] Subtracting the costs of driving time from runtime prior to applying the CAT/FAT stop variability factors, however, is inconsistent with the design of the CAT/FAT study, for reasons explained in the discussion of motorized letter routes. To reconcile them, a new CAT/FAT simulation is required that separates the effect of stop coverage on driving time from the effect of stops on other runtime. At the same time, the new CAT/FAT study should be based on coverage levels that are more representative of current levels, and eliminate other defects that were identified at pages III-21-22 of the Commission's Opinion in Docket No. R90-1.

[3229] Another basic study that is not consistent with the STS-derived street time costs is the Load Time Variability (LTV) study. Conducted in 1985, this study is an engineering study of the volume variability of load time. It implies a total base year accrued load time cost that is substantially less than that derived from STS proportions. Reconciling the accrued load time amounts implied by the STS-based proportions with those implied by the LTV study requires the Commission to choose between conflicting, unverified assumptions. These choices are discussed in more detail in section 3.

[3230] It would be far preferable to have current, valid studies that are structured to allow these choices to be made on an empirical basis. This would require new STS and LTV studies that define a consistent boundary between access and load time. In this regard, new studies should address the problem of how to define and account for the carrier's common practice of selecting mail from various bundles and combining them for delivery at the next stop while still walking toward that stop. A new LTV study should also avoid the substantial bias that is likely to arise if sample measures of employee performance are taken only when the employee is aware of the sampling.

[3231] The new LTV study should also be designed to remedy the inconsistencies between the established LTV model and current delivery operations. Volumes of detached label and Delivery Point Sequenced mail, which were small or non-existent in 1985 when the LTV study was conducted, now account for a substantial portion of delivered volume. As Postal Service witness Baron recognizes, these volumes are now handled as separate bundles by the carrier, and should be modeled as distinct shape variables if their effect on load time is to be captured. Tr. 10/5225. A related development of potential significance is the pronounced trend since 1985 toward using cluster boxes rather than single delivery residential boxes. This has the potential to alter both the typical access and the typical load time characteristics of stops and is an additional reason for concluding that the CAT/FAT and LTV studies are obsolete and should be updated.

2. Runtime Variability

[3232] City Carrier street time on letter routes is apportioned to its constituent functions in proportion to tallies gathered in the 1986 Street Time Survey (STS). One of those functions is runtime, defined as the time that it takes a carrier to travel between stops on his route. Under the established analysis, runtime is decomposed into “route time,” defined as the time that a carrier requires to traverse his route without deviating from it to access delivery points, and “access time,” defined as the time that a carrier spends deviating from his route to access delivery points. Regression analysis is used to identify the portion of runtime that varies with the number of stops covered. That portion is then multiplied by the volume variability of stops to estimate volume variable access time. The portion of runtime that does not vary with the number of stops accessed is regarded as fixed route time, which is an institutional cost.

[3233] Elasticities of runtime with respect to covered stops are derived from regression analysis of data collected in a 1988 survey known as the Curbline and Foot Access (CAT/FAT) Study. This study evaluated carrier activity on a random sample of

438 city carrier routes: 161 curbline routes, 78 foot routes, and 199 park and loop routes. In an experimental simulation, carriers were observed traveling over a designated portion of each test route five different times, accessing a different percentage of possible stops on each run. The carriers delivered no mail, but paused at each stop to mark a data collection sheet. Of the five experimental runs conducted on each route, one was at 100 percent coverage, one at 90 percent, and one each at 80 percent, 70 percent, and 60 percent. For each run, data collectors recorded the time expended by the carrier (i.e. the runtime) at the various levels of coverage.[30]

[3234] The established runtime variability model has been in use since Docket No. R90-1. It is a more general version of the model proposed in that docket by the Postal Service witness Colvin in USPS-T-7, and proposed again in this docket by witness Baron. The established model has the following specification:

$$RUNTIME_{it} = \alpha_0 + \sum_{i=1}^{n} \beta_{1i}*\mathrm{STOPS}_{it}*\mathrm{ROUTE}_i + \sum_{i=1}^{n} \beta_{2i}*\mathrm{STOPS}_{it}^2*\mathrm{ROUTE}_i + \sum_{i=1}^{n-1} \alpha_i*\mathrm{ROUTE}_i + \sum_{j=1}^{8}\sum_{t=1}^{4} \gamma_{jt}*\mathrm{RUNUM}_t*\mathrm{RTYPE}_j$$

where there are n routes, indexed by i, 5 runs for each route, indexed by t, and 8 route types, indexed by j.[31]

[3235] The established model form is quadratic. The cost driver is STOPS. A separate slope coefficient is estimated for the STOPS and for the STOPS squared variable for each route. In addition, a separate intercept coefficient is estimated for each combination of run and route type.

[3236] Because each test route in the CAT/FAT study had unique characteristics, dummy variables were included to control for route-specific factors. To control for any

[30] Details of the CAT/FAT test implementation, field instructions, and data collection and recording were presented in Docket No. R90-1, Exhibit USPS-7A, and USPS LR F-187 through F-190.

[31] USPS-T-17 at 49. Route_n and RUNUM_5 are excluded from the estimation to ensure that the independent variable data set is nonsingular.

"learning curve" effect that would influence running time, a dummy variable was included to control for the run number. The model is estimated separately for three route groups - curbline, foot, and park & loop - producing one regression for each group. *See* PRC Op. R90-1, para. 3052, and PRC LR-10.

[3237] Witness Baron proposes restricting the established model to require all of the STOPS and $STOPS^2$ coefficients to be equal across all routes, and to require all of the run number coefficients to be equal across all route types. The model that the Postal Service proposes has the following specification:

$$RUNTIME_{it} = \alpha_0 + \beta_1 * \mathrm{STOPS}_{it} + \beta_2 * \mathrm{STOPS}_{it}^2 + \sum_{i=2}^{n} \alpha_i * \mathrm{ROUTE}_i + \sum_{t=2}^{5} \gamma_t * \mathrm{RUNUM}_t$$

where there are n routes indexed by i, and 5 runs for each route, indexed by t.[32]

[3238] The table below compares route group elasticities and the resulting accrued access costs estimated by the established model with those estimated by the model proposed by the Postal Service.

[32] USPS-T-17 at 46. $ROUTE_1$ and $RUNUM_1$ are excluded from the estimation to ensure that the independent variable data set is nonsingular.

Table 3-3
FY 1996 Accrued Access Costs ($000)

	ACCRUED RUNTIME COSTS	ELASTICITY (USPS)	ELASTICITY (PRC)	ACCRUED ACCESS COSTS (USPS)	ACCRUED ACCESS COSTS (PRC)
CURBLINE ROUTES					
SDR	$ 542,638	.494	.439	$ 268,193	$ 238,399
MDR	34,550	.487	.396	16,813	13,671
BAM	53,353	.498	.463	26,563	24,681
TOTAL	$ 630,541			$ 311,570	$ 276,751
FOOT ROUTES					
SDR	$ 177,844	.596	.666	$ 105,938	$ 118,497
MDR	49,342	.597	.679	29,471	33,525
BAM	76,194	.598	.683	45,543	52,059
TOTAL	$ 303,380			$ 180,953	$ 204,081
PARK & LOOP ROUTES					
SDR	$2,202,723	.480	.562	$1,056,426	$ 1,237,479
MDR	172,629	.470	.616	81,077	106,410
BAM	270,000	.482	.546	130,191	147,318
TOTAL	$2,645,352			$1,267,694	$ 1,491,207
TOTAL					
SDR	$2,923,205			$1,430,557	$ 1,594,375
MDR	256,521			127,361	153,606
BAM	399,547			202,298	224,058
GRAND TOTAL	$3,579,273			$1,760,217	$ 1,972,039

Source: USPS-T-17 at 65 (Table 22).

[3239] As noted, witness Baron advocates imposing a single, common slope coefficient on the STOPS and $STOPS^2$ terms, which assumes that the individual route coefficients are equal. He also advocates imposing a common slope coefficient on each run number variable, which assumes that the individual route type coefficients are equal.

In Docket No. R90-1, the Commission explained why it believed that the Postal Service should have tested these restrictions statistically to see if they were consistent with the data, rather than simply adopting those assumptions *a priori*. At paras. 3053-54 of its Opinion, the Commission stated

> [w]ithout testing for statistical significance, it is not prudent to assume that most of the variation in the FAT/CAT data arises from variations within routes due to variations in the five coverage levels, rather than to variations across routes due to variations in their physical characteristics. The Postal Service itself states that the purpose of the FAT/CAT test is to measure the effect of those characteristics, as we noted above. It is plausible, a priori, that the physical characteristics of carrier routes that determine the relationship between runtime and access time vary widely, even within the same route type. It is our impression that the topography varies greatly across routes, as do the number of stops, the average distance between stops, the average distance from the curb to the delivery point at a stop, etc. Therefore, we tested whether generalizing the [Postal Service's] model to allow the coefficients of the STOPS and $STOPS^2$ terms to vary by individual route would result in improved fit.
>
> We found the fit much improved. The route coefficients of both the linear and the squared STOPS terms were significantly different from each other (and from zero) at the confidence level of .01 or better, across routes within each route type and stop type. These statistical results are a marked improvement over the more restricted [Postal Service] model.

[3240] Witness Baron argues that generalizing the Postal Service's model did not improve the fit. USPS-T-17 at 52. Generalizing the Postal Service's model, however, clearly improves the fit under the standard measure of goodness of fit. The coefficient of determination, or "R^2" statistic, is the standard measure of how well a regression model fits the data. It indicates the proportion of the variation in the dependent variable that can be attributed to the variation in the independent variables. *See*, *e.g.*, Kmenta, *Elements of Econometrics*, at 148-49, 232-33. A statistically significant F-value for a set of independent variables means that including the set of variables in the regression model causes a statistically significant improvement in the R^2 statistic. The results are extraordinarily high R^2 values.[33]

[3241] Witness Baron does not question the accuracy of the F-tests that demonstrated that generalizing the Postal Service model by including route-specific STOPS and $STOPS^2$ variables increases the R^2 by a statistically significant amount. He argues, however, that these tests were improperly applied. He observes that in the Postal Service's model, the STOPS and $STOPS^2$ variables have individual t statistics that "are statistically significant at the 95 percent level." USPS-T-17 at 49. For the established model, he raises the bar to 99 percent, and then notes that only a minority of the STOPS and $STOPS^2$ variables have individual t statistics that are statistically significant at that higher level. He labels those that are not statistically significant at that level "statistically invalid." *Id.* at 52. He argues that the F-statistics that reject the Postal Service's model

> . . . merely demonstrate that some of the $STOPS^2$ coefficients are statistically significantly different from each other. And, as shown in table 18, t-statistics further demonstrate that only 4% of curbline, 7% of foot, and 7% of park and loop $STOPS^2$ coefficients are statistically significant at the .01 level. Therefore, had PRC LR-10 correctly applied these statistical tests, it would have eliminated at least 96% of curbline, 93% of foot, and 93% of park and loop ROUTE interacted STOPS and $STOPS^2$ coefficients before using the coefficient estimates to compute elasticities.

(Emphasis in original) *Id.* at 53.

[3242] It is important to bear in mind that if the proper application of the referenced F-test results were to retain variables with individual t-values that were statistically significant at the 99 percent level and eliminate all of the rest, witness Baron did not do so. He omits route-interacted variables from his model that are statistically significant by the standard he applies to the established model. At the same time, he includes variables in his model that are statistically insignificant by the standard he applies to the

[33] These tests are documented in Docket No. R90-1, PRC LR-10. Generalizing the Postal Service's model increases the R^2 statistic for foot routes from .9682 to .9920, for curbline routes from .9471 to .9852, and for park and loop routes from .9619 to .9872. Docket No. R97-1, USPS LR-H-141 at 14, 57, 78 and USPS LR-H-142 at 5, 12, 24.

established model.[34] If variables must be retained or discarded according to whether their individual t-statistics are significant, as witness Baron contends, his own model fails to meet that standard.

[3243] Using t-statistics in this way, however, is clearly improper. It is obvious that the STOPS x ROUTE and $STOPS^2$ x ROUTE variables in the established model are highly correlated, since each individual route variable is just a dummy variable. For highly correlated variables individual coefficient estimates are jointly distributed. Therefore, their statistical significance must be tested jointly, which requires an F-test. A statistically significant F-value indicates only that at least one of the set of coefficients jointly tested is non-zero. Individual t-statistics cannot identify which of the tested coefficients in the set is non-zero. This is because t-statistics for individual coefficients are conditional. The t-value for a given coefficient treats the other coefficients as fixed at their estimated values. If variables are correlated, discarding any of the individual variables alters the values for the estimated coefficients of the variables remaining in the set. Kmenta, *supra* at 393-94.

[3244] Individual t-statistics for a large set of highly correlated variables are typically small, because multiple correlated variables divide up responsibility for a particular effect. That is why individual t-statistics could imply that every variable in a highly correlated set is statistically insignificant, yet an F-test of their joint significance could show that they were jointly non-zero. *See id.* at 367-70, 405.

[3245] Using individual t-statistics to test and sequentially discard apparently insignificant variables in the manner that witness Baron advocates is an example of "blind" stepwise significance testing (stepwise significance testing unguided by economic theory). This is a specification search procedure that has been previously condemned by Postal Service witness Bradley. *See* Docket No. R94-1, USPS-T-5 at 52-54. As discussed above, the statistical significance of variables known to be highly correlated

[34] For foot routes, three of the five run number variables have individual t-statistics that are not significant at the 99 percent level. For curbline routes, two of the five run number variables have individual t-statistics that are not significant at the 99 percent level. USPS LR-H-141 at 14, 57.

must be tested as a set. Stepwise testing and elimination of such variables according to their individual t-statistics risks discarding variables that are jointly significant, resulting in a biased specification. Failing to apply t-statistics in this manner is not a legitimate ground for criticizing the established model. If it were, the Postal Service model would fail as well, as already noted.

[3246] To assume that the route coefficients for the STOPS and $STOPS^2$ variables are zero when statistical tests say with a very high probability that they are not, biases the results. See Tr. 29/16143-45 and the econometric literature cited there for the proposition that omitting statistically significant variables from a regression equation biases the results, because it amounts to incorporating incorrect information in the estimation. When witness Baron asserts that the Postal Service model fits the data better, he ignores the bias inherent in that model. Bias in the coefficients of the runtime variability equation is a serious concern because the coefficients are used directly in the calculation of variability.

[3247] In addition to criticizing the statistical criteria that the Commission used to select the more general model, witness Baron argues that the output of the model indicates that it should be rejected on statistical and operational grounds. Witness Baron asserts that runtime is expected to rise as stop coverage rises, but that the rise in runtime is expected to decelerate at higher coverage levels, because new accesses are more likely to be found between already covered stops. USPS-T-17 at 46.

[3248] To reflect this expectation, he argues, the STOPS term should be positive and the $STOPS^2$ term should be negative. He observes that in the established model, for foot and curbline routes, 40 percent of the STOPS coefficients are negative, and almost half of the $STOPS^2$ coefficients are positive, while for park and loop routes, 53 percent of the STOPS coefficients are negative, and 59 percent of the $STOPS^2$ coefficients are positive. He calls these results implausible. *Id.* at 51-52.

[3249] It is clear that runtime should rise with coverage levels. It is less clear that the rise in runtime should decelerate in a definite and pronounced way as coverage levels rise. At the high coverage levels currently experienced on most routes, there are

few sections of routes that remain unaccessed. Therefore each new access tends to be independent of existing accesses. More importantly, the percentage of individual route coefficients that have the sign that witness Baron expects is not particularly relevant. The elasticity of runtime is found by differentiating the runtime function. The derivative of the runtime function is a linear function in two coefficients (of both STOPS and $STOPS^2$) and the average number of stops. The relevant issue is whether the combination of coefficients behaves in the expected way at the average number of stops. Generally, it does.

[3250] Although the Postal Service's model is demonstrably biased, its parameters have smaller variances than those of the established model because it has fewer variables and more degrees of freedom. Whether it is preferable to use a more general, unbiased model whose parameters are less precisely estimated, or a simplified, biased model, whose parameters are more precisely estimated requires a judgment about the relative size of the bias and of the imprecision.

[3251] This judgment call might be a close one if there were a only small number of observations in the model. If there were, using the more general model might result in parameter estimates that were unacceptably imprecise. The CAT/FAT data, however, provides a relatively large number of routes from which to estimate an average elasticity for the group. When the sample mean of the route elasticities in each route group is computed, the imprecision of the individual route elasticities is mitigated. Since the desired output of the model is an average elasticity for broad route groups, the precision of the individual route elasticities becomes relatively unimportant. For this reason, the Commission adheres to its view that the unbiased model is statistically superior, even though its individual coefficient estimates are somewhat less efficient.[35] In statistical

[35] The superiority of the established model in terms of the bias/efficiency trade-off can be confirmed by comparing the adjusted R^2 statistics of the two models. Adjusted R^2 statistics are designed to take into account the loss of efficiency that results from adding explanatory variables. *See* Kmenta at 364-65. The adjusted R^2 statistics are only slightly lower than the normal R^2 statistics for the established model, and higher than the adjusted R^2 statistics for the Postal Service's model. This indicates that the price of generalizing the Postal Service's model to eliminate bias is a relatively minor loss of precision.

estimation, as Postal Service witness Degen observes, elimination of bias nearly always takes precedence over efficiency, and the efficiency of the ultimate variable cost estimate is the one that matters. Tr. 36/19335.

[3252] Although the restrictions on the established model proposed by the Postal Service are rejected by the data, it might be worthwhile in the future to investigate whether less drastic restrictions could be imposed on the established model, and parameter estimates made more precise, without introducing bias.

3. Load Time Variability

[3253] "Load time" is the time that a carrier spends at a stop that is associated with delivering mail, collecting mail, or attending to customer needs. The established analysis divides load time into two categories, each with its own cost driver. "Elemental" load time is that portion of total load time that varies directly with volume. Its cost driver is volume, expressed as pieces per stop. "Coverage-related" load time is the amount of accrued load time that remains after elemental load time is identified and deducted. Its intermediate cost driver is the number of stops that are covered. The number of stops that are covered, in turn, is driven by volume. The attributable portion of coverage-related load time is estimated with Carrier Cost System (CCS) data from which the percentage of deliveries that are made exclusively to deliver a single subclass of mail can be estimated, and the corresponding coverage-related load time costs attributed.[36]

[3254] Estimating load time variability begins by dividing overall base year carrier street time into its constituent parts, one of which is load time. This is done by applying the STS proportions to base year accrued carrier street time costs. STS was a sample

[36] For practical reasons, the established analysis uses the number of stops as the intermediate cost driver of coverage-related load time, even though it assumes that the theoretically relevant cost driver is the number of deliveries. In this docket, witness Crowder has shown that for coverage-related load time, the number of stops is the theoretically correct cost driver. *See* Tr. 29/16214-16.

survey of 2,400 routes in which carriers reported the activity they were performing at the time that they were paged.

[3255] Estimating the portion of load time that varies directly with volume requires data on volumes of loaded mail by subclass, and by shape (letters, flats, parcels, and accountables) as well as a count of collected mail. It also requires data on the delivery container type (e.g., loose mail, bundles), and receptacle type (e.g., mailbox, desk drop) used to load mail at a stop. These data are collected separately by stop type [Single Delivery Residential (SDR), Multiple Delivery Residential (MDR), and Business and Mixed (BAM)]. This highly detailed delivery data was last collected in 1985 by the Load Time Variability (LTV) survey. The LTV survey was a nationwide sample involving some 20,000 stops on 400 routes. *See* Docket No. R87-1, USPS-T-7, Exh. 7C at 4-5.

[3256] Load time includes the time spent preparing to load mail, loading mail, and serving the customer at the stop. For each of the three stop types, the portion of total load time that varies directly with volume (elemental load time) is estimated with regression models. The established load time variability function is developed from the 1985 LTV data. Elemental load time is estimated by evaluating this function at the base year mean pieces per stop for the various shape variables and summing the results.[37] There are five separate volume variables which represent the four delivered mail shapes, and collected mail. The dependent variable is the average load time per stop associated with each individual volume variable. Data on volume, stops, and deliveries from the 1996 Carrier Cost Survey (CCS) are used to calculate average shape volumes per stop in the base year.

[3257] The established elemental load time models are specified as they were in Docket No. R90-1. The explanatory variables include all statistically significant shape volumes and cross-shape-volume variables, as well as possible deliveries, and all statistically significant cross-product variables derived from the interaction of

[37] The partial derivatives of the cost function with respect to the five pieces per stop shape variables are summed and multiplied by the average seconds per stop and the number of stops in the base year to yield elemental load time.

shape-volumes and possible deliveries. Once it has been separated from total load time, elemental load time is treated as 100 percent attributable.

a. Postal Service Direct Case

[3258] *Redefining coverage-related load time.* Postal Service witness Baron argues that the established distinction between "elemental" load time for which volume is the cost driver, and "coverage-related" load time for which covered deliveries is the cost driver, is conceptually invalid. He asserts that "[i]t is commonly accepted that this time increment is independent of the amount of mail delivered at the stop, and should therefore equal a fixed time at each stop." USPS-T-17 at 6.

[3259] Witness Baron purports to discredit the conceptual underpinning for coverage-related load time by observing that it would go to zero if the volume of loaded mail were to go to zero. He also purports to demonstrate that when the number of stops is held constant, an increase in loaded volume will cause both elemental and coverage-related load time to increase. *Id.* at 35. He therefore recommends that the remnant of accrued load time that remains after elemental load time is deducted be treated as an institutional cost. In effect, he proposes that the concept of coverage-related load time be abandoned. His proposals would reduce base year attributable load time costs by approximately $169.9 million from the amount that would be attributed under the established load time variability analysis.

[3260] Witness Baron notes that the Commission has defined coverage-related load time as "independent of the amount of mail delivered at a stop," and depends, instead, on whether or not the stop receives mail at all. *Id.* at 36 citing PRC Op. R90-1, para. 3125. He interprets this to mean the coverage-related load time is defined as time that cannot be influenced even indirectly by changes in volume. He asserts that for "a given stop-type, coverage-related load time at each stop is supposed to be the same fixed value no matter how much volume is delivered." *Id.* at 34. He explains that the "preparation time" recorded in the LTV study as load time does not qualify as

coverage-related load time, because it is all associated with the need to handle mail. This implies that it would be influenced by such things as volume, container type, receptacle type, or other characteristics that can vary from one stop to another. For the same reason, he argues, "load time" and "attend time" (the remaining categories of load time recorded in the LTV study) do not qualify as coverage-related load time.

[3261] Witness Baron conceives of coverage-related load time as "pre-loading prep time encompassed by fixed-time at a stop . . ." Tr. 10/5173. To be absolutely immune from the influence of volume, he reasons, it must consist of "a fixed, observable activity the carrier has to perform at each stop regardless of how much volume is loaded at the stop." Tr.29/16151. He declines to identify what activity this might be, but he recognizes that few activities would qualify, since the time per stop that he associates with coverage-related load activity is so short (about a second). For his purposes, he emphasizes, it is not important to identify what invariant activity unrelated to mail handling is repeated at every stop. "The only important issue is whether the method used to measure fixed-time at stop produces an estimate that is truly independent of the total volume loaded and collected at each actual stop." *See* Tr. 10/5127.

[3262] Witness Baron concedes that the "fixed observable activity" that he insists must underlie all coverage-related load time is, in fact, "unobserved" in the LTV data. To estimate it, he assumes, *a priori*, that some discreet fixed activity is repeated at every stop, and then infers from LTV data what the length of that unidentified activity might be. *See* USPS-T-17 at 9-12, 35, and Tr. 10/5185-87. He theorizes that fixed stop time is the additional load time that would be incurred if a new stop were accessed with "zero volume" to load. He reasons that it could not be more than the minimum load time that is actually observed in the LTV data. He considers the times recorded in the LTV study for loading a single letter to be that minimum. For each stop type, he samples LTV times recorded for the delivery of single letters at a stop. He examines the lower end of this distribution of times for a quantity that he can judgmentally regard as an "upper bound" on fixed time per stop. He settles on the average of the lowest fifth of those times as a "common sense" estimate of that time. *See* Tr. 10/5201 and USPS-T-17 at 9-12. For

SDR and MDR stops, he estimates that fixed time per stop is slightly more than one second. For BAM stops, he estimates that it is slightly less than one second. USPS-T-17 at 12.

[3263] Because fixed stop time, as witness Baron defines it, has nothing to do with the volume of mail loaded, and varies only with the number of stops accessed, he argues that it should be considered access time. He therefore multiplies his estimate of fixed time per stop by the number of actual stops, deducts it from the pool of accrued load time, and adds it to the pool of accrued access time. The amount of STS-based accrued load time costs that witness Baron transfers to accrued access time costs is approximately $163 million. *Id.* at 13. He applies the variability of access time derived from the Postal Service's access time model to the new, higher accrued access cost totals. *Id.* at 14. He applies the elemental load time variability obtained from the established load time variability model to the STS-based accrued load time that remains. *Id.* The residue of STS-based accrued costs of $540.1 million he would treat as institutional cost.

[3264] Witness Baron interprets what remains of accrued load time after "fixed stop time" is removed as strictly unrelated to system- or route-level stops coverage. According to witness Baron, this load time is variable as a result of both the "volume effect" and the "deliveries effect" on load time at a stop. To estimate the "volume" (elemental) effect, witness Baron estimates the marginal and the average per piece stop time by piece shape, using the established LTV model. After he estimates elemental load time variability, he applies it to STS-based accrued load time, reduced by the amount of "fixed stop time" described above. This describes witness Baron's calculation of volume variable load time for SDR stops.

[3265] *The "deliveries effect."* For multiple delivery stops (MDR and BAM), witness Baron departs from the established load time variability model. In the established model, possible deliveries is employed as a control variable that absorbs variability that should not be associated with the shape volume variables. Witness Baron substitutes an "actual deliveries" variable for the "possible deliveries" variable. According to witness

Baron, this enables him to interpret the coefficient of the possible deliveries variable as a measure of the change in load time per stop as the number of actual deliveries per stop changes. [38] Under the chain rule of calculus, he applies this variability to the system-level delivery coverage variability derived from the established access time variability model. *Id.* at 17. Witness Baron estimates that the volume variable portion of the deliveries effect is approximately $45 million for MDR stops, and less than $2 million for BAM stops. *Id.* at 29-30. He adds these amounts to the elemental load time cost estimated for each of these respective stop types. Witness Baron does not make this modification in the SDR stop model, since each of those stops has only one possible delivery.

b. Notice of Inquiry No. 3

[3266] The Commission issued Notice of Inquiry No. 3 asking the parties to comment on the appropriateness of witness Baron's proposed changes to the established analysis of coverage-related load time. It focused on his proposal to treat the time that remains after "fixed stop time" and elemental load time are deducted from accrued load time as an institutional cost. Two responses were received. Witness Baron presents comments on behalf of the Postal Service. Witness Crowder presents comments on behalf of five parties (AMMA, DMA, MOAA, PSA, and Advo). These comments were received into evidence.

[3267] *Postal Service.* Witness Baron uses Notice of Inquiry No. 3 as an opportunity to reiterate his view that prior Commission opinions regard coverage-related load time as independent of all direct and indirect effects of volume. He argues that "to conceptualize that such a time interval depends on volume loaded eliminates the operational distinctiveness of the coverage-related activity." Tr. 29/16153. He argues that

[38] Modifying the established load time variability models in this way alters the resulting estimates of elemental load time variability.

> [i]t makes no sense to think of the coverage load activity as a separable independent activity that a functional analysis can observe a carrier perform, if the time taken to conduct that activity is not also an independently measurable, separable block of time. To be a unique, observable, event, the coverage load activity must be independent of volume.

Id. at 16153-54. He reaffirms that his *a priori* definition of fixed stop time is the only way to preserve a valid functional distinction between load time and access time. *Id.* at 6.

[3268] *Joint parties.* Witness Crowder argues that there is no basis for witness Baron's proposal to treat most non-elemental load time as an institutional cost. She contends that the established analysis of the variability of load time is integrated, comprehensive, and conceptually sound. As she describes it, system-wide load time is the product of average stop time and the number of stops within the system, while average stop load time is the product of average delivery time and the number of deliveries within the stop. For all three stop types, she regards the elemental variabilities derived from the LTV models as within-stop variabilities. She demonstrates mathematically that the volume coefficients in the LTV models reflect all of the within-stop load time changes caused by volume, both the direct (elemental) changes and the indirect (deliveries-coverage) changes. She goes on to demonstrate mathematically that the volume variability of non-elemental load time (the accrued load time that remains after elemental load time is calculated and deducted) is fully accounted for by multiplying non-elemental load time by the system-level elasticity of stops. Tr. 29/16190-91.[39]

[3269] Witness Crowder notes that witness Baron substitutes an “actual deliveries” variable for the “possible deliveries” variable in the established elemental load time variability model, as part of an attempt to separately estimate the volume variable load time caused by the number of deliveries. She argues that in doing so, witness Baron

[39] Under this analysis, witness Crowder asserts, the established assumption that coverage-related load time varies in proportion to system-level delivery elasticity (rather than system-level stop elasticity) is incorrect. *Id.* at 16215-16.

over-estimates elemental load time variability (primarily for MDR stops). *Id.* at 16218. She further argues that when witness Baron adds the deliveries effect to the elemental effect, he double counts the deliveries effect. *Id.* at 16219.

[3270] Witness Crowder argues that witness Baron's elemental load time costs are overstated for another reason. Witness Crowder observes that the amount of base year accrued load time calculated using STS-based proportions of total carrier street time is $1.783 million. She notes that the amount of accrued load time predicted by the established LTV model when it is updated with base year volume and stop data is almost one-third less ($1.214 million). She considers the modeled amount of accrued load time more accurate, arguing that it is likely to reflect a narrower, more precise definition of load time than the STS-based figure. She recommends that the modeled estimate be used as the base amount of accrued load time to which elemental volume elasticity is applied.

[3271] Witness Crowder speculates that the difference between the SDS-based accrued load time cost and the LTV-implied accrued load time cost consists of "relatively fixed" load time caused by such things as the need to open and close the satchel and the mail box, rather than the actual handling of mail, mail equipment, or customer requirements associated with loading and collecting mail. Accordingly, she recommends that the excess of STS-based accrued load time over LTV-implied accrued load time be viewed as "fixed stop load time" and treated as though it were access time, with its associated variability. *Id.* at 16192 and 16202.

[3272] Applying the established LTV and coverage variability models to the amount of accrued load time implied by the LTV model, witness Crowder estimates volume variable load time costs that are less than those estimated by witness Baron by $299.9 million. Her estimates are below witness Baron's by $58.2 million for SDR stops, $233.2 million for MDR stops, and $8.5 for BAM stops. *Id.* at 16198-200.

c. Rebuttal

[3273] On rebuttal, witness Baron argues that witness Crowder's model of system-wide load time variability is invalid because it incorrectly assumes that the average of load time for all actual stops equals load time at a stop that receives the average volume times the total number of actual stops. Witness Baron notes that this conflicts with the mathematical principle that the expected value of the function of a random variable does not precisely equal the value of the function evaluated at the expected value of the random variable. Tr. 33/17735-37. He argues that because this assumption underlying witness Crowder's model fails, all other properties of her model are invalid, including the property that volume variable load time includes a coverage-related component equal to the residual of accrued load time after elemental load time is removed. *Id.* at 17738.

[3274] Witness Baron also disputes witness Crowder's assertion that he double counts the within-stop deliveries effect on load time. He argues that witness Crowder should have assigned some of the load time effect to the possible deliveries variable. *Id.* at 17740-45.

[3275] Witness Baron remains agnostic as to whether elemental volume variability should be applied to STS- or LTV-based accrued load time. He notes that witness Crowder argues for the use of the LTV figure is based, in part, on an empirical assessment of the objectives and implementation of the STS and LTV surveys that he does not share. He criticizes witness Crowder for her "failure to provide a consistent operationally-sensible definition of the excess of the STS-based costs over the LTV-based costs." *Id.* at 17746. He also argues that if LTV-modeled accrued costs are to be substituted for STS-based costs for load time, they should be substituted for the accrued costs of all other street time functions. Otherwise, the LTV-based accrued load time will be disproportional to the accrued load time estimated for other street time functions. *Id.* at 17747.

d. Commission Analysis

[3276] *Redefining coverage-related load time.* Witness Baron's proposals to change the established analysis of coverage-related load time stem from his observation that the Commission in previous opinions has described coverage-related load time as “independent” of volume delivered at a stop, and “dependent” on the number of stops where mail is delivered. To remain completely free of the influence of volume, he argues, coverage-related load time must exclude any time that has anything to do with the need to handle mail in order to load or collect it. It must also exclude any time that is non-uniform in duration from one stop to another, he argues, since any non-uniformity is likely to be volume-related. Tr. 10/5198 and 5202; Tr. 29/16131. He contends that the small fraction of load time that satisfies this restrictive definition should be considered access time. He argues that once elemental load time is deducted from accrued load time, the residue should be considered an institutional cost. He does not consider it relevant that the residue can be shown to vary in proportion to system-level stop coverage.

[3277] Witness Baron's position boils down to this: coverage-related load time by definition must be absolutely independent of volume. He argues that to be independent of volume, it must be divorced from the real-world characteristics of particular stops on particular routes, such as the amount and kind of volume delivered there, the receptacle types found there, the kind of container-types used to deliver the mail, etc. The only thing left would be an unidentified “fixed observable activity” that is repeated at every stop. Otherwise, he argues, the Commission must find a regression that will measure the distinct stops coverage effect in a way that allows it to vary with the volume and mix of mail going to the new SDR stop. Tr. 29/16153.

[3278] Witness Baron reads far too much into the Commission's previous descriptions of the distinction between elemental and coverage-related load time. R87-1 was the first docket to use LTV survey data to econometrically estimate load time driven

by volume (elemental load time) and load time driven by coverage. There the Commission said

> [T]he intent of the LTV analysis was to find the volume variable portion of total load time, given that a stop actually had mail. The coverage-related load time analysis was intended to find the additional volume variability resulting from the fact that additional deliveries are caused by additional volumes.

PRC Op. R87-1, para. 3373. In R90-1, the Commission said that coverage-related load time "is independent of the amount of mail delivered at a stop. It depends, instead, on whether or not the stop receives mail at all." PRC Op. R90-1, para. 3125. These statements do not mean that coverage-related load time is completely insulated from all influence of volume, direct or indirect.

[3279] Clearly, neither the STS nor the LTV surveys of load time contemplated that there was a "fixed observable activity" taking up an "independently measurable, separable block of time" at every stop that is unrelated to the need to load mail at that stop or they would have made some effort to identify it. Nor is this conception of load time found in previous Commission opinions. It does not correspond to any engineering concept, operational reality, or empirical data that witness Baron can identify. Such a conception is not required to maintain a meaningful functional distinction between load time and access time. Nor is it required to allow the effect of stop coverage to be measured by a regression of non-elemental load time on system-level stops coverage. It confuses rather than clarifies analysis of access and load time variability. Witness Baron's proposal, has however, been beneficial. It has elicited from witness Crowder a clear and comprehensive explication of the established load time analysis, including a mathematical derivation of the established model of system-level load time variability.

[3280] Both the STS survey and the LTV survey define load time in a comprehensive way. They both define it essentially as time spent at a stop associated with the need to deliver mail, as opposed to time traveling between stops (access time). Since the load time measured by both surveys is derived from operational data from city

carriers on their routes, it reflects all real-world effects on stop load time. The established elemental variability model is structured to capture all individual and cross-volume variabilities arising from these effects. Tr. 29/16194-95. That model econometrically estimates the portion of time at the average stop that is directly caused by within-stop volume. The established analysis then econometrically estimates the portion of the residue that is directly caused by system-level stop coverage. It then estimates the volume variability of system-level stop coverage, and adds it to elemental load time to obtain total volume variable load time.

[3281] As witness Crowder has demonstrated mathematically, stop-level volume drives average stop-level load time directly, and also indirectly through the delivery coverage effect. System-level volume, in turn, drives stop coverage. She has also demonstrated mathematically that system-level volume variable load time is the sum of the effect of stop-level volume on average load time per stop, and the effect of system-level volume on the number of stops. *See* Tr. 29/16210-16. By estimating and deducting elemental load time from accrued load time, the established analysis accounts for all of the effects of stop-level volume. *Id.* at 16195.

[3282] The size of elemental load time determines the size of the residual that is used in the first step in calculating coverage-related load time. In this sense, within-stop volume effects influence coverage-related load time. By characterizing coverage-related load time as “independent of the amount of mail delivered at a stop,” previous Commission opinions have meant only that stop level effects of volume have already been accounted for by the elemental load time estimate, and, therefore, analysis of the residue of accrued load time left after elemental load time is deducted is confined to estimating the system level effects of the number of stops on load time. There was then, and is now, no need to decide whether new stops might affect load time because they require a “fixed observable activity” to be repeated at each new stop, or because they might require a variety of additional activities that are directly related to the loading of mail, and vary in duration from stop to stop. As witness Crowder has shown, the model is capable of distinguishing the stop-level effects of the volume cost driver on load time

from the system-level effects of the actual stops cost driver on load time. It is entirely possible that these distinct cost drivers affect load time in distinct ways through the same kinds of load-related activity. If so, the model properly reflects these effects. Under the established analysis, average stop time is simply the product of average delivery time and the number of deliveries within the stop. *Id.* at 16193. System-wide load time, in turn, is simply the product of average stop time and the number of stops. As with variable access time analysis, no assumptions about how coverage-related load time might be distributed across stops are necessary. There is no need to impose a new, more restrictive definition on coverage-related load time, as witness Baron proposes.

[3283] *Use of average values.* Witness Baron argues that witness Crowder's mathematical derivation of the established system-level load time model is invalid in every respect, because it assumes that the average value of the load time function equals the function of the average value of the cost driver. Tr. 33/17738.

[3284] It is true that models that use average values for the independent variable under investigation are only approximations of models that attempt to account for the specific distribution pattern of the independent variable across a sample. They are close approximations, however, where the function is well behaved. The elemental variability function is such a function.[40]

[3285] For witness Baron to argue that using this form of approximation invalidates all aspects of witness Crowder's model is disingenuous, since he relies on this same form of approximation in the runtime and access time variability models. He even uses it in the load time variability model that he proposes, notwithstanding his disclaimer. *See id.*, n. 14. In fact, the Postal Service evaluates functions at the average values of independent variables and assumes that the result is the average value of the function throughout its volume forecasting and cost variability analyses, notably witness Bradley's

[40] Because the elemental load variability function is non-linear, the distribution of the shape volume cost driver at specific stops could largely be taken into account by including the non-linear contribution of the variance. The mathematical process, however, would be cumbersome, and the result is unlikely to be to be substantially different.

mail processing and purchased transportation variability models, and witness Tolley's volume forecasts.

[3286] The imprecision that results from such an approximation does not affect the basic logic of witness Crowder's load time model derivation and its conclusion that there is a distinct component of variable load time that responds to the number of stops. Her derivation depends only on the validity of the assumption that a functional relationship exists between average load time per stop, E(g(x)), and average volume per stop, E(x). Accordingly, this criticism of witness Crowder's derivation is not dispostive.

[3287] *The "deliveries effect."* For multiple delivery stops (MDR and BAM), witness Baron substitutes an "actual deliveries" variable for the "possible deliveries" control variable in the established LTV model. According to witness Baron, this enables him to interpret the coefficient of the possible deliveries variable as a measure of the change in load time per stop as the number of actual deliveries per stop changes. Under the chain rule of calculus, he applies this variability to the variability derived from the access time variability model. USPS-T-17 at 17. He adds these amounts to the elemental load time cost estimated for multiple delivery stop types. He contends that witness Crowder improperly ignores the contribution of possible deliveries to the volume variability of load time. Tr. 33/17742.

[3288] Witness Baron substitutes actual deliveries at a stop, AD, for possible deliveries at a stop, PD, in the equation defining MDR and BAM load time at a stop. To be correct, actual deliveries and possible deliveries must be the same at those stops. Witness Baron offers no grounds for assuming that they are the same.

[3289] Witness Crowder demonstrates that this incorrect substitution is the cause of his delivery effect. She shows that load time at a stop, LT, is a function of volume at the stop, v, and actual deliveries at the stop, AD, so that LT = g(v,AD). If there is a functional relationship between actual deliveries, volume, and possible deliveries, AD = f(v,PD), it can be rewritten as LT = g*(v,PD), the same form as witness Baron's equation 3 in USPS-T-17 at 8, or equation 5 at Tr. 33/67740. *See* Tr. 29/16220-21 (Crowder). If possible deliveries do not vary with volume, all of the effects of changes in

volume, v, that operate through the volume effect on actual deliveries are included in this functional form and represented as direct volume effects. Although witness Crowder simplifies the mathematics in ways that witness Baron finds objectionable, the simplifications do not affect the basic logic of her demonstration.

[3290] The volume coefficients in the LTV models reflect all of the within-stop load time changes caused by volume, both the direct (elemental) changes and the indirect (deliveries-coverage) changes. Tr. 29/16190-91. Witness Crowder correctly concludes that calculating an “actual deliveries” elasticity using the possible deliveries coefficient with the actual deliveries variable, applying it to system-wide delivery coverage variability, and then adding the result to elemental volume elasticity double counts the effect of within-stop delivery coverage. *Id.* at 16219-21. Accordingly, the Commission rejects witness Baron's proposal to respecify the established LTV model, and reinterpret it to measure a separate within-stop delivery coverage elasticity.

[3291] *Measuring accrued load time.* The LTV model is a regression of average load time per stop on average volume per stop. It was originally estimated with the 1985 LTV data. An updated evaluation of this modeled relationship is obtained by finding the point on the modeled function that corresponds to current average volume per stop. A horizontal line drawn from that point on the curve to the vertical axis is the current average accrued load time predicted by the model. When it is multiplied by the current number of stops, the result is the current total accrued load time predicted by the model. The updated elasticity of elemental load time is found by dividing marginal load time per stop by average load time per stop calculated at the point on the curve that corresponds to current volume per stop. Total accrued load time predicted by the model is the numerator of average load time per stop. Therefore, it is one of the determinants of elemental elasticity.

[3292] Since the Postal Service first proposed using the LTV model to estimate the elasticity of elemental load time in Docket No. R87-1, the Commission and the Postal Service have applied the elemental load time elasticity derived from the model to the total accrued load time derived from the 1986 STS survey. The STS survey sampled

carrier activity on the street through random tallies, and allocated total carrier street time to its various functions (including load time) in proportion to the tallies recorded. Witness Crowder observes that the updated accrued load time cost based on STS tallies is $1,783 million, while the updated accrued load time cost predicted by the LTV model is $1,214 million, almost one third less than the STS figure. The discrepancy has existed in essentially the same proportion since these surveys were first used as the basis for estimating volume variable load time in Docket No. R87-1. *Id.* at 16207.

[3293] At average volume per stop, the STS-based accrued load time lies well above the curve estimated by the LTV model. Witness Crowder argues that the elemental elasticity derived from the model should not be applied to the STS-based accrued load time cost because it is inconsistent with the relationship predicted by the model. Witness Crowder argues that consistency requires that the modeled elasticity be applied to the accrued load time cost predicted by the LTV model, since accrued load time predicted by the LTV model is one of the factors that determines elemental load elasticity. *Id.* at 16185.

[3294] As noted previously, the elemental elasticity of load time is determined by dividing marginal load time per stop by average load time per stop at a point on the curve that corresponds to the base year average volume per stop. The STS based accrued load time amount can be reconciled with the loadtime/volume relationship predicted by the model if the curve is shifted upward so that it passes through the point corresponding the STS accrued load time.

[3295] The modeled curve predicting average load time per stop can be made to pass through the point corresponding to STS accrued load time if it is shifted upward by a *constant amount* all along the range of volume. This would cause average load time to increase while marginal load time remains unchanged. This, in turn, would cause elemental volume elasticity to decrease and volume variable coverage-related load to increase. This would cause overall volume variable load time to decrease.[41] The curve

[41] Response of Joint Parties' Witness Antoinette Crowder to Inquiries Raised in Presiding Officer's Notice, March 1, 1998, Tr. 29-16225.

can also be made to pass through the point corresponding to STS accrued load time if it is shifted upward by a *constant proportion* all along the range of volume. This would cause average and marginal load time per stop to increase by the same percentage. As a result, elemental volume elasticity would remain unchanged.[42] Applying that unchanged elemental volume elasticity to the STS-based accrued load time would leave the estimate of elemental, coverage-related, and total volume variable load time unchanged from the established method.

[3296] Witness Crowder argues for an assumption that would make it unnecessary to reconcile STS accrued load time with the LTV model. She assumes that the amount by which the STS figure exceeds the LTV figure reflects “relatively fixed” load time that is the rough equivalent of access time. She proposes treating the excess as though it were access time, and assigning it the variability associated with the access variability model. Tr. 29/16192 and 16202. Assuming that the excess is something other than load time would make it unnecessary to adjust the model.

[3297] There is no direct evidence that can explain the discrepancy between STS- and LTV-based accrued load time. How the two should be reconciled depends on the nature of the relationship between STS and LTV accrued load time. The task is to draw the most reasonable inference as to the nature of that relationship from the indirect evidence available. If it is assumed that there is no systematic relationship between the STS and the LTV figure, the two can't be reconciled. If it is assumed that the excess of STS over LTV load time reflects “fixed” load time that was recorded in the STS survey but not the LTV survey, as witness Crowder does, it might be reasonable to assume that the STS figure exceeds the LTV figure by a relatively constant amount over the range of volume. If it is assumed that the load time recorded by both surveys is essentially the

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[42] It is axiomatic that the elasticity of a quantity L (load time) is the same as the elasticity of a quantity (1+k)L where k is a constant. If LTV accrued load time is L, then the elasticity of L is $E_L = \frac{\partial L}{\partial V}\frac{V}{L}$. If STS accrued load time is (1+k)L = L*, the elasticity of L* is $E_{L*} = \frac{\partial L*}{\partial V}\frac{V}{L*}$. Substituting (l+k)L for L* yields:

$$E_{L*} = \frac{(l+k)\partial L}{\partial V} \bullet \frac{V}{(l+k)L} = \frac{\partial L}{\partial V}\frac{V}{L} = E_L .$$

same mix of “fixed” and volume-related activities, it is more reasonable to assume that the STS figure exceeds the LTV figure by a constant proportion over the range of volume. This is the assumption adopted by the Commission. For reasons explained in Appendix K, we conclude that the two surveys measure essentially the same load time activities, and therefore are more likely to differ by a constant proportion than a constant amount over the range of volume. This conclusion allows STS based accrued load time to be reconciled with the LTV model, and yields the same load time variabilities as the established method.

[3298] Witness Crowder argues that the LTV survey probably applied a tighter definition of load time that excluded relatively fixed load time because it was administered by industrial engineers observing carriers actually delivering mail on their routes. She considers it likely that in the STS, broader definitions were employed to allow carriers to self-report the nature of their activity while delivering mail on their routes. She regards the tighter definition that she assumes the engineers to have applied to be more accurate. Tr. 29/16191, 92, 94 and 16202, 16205.

[3299] Witness Crowder’s speculation that the STS survey defines load time more broadly, or measures it less accurately than the LTV survey is not supported by careful examination of the survey documentation accompanying the respective surveys. The LTV and STS studies were designed and supervised by the same Postal Service contractor (Foster Associates). They were conducted little more than a year apart. Shortly after they were completed, Postal Service witness Hume (of Foster Associates) presented them as the empirical support for the Postal Service’s load time variability estimates in Docket No. R87-1. *See* Docket No. R87-1, USPS-T-7. He describes these surveys as “carefully arranged to complement each other.” *Id.* at 10. Close examination of their design and implementation bears this out.

[3300] In deciding whether definitional differences explain the discrepancy between STS and LTV accrued load time, the determining factor is the boundary that both surveys establish between load time and runtime, since both surveys account for all of the time spent at the stop, and all of the time spent moving between stops. Both surveys draw a

precise and consistent boundary between load time and runtime that leaves little room for interpretational differences. Equally important, both surveys relied on trained technicians with a common understanding of the purpose of both surveys to interpret that boundary.

[3301] As discussed in Appendix K, there is little support for the assumption that LTV accrued load time is less than STS accrued load because the STS survey was misidentifying access-like activities as load-related. There is more support for the assumption that the discrepancy reflects the likelihood that carriers in the LTV survey were performing both access and load activities at a substantially faster pace because they were under the direct observation of industrial engineers. This implies that the STS figure is higher than the LTV figure by a **constant proportion** over the range of volume. This implication is consistent with the data. It shows that while the average volume per stop has grown slowly over the decade since the two surveys were conducted, the proportion of STS to LTV accrued load time has remained essentially constant. *See* Tr. 29/16205-207.

[3302] The Commission concludes that the most reasonable inference from the indirect evidence available is that STS-based accrued load time is higher than the LTV accrued load time by a constant proportion. This inference allows STS-based accrued costs to be viewed as consistent with the elemental volume variability model and, at the same time, allows volume variable load time costs to be viewed as consistent with the proportion of load time to other street time functions found in the STS survey. It affirms the reasonableness of the elemental, coverage-related load, and overall load time variability estimated by the established method.

[3303] It is worth noting that in R87-1, shortly after completing the STS and LTV surveys and the LTV model, the Postal Service itself applied the elemental volume elasticities developed from that model to the STS-based measure of accrued load time, on the assumption that it more reliably reflected total accrued load time. It has proposed doing so ever since, and the Commission has accepted its judgment. To the extent that the issue turns on empirical fact, it is reasonable to impose the burden of proof on those

who now would argue, after a decade, that the LTV survey is the one that contains the most accurate measure of total accrued load time. The Joint Parties sponsoring the testimony of witness Crowder have not carried that burden.

[3304] In the future, this issue should be resolved on the basis of data that reflects a consistent definition of accrued load time and measures it in a consistent way. Section 1 discusses the need to update the obsolete STS and LTV studies, and to design the new studies in a way that produces a consistent definition and a consistent estimate of accrued load time.

[3305] In recent dockets, the Commission has used single subclass ratios to attribute coverage-related load time. The assumption was that the cost of a delivery made for only one subclass is caused by that subclass. Deliveries coverage rather than stop coverage was assumed to be the theoretically relevant cost driver of coverage-related load time. The distinction is moot for SDR stops, since actual deliveries and actual stops are the same. The subclass content of actual deliveries at MDR and BAM stops is unknown. Previously, the Commission has used single subclass ratios at SDR stops as proxies for single subclass delivery ratios at MDR stops. It has not attributed coverage-related load costs for BAM stops, since SDR ratios are not reasonable proxies for BAM ratios. For these reasons, assuming that the number of actual deliveries rather than the number of actual stops was the relevant cost driver had little practical impact.

[3306] In this docket, witness Crowder has demonstrated mathematically that the number of stops is the correct cost driver for coverage-related load time. *See* Tr. 29/16214-16. This allows the Commission to attribute coverage-related load time costs for both MDR and BAM stops on the basis of single subclass ratios actually observed there. As a result, the Commission recommends attributing $29.2 million less in coverage-related load costs for MDR stops, and $24.0 million more in coverage-related load costs for BAM stops, than it would have under the method previously used.

[3307] The table below compares the estimates of the cost of accrued load time, "fixed stop time," elemental load time, volume variable delivery-coverage-related load time, volume variable stop-coverage-related load time, total volume variable load time, and changes to total volume variable access time, under the Postal Service, Joint Parties, and Commission analyses of load time.

Table 3-4
Load Time Costs Estimates Compared ($000s)

		Postal Service (a)	Joint Parties (b)	PRC R94-1 (c)	PRC R94-1 With Stop Coverage (d)
1	STS Accrued Load	1,783,086	1,783,086	1,783,084	1,783,084
2	"Fixed Stop Time"	163,353	569,453	0	0
3	Adjusted Accrued Load (Line 1-Line 2)	1,619,733	1,213,633	1,783,084	1,783,084
4	**Volume Variable "Fixed Stop Time"**	**11,946**	**25,285**	**0**	**0**
	Elemental Load:				
5	Shape Volume Component	1,032,468	740,794	1,096,088	1,096,088
6	Delivery Component	47,147	0	0	0
7	**Total of Elemental Load**	**1,079,615**	**740,794**	**1,096,088**	**1,096,088**
8	Coverage Related Load (Line 3-Line 7)	540,118	472,839	686,996	686,996
9	**Attributable Coverage Related Load**	**0**	**25,213**	**165,358**	**160,181**
10	**Total Attributable Load Time Costs (Line 4+Line 7+Line 9)**	**1,091,561**	**791,292**	**1,261,446**	**1,256,269**

(a) USPS-T-17, Sum of Tables 14, 15 and 16
(b) JP-NOI-1, Sum of Tables 1, 2 (corrected), and 3
(c) PRC LR 5 with Single Delivery Residential Single Subclass Stop Ratio for Attributable Coverage Related Load
(d) PRC LR 5 W/S 7.0.4.1

4. Other Carrier-Related Costs

[3308] Witness Nelson presents the results of a series of analytical refinements and new data collections related to special purpose route carrier activities, special delivery messenger activities and driving time on motorized letter routes. These studies alter the method of calculating the variabilities for these activities and lead to numerous modifications in the associated cost spreadsheets for Cost Segments 6, 7, and 9 in USPS-T-5, Workpapers B. Witness Nelson's testimony uses data from four new field surveys of carrier and messenger activities covering: Motorized Letter Routes; Special Purpose Routes, Expedited Mail and Labor Distribution Code (LDC) 24 activities. The changes proposed by witness Nelson have not be controverted in this proceeding.

a. Labor Distribution Code 24 Activities

[3309] According to the National Workhour Reporting System, Labor Distribution Code (LDC) 24 is used to accumulate costs for "all nonsupervisory hours of special delivery messengers, including meeting and union duty time of certified stewards." LR-146 at I-33. The LDC 24 charges accrue in Cost Segment 9. LR H-1 at 9-1. According to the Postal Service, however, significant charges to LDC 24 result from the activities of carrier craft employees assigned to routes that perform interfacility distribution of Express Mail and/or delivery of Express Mail and special delivery items. USPS-T-19 at 3. Despite the direct charge of some carrier activities to LDC 24 and accumulation in Cost Component 9, past proceedings have also recognized this carrier activity involving Express Mail in Cost Segment 6. In particular, IOCS tallies on Route Type 98 associated with activities involving Express Mail, have been attributed to Express Mail in Cost Segment 6 as a proxy for the carrier costs caused by Express Mail. LR-H-1 at 6-4, footnote 3.

[3310] Witness Nelson asserts that the net result has been a double-counting in which carrier distribution and delivery activities have caused costs to be borne by

Express Mail in both Cost Segments 6 and 9. USPS-T-19 at 4. The new studies are used to eliminate this double-counting:

> In the new data collections, messenger and special purpose route carrier activities that accrue to LDC 24 have been observed directly (in the Expedited Mail Survey and LDC 24 Survey, respectively). Analysis of these activities is performed in Cost Segment 9. Similarly, messenger and special purpose route carrier activities that accrue to carrier street time LDC's have been observed directly (in the Expedited Mail Survey and Special Purpose Route Survey, respectively) and are analyzed in Cost Segment 7. The use of data from these different surveys to develop variability parameters, distribution keys and other needed information is shown in Exhibit USPS-C, Workpaper 1 and Workpaper 2.

USPS-T-19 at 4.

[3311] With the new calculation of accrued and attributable costs in Segments 7 and 9 designed to account for all of the delivery costs associated with Express Mail, the previous cost entry for Express Mail activities in Segment 6 is eliminated.

[3312] The proposed modification improves the accuracy of the cost determination for Express Mail and is adopted by the Commission in PRC LR-5.

b. Motorized Letter Routes

[3313] The traveling time between delivery points on routes is referred to as runtime, which includes the time a carrier spends walking and driving. PRC Op. R87-1 at 221-24. Since Docket No. R87-1, the results of a Street Time Sampling (STS) survey conducted in 1986 have been used to determine the percentage of total city carrier street time that is spent on runtime. Total city carrier street time payroll costs are multiplied by the STS percentages, presented in LR-H-1 at 7-4, to calculate accrued runtime costs. The variable portion of runtime is considered access time and the residual is considered route time. The variable portion is estimated from regression analyses of CAT/FAT data. Access costs are the product of runtime costs and the CAT/FAT variability factors. *See* LR-H-1 at 7-8. The CAT/FAT data specifically includes both driving time and walking

time, and the regression results reflect both. Docket No. R87-1, USPS-T-7, Exhibit D at 1.

[3314] Prior to Docket No. R90-1 no route costs were attributed. In Docket No. R90-1, the Commission adopted the established analysis in which driving time on park-and-loop routes was determined to be 50 percent variable with the number of actual stops. Under the established method, attributable route costs are obtained by multiplying total accrued park-and-loop driving time by the 50 percent variability factor. Total accrued park-and-loop driving time is calculated as a percentage of the total accrued park-and-loop route costs, using data from the Street Time Sampling survey. *See* Docket No. R90-1, Tr. 33/17247, Table, Column 3, and the Segment 7 cost worksheets in MC96-3, PRC-LR-4, W/S 7.0.1 Line 31, Column 2.

[3315] In this docket, Postal Service witness Nelson proposes to change the method for calculating accrued and volume variable costs for motorized letter routes. The results of special studies performed on the activities of carriers on motorized letter routes are presented in USPS-T-19 and are used to develop new variability factors that extend the variability analysis beyond park-and-loop routes to all letter routes. Witness Nelson continues to apply the established assumption that 50 percent of driving time varies with stops, but through the use of econometric techniques obtains the variability of stops as a function of the different activities that occur on motorized routes to generate stops. The different activities accounted for in witness Nelson's analysis are routine looping points/dismounts, "deviation" deliveries for such things as expedited items or large parcels, and collection-related events. USPS-T-19 at 6. The new variabilities are calculated in Exhibit USPS-19C. The variable costs are calculated as a product of the driving time and the assorted variabilities.

[3316] Witness Nelson begins his analysis of attributable driving time costs by using STS survey data to identify $501.3 million of accrued runtime costs associated with driving time. USPS T-5, Workpaper B, W/S 7.0.4.1, Line 12d, Column 11 and W/S 7.0.4.4. These accrued driving time costs are over twice as large as the $242.8 million park-and-loop driving costs analyzed for variability in Docket No. MC96-3. Docket No.

MC96-3, PRC-LR-4, W/S 7.0.4.4. Using the variabilities presented in USPS-T-19, witness Nelson estimates that variable driving time costs are $110.9 million. USPS T-5, Workpaper B, W/S 7.0.4.4.

[3317] Under the established method, the CAT/FAT stop variability factors are applied to all accrued runtime costs, including driving time, to obtain the portion that varies with stops (access costs) and the portion that doesn't (route costs). In this docket, the Postal Service proposes to subtract accrued driving time costs from accrued runtime costs and apply the CAT/FAT stop variability factors to only the non-driving time portion of accrued runtime costs to obtain access and route costs. To the total route time costs thus obtained, the Postal Service adds the $501.3 million in accrued driving time costs that it identifies. Of the resulting total accrued route time cost, it attributes the $110.9 million that it estimates represents volume variable driving time costs. *See* USPS T-5, Workpaper B, W/S 7.0.4.1, Line 21a. Adding accrued driving time to total route time and then attributing a portion of the new route time total conforms to the established treatment of route time, at least in terms of spreadsheet organization.

[3318] Subtracting all accrued driving time from accrued runtime and analyzing it separately, in depth, for volume variability is an improvement over the established method. The Commission adopts the Postal Service's proposal, but considers it suitable only as an interim approach. But subtracting driving time from accrued runtime before the CAT/FAT variability factor is applied has the effect of excluding all driving time from access costs and any subsequent determination of the volume variable portion of access costs. Doing so reduces overall attributable costs by about $75 million.[43]

[3319] Subtracting driving time costs from runtime prior to applying the CAT/FAT stop variability factors is not consistent with the way the CAT/FAT experiment was conducted. When the CAT/FAT experiment was conducted, attempts were made to specifically capture the effect of stops on driving time as well as the other components of

[43] Total access costs using R94-1 methodology are $608.2 million. USPS LR-H-196 "Rule 54(a)(1) Alternate Commission Cost Presentation (Base Year)" Revised Sept. 4, 1997, W/S 7.0.4.1 Line 77, Col. 11. Total access costs using the proposed methodology are $533.0. See PRC LR-5 [Line 77, Col. 11] in this docket.

runtime. Docket No. R87-1, USPS-T-7, Exhibit D at 1. If the variability of drive time is lower than the variability of other runtime, as the Postal Service's analysis concludes, the proper approach is to construct an experiment that does not confound the variability of drive time with the variability of other runtime. The approach that the Postal Service proposes, and that the Commission adopts on an interim basis, is likely to understate the variability that runtime would exhibit if driving time were removed. For that reason, the exclusion of driving time requires a new CAT/FAT experiment that separates the effects of stops on driving time from the effects of stops on other runtime.[44]

[3320] In general, the Service is to be commended for improving the analysis of the variability of driving time. It should now update the STS and CAT/FAT studies in a way that will provide a basis for converting witness Nelson's interim analysis into a consistent, comprehensive calculation of attributable access and route costs, as described above, and in Section 1.

c. Express Mail Cost Calculations

[3321] In previous dockets, the cost of sweeping Express Mail collection boxes is estimated by using a proportional allocation of all collection load costs between Express Mail collection and ordinary collection boxes. However, the new surveys reveal that Express Mail collection boxes rarely contain many pieces when swept, and it is reasonably common for such boxes to be empty, whereas regular collection boxes almost always contain mail. USPS-T-19 at 5 and LR-H-153.

[3322] The new surveys provide data for the development and application of new load time factors to determine volume-variable costs associated with sweeps of Express collection boxes directly. The cost calculations are reflected in a revised W/S 7.0.5 in which the new variable cost calculations are used. USPS-T-5, Workpaper B.

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[44] Witness Nelson also presents a new key for the distribution of route costs that is based on current activities on motorized letter routes. This key reflects the fact that many deviation deliveries are caused by bulky and heavy pieces of mail and distributes costs accordingly.

[3323] The proposed change in cost method appears to better reflect the operational differences between collections for the Express Mail and regular boxes than the current method. For that reason it is adopted by the Commission.

[3324] Similar changes in method are proposed by witness Nelson to separate the determination of Express Mail collection box access and stop time costs from that of regular boxes. Also the new data are used to calculate the various Express Mail cost differentials due to the provision of different types of pick-up and delivery services. USPS-T-19 at 9-10.

[3325] The new survey data are further used by witness Nelson to differentiate interfacility distribution movements dedicated to Express Mail from other types of carrier or messenger activities. This differentiation has not been available in previous dockets. It is appropriate, since the Express Mail "distribution" requirements have cost characteristics quite different from other carrier and messenger activities. *Id.* at 8.

[3326] The Express Mail cost refinements proposed by the Postal Service are implemented by the Commission in PRC LR-5.

d. Special Purpose Routes

[3327] Using the new survey data, witness Nelson updates estimates of the proportions of special purpose route time that are spent driving between stops, at stops, and traveling to and from the route. He also updates the distribution keys by major classes. The new data are also used in new econometric models to analyze coverage-related variability and the time spent at delivery stops. Witness Nelson reviewed and accepted the stop variability estimate of 0.6342 adopted by the Commission in Docket R90-1 in the method he uses to compute the stop variability of Special Purpose driving time. USPS-T-19 at 7.

[3328] The Commission commends the Service for updating the seventeen-year-old data and analyses in this area and adopts the methods in the calculations in the Segment 7 worksheets in PRC LR-5.

e. Special Delivery Messengers

[3329] Express Mail may be picked up or delivered by a special delivery messenger according to a custom-designed schedule, or may be delivered by a special delivery messenger to meet delivery objectives. USPS-LR H-1 at 9-2. In past dockets, the special delivery analysis did not consider the differences in cost causality due to different functions being performed, such as driving time, delivery stop time, and nondelivery stop time. Also, differences in mail characteristics, such as accountables versus nonaccountables were ignored. In this docket, witness Nelson uses the new survey data from special delivery routes to enhance the functional detail of the cost estimation. Volume variable costs associated with driving, customer delivery, and collection activities are identified.

[3330] This special purpose route analysis is similar to the level of detail in the attribution of letter route costs. It is adopted by the Commission, and implemented in PRC LR-4.

C. Vehicle Service Drivers

[3331] *Introduction.* This segment includes the salaries and related costs of personnel classified as Vehicle Service Drivers (VSD). The work covered by this segment is the local transportation of mail (mainly intra-city) in Postal Service owned or leased vehicles. Functions performed include transporting mail between general mail processing facilities, carrier stations, and other locations such as airport mail facilities and collection stops. VSDs are also utilized by bulk mail centers (BMCs), largely as spotters for moving trailers around the yard.

[3332] Prior to Docket No. R90-1, variability estimates were based on an analysis of volume and time spent loading and unloading vehicles. Load/unload time was assumed to be the only activity that varied with volume. In R77-1, a one-day survey of Washington, DC VSDs yielded a variability estimate of 7 percent. In R80-1, the same methodology was applied to a sample of nine cities and resulted in an estimate of 16 percent. This result was also used in R84-1 and R87-1.

[3333] The Postal Service proposed in R90-1 to use the variability for intra-SCF highway contract routes (47.3 percent) as a proxy for VSD variability, based on the logic that the services are similar. For various reasons, the Commission did not fully accept the assumption of equivalence and decided instead to take the average of the Postal Service estimate and the 16 percent from previous cases to reach an estimate of 31.65 percent. PRC Op. R90-1, Appendix J, CS VIII at 14. This variability estimate was applied again in R94-1.

[3334] In this docket, the Postal Service proposes a new methodology for determining the volume-variability of Vehicle Service Drivers. Postal Service witness Wade conducts a survey of VSD activities to which he applies a statistical analysis to estimate how VSD workhours relate to hypothesized cost-driving factors. This analysis is presented as an improvement over previous cases because it reduces the operational assumptions that must be made, and it recognizes that other factors besides load time affect costs.

[3335] The Postal Service chooses to use VSD route schedules (Form 4533) as the primary source of data for analysis. However, Wade determines that it is necessary to conduct a survey of all P&D facilities with vehicle service drivers in order to gather the information needed to derive the volume of mail carried by each route. Fifty-three facilities, accounting for approximately 43 percent of all non-BMC VSD workhours, respond with usable data. Tr. 7/3184. These results are then combined with information gleaned from VSD route schedules for those facilities. The combined data are fit to a model, constructed by witness Wade, which estimates the volume-variability of VSD workhours.[45]

[3336] Wade asserts that CFM and NETWORK are the most crucial of the defined variables to explaining the usage of VSD drivers. He claims that CFM is crucial because it can affect load time at the route level and the number of trips or routes at the facility level. NETWORK is important, Wade says, because generally more runs will be required to service more facilities.

[3337] After statistically testing six different regression equations, Wade chooses the one that he finds best fits the data and derives his recommended variability estimate from it. USPS-T-20, Exhibit 1.

[3338] BMCs are not included in the survey and analysis because they primarily use vehicle service drivers as spotters, for which the Postal Service proposes to assume a zero variability. Therefore, Wade makes an adjustment to the result of the regression analysis by calculating a weighted average variability for all VSDs. The resulting variability of 60.44 percent is the estimate he proposes to use for Cost Segment 8 in this docket. USPS-T-20, Exhibit 2, Revised 10/8/97.

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[45] USPS-T-20 at 8; The general form of the model at the facility level is:

HOURS= f(CFM,AVGMPH,AVGDIST,AVGCAP,NETWORK) where:
CFM is cubic-foot miles of mail distributed over the network served by a facility,
AVGMPH is the average scheduled travel speed,
AVGDIST is the average scheduled mileage per scheduled trip for a facility,
AVGCAP is the trip-weighted average truck volume in cubic feet, and
NETWORK is a measure of the stops serviced by a facility.

[3339] *Commission Analysis.* No rebuttal to the postal service's proposal for VSD variability has been filed, but there are several interrogatory responses on the record. In some of these, errors are pointed out that require minor corrections to be made. Tr. 7/3173-74, 3201 and 3208-09. The net effect of the changes is to increase the final variability estimate by less than a full percentage point from the initial filing.

[3340] Also through interrogatories, some questions are raised concerning the quality of the data gathered for the analysis. Among these issues is the possibility that bias is introduced when 36 of the 89 facilities responding to the survey are excluded for lack of consistent and reliable data. *Id.* at 3177-79 and 3183-84. Another concern is that inconsistent estimation of load factors might have occurred due to the lack of specific guidelines provided in the survey instructions regarding the method to be used. *Id.* at 3176-78 and 3198. It is also pointed out that no quality checks are performed on the data from Form 4533. *Id.* at 3199 and 3211.

[3341] The Commission has been calling for a more complete analysis of vehicle service drivers from the Postal Service since Docket No. R77-1; and while the analysis witness Wade presents is not altogether ideal, it is a step in the right direction. For the first time, the Postal Service has produced a variability estimate for VSDs that considers multiple variables which influence workhours.

[3342] As the Postal Service's analysis is based on recent data, conforms to generally accepted methodology, and is not disputed by any party, the Commission accepts the adjusted variability of 60.44 percent. However, it should be noted that improvements are possible and should be considered for incorporation in future proposals. Specifically, the means of determining capacity utilization could be improved in order to achieve a greater degree of accuracy in the calculation of the crucial CFM variable. Also, Wade acknowledges that spotter workhour variability is likely greater than zero. *Id.* at 3221. A study to estimate the variability of this 9 percent of VSD costs would certainly improve the overall VSD variability estimate.

D. Rural Carriers

[3343] *Introduction.* Cost Segment 10 consists of the salaries and related expenses of rural carriers. Rural carrier activities involve the collection and delivery of mail, as well as providing certain retail services to customers on rural routes.

[3344] Most rural routes are evaluated routes. Evaluated routes are those for which costs are calculated using a set of standard time allowances derived from the National Mail Count (NMC), which is conducted over two pay periods each year. Time allowances, known as evaluation factors, are applied to workload measures (e.g. mileage, delivery boxes, quantity of mail by shape, etc.) to project total hours and thus salary. In FY 1996, 90 percent of volume variable and 83 percent of total accrued segment 10 costs were generated by evaluated routes. The two other types of routes are mileage routes and auxiliary routes. Mileage routes are low density routes for which compensation is based on route length. Carriers on auxiliary routes, routes requiring less than thirty-five hours per week, are paid on the basis of an evaluated schedule.

[3345] In prior cases, the Postal Service has estimated the volume variability of rural carrier costs by performing regression analysis on data generated by a simulation performed to estimate the effects of changes in volume. The cost effects of increases in volume of three percent, five percent, and ten percent are estimated. A regression line is then calculated based on these results, and a volume variability is derived from it. Some evaluation factors are fixed with respect to volume and the remainder are 100 percent volume variable. This produces a variability that is roughly equal to the ratio of variable to total evaluation minutes. The reason it is not exactly equal to the ratio of variable to total evaluation minutes is that the simulation takes into account the structure and classification changes that routes would undergo in the event of a significant change in volume. USPS-T-17 at 71.

[3346] In this docket, Postal Service witness Baron proposes to cease accounting for these structure and classification changes, dropping the simulation procedure entirely. Thus, his proposal is to estimate volume variability for Rural Carriers as the

ratio of variable evaluation time to total time. This has the effect of slightly increasing variability from what it would be under the previous methodology. He asserts that the assumption of a ten percent increase in volume is arbitrary, and that assuming a different increase would change the results of the simulation. The Postal Service also claims that the new methodology is consistent with the calculation of marginal cost, which the Commission has tended to favor over the finite incremental approach applied in the current simulation model. *Id.* at 73.

[3347] Costs by activity for Rural Carriers are derived from the National Mail Count data, but the NMC does not break down volumes by subclass. Thus, the Rural Carrier Cost System (RCCS) has, in previous cases, been used to develop distribution keys whereby segment 10 costs are distributed to subclasses of mail. However, the NMC and the RCCS differ in how they define a flat. This results in differing flats ratios (the ratio of flats to flats and letters combined) between the two systems. As the costs for each shape come from the NMC, it has been generally viewed as having the preferable flats ratio. Therefore, an adjustment is applied to the RCCS volumes, such that a number of letters are reclassified as flats sufficient to bring the RCCS flats ratio in line with that of the NMC.

[3348] In Docket No. R90-1, the Postal Service first proposed this flats adjustment. The magnitude of adjustment necessary was determined by comparing the NMC flats ratio to the RCCS flats ratio for the entire year. Docket No. R90-1, USPS-T-13 at F-30. The Commission chose to adopt the resulting cost distribution. Compare R90-1 Exhibit USPS-13A at 31-32, and R90-1 PRC LR-5, Matrix byearcp.lr at 7-8.

[3349] In Docket No. R94-1, this procedure was modified so that the magnitude of adjustment necessary was determined by comparing the NMC flats ratio to the RCCS flats ratio over the time frame which corresponded to the NMC data. An identical portion of letters were reclassified as flats in the annual RCCS volumes. Docket No. R94-1, USPS-T-4, WP B, W/S 10.0.3. The adjusted annual RCCS volumes were then used as the key to distribute Rural Carrier costs to subclasses. Again, the resulting distribution

was accepted by the Commission as proposed. Compare R94-1 Exhibit USPS-4A, at 33-4, and R94-1 PRC-LR-17, Matrix by93rp.lr at 8.

[3350] In this docket, Postal Service witness Alexandrovich applies the technique of comparing NMC data to RCCS data from the corresponding 4-week period. He also uses the adjusted full-year volumes from the RCCS as the key for distributing Rural Carrier costs to subclasses, thus proposing to essentially follow the method for distribution established in R94-1. One major, and controversial, difference is the addition of a new key for the distribution of Delivery Point Sequencing (DPS) and Sector Segment (SS) costs. USPS-LR-H-201, WS 10.

[3351] *Intervenor Opposition.* MPA witness Glick, in direct testimony, claims that there is a problem with the distribution of Rural Carrier costs. He finds, initially, that the cost distributed per flat is higher than the cost per flat implied by the flat evaluation factor, while the cost distributed per letter is lower than the cost per letter implied by the letter evaluation factor. This would suggest that subclasses with high proportions of flats, relative to letters, have an inordinately large share of Rural Carrier costs assigned to them. As an alternative, he suggests a flats adjustment which reclassifies more letters as flats, thus reducing the distributed cost per flat and increasing the distributed cost per letter.

[3352] In response to interrogatories from the Postal Service, Glick acknowledges that he incorrectly assumed that the “Letters Delivered” key excluded DPS and Sector Segment volumes. Based on this assumption, he originally calculates the distributed cost per letter by dividing the total costs distributed to Letters Delivered (non-DPS) by the total Letters Delivered volume (which includes DPS). This results in a distributed cost per letter that is below the evaluated cost per letter. Glick also initially removes DPS and Sector Segment volumes from the NMC letters volume for the purpose of determining the shape adjustment. He corrects these mistakes, and recalculates the distributed cost per letter as being greater than the evaluated cost per letter, but not to the degree by which the distributed cost per flat exceeds the evaluated cost per flat. He also calculates

a revised shape adjustment which, while considerably closer to that of Alexandrovich, still differs slightly. Tr. 28/15493-97.

[3353] In his rebuttal testimony, Postal Service witness Baron addresses the issues raised by Glick. He defends Alexandrovich's shape adjustment factor, but acknowledges that Glick uncovered a problem with the Letters Delivered distribution key. Baron claims that because DPS and Sector Segment costs are distributed on a distinct key, those volumes should be excluded from the Letters Delivered key. Tr. 33/17752-53. After removing the DPS and Sector Segment volumes from the Letters Delivered key, he compares the resulting ratios of distributed cost per item to evaluation cost per item for letters and flats and finds them to be closer to each other than in Alexandrovich's testimony. Thus, he concludes that he has found the cause and solution to the inconsistency pointed out by Glick.

[3354] *Commission Analysis.* Upon examining the debate surrounding Rural Carrier costs, it appears that there are three central issues to be decided. The first is the undisputed proposal to change slightly the method for determining volume variability. This simplification appears to be justified. The previously applied arbitrary assumptions about future changes in volume should be removed from consideration, and thus the proposed variabilities of 0.4904 for Evaluated Routes and 0.4987 for Other Routes are accepted.

[3355] The other two issues are much more controversial. The first of these is the shape adjustment. None of the parties dispute the need for an adjustment; the issue is whether the NMC should be compared to RCCS data for the corresponding two pay periods, or for the entire year. Glick advocates the use of full year volumes, and on brief, MPA makes the point that Glick's shape adjustment generates results which are reasonable in that the "markups" of distributed cost over evaluated cost are relatively equal for flats and letters. MPA Brief at 5-6. Postal Service witness Baron counters in his rebuttal testimony that the method of applying NMC percentages to the RCCS volumes for the same 4-week period was the most recently employed, and he sees no reason to go back to the R90-1 procedure. Tr. 33/17757.

[3356] The second disputed issue is what, if any, DPS and Sector Segment percentages are appropriate to use for the purpose of creating a separate DPS and Sector Segment distribution key. Clearly, if a DPS/Sector Segment key is to be created, it must make use of DPS percentages by subclass. The only data on the record which meet this criterion are those used by the Postal Service's witnesses Alexandrovich and Baron. However, as the Joint Parties (AMMA, DMA, MOAA, PSA, and Advo) point out on brief, the DPS percentages used by the Postal Service are systemwide rather than rural-specific, and are relatively old. Joint Parties Brief at 18. This is a significant problem when dealing with DPS, which is growing and changing in makeup rapidly. A clear symptom of this flaw is that the distributed cost per DPS Letter, as calculated by the USPS, is actually less than the evaluated cost for a DPS letter. Tr. 33/17816.

[3357] A logical alternative to creating a separate distribution key for DPS and Sector Segment letters is to distribute the costs for all letters (DPS and non-DPS) on a key consisting of volumes for all letters (DPS and non-DPS). This is suggested by Advo witness Crowder in a footnote to her rebuttal testimony. Tr. 34/18342. The idea deserves consideration, as it would eliminate the ill effects of applying questionable DPS percentages. It should be noted that the cost distribution which would result from combining the two keys is closer to the distribution originally proposed by Alexandrovich than to that of either Baron or Glick. However, this method would ignore the cost difference between DPS and non-DPS letters, effectively overstating costs in subclasses which make use of DPS.

[3358] Glick's and Baron's proposals each have their merits, as well as their flaws, and neither appears to be clearly superior. While the method used by Alexandrovich also is imperfect, the resulting distribution of costs falls between the other competing analysis. The Commission accepts the results of the Rural Carrier distribution as submitted by Postal Service witness Alexandrovich as an interim solution. It is hoped that before the next rate case appropriate distribution keys will be developed.

[3359] Many, if not all, of the issues in question with regard to Rural Carrier costs arise because the information systems used in the development of the costs and

distribution keys are incomplete in and of themselves. The result is that before the volumes from the RCCS can be used to distribute costs, they must first be modified to reflect differences with at least two other sources. One possible solution to this problem is to gather more information with each system in order to reduce the number of differing sources from which data must be combined. For example, the RCCS could be modified in such a manner as to collect volumes for DPS and Sector Segment letters. Perhaps then the resulting distributed costs per piece would be more uniformly related to the evaluated costs.

E. Transportation

[3360] *Introduction*. Contract services for transporting mail are accounted for in Cost Segment XIV, Purchased Transportation. Purchased transportation contracts are usually limited to a specific mode and route or geographic area. A typical contract provides a schedule of rates for a defined set of services over the duration of the contract. When a purchased transportation contract applies to a highway truck route, the routes often originate and terminate at a single Bulk Mail Center (BMC) or Sectional Center Facility (SCF).

[3361] The Commission's method for attributing purchased highway transportation costs to subclasses of mail involves both an attribution step and a distribution step. In the attribution step the volume-variable component of these costs is determined by multiplying these costs by econometrically-derived estimates of the elasticity of transportation costs with respect to a cost driver defined, usually, as the cubic foot miles of purchased highway transportation. In the distribution step the volume-variable component is allocated to subclasses according to distribution keys. These distribution keys are obtained from the Postal Service's Transportation Cost System (TRACS). They are intended to measure the proportions of cubic foot miles of transportation capacity that are purchased for each subclass.

1. Transportation Cost Variability

[3362] In Docket No. R87-1, the Commission adopted translog cost models for purchased highway transportation. These models were fit by Postal Service witness Lion to a sample derived from postal highway contracts data extracted by Postal Service witness Bradley. These models were applied by the Commission to determine the volume variability of transportation costs for several categories of highway contracts:

- Inter-BMC: Contracts primarily between BMCs. Such contracts sometimes include stops at SCFs.

- Intra-BMC: Contracts primarily between a BMC and the SCFs and Associate Offices (AOs) within the BMC's service area.
- Inter-SCF: Contracts primarily between SCFs. Such contracts sometimes include stops at AOs.
- Intra-SCF: Contracts primarily between an SCF and the AOs within the SCF's service area but excluding Intra-City contracts.
- Intra-City: Contracts between an SCF and the AOs within a single city.
- Box-Route: Contracts providing for delivery, collection and retail services to rural customers along a box route.

[3363] The models were applied again by the Commission without any changes in Docket No. R90-1 and in Docket No. R94-1.

[3364] When adopting these models in R87-1, the Commission observed that "[c]ost attribution for ratemaking is an ongoing process which builds upon previous determinations and adapts to new developments and availability of better data." See PRC Op. R87-1 at 319. In this proceeding Postal Service witness Bradley has provided a revised and refitted version of the R87-1 models. *See* USPS-T-13. These models have been fit to a more recent and much larger cross-section of highway transportation contracts. They exploit geographic and vehicle-type information in the sample not used in fitting the R87-1 models. Witness Bradley has also extended the application of the translog model approach to include *plant-load* contracts. These contracts typically are tractor-trailer hauls in which the Postal Service provides mail transportation from a bulk mailer to a downstream facility thereby bypassing unnecessary processing at the local office. In R87-1, the Commission noted that "[a]nother area needing additional work is plant load cost distribution." PRC Op. R87-1, para. 3569. In past proceedings the costs of plant-load contracts have been regarded by the Commission as 100 percent volume variable.

[3365] The Commission accepts the revisions and reestimations presented by the Postal Service as timely improvements to the R87-1 models. Therefore, volume-variable highway transportation costs have been determined for this proceeding using the elasticities for cost drivers derived by witness Bradley. For all but box-routes, these cost

drivers are cubic foot miles (CFM) of contract capacity. For box-routes, the cost driver is the number of boxes. The Commission has also used the new model for plant-load contracts as the source for the elasticity for CFM to determine the volume-variability of plant-load costs.

[3366] The Commission's acceptance of witness Bradley's models and estimates continues to rely significantly upon the extensive testimony and findings in support of the models that are part of the record of Docket No. R87-1. See Docket No. R87-1, paras. 3490-3569. The findings from R87-1 that the Commission continues to rely upon in our assessment and acceptance of witness Bradley's reestimations and revisions are as follows:

- The data assembled by witness Bradley from highway contract records are representative of the cost and operation of the Postal Service's national highway purchased transportation network and are suitable for the statistical purposes to which they have been put. Id., para. 3490-3493.
- The models, as described and defended by Postal Service witnesses in R87-1, are basically consistent with the Commission's understanding of how the Postal System purchases and uses highway transportation. The Postal Service's operational witnesses in R87-1 and the Postal Service rebuttal witnesses Pickett and Young in this proceeding all provide similar descriptions, compatible with the Commission's understanding of the models, of how the highway transportation system adapts to changing volumes. *See* USPS-RT-2, USPS-RT-3 and PRC Op. R87-1, paras. 3490-3491 and 3494-3497.
- The Commission's requirement for volume-variable costs does not coincide precisely with the standard economic definitions of either short-run variable costs or long-run variable costs. Instead, the Commission applies a definition of variable costs described in R87-1 as "longer" run and encompassing responses of costs to volumes that might require as long to occur as a complete rate case cycle lasting approximately three to four years. PRC Op. R87-1, paras. 3527-3531.
- Models that are fit using a cross-section data set may reasonably be expected to correctly represent cost responses that are volume-variable over the "longer run" if they fit the evidence. In R87-1, witness Bradley testified that "his data base incorporates contracts corresponding to all of the many situations the Postal Service faces when dealing with the need to provide transportation for different mail volumes." Id., para. 3538 (citation omitted). Therefore, the Commission concluded that "using the translog model with the extensive data set available, the variability levels estimated reflect the entire range of cost-affecting changes." Id., para 3539.

- The translog cost model best fits the evidence describing actual operations. In R87-1, the Commission noted that the translog could be considered the source of all of the other proposed models in the sense that the others could be considered simplified derivations from it. While the translog is the most complicated it is also the most general and flexible. It constrains the least and can approximate whatever functional form the data actually follow. Id., paras. 3542-3543. Therefore, the translog will remain the preferred model so long as the data set includes a number of observations that is large relative to the number of terms in the translog equation.
- Cubic-foot-miles (CFM) is an acceptable driver for purchased transportation costs. And, it is appropriate to use the variability evaluated at the mean of the sample to compute volume-variable costs. Id., para. 3547.
- The Commission resolved a dispute over the inclusion of route-length in the estimated relationships by opting to include route-length, even though Postal Service witnesses testified that route-length could be changed in practice in the choosing of optimal route combinations to produce the necessary CFM. In their view, including route-length converted the translog into a short-run cost relation since, given time, route-length would also vary with volume. However, including route-length significantly improved the predictive power of the estimated models. Therefore, in R87-1 the Commission concluded that: "Even if the Postal Service's assumption is correct, the evidence in the record supports the model's ability to reflect accurately the cost-related functioning of the network. It appears that, although route length is one of the factors managers vary in their effort to deal with volume changes in the least costly manner, the average route length for the categories does not vary much." Id., para. 3554.
- The proportionality assumption could be rejected based upon the evidence on the record. The proportionality assumption is that as volume increases, the number of contracts, vehicles and routes increases proportionately. Under the proportionality assumption, neither average RL nor average CFM would increase with volume in the long run and the volume variability of the system would be 100 percent. The Commission concluded from the evidence that "a proportionate increase in the number of vehicles as volume increases is not an acceptable theory of how the network operates." Id., para. 3559. Nevertheless, this remains an area where the response of the system to volume increases has not been adequately investigated. In time research using the HCSS data system could supply an answer to the still-open questions regarding how the number of contracts, vehicles and routes change with postal volumes.

2. Witness Bradley's Econometric Research

[3367] Witness Bradley relies upon the new (1995) Highway Contract Support System (HCSS) for most of his data. A set of 15,511 records, comprising all of the highway contracts in force in the first week of August 1996 was extracted. These records enabled the construction of a somewhat larger cross-section data set of 15,714 observations corresponding to individual route part / cost segments. The record for a contract from HCCS includes annual cost, annual miles traveled, number of trucks, cubic capacity of the trucks, route length, the highway cost account and additional information in the form of identification codes and the regional office source. Witness Bradley can reliably infer equipment types, operating regions and identify box-route contracts from this information. For power-only contracts in seven regions the cubic capacity of trucks is taken to equal the average trailer size for BMC leased fleets as found in a Price-Waterhouse survey. *See* Docket No. MC97-2 LR PRC-13.

[3368] In most respects witness Bradley's data set is superior to the data set used to fit similar models for R87-1. It is certainly more recent and much larger than the R87-1 sample of 2,099 contracts. It is also richer in the sense that it offers opportunities to improve the original models. It includes information allowing each contract to be assigned to one of thirteen operating regions, and it allows inter-SCF and intra-SCF contracts to be divided into routes served by tractor trailers and by fixed-body vans. For a relatively small number of observations involving multiple vehicle capacities on a single contract, the HCSS requires an approximation of CFM that is somewhat cruder than the calculated CFM for such routes in the R87-1 sample. However, the effects of this approximation are minimal. See USPS-T-13 at 19.

[3369] Witness Merewitz claims that witness Bradley should have used data from the Postal Service's Transportation Reporting System (TRACS). Tr. 22/11413. According to Postal Service witness Nieto, TRACS samples purchased transportation costs incurred for the following accounts: Intra-SCF, Inter-SCF, Intra-BMC and Inter-BMC. USPS-T-2 at 2. "Information on weight and volume by rate category is

recorded for the contents of sampled containers and items. In order to develop estimates of cubic-foot-miles, data collectors also record the facility where the mail was loaded onto the test truck (to establish miles traveled) and the percent of the floor space of the truck occupied by each container type (to establish cubic-feet utilized)." Ibid. Therefore, TRACS does record values for the essential variables of the Commission's accepted models.

[3370] Also, TRACS could be modified to report volumes, or at least weights from which volumes can be estimated. So TRACS offers the opportunity to fit models in which volumes appear directly as explanatory variables instead of indirectly as represented by the driver CFM. Witness Merewitz states that models using volumes directly would avoid the use of CFM as a proxy for volume. "The TRACS sampling process actually yields volume data for proper investigation and to find the impact of additional pieces … without the dubious interconnection of the relationship between capacity and volume." Tr. 22/11413 (footnote omitted).

[3371] There is little in witness Bradley's testimony to indicate that he ever seriously considered using TRACS data, even though this data could have been made available to him. See USPS LR H-82 and H-84. However, this does not supply any ground for rejecting witness Bradley's research. Models that use drivers such as CFM as proxies for volumes are not automatically misspecified, as witness Merewitz would have us believe. Tr. 22/11414. The Commission is always interested in reviewing alternative models and models fit to alternative data sets when they are relevant to the Commission's work. Certainly, the econometric research proposed by witness Merewitz would be of interest to the Commission; however, this work has not yet been done, and the Commission finds witness Bradley's existing analysis adequate for its intended purpose.

[3372] Witness Bradley describes his research as a linear sequence of fitted models and associated tests beginning with reestimations of the Commission's R87-1 models, using the new data set and terminating with the estimated models he recommends and upon which the Commission has relied. Along the way witness

Bradley (1) adds selected dummy variables to control for region-specific effects, (2) applies the translog approach to plant-load contracts, (3) splits the inter-SCF and intra-SCF data sets into tractor-trailer and fixed-body subsets and fits separate models for each, (4) tests for and corrects his standard errors for heteroscedasticity, and (5) scrubs the data set for extreme observations that were investigated and found to be for highly unusual contracts. His workpapers also display results for models fit with a complete complement of dummy variables for region-specific effects. USPS-T-2 Workpaper 3.

[3373] The translog cost equations used by witness Bradley differ little from those described in Docket No. R87-1.[46] The main advantage of fitting cost functions in this form is that a translog equation is a general approximation that allows the data to determine the shape of the estimated function. It is also a form that facilitates the extraction of the elasticities that are the volume variabilities used by the Postal Service and the Commission. All of witness Bradley's equations are fit to mean-centered values of the variables, as were the Commission's R87-1 equations. This permits extraction of the volume-elasticities at the mean.

[3374] The Commission's rules require econometric research to be offered as evidence to be in a context that enables the Commission and parties to judge the stability and robustness of the recommended estimates and to verify that the research has not excluded any practical alternative models that might reasonably be expected to be

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[46] For all-but-box-route contracts the translog equation takes the following form:

$$\ln Cost = \alpha + \beta_0 Region + \beta_1 \ln CFM + \beta_2 (\ln CFM)^2 + \beta_3 \ln RL + \beta_4 (\ln RL)^2 + \beta_5 (\ln CFM)(\ln RL)$$

Where:Region=Dummy variables for up to 11 (out of 12) geographic regions
CFM=Cubic Foot Miles
RL=Route Length
For box route contracts:

$$\ln Cost = \alpha + \beta_0 Region + \beta_1 \ln BOX + \beta_2 \ln BOX^2 + \beta_3 \ln YRMILE + \beta_4 (\ln YRMILE)^2 + \beta_5 \ln RL$$
$$+ \beta_6 (\ln RL)^2 + \beta_7 (\ln BOX)\ln(YRMILE) + \beta_8 (\ln BOX)(\ln RL) + \beta_9 (\ln YRMILE)(\ln RL)$$

Where:Region=Dummy variables for up to 11 (out of 12) geographic regions
BOX=The number of boxes on the route
YRMILE=Annual miles traveled on the route

superior. Witness Bradley has reported sufficient results and tests to satisfy the Commission in these respects.

3. Transportation Cost Attribution

[3375] In Docket No. R90-1, the Postal Service introduced the Transportation Cost System (TRACS). TRACS is a sampling system from which the Service derives distribution keys for purchased transportation. For highway and freight rail these keys are based upon CFM of truck and railcar capacity. TRACS was accepted by the Commission and is now used to develop the distribution keys to distribute purchased transportation costs to the various subclasses of mail. The Commission accepted TRACS partly "because TRACS is an ongoing sampling system, it should capture and reflect the effects of operational changes as they occur." PRC Op. R90-1, para. 3643 (citation omitted). TRACS was relied upon for distribution keys in Docket Nos. R90-1 and R94-1.

[3376] The rebuttal testimony of Postal Service witness Christensen contains a concise statement of the relationship that should be preserved between volume-variability of cost, volume-variability of a cost driver such as CFM and distribution keys for the driver. Tr. 34/18222-23. The elasticity of cost with respect to the subclass volume is multiplied by the cost pool corresponding to the driver to obtain the subclass's volume–variable cost for that pool[47]. An implied assumption of the mathematics is that the subclass distribution key is not itself volume-variable. In other words, all of the volume-variability of purchased transportation is captured by the elasticity of cost with respect to the driver, CFM.

[3377] Although witness Christensen describes his relationship in the context of witness Bradley's and witness Degen's uses of piece-handling data from the

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[47] The relationship is:
Elasticity of Cost w/r Subclass Volume = (Elasticity of Cost w/r Driver) X (Elasticity of Subclass w/Driver).

Management Operating Data System (MODS), the relationship is general and applies wherever drivers such as piece handlings and CFM are used to attribute volume-variable costs. The subclass distribution key is the subclass's proportionate contribution to the driver. In the case of purchased highway transportation the distribution keys are estimated following Christensen by taking the ratio of the CFM attributed to the subclass by TRACS and dividing by total CFM. Id. at 18223 (footnote 6). Witness Chrisensen's point, with which the Commission agrees, is that the integrity of the mathematics requires that all of the components on the right-hand-side of the equation be properly defined for the same driver. For purchased highway transportation this means that the distribution keys produced by TRACS must correctly distribute total CFM by subclass. When the Commission accepted TRACS in R90-1 it noted that it replaced a system based on volume with a system based on CFM. PRC Op. R90-1, paras. 3638-3642. The contribution of a subclass to CFM is *assumed* to be proportional to volume in the way the distribution keys are derived. The assumption is not necessary for witness Bradley's econometrics.

[3378] In this proceeding TRACS has been criticized in testimony by witnesses Haldi (ANM-T-1), Merewitz (FGFSA-T-1) and Ball (FGFSA-T-2). This testimony rests largely upon a common concern regarding the manner in which TRACS relates the mail found in sampled vehicles to CFM and cost. The TRACS "sampling unit" is not always the entire route that a truck follows on a given day. Tr. 35/18769-71. In witness Haldi's terminology the truck is often sampled on a "segment" of a route. Witness Merewitz believes that much of the TRACS sampling occurs on "backhauls." Postal Service rebuttal witness Pickett calls the sampling unit a "route trip destination day." In R90-1, the Commission understood the sampling unit to be "one destination day" defined as "one trip to one destination on the selected day for a route within a particular transportation category." PRC Op. R90-1, para. 3644 (citation omitted). Whatever it is called, all agree that TRACS assigns all of the cost of the contracted CFM for the segment, backhaul or route trip destination day to the subclass of mail found on the truck when it is sampled at the destination.

[3379] In economic terminology, TRACS imputes the cost of the CFM for the route trip destination day entirely and only to the mail found on the truck at the destination where it is sampled. TRACS' method for imputing costs was recognized, accepted and described by the Commission in Docket No. R90-1. Id., paras. 3645-3655. Since R90-1 there have been few changes in TRACS data collection procedures, and none have been proposed by the Service in this proceeding.

[3380] There would be little reason for concern if transportation was purchased by the Postal Service independently in the same units in which it is sampled by TRACS. This would be the case if the Service's transportation could be purchased in units that corresponded to route trip destination days. But it can't. Transportation services for route trip destination days are purchased jointly by routes or in other blocks specified in the HCSS contracts. In the simplest case, an outhaul from a facility and a backhaul to the same facility comprise a pair of route trip destination days that must be purchased together. The purchased cost of the route is a joint cost of the mail carried on both the outhaul and the backhaul. When TRACS samples either the outhaul or the backhaul as a route trip destination day, the cost of the outhaul or backhaul is part of the joint cost of the route. When TRACS assigns this cost to the mail found on the truck at its destination, it is making an arbitrary division of a joint cost.

[3381] In past proceedings the Commission has accepted descriptions of Postal Service use of purchased transportation as efficient. This should mean that the Service has purchased transportation services in a way that minimizes the cost of transporting mail volumes to meet various scheduling commitments and standards. Put formally, the Service solves an implied optimization problem when it determines its purchases of transportation services. It minimizes cost subject to a system of constraints that specify the services needed and other limiting conditions such as the requirement that purchases conform to the terms of the contracts. The solution to this kind of optimization problem provides, also, a means to impute the minimum transportation cost to the services and requirements that have been met. In linear programming representations of the optimization problem, the imputation is found in the shadow prices that solve a

dual program. More generally, the imputation is associated with the Lagrange multipliers that appear in the necessary conditions for a solution.

[3382] The thrust of witnesses Haldi, Merewitz and Ball's testimony is that the imputations made by TRACS can be incorrect. From an economic perspective an incorrect imputation would occur whenever the CFM on a destination day was purchased for some purpose other than or in addition to transporting the mail found in the truck at the destination. When the Service purchases transportation efficiently, the requirements and constraints that may determine a particular route trip destination day are not limited to just the need to transport the mail found on the truck at the destination. The testimony in this proceeding, including the testimony of Postal Service rebuttal witnesses Pickett and Young, describe a variety of plausible circumstances and ways in which this occurs. Therefore, it appears that the TRACS sample is collected and reported in a way that incorporates an imputation that oversimplifies the true economic relationship between CFM and volumes.

[3383] One of Postal Service witness Bradley's responses to interrogatories describes how economists would be likely to view a leg-by-leg allocation of a transportation contract's cost. "For the postal transportation network, I view the cost of a contract being jointly determined by the cost of serving all of the legs on all of the route/trips on the contract." "In other words, the cost of transportation on a contract varies with changes in the total cubic foot-miles specified in the contract and is not directly allocable to any specific leg." Tr. 7/3585 (emphasis omitted).

[3384] It is possible that the TRACS imputation creates a bias that favors one subclass of mail over another, such as bulk mail drop shipped to BMCs as alleged by witnesses Merewitz and Haldi. It is also possible that TRACS provides unbiased distribution keys because the errors produced by the oversimplified imputation rules are random with respect to the subclasses in their effects. Finally, it is possible that an imputation of costs over the transportation system that is not entirely defensible from the standpoint of economic theory may still be regarded as a fair and reasonable basis for the attribution of transportation costs for the purposes of a rate proceeding. This seems

to be the underlying assumption of Postal Service rebuttal witness Pickett. Tr. 35/18768-69.

4. The Alleged Biases in TRACS

[3385] All parties are in agreement on how TRACS assigns unused capacity in trucks and containers to the mail found on the truck when it is examined at its destination. This process was described by the Commission in Docket No. R90-1. With TRACS, all unused truck capacity is accounted for and distributed to the mail on a sampled vehicle. Also, the entire cost of transporting a partially empty container is charged to those subclasses of mail sampled from the container. See PRC Op. R90-1, para. 3653-3655. This is the "expansion" process described by witness Haldi and by witness Merewitz. Tr. 22/11817-21 and 11416. An even more detailed description may be found in the rebuttal testimony of Postal Service witness Pickett. Tr. 35/18764-68.

[3386] Witnesses Haldi and Merewitz assert that the "expansion" process will bias the distribution keys derived by the Service from TRACS and relied upon by the Commission in this proceeding. Postal Service rebuttal witness Pickett denies that TRACS imparts any bias to the distribution keys. In his rebuttal testimony witness Pickett describes an experiment in which he "removes the empty space algorithm" and recomputes the distribution keys on six categories of mail. He finds that the changes are small. See USPS-RT-2 at 10-11.

[3387] The Commission cannot tell from the record evidence in this case if the TRACS distribution keys are *actually* biased. Furthermore, there is no good alternative method for estimating the distribution keys on the record for this proceeding. Therefore, the Commission continues to use the TRACS-based distribution keys. However, a *potential* for bias is clearly present in the TRACS "expansion" process.

[3388] When a truck is sampled by TRACS and found to be fully loaded, and any containers carried on the truck are similarly fully loaded, even allowing for settling, weights and other restrictions as described by witnesses Pickett and Young, it is difficult

to avoid the conclusion that the cost of the destination day should be fairly attributed to the mail found on the truck at its destination. Tr. 35/18764-67 and 18862-63. However, the same cannot be said for a partially loaded truck or for a truck carrying partially empty containers. The mail sampled on a partially empty truck and in partially empty containers may have little to do with the transportation requirements and operational decisions that produced a truck of a particular size running a particular route to that destination on that day.

[3389] According to witness Haldi "[m]ost highway routes involve round-trips, whereby trucks return to the facility from which they start the route. On any given day, all segments of the route are necessarily served by the same truck. Capacity of the truck must obviously be sized for whatever segment or segments have the highest average volume." Tr. 22/11818 (footnote omitted). But even if routes are not required to be round trips, a certain amount of movement would be necessary to reposition vehicles, because much of the mail that arrives and some of the mail that departs Postal Service facilities is not carried on postal vehicles. Repositioning occurs whenever vehicles are moved primarily for the purpose of going to a location where they are required rather than for the purpose of transporting the mail found in them. For example, bulk mail is frequently delivered to BMCs on trucks that belong to postal customers. This mail leaves the BMCs on postal service trucks. When these trucks return to the BMCs they also carry mail, however, the primary reason for the return trips may be to get back to the BMCs to carry more outbound mail. So when TRACS samples mail on a truck that is returning to a BMC, the sampled mail may have little to do with why the truck was returning to the BMC.

[3390] If it was not apparent before, it is certainly apparent now from the rebuttal testimony of Postal Service witness Young that postal transportation is contracted and scheduled in response to a very complex set of requirements and constraints. Among the considerations are "the requirements of downstream mail processing and delivery facilities," "service commitments to customers," "how many containers of mail each downstream facility normally receives on the busiest day or night of the week," "what

plants can handle which types and sizes of highway equipment," "downstream facilities operating plans," and meeting "the last scheduled dispatch, called the dispatch of value" to avoid delaying the mail. Tr. 35/18855-56. These scheduling considerations are in addition to matching truck capacities on individual legs of a route to the volume of mail being carried. Or, to put it somewhat differently, a schedule that meets witness Young's considerations is bound to include truck movements that are undertaken for reasons that go beyond just transporting the mail found on the truck at its destination.

[3391] It appears to the Commission that TRACS would better serve the purpose of supplying information for a rate proceeding if the data collection and reporting were kept separate from the imputation that is made when the contents of trucks and containers are "expanded" to fill unused capacity. The Postal Service should consider whether it is possible to modify TRACS so that the data collection and reporting omit the expansion calculation. Basically, TRACS would have to be modified to report, or at least to estimate, the actual volumes of mail found on the trucks.

[3392] Witnesses Haldi and Merewitz also claim that TRACS is subject to sampling bias. According to witness Merewitz TRACS takes a disproportionate share (70 percent) of its Intra-BMC and Inter-BMC sample on inbound movements. TRACS sampling is not supposed to delay the mail. If a delay is possible, a TRACS observation is aborted or incompletely recorded. Tr. 22/11416 and Tr. 35/18770. Trucks outgoing from BMCs often carry periodicals, which are time sensitive, while trucks incoming to BMCs are less likely to be carrying mail in a time-sensitive subclass. A selection bias results if the distribution of mail in the aborted or incomplete observations is unrepresentative of the distribution in the completed sample. This kind of selection bias is not corrected by the Postal Service's practice of weighting the TRACS sample according to the frequency of inbound and outbound movements at the BMCs when calculating the distribution keys.

[3393] Finally, witnesses Merewitz and Ball point out that the distribution keys derived from TRACS are different from the distributions of subclass volume statistics for the mail subclasses that are commonly carried intra-BMC with purchased highway transportation. Tr. 22/11415 and 11427-28. There could be several reasons for the

distribution keys to differ so much from subclass volumes distributions, including the entering of large volumes of mail beyond the BMCs and defects in witness Merewitz's calculations. It would improve the Commission's confidence in the distribution keys from TRACS if the Service could offer more than just hypotheses to explain the differences noted by witnesses Merewitz and Ball.

F. Miscellaneous Cost Attribution Issues

[3394] In previous sections of this chapter, the Commission has discussed its policies regarding the determination of attributable costs. The Commission explains in Chapter IV why these causally related or attributable costs are the proper floor for evaluating the allocation of institutional costs. The Commission's attributable costs consist of appropriately calculated variable costs, plus other costs for which a causal connection has been identified and established. The Commission has resolved issues concerning this basic approach and the particular costs involved in decisions in previous omnibus rate cases. For completeness, the nonvolume variable attributable costs that are reflected in the Commission's attributable cost base are discussed briefly below. The established treatment of these costs is unchallenged on this record, except in the overall sense of Postal Service witness Panzar's analysis, which has been rejected. The Commission maintains the established analyses of these costs, but makes modifications to reflect the record of this proceeding.

1. City Delivery Carrier Single Subclass Costs

[3395] Certain costs of city delivery carrier access and load time can be associated with individual mail subclasses. Specifically, these are the costs of accessing delivery points and loading mail into receptacles when only one subclass of mail is involved. Previous Commission decisions have discussed the causal analysis in considerable detail. Briefly stated, if the particular subclass being delivered did not exist, the access and load time involved would not have been incurred. The established attributable treatment of these costs is continued in this opinion.

2. Special Delivery Messengers

[3396] Since Docket No. R84-1, the fixed portion of the costs of special delivery messengers (included in cost segment 9) have been attributed. Messengers provide expedited delivery for certain service offerings. Absent the expedited treatment, delivery would be provided by the standard delivery system. Thus, the fixed portion of special delivery messenger costs are attributed to the expedited services that cause these fixed costs to be incurred: Express Mail and International Mail. Special delivery service, discontinued as a result of Docket No. MC96-3, was previously included in the distribution of these costs.

3. Intra-Alaskan Nonpreferential Air

[3397] Beginning in Docket No. R90-1, a portion of the costs of intra-Alaskan air transportation costs (segment 14) have been considered institutional, although they are recognized as being volume variable in nature. The costs of serving areas without road access, the so-called Bush Country of Alaska, are considerably higher than the costs of providing service to other areas in the United States. Since the Postal Service's universal service obligation extends to citizens of all regions of the United States, it would not be appropriate to recover all these costs from the nonpreferential classes carried by intra-Alaska Air. Consequently, the attributable portion of nonpreferential Alaskan air service is calculated based on the nationwide weighted average costs of inter-SCF and intra-BMC highway transportation. The remaining portion, approximately $70 million for the test year, is transferred to the institutional cost pool and recovered through the markup procedure pursuant to the Act.

4. Air Transportation Network

[3398] The costs of the Eagle Expedited Air network, the Western Air network, and the Christmas Air network are all considered partially variable in the Service's filing. Variable costs are calculated assuming commercial air rates and distributed to the mail classes flown on each network on the basis of pounds and/or pound-miles as measured by TRACS. Remaining costs, under the Service's approach, are recovered by all classes through the markup process.

[3399] The Commission concurs with the Service's cost variability analysis. However, consistent with past decisions, the Commission finds that a causal relationship with service offerings exists for network fixed costs[48]. Specifically, the networks exist to provide expedited service – absent Express Mail and Priority service offerings the networks would not exist. This causality feature requires the attribution of network fixed costs to the appropriate expedited class. Consequently, fixed costs of the Eagle and Western networks are attributed to Express Mail, while the fixed costs of the Christmas network is attributed to Priority Mail.

[3400] In past proceedings, Eagle network fixed costs were attributed to Express Mail and Priority Mail, since both classes were considered responsible for the cost incurrence. However, the record of this case indicates that a revised treatment is in order. In direct testimony, Postal Service witness Takis states:

> I assume that if Express Mail were eliminated, then the Eagle Network would be shut down, and Priority and First-Class Mail would be diverted onto commercial flights with no degradation of service quality.

USPS-T-41, p.12.

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[48] The Commission's analysis was confined to the Eagle Air network in previous decisions. The record in this proceeding allows extension of the fixed attribution concept to Western Air and the Christmas Air network.

As a result of this testimony, the Commission attributes fixed Eagle network costs solely to Express Mail.

5. Advertising

[3401] The advertising costs associated with specific subclasses of mail are considered attributable under the Commission's established attribution principles. These costs are included in segment 16, Supplies and Services. This advertising is primarily focused on Priority Mail and International Mail, although the Service's FY 1996 CRA Report attributes small amounts of advertising expense to other classes. The Commission adopts the advertising attributions shown in that report.

6. Other Specific Fixed Costs

[3402] The Service's FY 1996 CRA also identifies certain other specific fixed costs. Express Mail costs in the administrative component of cost segment 3, Clerk and Mailhandlers, CAG A-J offices; computerized tracking and tracing Express Mail costs included in cost segment 16, Supplies and Services; and money order division personnel costs in segment 18, Administrative and Regional Operations. These costs are likewise attributed in this opinion, consistent with past Commission practice of attributing specific fixed costs.

Summary of PRC Attributable Costs
Test Year/PRC Recommended Rates
($000)

	Short Run Variable	Specific Fixed Costs	Longer-Run Variable	Total Attributable	Final Adjustments	Net Attributable	Contingency @ 1.0 Percent	Grand Total Attributable
First-Class Mail:								
Single-Piece Letters	11,734,764		2,496,923	14,231,687	427,590	14,659,277	146,593	14,805,870
Presort Letters	3,770,616		783,377	4,553,993	4,636	4,558,629	45,586	4,604,216
Total Letters	15,505,380		3,280,300	18,785,680	432,225	19,217,905	192,179	19,410,085
Single-Piece Cards	429,297		83,001	512,298	(4,332)	507,966	5,080	513,046
Presort Post Cards	159,189		31,516	190,705	200	190,905	1,909	192,814
Total Cards	588,486		114,517	703,003	(4,132)	698,871	6,989	705,860
Total First-Class	16,093,866		3,394,817	19,488,683	428,093	19,916,776	199,168	20,115,945
Priority Mail	2,134,733	64,312	295,729	2,494,774	(99,124)	2,395,650	23,957	2,419,607
Express Mail	605,061	12,035	118,475	735,571	(12,740)	722,831	7,228	730,059
Mailgrams	478		82	560	1	561	6	567
Periodicals:								
Within County	73,297		13,989	87,286	131	87,417	874	88,291
Regular Rate	1,410,589		254,603	1,665,192	1,149	1,666,341	16,663	1,683,004
Nonprofit	298,665		50,224	348,889	312	349,201	3,492	352,692
Classroom	10,308		2,059	12,367	7	12,374	124	12,498
Total Periodicals	1,792,859		320,875	2,113,734	1,600	2,115,334	21,153	2,136,486
Standard Mail (A):								
Single Piece	213,444		43,529	256,973	(256,973)	-	-	-
Regular - Other	5,069,395		1,081,133	6,150,528	(253,285)	5,897,243	58,972	5,956,215
- ECR	1,774,341		340,350	2,114,691	(27,144)	2,087,547	20,875	2,108,423
Total Bulk Rate Regular	6,843,736		1,421,483	8,265,219	(280,429)	7,984,790	79,848	8,064,638
Nonprofit - Other	986,115		214,271	1,200,386	(41,275)	1,159,111	11,591	1,170,702
- ECR	116,488		23,413	139,901	(5,554)	134,347	1,343	135,689
Total Bulk Rate Nonprofit	1,102,603		237,684	1,340,287	(46,830)	1,293,457	12,935	1,306,391
Total Standard Mail (A)	8,159,783		1,702,696	9,862,479	(584,232)	9,278,247	92,782	9,371,029
Standard Mail (B):								
Parcel Post	577,577	-	105,721	683,298	(4,179)	679,119	6,791	685,910
Bound Printed Matter	305,224		61,988	367,212	16,130	383,342	3,833	387,175
Special Rate	254,627		54,604	309,231	(467)	308,764	3,088	311,852
Library Rate	49,393		10,193	59,586	39	59,625	596	60,221
Total Standard Mail (B)	1,186,821	-	232,506	1,419,327	11,523	1,430,850	14,309	1,445,158
USPS Penalty Mail	170,046		35,073	205,119	(205,119)	-	-	-
Free Mail for the Blind & Hndc	29,571		6,704	36,275	16	36,291	363	36,654
TOTAL DOMESTIC MAIL	30,173,218	76,347	6,106,957	36,356,522	(459,981)	35,896,541	358,965	36,255,504
International Mail	1,175,368	17,473	106,459	1,299,300	86	1,299,386	12,994	1,312,380
TOTAL ALL MAIL	31,348,586	93,820	6,213,416	37,655,822	(459,895)	37,195,927	371,959	37,567,884
Special Services:								
Registered Mail	49,400		36,649	86,049	27	86,076	861	86,937
Insured Mail	35,687		5,647	41,334	5,421	46,755	468	47,223
Certified Mail	301,260		68,085	369,345	(3,820)	365,525	3,655	369,180
Collect-On-Delivery	15,297		3,376	18,673	20	18,693	187	18,880
Special Delivery	26		5	31	(31)	-	-	-
Money Orders	121,681	3,286	30,279	155,246	-	155,246	1,552	156,798
Stamped Envelopes	13,849		416	14,265	5	14,270	143	14,413
Special Handling	987		312	1,299	-	1,299	13	1,312
Post Office Boxes	82,272		507,101	589,373	1	589,374	5,894	595,268
Stamped Cards	-			-	4,699	4,699	47	4,746
Bulk Parcel Return Service	-			-	6,199	6,199	62	6,261
Packaging Service	-			-	27,481	27,481	275	27,756
Delivery Confirmation	-			-	21,920	21,920	219	22,139
Other Special Services	156,296		39,296	195,592	13,497	209,089	2,091	211,180
Total Special Services	776,755	3,286	691,166	1,471,207	75,419	1,546,626	15,466	1,562,092
Total Attributable	32,125,341	97,106	6,904,582	39,127,029	(384,476)	38,742,553	387,426	39,129,976
Other Costs	27,949,653	(97,106)	(6,904,582)	20,947,965	205,119	21,153,084	211,531	21,364,616
Total Costs	60,074,994			60,074,994	(179,357)	59,895,637	598,956	60,494,592
Prior Years Loss Recovery								377,063
Total Revenue Requirement								60,871,655

PRC Distribution of Attributable Costs to Classes and Services
Test Year/PRC Recommended Rates
($000)

	Post-Masters	Supervisors	Clerks & Mailhandlers CAG A - J	Clerks, CAG K	City Delivery Carriers	Vehicle Service Drivers	Special Delivery Messengers	Rural Carriers	Custodial Maintenance Service	Motor Vehicle Service	Misc. Operating Costs
First-Class Mail:											
Single-Piece Letters	114,494	806,063	6,833,718	2,590	2,004,202	30,150	715	303,280	699,042	67,285	2,544
Presort Letters	62,532	241,199	1,551,843	634	1,073,514	20,504	349	288,844	195,353	47,624	1,578
Total Letters	177,026	1,047,262	8,385,561	3,224	3,077,716	50,654	1,064	592,124	894,395	114,909	4,122
Single-Piece Cards	3,501	30,579	236,440	79	87,651	248	40	20,344	20,306	3,176	118
Presort Post Cards	2,350	10,893	73,887	26	43,811	250	23	14,840	6,819	1,928	65
Total Cards	5,851	41,472	310,327	105	131,462	498	63	35,184	27,125	5,104	183
Total First-Class	182,877	1,088,734	8,695,888	3,329	3,209,178	51,152	1,127	627,308	921,520	120,013	4,305
Priority Mail	21,360	88,162	773,319	138	134,057	25,392	1,178	15,810	51,731	14,714	150
Express Mail	4,163	22,201	189,970	-	23,200	1,623	91,288	5,060	10,139	9,225	313
Mailgrams	-	31	153	-	186	1	54	13	8	29	-
Periodicals:											
Within County	424	4,261	21,953	3	26,245	2,496	3	14,433	1,778	1,515	32
Regular Rate	8,775	79,427	593,145	90	246,372	32,360	25	113,908	49,424	14,516	296
Nonprofit	1,736	15,514	103,437	15	62,825	6,131	5	34,226	9,102	3,712	77
Classroom	39	590	4,886	1	1,539	235	-	723	459	114	2
Total Periodicals	10,974	99,792	723,421	109	336,981	41,222	33	163,290	60,763	19,857	407
Standard Mail (A):											
Single Piece	824	14,909	121,254	22	30,403	504	8	1,324	10,848	986	32
Regular - Other	43,110	319,262	2,465,235	491	1,134,647	49,873	9	392,962	246,016	50,977	1,476
- ECR	23,001	96,001	392,024	66	807,237	39,750	5	263,088	50,209	45,291	1,035
Total Bulk Rate Regular	66,111	415,263	2,857,259	557	1,941,884	89,623	14	656,050	296,225	96,268	2,511
Nonprofit - Other	6,678	62,527	477,217	106	222,434	7,574	4	81,652	49,793	10,068	305
- ECR	1,169	6,700	36,939	7	44,406	1,816	-	12,670	4,281	2,247	57
Total Bulk Rate Nonprofit	7,847	69,227	514,156	113	266,840	9,390	4	94,322	54,074	12,315	362
Total Standard Mail (A)	74,782	499,399	3,492,669	692	2,239,127	99,517	26	751,696	361,147	109,569	2,905
Standard Mail (B):											
Parcel Post	3,782	27,369	202,574	-	46,868	27,264	41	10,157	27,264	9,367	55
Bound Printed Matter	2,649	16,540	113,293	-	59,187	15,607	3	11,623	14,474	9,100	67
Special Rate	1,979	13,622	116,176	-	32,091	5,695	3	5,821	14,594	3,856	37
Library Rate	258	2,615	23,731	-	4,826	649	3	1,265	2,764	584	5
Total Standard Mail (B)	8,668	60,146	455,774	-	142,972	49,215	50	28,866	59,096	22,907	164
USPS Penalty Mail	-	13,682	123,656	-	11,927	997	1	1,308	7,205	512	13
Free Mail for the Blind & Hndc	-	1,899	16,001	-	3,887	622	-	779	1,874	311	5
TOTAL DOMESTIC MAIL	302,824	1,874,046	14,470,851	4,268	6,101,515	269,741	93,757	1,594,130	1,473,483	297,137	8,262
International Mail	7,159	31,511	306,796	-	22,822	5,611	15,494	2,541	30,310	3,685	74
TOTAL ALL MAIL	309,983	1,905,557	14,777,647	4,268	6,124,337	275,352	109,251	1,596,671	1,503,793	300,822	8,336
Special Services:											
Registered Mail	502	3,389	33,156	13	5,969	-	40	1,957	7,369	526	10
Insured Mail	277	1,649	14,949	1	2,972	-	-	2,919	752	244	5
Certified Mail	3,360	16,611	96,645	17	109,457	-	-	61,587	8,471	7,466	164
Collect-On-Delivery	93	763	6,282	2	2,601	-	3	3,182	471	163	4
Special Delivery	-	-	-	-	-	-	-	-	1	25	-
Money Orders	1,353	9,850	102,253	-	-	-	-	1,428	4,203	2	-
Stamped Envelopes	85	132	1,368	-	-	-	-	-	59	-	-
Special Handling	2	84	861	-	-	-	-	-	61	-	-
Post Office Boxes	3,063	7,003	71,582	-	340	-	-	-	109,028	1	-
Stamped Cards											
Bulk Parcel Return Service											
Packaging Service											
Delivery Confirmation											
Other Special Services	-	13,573	124,684	65	8,345	-	19	27	9,583	202	9
Total Special Services	8,735	53,054	451,780	98	129,684	-	62	71,100	139,998	8,629	192
Total Attributable	318,718	1,958,611	15,229,427	4,366	6,254,021	275,352	109,313	1,667,771	1,643,791	309,451	8,528
Other Costs	1,391,110	1,461,145	2,278,887	5,591	5,611,308	168,621	1,010	2,042,072	668,428	338,984	282,017
Total Costs	1,709,828	3,419,756	17,508,314	9,957	11,865,329	443,973	110,323	3,709,843	2,312,219	648,435	290,545
Prior Years Loss Recovery											
Total Revenue Requirement											

PRC Distribution of Attributable Costs to Classes and Services
Test Year/PRC Recommended Rates
($000)

	Trans-portation	Building Occupancy	Supplies & Services	Research & Development	Admin. & Regional Operations	General Management Systems	Depreciation & Service-wide Costs	Final Adjustments	Contingency	Total PRC Attributable Costs
First-Class Mail:										
Single-Piece Letters	603,120	306,237	623,445	-	821,125	-	1,013,676	427,590	146,593	14,805,869
Presort Letters	267,272	93,547	121,598	-	261,875	-	325,731	4,636	45,586	4,604,217
Total Letters	870,392	399,784	745,043	-	1,083,000	-	1,339,407	432,225	192,179	19,410,085
Single-Piece Cards	9,006	10,052	28,004	-	30,304	-	32,452	(4,332)	5,080	513,047
Presort Post Cards	2,996	3,664	4,922	-	11,622	-	12,607	200	1,909	192,813
Total Cards	12,002	13,716	32,926	-	41,926	-	45,059	(4,132)	6,989	705,860
Total First-Class	882,394	413,500	777,969	-	1,124,926	-	1,384,466	428,093	199,168	20,115,945
Priority Mail	849,335	48,893	292,814	-	85,839	-	91,881	(99,124)	23,956	2,419,606
Express Mail	192,500	11,751	125,689	-	23,501	-	24,946	(12,740)	7,228	730,056
Mailgrams	-	8	10	-	34	-	33	1	6	566
Periodicals:										
Within County	64	1,777	1,950	-	5,465	-	4,888	131	874	88,290
Regular Rate	273,277	35,128	44,060	-	85,950	-	88,439	1,149	16,663	1,683,003
Nonprofit	61,739	6,626	8,073	-	17,802	-	17,869	312	3,492	352,690
Classroom	1,735	286	372	-	649	-	738	7	124	12,498
Total Periodicals	336,815	43,817	54,455	-	109,866	-	111,934	1,600	21,153	2,136,482
Standard Mail (A):										
Single Piece	31,502	5,752	8,280	-	13,743	-	16,582	(256,973)	-	-
Regular - Other	343,805	139,219	191,332	-	355,088	-	417,024	(253,285)	58,972	5,956,214
- ECR	53,054	42,198	47,588	-	127,938	-	126,209	(27,144)	20,876	2,108,426
Total Bulk Rate Regular	396,859	181,417	238,920	-	483,026	-	543,233	(280,429)	79,848	8,064,640
Nonprofit - Other	61,929	27,492	39,155	-	69,327	-	84,124	(41,275)	11,591	1,170,701
- ECR	5,824	2,979	3,737	-	8,259	-	8,810	(5,554)	1,343	135,690
Total Bulk Rate Nonprofit	67,753	30,471	42,892	-	77,586	-	92,934	(46,830)	12,935	1,306,391
Total Standard Mail (A)	496,114	217,640	290,092	-	574,355	-	652,749	(584,232)	92,782	9,371,031
Standard Mail (B):										
Parcel Post	224,653	15,947	21,910	-	26,901	-	39,144	(4,179)	6,791	685,911
Bound Printed Matter	62,923	8,538	11,363	-	18,134	-	23,710	16,130	3,833	387,172
Special Rate	60,738	7,791	11,096	-	14,692	-	21,039	(467)	3,088	311,852
Library Rate	12,645	1,434	2,089	-	2,785	-	3,933	39	596	60,220
Total Standard Mail (B)	360,959	33,710	46,458	-	62,512	-	87,826	11,523	14,308	1,445,155
USPS Penalty Mail	10,323	4,806	6,433	-	12,084	-	12,173	(205,120)	-	-
Free Mail for the Blind & Hndc	4,169	922	1,307	-	1,926	-	2,575	16	363	36,654
TOTAL DOMESTIC MAIL	3,132,609	775,047	1,595,227	-	1,995,043	-	2,368,583	(459,982)	358,965	36,255,494
International Mail	736,409	13,155	54,640	-	31,681	-	37,410	86	12,994	1,312,380
TOTAL ALL MAIL	3,869,018	788,202	1,649,867	-	2,026,724	-	2,405,993	(459,896)	371,959	37,567,874
Special Services:										
Registered Mail	-	8,567	8,203	-	4,378	-	11,973	27	861	86,937
Insured Mail	-	954	861	-	1,806	-	13,947	5,421	468	47,223
Certified Mail	-	10,423	9,841	-	22,800	-	22,503	(3,820)	3,655	369,180
Collect-On-Delivery	-	574	552	-	1,030	-	2,954	20	187	18,880
Special Delivery	-	1	1	-	-	-	2	(31)	-	-
Money Orders	-	5,422	9,460	-	12,768	-	8,510	-	1,552	156,798
Stamped Envelopes	-	75	12,305	-	126	-	116	5	143	14,413
Special Handling	-	57	59	-	77	-	97	-	13	1,312
Post Office Boxes	-	143,468	124,029	-	21,566	-	109,293	1	5,894	595,266
Stamped Cards								4,699	47	4,746
Bulk Parcel Return Service								6,199	62	6,261
Packaging Service								27,481	275	27,756
Delivery Confirmation								21,920	219	22,139
Other Special Services	-	5,696	7,373	-	11,938	-	14,079	13,497	2,091	211,181
Total Special Services	-	175,237	172,684	-	76,489	-	183,474	75,419	15,466	1,562,091
Total Attributable	3,869,018	963,439	1,822,551	-	2,103,213	-	2,589,467	(384,477)	387,426	39,129,965
Other Costs	420,118	575,787	1,719,142	57,201	2,459,306	38,855	1,428,376	205,120	211,531	21,364,627
Total Costs	4,289,136	1,539,226	3,541,693	57,201	4,562,519	38,855	4,017,843	(179,357)	598,956	60,494,592
Prior Years Loss Recovery										377,063
Total Revenue Requirement										60,871,655

Unit Attributable Cost Comparison
Test Year

	PRC R94-1 ($)	PRC R97-1 ($)	Change Over PRC R94-1 (%)
First-Class			
Single Letter	0.2431	0.2748	13.0%
Presort Letter	0.1261	0.1106	-12.3%
Total Letter	0.1978	0.2032	2.7%
Cards	0.1465	0.1240	-15.3%
Priority Mail	1.8402	2.1790	18.4%
Express Mail	10.8706	12.1853	12.1%
Periodicals:			
Within County	0.0823	0.0916	11.3%
Regular Rate	0.1953	0.2355	20.6%
Nonprofit	0.1460	0.1643	12.5%
Classroom	0.1306	0.2756	111.1%
Standard (A):			
Single Piece	1.5253	-	0.0%
Regular Rate - Other	0.1647	0.1573	-4.5%
Regular Rate - ECR	0.0721	0.0733	1.7%
Total Regular Rate	0.1167	0.1211	3.7%
Bulk Nonprofit - Other	0.1167	0.1110	-4.9%
Bulk Nonprofit - ECR	0.0558	0.0524	-6.1%
Total Nonprofit	0.1020	0.0994	-2.5%
Standard (B):			
Parcel Post	3.3953	3.1984	-5.8%
Bound Printed Matter	0.7233	0.6889	-4.8%
Special Rate	1.7640	1.5089	-14.5%
Library Rate	1.8869	2.0184	7.0%
Free for the Blind	0.5155	0.6496	26.0%
International Mail	1.3846	1.3037	-5.8%
Registry	4.0162	5.7278	42.6%
Certified	1.1605	1.2302	6.0%
Insurance	1.2199	1.5854	30.0%
COD	4.0320	4.8571	20.5%
Money Orders	1.0377	0.6504	-37.3%

IV. PRICING

[4001] *Introduction and Background*. The Commission's recommended rates are determined in accordance with the requirements of the Postal Reorganization Act of 1970. This Act imposes upon the Commission "the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that type *plus* that portion of all other costs of the Postal Service reasonably assignable to such class or type." 39 U.S.C. § 3622(b)(3) (emphasis added).

[4002] This language imposes two obligations on the Commission. The Commission must show that the recommended rates for "each class of mail or type of mail service" are at least high enough that the class or type bears "the direct and indirect postal costs attributable to that type." This is what Postal Service witness Panzar calls the "statutory notion of attributable costs. …" *See* USPS-T-11 at 5. The Act also instructs the Commission to recommend rates that recover costs. Therefore, the Commission's volume forecasts and projected costs for a representative test year must show that the Postal Service would break even under the recommended rates. The "all other costs of the Postal Service" in the language of the Act are called "institutional costs" by the Commission. The Act requires that the Commission's recommended rates for each class of mail or type of service provide revenues that include the share of institutional costs "reasonably assignable to such class or type." So, at the least, the Commission must be able to demonstrate that its recommended rates include an amount above attributable costs to recover the Service's institutional costs.

[4003] The Act specifies nine factors that the Commission is to consider in its determination of the shares of institutional cost that are reasonable. These factors are discussed throughout the direct testimony of USPS witness O'Hara and at some length by UPS witness Henderson. *See* USPST30 and UPS-T-3 at 3-6. The complete text of 39 U.S.C. § 3622(b) reads as follows:

> (b) Upon receiving a request, the Commission shall make a recommended decision on a request for changes in rates or fees in each class of mail or type of service in accordance with the policies of this title and the following factors:
>
> (1) the establishment and maintenance of a fair and equitable schedule;
>
> (2) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;
>
> (3) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;
>
> (4) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;
>
> (5) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;
>
> (6) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;
>
> (7) simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;
>
> (8) the educational, cultural, scientific, and informational value to the recipient of mail matter; and
>
> (9) such other factors as the Commission deems appropriate.

[4004] This section of the Act enables all interested reviewers to identify the criteria the Commission applies to make a reasoned assignment of institutional burdens to the subclasses and services. The language of the Act is quite broad. The objectives of the Act suggest, in one form or another, virtually every standard for equity and efficiency found in economic theory. Many of the objectives of the Act can conflict; thus, the Act assigns to the Commission the judgments that are needed to apply them. It is the Commission's understanding that it has an obligation to evaluate evidence and to recommend rates in consideration of *all* of the objectives of the Act. The Commission does not ignore any of them, nor does it adopt rules for attributing and assigning costs that constructively waive any of them.

[4005] The Commission has adhered to a simple and well-understood procedure for pricing by making reasoned assignments of institutional costs to the subclasses of mail. That procedure has been explained in some detail in past opinions.[49] Simply stated, the Commission relies on the precedential value of its past evaluations of the evidence as a starting point and then evaluates new evidence presented to determine whether changes from its past allocation decisions are appropriate. A markup index has been developed that allows comparison of the institutional cost burden of each class and subclass relative to its share of systemwide attributable costs. The markup for each subclass is its contribution to institutional costs as a percentage of its attributable costs. The index makes markups comparable from case to case by showing them relative to the system-wide average markup. The markups and markup index numbers for each case are shown in Appendix G, Schedule 3. The relationships exhibited in these tables reflect the application of the statutory rate-making criteria from case to case.

[4006] A significant portion of the evidence presented in every rate case is directed toward determining which categories of costs can be considered attributable to providing the various types of mail service. In this proceeding as well, participants have offered evidence suggesting improvements in the methods and analysis used to attribute costs directly or indirectly to types of mail. *See*, for example (Bradley; Postal Service) and (Glick; MPA). The Commission's evaluation of these suggestions has been described in Chapter III.

[4007] Additionally, testimony has been presented urging the Commission to give greater weight to particular public policies in setting rates, (Erickson; GCA) and to give added recognition to specific factors (Bradstreet; AAPS) in allocating institutional cost burdens among the classes and subclasses. This testimony is evaluated in Chapter V in the context of arriving at appropriate markups for each of the classes, subclasses and services.

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[49] *See*, for example, PRC Op. R87-1, para. 4022 *et seq*.

[4008] This case is unusual, however, in that three parties have sponsored testimony telling the Commission that it should change the basic definition of attributable cost, or, equivalently, that it should use a different cost concept for its markups.

[4009] United Parcel Service witness Henderson suggests that a well-defined economic concept be substituted for attributable costs and used as the basis for allocating the remaining costs to mailers. He equates attributable costs to single-subclass incremental costs, the costs that would no longer be incurred if the specific subclasses individually were eliminated from the mailstream.

[4010] A second new base for distributing institutional costs is offered by Newspaper Association of America witness Chown. She proposes that the Commission continue to identify attributable costs in the traditional manner, but then use a new "metric" that she has developed, "total weighted attributable costs," as the base for the markups to find the appropriate amount of nonattributable (institutional) costs to be borne by each subclass and service. Tr. 25/13263.

[4011] The Postal Service has sponsored the testimony of witness Panzar, who suggests that the Commission should set rates sufficient to recover marginal costs plus an appropriate portion of the remaining costs of the Service. According to witness Panzar "the efficient pursuit of any objective subject to a break-even constraint requires that one trade-off costs and benefits at the margin." USPS-T-11 at 28 (emphasis omitted). This entails markups based on marginal costs such as those found in the well-known inverse elasticity formulas for Ramsey pricing.

[4012] Witness Panzar also interprets the language of the Act as an injunction against cross subsidies. The test that witness Panzar proposes to identify all possible cross-subsidies in postal prices is the "incremental cost test." "The revenues collected from any service (or group of services) must be at least as large as the additional (or incremental) cost of adding that service (or group of services) to the enterprise's other offerings." *See* USPS-T-11 at 8. The testimony of Postal Service witness Takis attempts to make operational the incremental cost test specified by witness Panzar. The actual mechanics of witness Takis' test makes use of the testimony of Postal Service witnesses

Baron and Bradley for determining volume variable costs. In other respects the calculation of incremental costs for single subclasses and services largely resembles the Commission's calculations of attributable cost.

[4013] Underlying all of the cost presentations of Postal Service witnesses in this proceeding, there is an assumption about postal costs that is fundamentally different from the assumption that is made in most economic theory. According to witness Panzar, it is not necessary to assume that postal costs are efficiently incurred. USPS-T-11 at 16. Postal costs are no more than the "costing out" of a stable operating plan that relates postal volumes to the amounts of various inputs through cost "drivers." Virtually all of the Postal Service's witnesses carry on their research and analyses as though this change is completely inconsequential.

[4014] Much of this testimony has the appearance of a dispute over form rather than substance. The Commission's view is that form should follow function. In the present case, evidence regarding the economic efficiency of proposed rates is most appropriately considered in relation to marginal costs, or average volume variable costs as they would be measured within the Commission's cost framework. Evidence regarding cross subsidies is appropriately considered within the framework of the incremental cost test. Per unit incremental costs are measured differently from marginal costs and will be somewhat higher for a firm with declining marginal costs. Finally, specific issues of fairness, equity and compliance that relate directly to the stated objectives of the Act are best considered in relation to a consistent measurable concept of attributable costs as applied for almost 30 years by this Commission.

A. Recommendations of Postal Service witness Panzar

[4015] The theory presented by witness Panzar and the application derived from it by witness Takis would alter the foundations of the rate-recommendation process as it is currently practiced by this Commission. Consequently, the Commission has considered this evidence critically and carefully even though it has received little attention from other parties. This body of testimony raises three major issues. These can be framed by considering the recommendations made by witness Panzar:

> [I]t is imperative that the Commission recognize that (per unit) incremental costs should be used for evaluating rates for the presence of cross-subsidization, and should <u>not</u> be [a] starting point for the application of the mark-ups required to enable the Postal Service to cover its costs.

USPS-T-11 at 28 (emphasis in original).

> [M]arginal costs, and not average incremental costs, are the economically correct base to which any necessary mark-ups should be applied.

Id. at 29.

> As long as it is given that postal services will be produced following Postal Service practices and procedures, the relevant marginal and incremental costs for pricing purposes are those calculated based on the Postal Service operating plan.

Id. at 17 (emphasis omitted).

[4016] In analyzing witness Panzar's position, the Commission first considers whether it is reasonable to limit the concept of attributable cost to marginal cost. The Commission has recognized since Docket No. R71-1 that marginal costs are the most important element of attributable cost. Over the years both the Service and the Commission have also included specific fixed costs under the rubric of attributable.

Further, the Commission has analyzed costs caused by the classes of mail and found other nonvariable costs to be attributable (the fixed portion of special delivery messengers, the fixed portion of the Eagle Air Network, and the single subclass stop portion of access, among others). The Commission has even deleted marginal costs from attributable costs as in the case of the air transportation of parcel post to the Alaskan bush. In the latter case, the Commission found that the primary cause of those costs was the Service's universal service obligation, even though the cost varied with the volume of parcel post being transported to the bush.

[4017] The Commission is not prepared to depart from the position that attributable cost means costs which can be said to be reliably caused by a subclass of mail or special service. Marginal costs, by definition, include only the additional costs caused by the last unit of output. Marginal costs are an important subset of attributable costs, but the Commission cannot agree that marginal cost is all that is meant by the term "attributable." Unlike incremental costs, marginal costs have been central to microeconomic theory for a long time. The framers of the Act knew about and could have used the concept of marginal costs, but they did not. The language of the Act requires the Commission to set rates for each subclass so that it covers its attributable cost and makes a reasonable contribution to all other costs. In interpreting this language the Commission continues to believe that the authors of the Act intended "attributable" to mean more than just marginal cost. If they had meant marginal cost, they would have said so.

[4018] Marking up attributable cost is the means by which the Commission makes its determination of a reasonable contribution to all other costs. All other costs are the difference between total cost and attributable costs. All other costs are not the difference between total cost and marginal cost. When the Commission determines the reasonableness of a subclass's contribution to all other costs, it must use attributable cost as a base and *mark-up*.

[4019] In his direct testimony, witness Panzar asserts that marginal costs and incremental costs are distinct concepts, each of which "must play a crucial role in rational

rate-making for a regulated enterprise operating under conditions of economies of scale and economies of scope. …" *Id.* at 5. The role reserved for marginal costs is to enable the ratemaker to avoid economic inefficiencies caused by setting rates to produce services which consumers value less than the resources used to produce them. Witness Panzar contends that "it is important for [the] Postal Service to be 'sending the right pricing signals,' both to enhance overall economic efficiency and to retain those markets in which it enjoys a true competitive advantage." *Id.* at 10.

[4020] The role of marginal costs in evaluating the efficiency consequences of the rate schedule is illustrated by the way that marginal costs appear in the formulas for Ramsey pricing. Ramsey prices are prices that maximize consumer and producer surplus, subject to the single constraint that the rates recover all costs. The pricing formulas that emerge from the optimization mathematics express these prices as markups involving marginal costs. Average attributable or incremental costs do not play any role in these formulas. As witness Panzar states, "nothing in the underlying mathematics ensures that such economically efficient prices will automatically be free of cross-subsidy." *Id.* at 11. When expressed as markups on average attributable costs, some of the Ramsey *markups* may become *markdowns* in violation of the Act. This tends to occur because specific fixed costs are included in attributable costs but not in marginal costs, and because economies of scope and scale affect costs in ways that generally make marginal costs lower than average incremental costs.

[4021] The role reserved for incremental costs is to identify cross-subsidies. Most economists would probably agree with witness Panzar's view of §3622(b)(3) of the Act. "[T]he economics literature has come to interpret such strictures as requiring that the rate schedule be free of cross-subsidy." *Id.* at 8 (emphasis omitted).

[4022] A test that eliminates cross-subsidy in Postal prices is the incremental cost test described by witness Panzar. "The revenues collected from any service (or group of services) must be at least as large as the additional (or incremental) cost of adding that service (or group of services) to the enterprise's other offerings." Id. at 8 (emphasis

omitted). Here, it is the "or group of services" that may cause an inconsistency with previous Commission applications of the provisions of the Act.

[4023] Witness Panzar believes the Commission is trying to make the statutory concept of attributable cost serve the roles of both marginal and incremental costs. "In my view, many of the contentious issues in postal costing and pricing have their origin in the attempt to have the statutory notion of attributable costs fulfill both these roles simultaneously." *Id.* at 5. But the Commission has never claimed that a schedule of recommended rates is both economically efficient and completely free of all possible cross subsidies on the basis of the attributable cost demonstration imposed by the Act.

[4024] The Commission's calculation of attributable costs by subclass and service does not precisely conform to witness Panzar's definitions of either marginal cost or incremental cost. However, they come closest to being the incremental costs associated with the subclasses and services taken one at a time. Therefore, nonnegative markups are good evidence against the presence of the most elementary cross subsidies.

[4025] Recommended rates for each subclass must recover attributable costs, plus a reasonable contribution to institutional costs. It is the Commission's experience in this and in prior proceedings that few rates are actually determined by their attributable cost floors. The sum of all attributable costs always leaves a sizeable institutional remainder for the Commission to assign to classes of mail and types of services in a manner that is "reasonable" in accordance with the criteria stated in the Act. These criteria do not exclude considerations of efficiency of the kind that motivate Ramsey pricing, the Postal Service's estimates of strictly volume-variable costs, or marginal cost concepts and estimates in the many other ways economists use them. When marginal costs are appropriate for economic concepts of reasonableness and efficiency, the Commission considers them.

[4026] The Commission also has no desire to recommend rates that allow cross subsidies. In this respect the Commission agrees completely with the prevailing opinion of the economics profession cited by witness Panzar. The intent of the framers of the Act was to prohibit cross subsidies. The testimony offered by witness Panzar regarding the

correct test for cross subsidy is also accepted by the Commission. The incremental cost test he describes in principle is the test that the Commission should attempt to apply. In 1970, economists had not yet determined that the proper economic test for cross-subsidy also involves considering services more than one at a time. Fortunately, the statutory framework is sufficiently flexible so that it can encompass a reliable measure of incremental costs. Such a measure has not been developed on this record.

[4027] The Postal Service notes, Postal Service Brief at IV-5, that its rate proposals do not focus on economic efficiency to the exclusion of other considerations found important by the Courts and past Commission decisions. It contends that the framework for allocating costs advocated by witness Panzar is fully consistent with reasoned application of statutory public policies. Id. at IV-13. However, witness Panzar's proposal elevates economic efficiency loss measurement to a preeminent status not justified either by the Act or by attainable policy goals. If any objective of the Act is entitled to preeminence, it would be the avoidance of cross subsidies. All currently identifiable cross subsidies are avoided by marking up "attributable" costs. The Commission further concludes that the current methodology is better suited for informing the mail-using public of how the policies specified in the law have been balanced in developing rates. It is only by marking up attributable costs that the Commission can assure itself, and explain to the mail-using public, that the contribution to all other costs made by each subclass is reasonable.

[4028] The Commission has developed volume variable costs in each rate decision, and it has been a relatively simple matter for any interested analyst to compare the projected revenues from any class with its projected volume variable costs. The Commission has been, and would continue to be, interested in evaluating presentations utilizing such comparisons, but that comparison is not particularly useful for assisting mail users to understand how the institutional costs of the Postal Service have been allocated among the classes of mail in recognition of the enumerated policies of the Act.

[4029] Witness Panzar equates attributable costs as developed by the Commission with single-subclass incremental costs. He contends that the Commission's use of

attributable costs as the starting point for setting rates is misguided because applying mark-ups to incremental costs instead of to marginal costs reduces economic efficiency unnecessarily. But the fact remains that the applicable statute not only prohibits cross-subsidy, but also specifically requires that every class and subclass "bear the direct and indirect postal costs attributable to that class or type *plus* that portion of all other costs of the Postal Service reasonably assignable to such class or type." 39 U.S.C. § 3622(b)(3). The language of the Act does not specifically identify the pursuit of economic efficiency as a policy objective. Therefore, it would be counter to the sense of the statute for the Commission to waive the demonstration that rates exceed attributable costs by margins that are reasonable and instead substitute marginal cost as the base for making markups, as proposed by witness Panzar.

[4030] When the Commission explains why a class is assigned a particular share of institutional costs, it is important that the public be able to compare that share with those applied to other classes and subclasses. The current markup index provides a consistent, understandable basis both for comparisons between classes and for comparisons over time. That index directly tracks the evolution of relative burdens assigned pursuant to the statutory obligation of the Commission, and it continues to be the best available means for showing how rate levels reflect public policy.

B. Efficient Costs versus Postal Costs

[4031] Witness Panzar explains the relationship of the cost functions used by the Service, and to some extent relied upon by the Commission, to the Service's "accounting data" as follows: "I assume that there exists a reasonably well-defined set of operating procedures which determine the steps taken and resources used to process a given volume of mail. This is what I mean by an operating plan. … The presumption of a well-defined operating plan makes it possible to predict the expenditures required for the Postal Service to handle a given vector of mail volumes (M), at given prices of labor and other inputs (w). This is accomplished by merely 'costing out' the operating plan to define a Postal Service cost function, C(M,w)." USPS-T-11 at 14. This description of postal cost functions is echoed in the testimony of other Postal Service witnesses, including witnesses Bradley, Christensen and Takis.

[4032] Witness Panzar's description contrasts starkly with the usual economic definition of a cost function, which derives the function C(M,w) by selecting labor and other inputs to *minimize* the cost of the vector of mail volumes, (M), at the given prices, (w). Witness Panzar is aware of the distinction but attaches no importance to it. "Clearly, the Postal Service cost function I have defined, C(M,w) will coincide with the minimum cost function of economic theory if the operating plan always specifies the most cost efficient possible way of providing service for the given mail volumes. However, it is important to emphasize that it is not necessary to assume perfect cost efficiency to apply the methodology being developed here to the calculation of Postal Service marginal costs." *Id.* at 16 (emphasis omitted). And later "the efficiency of the Postal Service operating plan is not an issue for the analyst." *Id.* at 17. And, within the context of the system used by Postal Service witnesses Baron, Bradley, Degen and Takis, among others, to derive costs, "It is *not* necessary to assume that this operating plan is the most cost efficient way to provide the mail services in question." *Id.* at 20 (emphasis in original).

[4033] The Commission holds no opinion regarding the cost efficiency of the Service's operating plan. However, it is difficult to accept the formalism proposed by witness Panzar as a sufficient basis for the Commission's understanding of postal costs. The Commission believes that Postal Service witnesses will encounter severe technical problems when they apply concepts and theories derived from regulatory economics while relying on witness Panzar's assurances that cost-minimization is an inessential assumption. The remainder of this section describes some of the difficulties that are encountered when postal costs are assumed to be inefficient in several areas of regulatory economics.

1. Ramsey-Pricing

[4034] An allocation of an economy's resources is efficient if it is not possible to reallocate these resources to improve the welfare of one consumer without reducing the welfare of other consumers in the economy. Economic efficiency has implications for the manner in which goods are both consumed and produced. In particular, at a welfare maximum the rate at which consumers trade off the benefits from consuming an additional unit of good A relative to the benefits from consuming an additional unit of good B is equal to the rate at which producers trade off the minimum cost of producing an additional unit of good A versus the minimum cost of producing an additional unit of good B.

[4035] This result places restrictions on market prices that can give rise to an efficient allocation of resources. In particular, efficiency in consumption implies setting ratio of the price good X to additional unit of good X to the increased utility a consumer obtains from an addition unit of good Y at the current level of consumption for both goods for all consumers. Efficient production implies setting the ratio of the price good A to the price of good B equal to the ratio of the minimum cost of producing an additional unit of good A (efficient marginal cost) to the minimum cost of producing an additional unit of good B, at the current level of output produced for all firms. If all firms are operating at

output levels where marginal costs are increasing in the level of output at a sufficiently rapid rate, these prices are efficient in the sense that they yield an efficient allocation of the economy's resources and feasible because all producers earn sufficient revenues from marginal cost pricing to cover their total production costs. However, if any firms are operating at a level of output where (minimum cost) marginal cost is decreasing in the level of output, firms may not earn sufficient revenues from these prices to recover total production costs.

[4036] Ramsey-pricing has been suggested as the constrained optimal (second-best) method of pricing when marginal cost pricing fails to yield sufficient revenues for the firm to cover its production costs. Specifically, the goal of Ramsey-pricing is to set prices to yield the greatest benefits to the economy (consumers and producers are equally weighted) subject to an economic feasibility constraint. This implies setting prices to maximize aggregate welfare subject to the constraint that all firms are able to generate sufficient revenues from the sale of their output to cover total production costs.

[4037] When the firm produces its output in a minimum cost (efficient) manner and the demand for each of these goods depends only on the price of that good, Ramsey prices take a simple form. The difference between the Ramsey-price and the efficient marginal cost of production divided by the Ramsey-price is equal to a constant factor of proportionality divided by the own-price elasticity of demand for that product.[50] This is the well-known inverse elasticity expression. For more realistic demand structures for the goods under consideration, computing Ramsey-prices is considerably more complicated because of nonzero cross-price elasticities between the various products, but the basic intuition of marking up prices over efficient marginal cost remains.

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[50] The inverse elasticity expression is:

$$\frac{P - MC^e}{P} = \frac{-k}{E}$$

where: P = Price
MC^e = Cost Minimizing Producer's Marginal Cost
E = Elasticity of Demand
k = a Constant Factor of Proportionality

[4038] Moving to the case in which the firm under consideration does not produce its output in a minimum-cost manner further complicates the computation of the optimal second-best prices. Consistent with the view that covering its total costs of production is a constraint on the economy-wide welfare maximization problem, optimal second-best prices in this context can be computed by maximizing the sum of consumer and producer surplus (assuming minimum-cost production), subject to the constraint that the firm actually producing the output in an inefficient (not minimum-cost) manner receives sufficient revenues from the prices to cover its total production costs. Even specializing to the case of demands that depend only on the own-price of the good, these optimal prices cannot be written in the usual fashion. Instead the appropriate marginal cost to include in the inverse elasticity expression is equal to a weighted sum of the inefficient marginal cost and efficient marginal cost of producing the good.[51]

[4039] The intuition for this result is as follows. By definition, a given level of output can be produced at lower cost by a minimum-cost producer relative to the actual inefficient producer. Because the inefficient producer misallocates resources relative to the efficient producer with each unit of output produced, there is a welfare loss to society associated with every unit of output produced by the inefficient firm, which is the difference between the actual marginal cost of production relative to the marginal cost of the efficient minimum-cost firm. Consequently, society trades off this misallocation of resources against the benefits consumers receive from this inefficiently supplied product in setting these prices. By marking up price relative to this weighted sum of efficient and inefficient marginal costs, this conflict between eliminating waste from inefficient production and providing benefits to consumers from these goods is optimally balanced in such a way that total production costs, although inefficiently provided, are covered by the prices set.

[4040] Applying the traditional Ramsey-pricing formula with inefficiently incurred marginal costs will not yield the correct optimal second-best prices, because these prices fail to account for the losses in economy-wide welfare due to inefficient (nonminimum cost) production. Depending on the degree of deviations from minimum-cost production

by the inefficient firm, the difference between these incorrectly computed "Ramsey-prices" and the optimal second-best prices can be substantial.

[4041] A simple example illustrates the idea that inefficient production functions like a tax. Suppose a firm produces and sells two goods, A and B. The inefficient mode of production yields a marginal cost which is ten percent higher than the cost-minimizing marginal cost for good A and 20 percent higher than the cost minimizing marginal cost

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[51] Proof that:

$$\frac{P_i(q_i) - \left[\frac{1}{1-\lambda} MC_i^e - \frac{\lambda}{(1-\lambda)} MC_i^I\right]}{P_i(q_i)} = -k\frac{1}{E_i}$$

where: MC^e = Efficient producer's Marginal Cost
MC^I = Inefficient producer's Marginal Cost
Let Q = Vector of quantities of output produced = $(q_1, q_2, \ldots q_N)$
$P_i(q_i$ = Inverse Demand Function for q_i
$C^e(Q)$ = Cost-Minimizing Producer's cost functions
$C^1(Q)$ = Noncost-minimizing Producer's cost functions

The Ramsey problem is to minimize the sum of consumers' and efficient producer's surplus over all N goods:

$$\sum_{i=1}^{N} \int_0^{q_i} P_i(t)dt - C^e(Q) ,$$

subject to the requirement that revenues from the sale of the N goods recovers the cost of the inefficient producer:

$$C^I(Q) = \sum_{i+1}^{N} P_i(q_i)q_i .$$

Form the Lagrangian

$$L = \sum_{i=1}^{N} \int_0^{q_i} P_i(t)dt - C^e(Q) + \lambda\left(C^I Q - \sum_{i=1}^{N} P_i(q_i)q_i\right)$$

with λ Las the multiplier for the revenue constraint.
Take the partial derivative with respect to q_i and set it to zero:

$$\frac{\partial L}{\partial q_i} = P_i(q_i) - MC_i^e + \lambda(MC_i^I - P_i'(q_i)q_i - P_i(q_i))$$

where MC_i^e and MC_i^I are, respectively, the marginal costs of producing q_i in a minimum cost manner and a nonminimum cost manner. Substitute $E_i\ P_i(q_i)/(P_i'(q_i)q_i)$ and rearrange:

$$\frac{P_i(q_i) - \left[\frac{1}{(1-\lambda)} MC_i^e - \frac{\lambda}{(1-\lambda)} MC_i^I\right]}{P_i q_i} = \frac{\lambda}{(1-\lambda)}\frac{1}{E_i}$$

Let $k = \frac{-\lambda}{(1-\lambda)}$ and the result follows.

for good B. These inefficiencies can be thought of as a 10 percent *ad valorem* tax on A and a twenty percent tax on B. Consumers will substitute away from these goods so long as the elasticity of demand for each good is not equal to zero. The process of substituting away from taxed or inefficiently produced goods creates deadweight losses to consumers and producers because less is consumed and produced than would be the case in the absence of the tax or inefficient production. Even if marginal cost pricing based on inefficiently incurred cost generated sufficient revenues to cover the firm's actual costs, consumers would still experience welfare losses due to inefficient production.

[4042] The alternative Ramsey prices derived above account for the presence of inefficiently incurred costs, or equivalently, the presence of taxes on the efficient mode of production, when computing the welfare-maximizing prices. On the other hand, Ramsey prices derived from the usual inverse elasticity expression using inefficiently incurred marginal costs ignore the deadweight losses to consumers due to inefficient production in the welfare maximization problem. Specifically, this calculation ignores the fact that more output could be produced at the same cost by a more efficient producer. Because each additional unit of inefficient production incurs more costs than the minimum marginal cost, there is a welfare loss to consumers that is not accounted for in the welfare function optimized to compute these prices. The alternative Ramsey prices include deadweight loss due to inefficient production in the welfare function and are therefore the optimal-second best prices for a firm characterized by inefficient production.

[4043] Inefficient production implies a second way that consumers can increase their welfare relative to setting prices based on inefficiently incurred marginal costs. Because the alternative Ramsey-pricing formula implies a markup over the same weighted average of efficient and inefficient marginal costs for all goods depending on the degree of inefficiency in the production of one product relative to another product, the optimal second-best prices for the two goods will change.

[4044] Consequently, inefficient production implies two ways that consumers can increase their welfare relative to setting prices using the traditional Ramsey-pricing formula with inefficiently incurred marginal costs: 1) by altering the quantity of consumption of either A or B because each good is inefficiently produced, and 2) by changing the mix of A relative to B in response to differences in the degree inefficiency in the production of the two goods.

2. Inefficient Marginal Costs Can be Manipulated by the Firm

[4045] If postal rates are not Ramsey prices then the marginal cost of production for each of the classes, subclasses and special services is only useful to the extent that it provides information about the inefficient (minimum cost) mode of production. Even if rates are not Ramsey prices, efficiently incurred marginal costs are still useful because they tell how much of society's resources must be spent to provide one more unit of the good under consideration. However, once assumption of cost minimizing behavior is abandoned, the marginal cost of any product becomes subject to the whims of the firm's management and does not provide an accurate measure of the efficient cost of society's resources to produce an additional unit of any of the firm's outputs.

[4046] In particular, if a regulated firm knows that it will be compensated according to fixed markups over its inefficiently incurred marginal costs, it has the incentive to inflate those marginal costs receiving a high markup through its choice of the mode of production (or operating plan in the language of witness Panzar) in order to pursue other objectives, such as raising the compensation paid to certain employees or more effectively competing in the markets where it faces competition. In the case of minimum cost production, this arbitrariness in the mode of production is eliminated because the firm is constrained to produce all bundles of outputs in a minimum-cost manner. Consequently, the marginal cost of a given level of production cannot be manipulated to obtain a higher or lower marginal cost than the minimum-cost marginal cost.

[4047] The incentive to inflate marginal cost through the choice of a mode of production is particularly strong in the case in which the firm faces competition in some of the products it supplies, and has a legal monopoly on other products it provides. A firm in this circumstance, whose prices are set based on markups over marginal costs may choose production plans that yield higher than minimum-cost marginal costs for those products that do not face competition and/or lower than minimum-cost marginal costs on the products that face competition.

[4048] The ability to set an operating plan that determines the level of marginal costs for each product puts a regulated monopolist in the position of being able to pursue objectives which may be contrary to the goals of society's welfare. Specifically, the firm may select an operating plan that results in higher than efficient (minimum-cost) marginal costs for products where it faces no competition, in order to enter the market for the supply of a new product where it may not be the most efficient producer. This entry into the production of the new product creates welfare losses for two reasons: 1) the firm's monopoly products are being sold at too high prices due to inefficiently incurred marginal costs, and 2) the firm is preventing the entry of more efficient producers of the new good because it uses some of the revenues from the sales of its monopoly products to finance the production of the new product.

[4049] Because the marginal costs of a firm not constrained to minimize total production costs in producing its outputs is endogenous to its choice of an operating plan, these marginal costs are of limited use in setting rates. As the above examples demonstrate, if the firm knows that its prices will be set based on its incurred marginal costs, it will have a strong incentive to select its operating plan to achieve the marginal costs which suit its revenue objectives or allow it to compete more effectively against its rivals in supplying its nonmonopoly products.

3. Properties of Inefficient Cost Functions are Unknown

[4050] Witnesses in Commission proceedings routinely apply economic theories that employ the standard economic definition of cost in their analyses and testimony. These theories allow the Commission to understand the properties of cost functions in relation to characteristics of production, factor pricing, competition and markets. For example, returns to scope and increasing returns to scale in the production of services are usually expected to produce a declining marginal cost function of the kind shown in witness Panzar's Figure 2 and at several locations in the direct testimony of witness Takis. *See* USPS-T-11 at 11, and USPS-T-41 at 4, 23 and 29. When taken as presented by witness Panzar, postal cost functions have almost no properties that can be ascertained *a priori*. This would appear to be a serious handicap to econometricians (among others), who would normally be expected to fit functions and to test estimates using the standard economic definition of a cost function as a benchmark. Postal Service witness Bradley, for example, expects his estimated functions to indicate declining marginal costs for purchased transportation and for mail processing labor costs. These expectations must be based upon more than just the assumption that the Postal Service has a stable operating plan.

4. The Incremental Cost Test Is Distorted

[4051] Finally, the Service may wish to consider more carefully the consequences of submitting estimated cost functions that do not describe approximately efficient postal operations. When such functions are employed in incremental cost tests along the lines recommended by witness Panzar and followed by witness Takis, the result will be a tendency to raise incremental costs for those services most affected by the inefficiencies. Witness Panzar's testimony provides a clear statement of the position the Service takes when an incremental cost exceeds the stand-alone cost of "alternative supply arrangements. … For example, it is obviously possible to supply parcel or overnight

services through separate, stand-alone operations. From a social point of view, stand-alone provision would be desirable whenever the stand alone costs of independent provision of a mail service (or group of mail services) are less than the Postal Service's incremental costs of that service (or group of services)." *See* USPS-T-11 at 9 (emphasis omitted).

[4052] Witness Takis makes a similar point in his testimony when he states that an incremental cost test based upon the cost structure of an "ideal" entrant will tend to discourage entry by postal competitors more than the same test based upon the Service's actual operating plan. USPS-T-41 at 10. The Service's own economists can tell it that rigorous application of the incremental cost could well price the Service out of the business of inefficiently supplying postal services in contested markets.

C. The Incremental Cost Test of Postal Service Witness Takis

[4053] The testimony of Postal Service witness Takis makes operational the incremental cost test for cross-subsidy specified by witness Panzar. The actual mechanics of witness Takis' test makes use of the testimony of Postal Service witnesses Baron and Bradley for determining volume variable costs. In witness Takis' own words, "it is imperative that any approach to estimating incremental costs starts with, and ultimately is consistent with, the analyses that determine volume variable cost in BY 1996." *Id.* at 8. Since the Commission has rejected the model proposed by witness Baron with respect to load time cost variability, and that of witness Bradley with respect to mail processing cost variability, it would be inconsistent for the Commission to depend upon evidence supplied by witness Takis that rests upon these rejected models. Also, the Commission's recommended rates differ from those requested by the Postal Service in this proceeding. Consequently, the Commission makes no use of witness Takis' estimates of incremental cost and relies instead on attributable costs, as it has in past proceedings, to demonstrate that its recommended rates are free of cross-subsidies.

[4054] Witness Takis' direct testimony describes an enormous effort whose size and complexity becomes more apparent from examining his large and detailed supporting workpaper. Witness Takis' attempt to develop the incremental costs of postal services directly responds to Commission interest expressed in Docket No. R94-1, PRC Op. R94-1, Appendix F, paras. 167 and 170. It clearly represents a serious effort to examine an extraordinarily complex and difficult problem. In reviewing this testimony, the Commission has had to bear in mind how the line of inquiry represented by witness Panzar's theories and witness Takis' applications might develop into a useful tool for identifying cross-subsidy in future proceedings. Would a future Commission wish to be alerted to the possibility of a cross-subsidy as identified by a more acceptable and applicable successor to witness Takis' incremental cost test? Clearly, the answer is "yes."

[4055] The advantages the Commission sees in witness Takis' approach to making the incremental cost test operational are as follows:

- Witness Takis works within the same cost accounting framework as the Commission. It is the same accounting framework that is followed by the Service in its data collection and cost reporting systems and that is used by Postal Service witness Degen whose cost pools and attributions have been largely accepted by the Commission.
- At the subclass level the approach is identical in many of its assumptions and calculations to the Commission's calculations of attributable cost. Specific fixed costs are identified and used in the same way. Other information such as the single-subclass stop information is also used in the same way. The approach taken by witness Takis parallels the Commission's calculation of attributable cost in many important respects.
- The approach is not limited to identifying cross-subsidy among subclasses. It can be extended to reveal cross-subsidy among postal product categories however defined. Thus the approach is capable, in principle, of identifying subsidies for such groupings as presorted mail and automated mail.

[4056] On the whole, witness Takis has found practical and mostly reasonable solutions to the problems of combining data and cost research results from postal sources within the theoretical scheme specified by witness Panzar's incremental cost test. This is the major strength and accomplishment of the work to date. Its major weaknesses are as follows:

- Witness Takis recognizes that "[l]ogically, there must be some degree of reconfiguration of operations when calculating incremental costs; otherwise, there would be no incremental costs at all." USPS-T-41 at 11. However, his approach avoids considering most kinds of reconfiguration by staying within the analytical framework described by witness Panzar for the operating plan. This may not be a problem when calculating the incremental costs of small subclasses, even several taken together. However the approach becomes less tenable for larger classes or combinations involving substantial volumes of mail. Ultimately, there are combinations of eliminated subclasses that make the operating plan irrelevant.
- In principle the approach should consider all possible combinations of subclasses and services for cross-subsidy as required by the theory. In practice this is neither necessary nor likely to be entirely feasible. In addition to the subclasses taken singly, witness Takis has actually considered only six combinations of subclasses and services. This small set was selected by identifying "groups that share operations" and "highly competitive groups of products" according to criteria provided by Postal Service witness Baumol for Docket No. R90-1. *See*

Tr. REM2/1040-2. Although six combinations fall considerably short of the theory, and may even be short of all of the combinations suggested by witness Baumol's criteria, it is still a more inclusive application of the incremental cost test than a simple subclass-by-subclass application.

- The approach depends upon the accuracy of assumed or fitted cost functions over considerable ranges. This is a weakness because the ranges usually involve extrapolations. In the case of econometrically estimated cost equations, the functions are often being evaluated outside the bounds of the sample used to fit them. In the case of assumed function forms, the cost functions may have to be evaluated where the assumed form is no longer providing an acceptable approximation.
- Witness Takis has difficulty converting from the base year to the test year. The roll-forward technique that has been developed for converting base year attributable costs to test year attributable costs cannot be applied at the cost pool level, so witness Takis relies upon a "simple ratio approach". *See* USPS-T-41 at 19-20. This approach has the unappealing property that both variable and fixed costs are changed proportionately from the base year to the test year.
- Witness Takis' direct testimony does not quite reach its intended destination. The incremental cost test specified by witness Panzar is never actually applied to the rates proposed by the Postal Service in this proceeding. The Commission has been left to apply the test itself using the numerical results provided by witness Takis in his Exhibits USPS-41B and 41C.

D. Recommendations of UPS Witness Henderson

[4057] Witness Henderson suggests an approach for allocating institutional costs that resembles in its logic witness Panzar's proposal. He also urges that the Commission use marginal cost as the basis for allocation in order to promote economic efficiency. The difference between the two proposals is that witness Henderson recommends the use of "longer run" marginal costs, which he equates to incremental costs, as the base for institutional cost allocations in preference to the marginal costs suggested by witness Panzar.

[4058] Witness Henderson contends that marginal cost as described by witness Panzar is a short-run cost measure, and it is therefore inappropriate for postal ratemaking. He argues that "the relevant cost basis for pricing decisions should correspond to the time period during which the rates will be in effect." Tr. 25/13559 (footnote omitted). As postal rates tend to remain in place for three to four years, he contends that this is the relevant time frame for evaluating potential cost changes. He characterizes this period as "longer run," as opposed to short run. Id. at 13560.

[4059] Witness Henderson points out that the marginal costs for any subclass theoretically change as a result of changes in volume, usage mixes, overtime rates, input costs, organizational changes, productivity improvements, general inflation, and other factors. To achieve the stated marginal cost pricing goal of economic efficiency, postal prices would have to be able to change frequently, to reflect or adjust for those changes in marginal cost. Ibid. By law, that is not currently possible. Therefore, witness Henderson concludes that marginal cost pricing must be based on marginal costs over the rate cycle.

[4060] Witness Henderson proposes that the Commission use what he terms longer-run incremental costs. His premise is that if economic efficiency is to be calculated by measuring the extent to which prices vary from what the price would be if it were adjusted to reflect the costs of efficiently produced services, then the appropriate measures must be the costs that reflect what efficient production would be when price

adjustments can be implemented. Since price adjustments occur only every few years, Henderson believes changes in the factors of production that would be made during that adjustment period to achieve efficient production should be used in the calculations.

[4061] Witness Henderson treats as equivalent, for purposes of applying his proposal, single-subclass incremental costs, "longer run" marginal costs as developed by Postal Service witness Takis, and attributable costs as described by the Act. The Commission will not adopt witness Henderson's suggestion that it use incremental costs as a base for allocating institution burdens among subclasses for the same reasons it does not adopt witness Panzar's suggestion that it use marginal costs for this purpose. In both cases, the suggestion is proffered as a way to measure the deviation from economically efficient rates, but neither proposal seems compatible with the language and purposes of the Act.

[4062] The Commission also sees some technical problems in witness Henderson's testimony. Witness Henderson derives the incremental cost for a subclass from a total variable cost function described in his Appendix. *See* Tr. 25/13578-79.[52] In witness Henderson's words the function "is the relationship between total variable cost and volume for a particular subclass." *Id.* at 13578. A total variable cost function with this form and a distinct set of parameters is assumed for every subclass of mail.

[4063] Witness Henderson believes that his total variable cost functions have constant elasticities. "This functional form has the property that no matter what the volume, the elasticity is always the same." *Ibid.*

[4064] In the Commission's view, witness Henderson's has chosen an inappropriate functional form to represent Postal Service variable costs. There are three major problems.

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[52] Define C = Subclass cost
V = Subclass volume
a,b,z = parameters
The cost function is shown mathematically as:

$$C = a*(z + V)^b$$

[4065] First, the function is not a constant-elasticity cost function, as he claims, except in a special case. This is easily demonstrated mathematically.[53]

[4066] Second, the function cannot possibly represent total variable cost because it is nonzero when volume is zero.[54] Therefore, witness Henderson's total variable cost function includes a fixed component. Properly defined total variable cost functions cannot have fixed components.

[4067] Third, witness Henderson has assumed that the total variable cost function for the Postal Service as a whole is separable into total variable cost functions by subclass of the kind shown in his equation. That is, one could sum the total variable costs derived from his equations for all of the subclasses to obtain total variable cost for the Service.

[4068] This separability assumption is incompatible with both the Service's estimations of incremental costs and the Commission's estimations of attributable costs. Both the Service and the Commission rely upon cost functions that relate total variable costs in cost pools defined for activities, to drivers such as "cubic foot miles" that are related through distribution keys to volumes in many subclasses. The functions relating costs for the pools to the drivers would all have to be linear in order for witness Henderson's separability function to be correct. The Commission uses nonlinear relationships between costs and drivers for several important transportation and mail carrier cost pools.

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[53] When z is greater than zero, as shown in witness Henderson's Figure 2, the elasticity of cost with respect to volume is an increasing function of V approaching the value of the parameter b as volume increases.

$$\frac{dC}{dV}\frac{V}{C} = a*b*(z+V)^{b-1}*\frac{V}{a*(z+V)^{b}} = b*\frac{V}{(z+V)} \neq b$$

[54] When V = 0, C is unequal to zero except when z = 0:

$$C = a*Z^{b} \neq 0$$

E. Recommendations of NAA Witness Chown

[4069] Witness Chown identifies a flaw in the current Commission procedure for allocating institutional costs, and proposes a modification to that procedure intended to remedy the flaw. Her proposal sparked extensive critical comment, and this dialogue has further informed the Commission allocation process. Although the Chown proposal is not a suitable replacement for the current Commission allocation procedure, the flaw she attempts to remedy is real.

[4070] The properties of postal costs indicating the flaw are illustrated by statistics derived from the Postal Service's filing taken from witness Chown's direct testimony and shown in Table 4-4. Certain postal functions give rise to costs that are mostly attributable, while other functions' costs are mostly unattributable and include substantial amounts of "identifiable" institutional costs. For instance, transportation costs are mostly attributable leaving only a small amount (3.05 percent) to be distributed as institutional. On the other hand, less than half of delivery costs are attributable, so the delivery function consists largely (60.83 percent) of institutional costs. The Commission's calculation of attributable costs in Appendix E exhibits a similar pattern.

Table 4-1
Witness Chown's Attributable Costs by Function and Subclass

Description	Mail Processing	Window Service	Transportation Costs	Delivery Costs	Other Costs Adjustment
Total First-Class Mail	57.64%	4.81%	5.24%	26.35%	5.96%
Priority Mail	37.16%	3.24%	35.39%	10.65%	13.56%
Total Periodicals	45.66%	0.22%	17.24%	34.65%	2.22%
Standard A Commercial Regular	57.79%	0.81%	6.12%	35.77%	-0.49%
Standard A Commercial ECR	22.69%	0.45%	3.25%	71.66%	1.95%
Parcel Post	36.71%	1.28%	43.48%	16.92%	1.60%
Bound Printed Matter	40.03%	0.30%	18.72%	35.08%	5.87%
Special Services	17.14%	25.70%	0.00%	19.52%	37.64%
Total Attributable Costs	50.08%	4.08%	11.10%	28.96%	5.78%
Identifiable Institutional Costs	28.11%	8.02%	3.05%	60.83%	0.00%

Source: Exhibit NAA-1B at p. 2 and NAA-T-1 Table 3 at p. 9.

[4071] Witness Chown maintains that using total attributable costs as the markup base implicitly assumes that institutional costs are incurred to provide the different functions of the Postal Service in proportion to the attributable costs of these functions. Tr. 25/13326. But this "implicit assumption" is not valid. *Ibid.* Therefore witness Chown reasons that the current system unfairly burdens mailers that use functions that give rise to mostly attributable costs, and unfairly benefits mailers that predominately use functions that incur few attributable costs.

[4072] In the past, most types of mail were accepted, processed, transported, and delivered. As a result, most mail subclasses incurred costs from a somewhat representative mix of postal functions. The development and recent extension of worksharing rate options has changed this situation. A significant portion of the mailstream now takes advantage of worksharing discounts and avoids significant mail processing and/or transportation costs. However, the mail that benefits from worksharing discounts still uses the Postal Service delivery function. This function gives rise to a disproportionately low share of attributable costs. Witness Chown suggests that mail that uses mostly the delivery function will therefore be given an unreasonably small share of the institutional cost burden under existing Commission methodology. *Id.* at 13270-71.

[4073] Several subclasses have distributions of attributable costs by function that are very different from the average. Standard A Commercial ECR is a case in point. Much of this mail is workshared to avoid mail processing and transportation. Consequently, its attributable costs are largely attributable delivery costs (71.66 percent). Since delivery costs are mostly institutional costs, the systems used by both the Postal Service and the Commission attribute fairly little of the Service's costs to Standard A Commercial ECR. Witness Chown's point is quite simple, since Standard A Commercial ECR mail is evidently highly dependent on the delivery function (71.66 percent), and the delivery function is responsible for the lion's share of institutional costs (60.83 percent), a reasonable assignment of institutional costs should reflect this association by giving Standard A Commercial ECR mail a high markup.

[4074] Witness Chown has proposed a systematic way for the Commission to allocate institutional costs in a way that reflects the different distributions of attributable costs by function. She suggests that the Commission construct a “new metric” as the basis for the allocation of institutional costs. This metric, dubbed “total weighted attributable costs,” would be used in the current institutional allocation methodology. *Id.* at 25/13384.

[4075] Witness Chown envisions a four step process. First, the Commission would identify attributable costs in the traditional manner and distribute these attributable costs to subclasses and services. These attributable costs would be the starting point in setting rates. Second, the Commission would begin the process of identifying the appropriate portion of the remaining institutional costs to be borne by each subclass and service by evaluating the evidence presented concerning each of the objectives of the Act, as it does at present.

[4076] The third step involves witness Chown’s proposed procedural change. Currently, the Commission attempts to balance fairly the relative contributions of each subclass by comparing “markups,” the contribution toward institutional costs of each subclass as a percentage of that subclass’ attributable cost. Chown suggests that the Commission measure the relative contributions of each subclass by comparing markups reflecting the contribution toward institutional costs of the subclass as a percentage of that subclass’ total weighted attributable cost. Fourth, and finally, the contribution developed using total weighted attributable costs would then be added to the actual attributable cost of the subclass to establish the revenue target that would be used to design actual rates.

[4077] Total weighted attributable costs would be developed by weighting the attributable costs for each of four major functions (mail processing, window service, transportation, and delivery) by a factor equal to the percentage of total institutional costs divided by the percentage of attributable costs for that function. *Id.* at 25/13275. The result of applying witness Chown’s proposal would be to give more weight, in the allocation of institutional costs, to attributable costs in functions that have large

proportions of institutional costs, and less weight to attributable costs in functions that have small proportions of institutional costs.

[4078] To explain her contention, Chown provides illustrative examples of a simple three subclass, two function system. These examples show that under the current system, institutional burdens can shift significantly as a result of worksharing. Witness Panzar extended her examples and made them the focus of sharp criticism in rebuttal testimony. Tr. 34/18449-56. The flaw witness Panzar finds in witness Chown's examples is that they depend upon an unrecognized cross subsidy that would be identified by a correct application of witness Panzar's incremental cost test.

[4079] Witness Panzar contends that the situation witness Chown views as a problem is of no economic significance. He points out that by definition, the institutional costs are "common costs" which are not caused by any subclass. "Therefore, just because a subclass incurs most of its volume variable costs in a cost component that has large institutional costs does not mean it is any more or less 'responsible' for those costs than any other single subclass." *Id.* at 34/18452 (emphasis omitted).

[4080] Witness Panzar is correct on this point. Institutional costs are those that have not been found to be linked by a reliable inference of causation to individual subclasses or services. For example, a carrier stopping to deliver pieces of several subclasses at every potential stop would make each stop, even if he were delivering one less (or one more) piece. The institutional costs of the delivery function can not be linked to any of the individual pieces delivered. However, witness Chown would presumably argue that there is a relationship between the extent to which a subclass makes use of a function and the institutional cost of the function, even though there may not be an identifiable or measurable inference of causation.

[4081] Witness Christensen points to instances where witness Chown, in explaining the benefits of her proposal, seems to imply a causal relationship between mail that uses a particular postal function and institutional costs incurred in providing that function. *Id.* at 34/18239. He argues this is inconsistent with both logic and established Commission practice. He notes that in Docket No. R90-1, when faced with a related proposal

designed to address the same flaw in its allocation process, the Commission chose to retain its existing allocation procedure. PRC Op. R90-1, para. 4044.

[4082] However, the Commission does not believe that witness Chown's concerns can be so easily dismissed on the basis of the technical errors found in her analysis by Postal Service witnesses. As noted elsewhere, the Commission's method of marking up attributable cost is not an inclusive test for cross subsidy. It is entirely possible, as witness Panzar's criticisms suggest, that a proper application of his incremental cost test would indicate higher rates for subclasses such as Standard A Commercial ECR that rely heavily upon the delivery function. The Commission's attributable costs, which include volume variable costs and specific fixed costs, are likely to be smaller than incremental costs for a subclass like Standard A Commercial ECR mail for a reason made clear by Postal Service witness Takis. *See* USPS-T-41 at 3-5. According to witness Takis, "an appreciable difference between incremental and volume variable cost requires either an elasticity that is very low (*e.g.,* less than 50 percent) or the dominance of a cost component by one class of mail." *Id.* at 24. No single class of mail dominates the delivery function. However, the elasticities associated with the delivery function are generally less than 50 percent. The Service's estimate of the volume-variability of City Carrier Street Costs is 28.4 percent. *See* USPS-T-5 Exhibit 5A at 28. Thus a proper application of the incremental cost test should exhibit the "appreciable difference" expected by witness Takis. This difference arises because the marginal cost curve for a function like delivery with a low volume variability will be a steeply declining function of its driver.

[4083] The Commission will not use total weighted attributable costs instead of attributable costs as the base for the allocation of institutional costs as witness Crowder suggests. This change would tend to make it more difficult for the public to understand the impact of markups on rates. Tr. 34/18353. Because witness Chown's metric uses weighted costs, changes in costing or attribution methodologies could have a more pronounced effect on the markup index than changes under the current system.

[4084] In past cases, the Commission has commented that allocating institutional costs on the basis of markup alone could fail to give adequate recognition to the benefit that subclasses with low attributable cost derive from the existence of a national integrated postal system. The Commission has reviewed the unit contribution of such subclasses and adjusted markups, where appropriate, to assure that the factors of the Act are fairly and equitably reflected.

[4085] Witness Chown's analysis convincingly suggests that the Commission should take this review one step further. If a subclass is a relatively heavy user of one or more functions that engender significant amounts of institutional costs, the Commission should assure itself that the unit contribution from that subclass is sufficient to recognize the value of those functions to users of the subclass. In this regard the Commission should also apply a more inclusive test for cross subsidy along the lines of witness Panzar's incremental cost test.

[4086] Witness Chown expresses particular concern about the contribution of Standard A ECR mail. Tr. 25/13380. This is the first case in which the Commission has had to apply the factors of the Act to Standard A ECR mail, as this subclass was recently established in Docket No. MC95-1. The Commission has carefully reviewed whether the contribution provided by this subclass will be adequate, and reviewed whether the relative markup and unit contribution for this subclass, both as proposed by the Postal Service and as recommended by the Commission, seem adequate to reflect fairly the noncost factors of the Act. However, witness Chown's point remains valid, and in future cases the Commission will continue to review the adequacy of contributions from subclasses that heavily rely on functions which account for a large share of the institutional costs of the Postal Service. *Ibid.*

V. RATES AND RATE DESIGN

A. Expedited Mail: Express Mail

1. Introduction

[5001] Express Mail is the Postal Service's flagship delivery service and constitutes the only service currently offered within the Expedited Mail Class.[1] Four service options are available for Express Mail and each provides either next-day or second-day delivery with guaranteed performance standards.[2] If the applicable performance standard is not met, postage is refundable. Direct Testimony of Thomas M. Sharkey, USPS-T-33, at 6.

[5002] Express Mail service is available for any mailable matter up to 70 pounds in weight, but combined length and girth of the piece may not exceed 108 inches. Pickup service is available for Express Mail; the current pickup fee is $4.95. Computerized Tracking and Tracing, which makes acceptance, arrival, and delivery information available to Express Mail customers, was introduced in February, 1992.

[5003] The rate design for Express Mail incorporates simplicity to a significant degree. All rates are unzoned and rounded to the nearest nickel. There is a flat "letter rate" for pieces weighing up to eight ounces, and an "envelope rate" (equivalent to the two-pound rate) for Post Office to Addressee and Post Office to Post Office mailings that can fit into the standardized envelope supplied by the Postal Service. In 1996, Express

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[1] In Docket No. MC95-1, the Commission approved the Postal Service's proposal to establish the Expedited Mail Class, with Express Mail Service as the sole component of that class. PRC Op. MC95-1, para. 6046; Appendix Two at 2-7.

[2] The four service options are: Next Day and Second Day Post Office to Addressee Service; Next Day and Second Day Post Office to Post Office Service; Custom Designed Service, and Same Day Airport Service. Approximately 98 percent of all Express Mail volume is Next Day or Second Day Post Office to Addressee Service. The Postal Service has suspended Same Day Airport Service for security reasons. USPS-T-33 at 6-7.

Mail accounted for 0.3 percent of total Postal Service volume and 1.4 percent of total revenue. *Ibid.*

[5004] For reasons presented below, the Commission recommends an average increase of nine percent in Express Mail rates and a Post Office to Addressee letter rate of $11.75. The cost coverage recommended for Express Mail is 114 percent.

2. Postal Service Proposal

[5005] The Postal Service proposes a modest increase in Express Mail rates averaging 3.65 percent. The level of this proposed increase is based on witness O'Hara's recommendation of a cost coverage of 205 percent, referenced to volume-variable costs. At the volume levels forecast by witness Musgrave (USPS-T-8 at 44), revenues generated by the Service's proposed rates would exceed the Service's $710 million estimate of test year incremental costs by $131 million. USPS-T-33 at 28-29. The Postal Service does not propose any classification change in Express Mail, nor any structural change in its rate schedule. *Id.* at 5, 14. Although the Same Day Airport to Airport Service has been suspended, witness Sharkey develops a proposed set of rates "in the event that security measures are put in place which would enable the Postal Service to offer the service again." *Id.* at 14.

[5006] Witness Sharkey begins development of the proposed Express Mail rates by separating test year Express Mail cost estimates from witness Patelunas' testimony (USPS-T-15) into distance-related transportation costs, non-distance-related transportation costs, and non-transportation costs. Distance-related transportation costs are distributed to zones by service category, based on the distribution of FY 1996 pounds to zones and on allocation factors for air and surface pounds. Non-distance-related costs are distributed to Next Day and Custom Designed total pounds. Transportation cost per pound is then calculated for Same Day, Next Day and Custom Designed. Finally, a non-transportation weight-related cost of two cents per

pound is added to transportation cost per pound and adjusted by the contingency factor to arrive at a total cost per pound. *Id.* at 14-15.

[5007] To develop piece-related unit cost, non-transportation costs (reduced by the subtraction of weight-related non-transportation cost) are divided by the total number of pieces. Using the results of witness Nelson's Express Mail cost study update (USPS-T-19), witness Sharkey apportions piece-related costs to the various service options. Weight-related costs are distributed to rate cells on the basis of postage weight.

[5008] The markup of the resulting costs, and judgmental limits on the percentage increase for each rate element, serve as the bases for witness Sharkey's proposed Express Mail rates. He constrains increases for each rate element to be no more than 11 percent, rounds rates up to the nearest nickel, and requires rates for Post Office to Addressee to be at least twice the corresponding Priority Mail rate for zone 5. He proposes that the popular letter rate be increased from $10.75 to $11.25, approximately a five percent increase. He also proposed a five-cent reduction in the two-pound rate and downward adjustments for some Custom Designed and Post Office to Post Office rates because of "much greater than average markups." *Id.* at 15-16.

[5009] Witness Sharkey also develops the proposed fee for the pickup service available to users of Express Mail, Priority Mail, and Standard B Mail. Based on his analysis of test year costs and volumes in Exhibit USPS-33J, he proposes a fee of $8.25, which he projects will provide a cost coverage of 102 percent for the pickup service.

3. Cost Coverage

[5010] In keeping with its high intrinsic value of service, Express Mail was assigned a comparatively high cost coverage when it was first introduced, and it always has produced the highest per-piece contribution to institutional costs. Witness O'Hara's recommended coverage of 205 percent is consistent with the factors that have led to high markups for Express Mail on value of service grounds.

[5011] However, other considerations have persuaded the Commission to moderate the markup of Express Mail costs in recent rate proceedings. In Docket No. R90-1, the Commission recommended a cost coverage 41 percentage points below the level recommended in the previous omnibus rate proceeding. The Commission noted that many competitors had entered the expedited delivery market, it had become increasingly competitive, and that "[t]he very high cost coverage that was possible previously is unrealistic if there is to be any Express Mail volume at all." PRC Op. R90-1, para. 6550. Similarly, in Docket No. R94-1 the Commission adopted a further reduction in markup, recommending a cost coverage of 119 percent, which represented a markup index of .33. PRC Op. R94-1, para. 5398. The Commission concluded that this reduction was justified by "basic marketplace considerations with regard to customers and competitors." *Id.*, para. 5408.

[5012] The only participant other than the Postal Service to present testimony on the appropriate institutional cost contribution of Express Mail is United Parcel Service.[3] UPS witness Henderson recommends a cost coverage of 118 percent, with a resulting average rate of $13.51, one dollar more than the average rate in the Postal Service's proposal. He notes that witness O'Hara does not identify any aspect of Express Mail service that has changed significantly since the last omnibus rate case and that the dynamic nature of the market in which Express Mail competes, which witness Musgrave's testimony cites as a prominent feature, is nothing new. Thus, he testifies, there is no evident basis for departing from the balance of § 3622(b) pricing objectives which led the Commission to approximately the same level of coverage he recommends. Tr. 25/13567-68.

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[3] On brief, David A. Popkin, a limited participant, argues that "[t]he requested increase in Express Mail rates should be denied until the Postal Service is able to design their service to be capable of delivering what is guaranteed." Popkin Brief at 11. While the Commission will consider Mr. Popkin's argument as one directed to the putative value of Express Mail service, his requested relief cannot be granted because documented increases in the cost of providing Express Mail service and the necessity of making a fair contribution to institutional costs require that its rates be increased in this proceeding.

[5013] Based on the Commission's analysis of the considerations bearing on Express Mail pricing, it recommends a cost coverage of 114 percent, which represents an index of 0.24. The recommended coverage is considerably less than the 205 percent proposed by witness O'Hara, because the Commission's attributable cost base is much larger than the limited pool of volume variable costs used in witness O'Hara's pricing analysis. The most notable sources of attributable costs omitted from witness O'Hara's pricing analysis are the Eagle Network and the Western Network, the costs of which have been attributed wholly to Express Mail in light of witness Takis' testimony that "the Eagle Network exists to meet the requirements of 'expediting' Express Mail." Tr. 9/4741; *see also* USPS-T-41 at 12, 26. The Commission's treatment of Special Delivery Messenger costs also increases attributable costs above the Postal Service's estimates.

[5014] In light of the level of these increased attributable costs, and of the unusually high sensitivity of Express Mail volumes to price increases, the Commission's recommended coverage results in a markup index of 0.25, somewhat lower than the 0.33 index in Docket No. R94-1. While this represents a comparatively low proportional contribution to institutional costs, the associated rate increase is sufficiently large to warrant concern about the consequences of recommending any larger contribution.

4. Rate Design

[5015] Inasmuch as the Postal Service has not proposed any alteration in the current design of Express Mail rates, and no other party has proposed any revision in the existing structure or identified any problems associated with it, the rates the Commission recommends retain the current design of Express Mail rates.

[5016] As noted earlier, the Commission recommends an overall increase of nine percent in Express Mail rates. The Commission's development of the recommended rates parallels witness Sharkey's method, which follows the procedures used by the Commission for Express Mail rates in prior dockets. However, in light of the overall magnitude of the recommended rate increase, the Commission recommends a Post

Office to Addressee letter rate of $11.75, an increase of 9.3 percent. Other rates were developed using differentials of $2.05 between Post Office to Post Office and Post Office to Addressee, and $2.20 between Custom Designed and Post Office to Addressee, which are based on differences between the non-transportation costs of these categories. In order to moderate the overall effect of the rate increase for Express Mail, the Commission restricted the recommended increase in Post Office to Addressee rates above 10 pounds to 15 percent. The Commission also accepts the Postal Service's proposal that the pickup fee for Express Mail and other services be increased to $8.25.

[5017] The Commission finds these recommended rates to be consistent with the factors set out in § 3622(b). These rates will recover all costs attributable to Express Mail, in compliance with § 3622(b)(3), and make a contribution to the institutional costs of the Postal Service that is reasonable in light of the impact on users (the § 3622(b)(4) consideration) and of the readily available competing alternative expedited delivery services (the § 3622(b)(5) factor). While these considerations operate to reduce the markup, Express Mail, will still make the highest per-piece contribution to institutional costs, which is fair in view of its high intrinsic value of service [§ 3622(b)(2)]. By retaining the established design of Express Mail rates, the recommended rates will maintain the comparative simplicity of structure and identifiable relationships between the rates charged for the various Express Mail services, in response to the § 3622(b)(7) factor.

B. First-Class Mail

[5018] *Introduction and Summary*. In this proceeding, the Postal Service proposes a one-cent increase in the price of single-piece First-Class Mail weighing an ounce or under, thereby raising the price of the First-Class stamp from 32 cents to 33 cents. The Service also proposes a one-cent increase for single-piece cards, increasing the rate from 20 cents to 21 cents. The additional-ounce rate remains at 23 cents under the Service's proposal, for both single-piece and presorted First-Class Mail. USPS-T-32 at 22.

[5019] The Service's worksharing discounts are based on continued interest in encouraging an automated mailstream and concern over relative discount relationships. In addition, a new benchmark has been established for letters. The overall effect is mixed: some discounts are reduced below their current level or stay the same, while others are somewhat larger. The Service's emphasis on automation is especially evident in the proposed reduction in the discount for presorted pieces that are not prebarcoded by one-half cent (from 2.5 cents to 2 cents) and the proposed one-cent difference, for prebarcoded pieces, between the basic and 3-digit presort discounts. Also, the Service proposes eliminating the 4.6 cent "heavy-piece" deduction, for which presorted First-Class pieces weighing more than two ounces are now eligible.

[5020] The Service's worksharing proposals for cards generally maintain their existing relationship to First-Class letter discounts.

[5021] Under the Service's proposal, nonstandard surcharges increase from 11 cents to 16 cents for single-piece mail and from 5 cents to 11 cents for presorted pieces.

[5022] The Service proposes several changes in the First-Class Mail rate structure, but leaves intact the fundamental subclass distinctions adopted in the recent reclassification case. One change — potentially affecting nearly one billion pieces of First-Class Mail — entails the introduction of two rate categories for certain prebarcoded reply mail, referred to as Prepaid Reply Mail (PRM) and Qualified Business Reply Mail

(QBRM). Each would offer a 3-cent discount. The Service also proposes instituting a 50-cent surcharge on certain hazardous medical materials sent through the First-Class mailstream. This is a counterpart to a proposed surcharge of $1.00 for Other Hazardous Materials (OHM), mailed as surface parcels.

[5023] *Overall Impact.* The Service's First-Class Mail rate proposals reflect an average class-wide increase of 3.4 percent, based on increases of 3.3 percent for letters and 5.9 percent for cards. *Id.* at 1. The Service expects these increases to generate revenues that are 199.5 percent of its calculated volume variable costs for letters and 183.7 percent of volume variable costs for cards. *Ibid.*

[5024] *Recommendations for Single-Piece Letters and Cards.* For the first ounce of single-piece letter mail, the Commission recommends the one-cent increase the Service has requested. The Commission does not recommend the requested one-cent increase in the card rate; instead, it recommends maintaining the rate at 20 cents.

[5025] *The Rate for Additional Ounces of First-Class Mail (Single-Piece and Presorted.)* The Commission does not recommend the Service's proposal to maintain the additional-ounce rate at 23 cents. Instead, it recommends a reduction of one cent, thereby reducing the rate to 22 cents. The Commission strongly agrees with intervenors' arguments that the Service's Request inappropriately omits a study addressing longstanding concerns about the cost/rate relationship of processing additional ounces; however, it does not agree with a proposal to fund a reduction in the additional ounce rate through an increase in Standard A Mail cost coverage.

[5026] Also, in a decision that affects both First-Class and Priority Mail, the Commission recommends 13 ounces as the transitional weight (breakpoint) between these two subclasses.

[5027] *Worksharing Rates and Discounts.* In general, the Commission agrees with the Service's basic approach to developing worksharing cost savings. In particular, the Commission commends the Service's proposed adoption of bulk metered mail (BMM) as the basis for calculating unit mail processing cost differences. It also agrees with the Service that the measured costs should be limited at this time to activities exhibiting

identifiable savings, namely unit mail processing and delivery costs. Thus, no adjustments for "compliance costs" associated with Docket No. MC95-1 or other proposed changes affecting the calculation are recommended. The Commission developed discounts using successive levels of worksharing consistent with the Docket No. MC95-1 decision.

[5028] The Commission does not recommend the Service's proposal to "shrink" the discounts for non-automated presorted mail, nor does it recommend elimination of the heavyweight discount. In general, the Commission recommends worksharing discounts somewhat larger than the Service proposes.

[5029] *Reply Mail Classification, Discounts and Fees.*[4] The Commission recommends both of the Service's proposed discounted reply mail options: PRM and QBRM. It also recommends, on a "shell" basis, the OCA's proposed CEM category. The Commission recommends a three-cent discount for QBRM and PRM letters and a 2-cent discount for QBRM/PRM cards. The recommended per-piece service fee for QBRM is 5 cents. Other reply mail fees are recommended as proposed.

[5030] *Nonstandard Surcharges.* The Commission does not recommend the Service's proposed increases in the nonstandard surcharges; instead, both surcharges are held at their current levels.

[5031] The following table compares current, proposed and recommended rates and fees affecting First-Class Mail.

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[4] The terms "reply mail" and "reply mail pieces" generally refer to pre-addressed, Postal Service-approved envelopes, cards and labels distributed by businesses or organizations as a convenience to their customers or correspondents. There are two basic types. One type allows the sender to mail the piece without affixing postage, pursuant to a special postal service called Business Reply Mail (BRM). The other type, referred to as courtesy reply mail (CRM), is similar to BRM in appearance, but requires the sender to affix postage. CRM is not part of BRM service nor any other special service or classification, and no permit, service, or accounting fees are associated with its distribution. However, its distribution is subject to postal regulations requiring prior approval of the mail piece and compliance with formatting and preparation standards.

Table 5-1
Summary of Rates for First-Class Letters and Sealed Parcels and Cards

	Cents per Piece Except Where Noted		
	Current	Postal Service Proposed	Commission Recommended
LETTERS AND SEALED PARCELS			
Single Piece			
First Ounce	32.0	33.0	33.0
Additional Ounce	23.0	23.0	22.0
Nonstandard Surcharge	11.0	16.0	11.0
Hazardous Medical Materials Surcharge	N/A	50.0	—
Presorted			
First Ounce	29.5	31.0	30.5
Additional Ounce	23.0	23.0	22.0
Nonstandard Surcharge	5.0	11.0	5.0
Heavy Piece Deduction	(4.6)	—	(4.6)
Automated (First Ounce)			
Basic Automation	26.1	27.5	27.0
3-Digit Letters	25.4	26.5	26.1
5-Digit Letters	23.8	24.9	24.3
Carrier Route Letters	23.0	24.6	23.8
Basic Automation Flats	29.0	30.0	30.0
3/5-Digit Flats	27.0	28.0	27.0
Nonstandard Surcharge	5.0	11.0	5.0
Additional Ounce	23.0	23.0	22.0
Heavy Piece Deduction	(4.6)	—	(4.6)
CARDS			
Single piece	20.0	21.0	20.0
Presorted	18.0	19.0	18.0
Basic Automation	16.6	17.6	16.6
3-Digit Automation	15.9	17.0	15.9
5-Digit Automation	14.3	15.9	14.6
Carrier Route Cards	14.0	15.6	14.1

1. Letters and Sealed Parcels

a. Preliminary Considerations

[5032] *The Service's presentation.* First-Class Mail consists of mailable matter weighing 11 ounces or less. USPS-T-32 at 8. The proposals addressed here affect the Letters and Sealed Parcels subclass; the Cards subclass (currently referred to as the "Stamped Cards and Post Cards subclass"); and two special postal services. The

Service proposes no change in the composition of the subclasses or the major worksharing rate categories established in Docket No. MC95-1.

[5033] Postal Service witness Fronk presents most of the Service's proposed First-Class Mail rate and classification changes and assesses the consistency of QBRM and PRM with statutory criteria.[5] *See generally* USPS-T-32. He relies on several other Postal Service witnesses for costing and pricing support. Fronk notes that the Service's First-Class proposals are affected by the relatively modest size of the revenue requirement; a proposed change in costing methodology that revises the treatment of mail processing costs; and continued emphasis on automation.

[5034] *Impact of cost revisions.* The Service filed numerous revisions to the costs initially provided in support of its Request. In First-Class, these resulted, among other things, in substantial increases in the estimates for the nonstandard surcharges and a one-cent increase from the original estimate of the new worksharing benchmark unit mail processing costs. Fronk acknowledges that these revisions alter some of the cost differences, passthroughs, and cost-rate relationships referred to in his testimony, but he asserts that his proposed rates are still consistent with statutory pricing requirements. However, he concedes he might have considered some alternative rates had the revised cost information been available earlier, and specifically identifies the proposed two-cent discount for nonautomated Basic Presort as a candidate for revision. Fronk Appendix (October 1997) at 1. On brief, the Service confirms that revised costs would support a discount "in the middle of the range" of 2.0 cents and 2.5 cents. Postal Service Brief at V-15.

[5035] *Absence of data on additional-ounce processing costs.* Notwithstanding the extensive supporting material the Service has filed, a glaring omission is information addressing the cost support for the First-Class Mail additional-ounce rate. The Service's failure to devote attention to this long-requested review has hindered the Commission's ability to review the additional-ounce issue. It also impedes analysis of the proposed

[5] Fronk also reviews First-Class Mail physical characteristics; presents a summary of rate, volume and revenue history; and highlights selected market characteristics.

elimination of the heavyweight deduction, which applies to presorted pieces weighing more than two ounces.

b. Development of Unit Mail Processing and Delivery Costs for First-Class Mail

[5036] *Methodology.* Postal Service witness Hatfield develops mail processing unit costs for First-Class letters and cards that entail three main steps. *See generally* USPS-T-25. First, Hatfield develops a mail processing unit CRA benchmark, which includes all volume variable mail processing costs.[6] He then develops mail flow models to estimate unit costs by presort level. Finally, he compares the weighted average model unit cost to the mail processing unit cost benchmark and adjusts each category for the difference.

[5037] Significant distinctions between the estimation of unit costs in this proceeding and Docket No. MC95-1 include changes in the analysis of mail processing volume variability, the use of MODS cost pools, and refinements reflecting both uniform and proportional CRA adjustment factors. An improved card cost methodology is also introduced. Specifically, the Service proposes, through witness Bradley, volume variabilities for certain mail processing activities that are less than 100 percent. This lowers the Cost and Revenue Analysis (CRA) benchmark cost and modifies the input data used in the mail flow models. The use of MODS cost pools, proposed by witness Degen, facilitates the breakdown between proportional and fixed costs used in the development of the CRA adjustment factors. The new card methodology, according to witness Hatfield, better reflects cost distinctions between letters and cards. *Id.* at 19. Postal Service witness Seckar develops mail processing unit costs for First-Class flats using a similar methodology.

[5038] In support of the Service's proposals, mail processing unit model costs are developed for non-automation presort, automation basic, 3-digit, and 5-digit letter mail,

[6] Noncarrier route presort mail is used as the First-Class CRA benchmark in this proceeding.

and automation flats. Coverage factors are derived from FY 1996 Origin-Destination Information System (ODIS) data. Flow densities are taken directly from Docket No. MC95-1; Accept and Upgrade rates are based on an updated 1993 study.

[5039] *CRA Adjustment Factor.* In Docket No. MC95-1, a "non-modeled cost factor" — referred to as a CRA adjustment — was applied to mail processing unit costs to account for differences between the modeled cost and the benchmark. In this docket the Postal Service proposes, and the Commission recommends, an improvement to the established CRA adjustment used in calculating worksharing unit costs. This adjustment is necessary to tie the engineering model costs back to the CRA costs and is used to develop First-Class, Standard and Periodicals discounts. Previously, a single CRA adjustment was used to reflect costs not captured in the engineering models. In this proceeding the Service proposes a proportional adjustment that reflects costs that vary by worksharing level and a uniform adjustment that reflects costs that do not vary by worksharing level.

[5040] The uniform adjustment is calculated by determining which of the 46 MODS-based cost pools for the appropriate rate category are related to activities that are uniform to all levels of worksharing. These pools are: platform; sack sorting; and, all BMC. The unit costs are summed across these pools to derive the uniform CRA adjustment.

[5041] To calculate the proportional adjustment, the unit costs for the remaining pools are summed and the result compared to the weighted model cost of workshared mail. The difference is the proportional adjustment. This adjustment is applied to the model unit costs for each worksharing category. The uniform adjustment is then added to obtain the total mail processing unit cost for each category.

c. Rates for Single-Piece (Nonpresorted) Letter Mail

[5042] *First-Ounce Rate.* In this proceeding, the Service proposes a one-cent increase in the first-ounce single-piece First-Class letter mail rate, thereby raising it from

32 cents to 33 cents. Fronk notes that the Service continues its practice of proposing this rate in whole cents, primarily for administrative ease and avoidance of burden on the public. He also asserts, among other things, that the one-cent increase is consistent with the Service's revenue requirement and the Postal Reorganization Act's statutory pricing criteria. USPS-T-32 at 22. Moreover, given the size of the revenue requirement, he says: "[A] proposal not to change this rate would impose unreasonably large rate increases in other classes of mail; conversely, a two-cent increase would unfairly relieve other classes of mail from sharing in the burden of the increase in the revenue requirement." *Ibid.*

[5043] The Service proposes maintaining the rate for each additional ounce at 23 cents, its current level. *Id.* at 23. Factors contributing to the development of this rate include consistency with the revenue requirement; the First-Class Mail cost coverage provided by witness O'Hara; and recognition of the additional-ounce rate's importance as a source of revenue for the Postal Service. With respect to the latter, Fronk notes that the additional-ounce rate generated about $4.3 billion in revenue (or 13 percent of First-Class Mail revenue) in FY 1996, and is expected to generate $4.5 billion in after-rates revenue in FY 1998. *Id.* at 22.

[5044] *Participants' Positions.* Several participants have addressed the level of the proposed single-piece rate. MMA and OCA contend that the Commission should consider retaining the 32-cent First-Class rate, given the Service's favorable financial situation. MMA witness Bentley estimates that holding the rate at 32 cents would result in a net revenue reduction of slightly more than $800 million.[7] Tr. 21/11166. He says that if other classes or subclasses were not asked to make up the revenues resulting from this decision, "the Commission would achieve its goal of 'roughly equivalent markup indices' for First-Class Mail (116) and Standard Mail (110)." *Ibid.* (citation omitted). *See also* MMA Brief at 11-12. The OCA endorses witness Bentley's suggestion, noting the

[7] Bentley's proposal is part of a comprehensive proposal which, among other things, would also reduce the rate applicable to the second ounce of First-Class Mail, for both single-piece and workshared mail, and alter the worksharing discounts.

Commission's longstanding concern over the relative contributions of First-Class and Standard A Mail. OCA Trial Brief at 5.

[5045] Another participant — the Greeting Card Association (GCA) — sponsors the testimony of witness Erickson, who urges the Commission to consider whether the proposed First-Class rate reflects appropriate consideration of the cultural value of greeting cards, in accordance with subsection 8 of the 39 U.S.C. 3623(b). Hallmark Cards, Incorporated (Hallmark), a GCA member, also advocates full recognition of the cultural value of First-Class single-piece correspondence in general and greeting cards in particular. Hallmark Brief at 2. Hallmark says this does not necessarily mean it opposes the "relatively small increase" proposed here; instead, it says it recognizes that, notwithstanding disparities between projected and apparent actual FY 1997 results, a one-cent increase in the first-ounce single-piece rate "may be a practical necessity." *Ibid.*

[5046] *Commission Analysis.* The Commission's assessment of appropriate First-Class single-piece rates is guided by a balancing test and adherence to the integer constraint. The balancing test, in the first instance, entails consideration of how other classes of mail would be affected by the share of total revenues to be recovered from First-Class Mail. The integer constraint generally holds that a rate for a postal category widely used by the general mailing public, such as the First-Class stamp, should be expressed in whole, rather than fractional, cents.

[5047] Under current circumstances, a one-cent change in the first-ounce First-Class rate equates to about $1 billion in net revenue. On this record, the Commission finds that holding the First-Class rate at 32 cents cannot be accomplished without imposing undue rate increases on other classes of mail. No party suggests departing from the whole-integer constraint, and the Commission finds no reason to do so on this record. Therefore, the Commission recommends a one-cent increase in the rate for the first ounce of letter mail. This rate covers costs (in accordance with 39 U.S.C. § 3622(b)(3)) and comports with other applicable statutory non-cost criteria.

However, the Commission finds that some relief can be provided to mailers of First-Class by lowering the additional-ounce rate and restraining increases for workshared mail.

d. Proposals Affecting Rates and Discounts for Workshared Mail (Letters and Flats)

(1) The Service's Proposals

[5048] *Introduction.* Since reclassification in Docket No. MC95-1, bulk presorted "workshared" pieces in the Letters and Sealed Parcels subclass of First-Class Mail have been distinguished primarily on the presence — or absence — of a mailer-applied barcode. Presorted pieces *without* a barcode are in the nonautomated Presort rate category. This category consists of one broad grouping of presorted letters and flats, referred to as Basic Presort. Automation-ready, barcoded presorted pieces are in the Automation rate category. This category recognizes shape distinctions (letter or flat) and degrees of presorting beyond the basic level.

[5049] The Service's proposed worksharing rates and discounts apply to the first ounce of pieces in both the automated and nonautomated worksharing categories. The Service proposes maintaining the rate for each additional ounce at the current level of 23 cents, paralleling the proposal for the single-piece category. The Service also proposes eliminating the 4.6 cent "heavyweight" deduction for presorted pieces that weigh more than 2 ounces.[8]

[5050] *Discount development.* Fronk notes that he considers establishing an appropriate benchmark for calculating First-Class worksharing cost savings a critical issue in First-Class rate design, and "as equally critical" as determining the measured cost of the rate category. USPS-T-32 at 19. He indicates that he generally adopts the Commission's PRC Op. MC95-1 conclusion that discounts should be based on the costs

[8] Fronk explains that in application, eligibility for the deduction means that heavy pieces pay a first-ounce rate that is 4.6 cents lower than it would otherwise be. Each additional ounce then pays a uniform rate of 23 cents. Thus, he notes that the proposed elimination of the discount increases only the first-ounce rate for affected pieces, not each additional ounce. Tr. 4/1437.

that the worksharing activity (such as prebarcoding and presorting) avoids, rather than full cost differences. Accordingly, he uses bulk metered mail (BMM) as the standard of comparison, rather than single-piece nonpresorted mail. BMM is trayed by the mailer, and thus does not require preparation, facing, or canceling.

[5051] Fronk says he focuses on the costs avoided by successive degrees of presorting or automation compatibility, but he also makes adjustments to achieve "a balanced consideration" of a number of the statutory pricing criteria, including fairness and equity, the effect of the rate increase on mailers, and simplicity in the rate structure. *Id.* at 20.

[5052] Fronk limits the measurement of cost savings to mail processing and delivery costs, in line with the prevailing First-Class Mail worksharing discount methodology. He also uses 3-digit mail as the "key" for developing Automation letter rates, noting that 60 percent of the prebarcoded volume is in this category. Cost revisions submitted after his testimony was filed do not alter his proposals, but change some of the cost differentials and the implicit passthroughs originally identified in his testimony.

[5053] *Proposed Elimination of the Heavyweight Deduction.* The heavyweight deduction, also referred to as the heavy-piece discount, was introduced in 1988, at 4 cents, following Docket No. R87-1. USPS-T-32 at 17; *see also* PRC Op. R87-1, paras. 5116-5122. In FY 1996, about 300 million pieces of presorted First-Class Mail received the deduction. USPS-T-32 at 24. In support of elimination, witness Fronk cites the reduced value of presorting alone in the current operating environment, given increasingly widespread use of barcodes. He points to a significant increase in the difference between the first-ounce and degressive rate since the discount was introduced in 1988. He claims this reduces the relative price for heavy First-Class pieces and renders a special discount "less necessary." *See generally* USPS-T-32 at 24-25. Fronk also cites the changing composition of the mail eligible for this benefit. He says that although the discount " may have been originally targeted at flats, it appears that a

significant percentage of pieces qualifying for the discount are now letters." Tr. 4/1437. Fronk also says elimination would simplify the rate structure.

(a) Presorted, Nonautomated Mail (Letters and Flats)

[5054] *Development of Unit Costs.* Unit mail processing costs for nonautomation presort mail models are developed with models of three separate mail flows: mail in OCR upgradable trays; OCR upgradable mail in non-OCR trays; and non-OCR upgradable mail in non-OCR trays. The resulting "model unit costs" are weighted together and CRA adjustments are applied. The mail processing unit cost for nonautomation presort letters under the Service's proposal is 7.2 cents. Unit delivery costs are 4.1 cents. Combined costs are 11.3 cents.[9]

[5055] *Rate and Discount Proposal.* Fronk proposes a rate of 31.0 cents for the first ounce of mail in this category, which represents a 2.0 cent discount from the proposed 33-cent rate. USPS-T-32 at 23. Fronk originally indicated that the discount reflected a passthrough, relative to the BMM benchmark cost, of 90 percent of the measured cost avoidance; however, subsequent cost revisions reduced this to 59 percent. *Id.* at 23-24.

[5056] *Effect on Existing Discount.* Fronk acknowledges that his proposal represents a discount of only two cents from the proposed single-piece First-Class mail rate of 33 cents, or a half-cent less than the current discount.[10] He says he "reduced the discount somewhat in order to increase the incentive for mailers to prebarcode their mail and thus to further the automation goals of the Postal Service." *Id.* at 24. The following table identifies the Service's proposals affecting this category.

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[9] The Commission's rejection of Bradley's volume variabilities raises these costs to 8.1 cents, 4.9 cents, and 13 cents, respectively.

[10] The current rate is 29.5 cents. Relative to the 32-cent stamp, the discount is 2.5 cents. Thus, the Service's proposal "shrinks" the discount by one-half cent.

Table 5-2
Nonautomated Presort Letters and Flats

	Rates/Discounts/Surcharge		
	Current	**Proposed**	**Recommended**
First Ounce	29.5¢	31.0¢	30.5¢
Each Additional Ounce (to 13 oz.)	23.0¢	23.0¢	22.0¢
Worksharing Discount*	2.5¢	2.0¢	2.5¢
Heavyweight deduction†	(4.6¢)	Eliminated	(4.6¢)
Nonstandard surcharge	5.0¢	11.0¢	5.0¢

* relative to current and proposed single-piece First-Class Mail rates of 32¢ and 33¢.
† applicable to pieces weighing 2 ounces or more.

Source: Adapted from USPS-T-32 at 4.

(b) Automated Letters

[5057] *Development of Unit Costs and Discounts.* The bulk automated letters category consists of four tiers: basic presort, 3-digit, 5-digit and carrier route.[11] *Id.* at 26. Separate unit costs are calculated using mail flow cost studies for all tiers except carrier-route letters, for which costs are taken directly from the MODS-based pools. Fronk sets discount levels based on cost differences from the 3-digit letter category because 60 percent of all automation letters are in this category. This differs from the Commission's approach, which reflects the savings from each additional increment of mailer worksharing. *Id.* at 27.

[5058] *Effect of Proposals on Existing Discounts.* Fronk notes that his proposals (shown in Table 5-3) reduce the current basic and 3-digit discounts (by different amounts); maintain the 5-digit discount at its current level; and decreases the carrier route discount. He attributes the smaller discounts in basic and 3-digit to the use of the

[11] The automation carrier route letter rate is restricted to qualifying pieces sent to offices without delivery-point sequencing capability as specified by the Postal Service.

new bulk metered mail benchmark, which he says "better isolates the cost savings from automation." Fronk acknowledges that the proposed carrier route discount is smaller than the current discount, but he maintains that it still recognizes the extra mailer preparation required to make carrier route trays and packages. *Id.* at 29.

[5059] Fronk notes that one broad effect of his proposal for Automation Letters is an increase in the gap — or step — between the basic and the 3-digit tiers from 0.7 cents to a full cent. He asserts that by increasing this gap, the Postal Service can reduce the risk that large 3-digit mailings will be fragmented into numerous smaller mailings, unnecessarily raising acceptance and mail processing costs.

Table 5-3
First-Class Mail Automated Letters

	Rates		
	Current	**Proposed**	**Recommended**
Letters (first ounce)			
Basic Automation	26.1¢	27.5¢	27.0¢
3-digit	25.4¢	26.5¢	26.1¢
5-digit	23.8¢	24.9¢	24.3¢
Carrier route	23.0¢	24.6¢	23.8¢
Additional-ounce rate	23.0¢	23.0¢	22.0¢
Heavyweight deduction	(4.6¢)	Eliminated	(4.6¢)

(c) Automation Flats

[5060] This category has two tiers: basic and presort (consisting of 3- and 5-digit flats). *Id.* at 25. As in Automation letters, the basic category operates as a residual tier. Fronk proposes increasing both tiers by one cent, thereby moving the basic automation rate for flats from 29 cents to 30 cents and the combined 3/5-digit rate from 27 cents to 28 cents. *Id.* at 4.

[5061] Fronk says the automated flats pricing proposal was developed to reflect cost data showing that automated flats are significantly more expensive to process than automated letters. He says the proposed rates were selected primarily "to preserve the appropriate rate relationships between letters and flats in the automated arena, and between flats and the non-automated presort rate that applies to both letters and flats." *Id.* at 29. Therefore, Fronk says that under the Service's proposal, barcoded flats pay *less* than nonautomated presorted flats, but *more* than barcoded letters.[12] *Id.* at 30. The following table shows the Service's proposals for automation flats.

Table 5-4
First-Class Mail Automation Flats

	Rates		
	Current	**Proposed**	**Recommended**
Basic Automation	29.0¢	30.0¢	30.0¢
3/5 Digit Flats	27.0¢	28.0¢	27.0¢
Each additional ounce	23.0¢	23.0¢	22.0¢
Heavyweight deduction	(4.6)¢	Eliminated	(4.6¢)
Nonstandard Surcharge	5.0¢	11.0¢	5.0¢

Source: USPS-T-32 at 4.

(2) Participants' Positions

[5062] Two sets of alternative worksharing rates and discounts for letters and two different approaches to the additional-ounce rate have been offered in response to the Service's First-Class proposals. The Major Mailers Association (MMA) sponsors witness Bentley's worksharing and additional-ounce proposals. The American Bankers

[12] Fronk notes that one-ounce flats are subject to the proposed nonstandard surcharge of 11 cents, so that the effective postage is 41 cents and 39 cents, respectively. USPS-T-32 at 29.

Association, the Edison Electric Institute, and the National Association of Presort Mailers (ABA/EEI/NAPM) jointly sponsor witness Clifton's worksharing proposal. ABA and the Newspaper Association of America (ABA/NAA) sponsor witness Clifton's additional-ounce proposal.

[5063] In addition to its sponsorship of witness Clifton's worksharing proposal, NAPM sponsors witness MacHarg's testimony on specific rate design issues. In connection with workshared letters, MacHarg provides an estimate of the cost savings associated with mailers' compliance with post-reclassification "Move Update" requirements, which witness Clifton incorporates in his worksharing proposal. MacHarg also addresses the impact of the Service's proposals on flats. In the interest of retaining flats in the mailstream, he opposes elimination of the heavyweight deduction and suggests that presort requirements for the second tier in the Automation flats category be redefined.

[5064] The Postal Service sponsors witness Murphy in rebuttal to NAPM witness MacHarg's "Move Update" estimate. On brief, the Service responds to witness Bentley's proposals and addresses witness Clifton's additional-ounce proposal at length. *See generally* Postal Service Brief at V-39-V-52. In addition, several participants representing Standard A mailers sponsor rebuttal witnesses critiquing witness Clifton's proposals, given their potential impact on Standard A Mail cost coverage and rates.[13] These include Advo (Advo), sponsoring witness Crowder; ValPak Direct Marketing Systems, Inc., Val-Pak Dealers Association, Inc., and Carol Wright Promotions, Inc. (VP/CW), sponsoring witness Haldi; and three participants appearing jointly — Mail Order Association of America, Advertising Mail Marketing Association, and Direct Marketing Association, Inc., (MOAA et al.) — sponsoring witness Andrew. The arguments of the Standard A mailers also relate, in part, to some of MMA witness Bentley's contentions.

[13] The testimony of these witnesses, as well as Clifton and Bentley, includes extensive analyses of complex data and mail processing studies. It also includes comparisons of the rate designs for First-Class Mail and Standard A Mail and assessments of previous Commission decisions on relative cost coverages. This discussion assumes familiarity with these matters.

[5065] *Alternative Worksharing Discount Proposals.* The following table presents a comparison of current and proposed worksharing discounts.

Table 5-5
Comparison of First-Class Letter Mail Worksharing Discounts

	Current	Fronk (USPS)	Bentley	Clifton
Basic Automation	5.9	5.5	5.7	6.9
3-Digit	6.6	6.5	6.7	8.6
5-Digit	8.2	8.1	8.3	10.2
Carrier	9.0	8.4	8.6	10.5

Source: Adapted from USPS-T-32 at 27-28 (Fronk); Tr. 21/11195 (Bentley); and Tr. 24/12506 (Clifton).

(a) MMA's Alternative Worksharing Proposals

[5066] MMA witness Bentley bases his alternative worksharing proposal on broad objections to the Service's proposed costing changes and on several policy considerations. In the costing area, he opposes the Service's introduction of Bradley's new volume variable costing methodology and witness Degen's use of MODS-based pools for cost attribution. Specifically, Bentley contends that Bradley's volume-variable approach understates First-Class letter mail cost avoidance by 1.5 cents to 2.6 cents, compared to the prevailing approach. He asserts that this results in an average understatement of cost savings by 21 percent. Tr. 21/11167.

[5067] Bentley also asserts that the Service's underlying models omit costs associated with mailers' compliance with certain post-reclassification requirements that reduce postal costs. These include "Move Update" requirements[14] (which relate to forwarding); mail preparation changes; and the requirement that reply pieces inserted in outgoing mailings must have a Facing Identification Mark (FIM). *Ibid.* However, Bentley

does not make a specific adjustment for the alleged understatement of cost savings; instead, he identifies this contention as one of several policy reasons for rejecting the Service's proposal.

[5068] Other policy considerations underlying Bentley's proposal include his observation that the average 4.6 percent increase for Automation letters is twice the average 2.3 percent increase for Standard A Automation letters and 50 percent more than the 3.1 percent increase for 1-ounce First-Class single pieces. *Ibid.* Based on these comparisons, Bentley characterizes the increase for automation letters as "rather high and counterproductive" for mailers who are cooperating with the Postal Service in providing automation-compatible prebarcoded letters. *Id.* at 11169-70. He also asserts that the implicit cost coverage for workshared mail is considerably higher than those for "all other major contributors" to institutional costs and, therefore, inconsistent with the Commission's stated intentions regarding the pricing of First-Class Mail. *Id.* at 11170. In addition, Bentley says the Service's proposal sends an inconsistent price signal. *Id.* at 11171.

[5069] *Methodology.* Based on his costing and policy positions, Bentley substitutes the Commission's Docket No. R94-1 mail processing cost methodology for Bradley and Degen's approach; uses the proposed BMM benchmark; passes through 81 percent of cost savings derived under the Commission's methodology and develops discounts that are at least 0.2 cents higher than the Service's. He maintains that recognizing savings from Move Update requirements and other mail preparation reforms would increase his estimate of unit cost savings by another cent, but he does not formally propose this adjustment. *Id.* at 11225-26. Bentley says his proposal generates a net revenue reduction of $72 million, but does not specifically identify how this should be funded. *Id.* at 11169. Bentley's set of discounts are shown in Table 5-5.

[5070] On brief, MMA argues that Bentley's proposed discounts are justified, even under Bradley's methodology. In support of this position, MMA observes that two

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[14] Bentley suggests that compliance with these requirements may be the reason the bulk metered mail benchmark differential is narrower than expected. Tr. 21/11172.

potential adjustments to cost savings proposed on this record would increase Automated letters' unit cost savings by almost a full cent. One is ABA/EEI/NAPM witness Clifton's estimated additional unit cost savings from Move Update requirements of 0.262 cents. The other is the Service's estimate that a relevant MODS cost pool that is omitted accounts for additional cost savings of 0.683 cents. MMA Brief at 16.

(b) ABA/EEI/NAPM Alternative Worksharing Proposal

[5071] Witness Clifton, on behalf of ABA/EEI/NAPM, asserts that the Service's worksharing proposals: 1) generate a historically high (implicit) cost coverage of 283 percent; 2) are contradicted by the decreasing attributable costs of this mail since 1994; 3) impose a disproportionate increase for workshared First-Class letter mail relative to Standard A Regular and ECR mail; and 4) continue the unfair institutional cost burden borne by this mail. *See generally* Tr. 24/12459 et seq.

[5072] Based on these assertions, Clifton proposes several changes to the Service's cost savings calculation. He characterizes two of these as "corrections" and one as an "adjustment." *Id.* at 12496. The "corrections" entail the addition of estimated cost savings of 0.262 cents per piece due to "Move Update" requirements, based on witness MacHarg's testimony, and the substitution of a roll forward factor of negative 3.6 percent with respect to mail processing labor costs, in lieu of the Service's rollforward factor. The latter change is based on Clifton's assertion that the Service's projected increase in unit labor costs from the base year to the test year — 7.1 percent — is inconsistent with a reported 13.8 percent decline between FY 1994 and 1996. He attributes this decline largely to increased prebarcoding by First-Class presort mailers and concludes that this two-year trend should be projected into the test-year. *Id.* at 12481. The "adjustment" Clifton proposes is a reduction in the cost coverage of First-Class workshared mail (to 276 percent), due to his observations about relative First-Class and Standard A mail cost coverages. Clifton states: "The revenue loss associated with my cost coverage and rate proposals for First-Class workshared mail is

eliminated by raising the cost coverages of Standard A Mail from the USPS proposed 167% to 175%." *Id.* at 12507. He notes that this raises the revenue contribution Standard A mailers would make by about $469 million. *Ibid.*

[5073] *Methodology.* Clifton uses single-piece First-Class letter mail as his benchmark, rather than the proposed BMM; establishes the Automated Basic discount at 78 percent of this cost difference; and passes through 100 percent of the additional cost differences to obtain the remaining discounts. He leaves the First-Class letter mail Retail Presort and carrier route discounts at their current levels of 2.5 cents and 9.0 cents, respectively. Overall, Clifton's proposal reduces workshared letter rates in the range of 1.0 to 2.1 cents per piece. He asserts that any final set of rates should include at least a one-cent difference between basic automation and 3-digit to foster an "added degree of worksharing." *Id.* at 12506 (footnote 14)

(c) NAPM Position

[5074] *Observations on the Service's Worksharing Proposal for Letters.* Notwithstanding general opposition to the Service's worksharing proposals, NAPM witness MacHarg approves of the element of the Service's Automation proposal for First-Class automation letters that provides a one-cent "gap" between the Basic and 3-digit tiers. Tr. 27/14961. MacHarg contends this will encourage a high volume of automation 3- and 5-digit letter mail relative to automation basic. *Ibid.* However, MacHarg urges a more expansive measure of worksharing cost avoidance based on the assertion that presort bureaus perform functions that reduce costs but are not included in the Service's measurement of cost avoidance for First-Class letter mail. In particular, he asserts that compliance with "Move Update" requirements will generate a reduction of at least 25 percent in the test-year forwarding costs for First-Class workshared mail. *Id.* at 14956. This is based on his assessment that at least 25 percent of workshared First-Class letter volume will have been processed through the Service's "FASTforward" system by March 31, 1998, and therefore will be free of almost all forwarding costs. *Ibid.*

MacHarg emphasizes that he considers his estimate conservative, since the portion of workshared First-Class Mail not covered by FASTforward is covered by other "Move Update" tools that should generate additional savings. *Id.* at 14957-58. According to MacHarg, other unrecognized cost savings arise due to mailers' performance of functions such as facing, culling, canceling, and banding and sleeving of trays. *Id.* at 14957. MacHarg also invokes, as a general consideration, the presort bureaus' considerable investment in physical plant and equipment and the Service's inability to handle reversion volume. Further, MacHarg questions the Service's treatment of FASTforward license fees. *Id.* at 14958.

[5075] *Opposition to the Proposed Treatment of Flats.* MacHarg also opposes the Service's proposed elimination of the heavyweight deduction, noting the Service has provided no supporting study. Moreover, he says that when coupled with the "significantly understated" worksharing discounts the Service has proposed, elimination of the discount results in unfair treatment of First-Class worksharing mailers. He also says the proposal damages "the very program that is so vital to the well being of the USPS," especially with respect to the Service's ability to attract barcoded First-Class flats. *Id.* at 14959. Citing witness Daniel's testimony, witness MacHarg says the cost savings from barcoded flats are substantial and "grossly in excess" of the incentives the Service offers. *Ibid.* He also says the Service is now enhancing its automation equipment in a way that will allow barcodes on flats to be read. *Id.* at 14960.

[5076] Witness MacHarg asks the Commission to consider increasing incentives for First-Class automated flats to a level that passes through a much more substantial portion of the cost savings the Service obtains from automated flats. He also asks that the Commission eliminate the 5-digit requirement for the second presort tier in the Automated Flats rate category, thereby establishing a category exclusively for 3-digit flats. *Id.* at 14960; 14988-89. *See also* NAPM Brief at 5-6.

(d) Response of Postal Service and Standard A Mailers to Alternative Proposals

[5077] *Postal Service Rebuttal to Testimony of NAPM Witness MacHarg.* Postal Service rebuttal witness Murphy challenges NAPM witness MacHarg's contention that implementation of the "Move Update" requirements will generate a reduction of at least 25 percent in the test-year costs of forwarding First-Class worksharing mail. *See generally* USPS-RT-18. His testimony describes the "Move Update" requirements for bulk First-Class, discusses the extent of their implementation, and suggests reasons for caution in developing savings estimates. In particular, he notes that the use of "Move Update" tools is a totally new concept and says it is premature "to estimate its efficacy today." Tr.33/17649. Moreover, he notes that postponement in the implementation of "Move Update" requirements from July 1996 to July 1997 and a further extension (to 10/31/97) was given to presort mailers that had elected the FASTforward option, given the technical complexities and equipment modifications that MLOCR manufacturers faced. *Id.* at 17651.

[5078] Murphy also asserts that MacHarg's projection fails to account for the extent to which mailers were using "Move Update" tools prior to mandatory use. *Ibid.* He asserts that with the exception of FASTforward, the other "Move Update" options have been in place for some time. *Ibid.* Therefore, he says it is "extremely difficult to measure, in the short term, without full industry compliance, the impact of the "Move Update" requirements on forwarding and other UAA [Undeliverable-as-addressed] volumes." *Id.* at 17652.

[5079] Murphy also says witness MacHarg underestimates the difficulty of reducing UAA volumes and overstates the effectiveness of the FASTforward system and other "Move Update" options. *Id.* at 17653. He cites the experience in Periodicals, where there is extensive use of Automated Correction Service, National Change of Address (NCOA) and other alternatives, but still a two percent UAA problem. *Ibid.* Finally, Murphy says the Service plans to review aggressively industry compliance, collect data and monitor the integration of "Move Update" tools into business processes. He says

this will help accurately quantify the impact of these requirements on postal operations, Computerized Forwarding Service (CFS) mail volumes, and UAA mail.

[5080] *Postal Service Response to the MMA and ABA/EEI/NAPM Alternative Worksharing Proposals.* On brief, the Service also argues that the Commission should reject both alternative proposals that have been offered. It dismisses witness Clifton's proposals on several grounds. First, it points out that his 3-digit and 5-digit rates are both *below* their current levels. Postal Service Brief at V-40. It says:

> While he [Fronk] acknowledged that his proposal calls for modest, 0.1 cent reductions in the 3-digit and 5-digit discounts, he pointed out that discounts have increased significantly when compared to the last omnibus rate case. ... In fact, these 5-digit mailers would still pay less than they did in 1995, even after this rate increase. Mailers at the 3-digit Rate would pay only 0.1 cent more than they did in 1995.

Id. at V-40-V-41. (citation omitted.)

[5081] With respect to Clifton's alternative rollforward factor, the Service says Clifton's elasticity measure, on which he bases his assertion regarding the relationship between the growth in prebarcoding and the decline in unit costs, is flawed. It says:

> … this flaw becomes apparent when one observes that, within the FY 94 to FY 96 period, unit cost declined before the change in nonautomation share. This decline in the nonautomation share is the same in each year (about 6 percent…).

Id. at V-42-V-43. (citations omitted.)

[5082] Thus, the Service contends that witness Clifton did not look at the relationship between nonautomation share and mail processing unit labor costs prior to FY 1994, since he questioned the use of "old" data. *Id.* at V-43 (citing Tr. 24/12661). The Service further notes that Clifton conceded that the resulting elasticities would be very different from those he indicated. *Ibid.* (citing Tr. 24/12515). The Service also notes that witness Clifton agreed, upon cross-examination, that the Service's automation

program could have led to a decline in mail processing labor unit costs, but he did not explore that possibility. It notes that much of the automation equipment witness Moden describes was deployed between FY 90 and FY 95. *Ibid.*

[5083] With respect to the "Move Update" correction, the Service asserts that witness Clifton's analysis, which relies on witness MacHarg's estimate of 25 percent savings, is rebutted by Postal Service witness Murphy's demonstration that it is premature to draw any conclusions about the impact of "Move Update" requirements on the volumes of forwarded First-Class Mail in the test year. *Id.* at V-47. Moreover, the Service says that even if there were a 25 percent decline in forwarding of workshared mail, Clifton's estimate (of 0.262 cents per piece) is still an overstatement, since the source figures relate to both forwarding and return. *Ibid.* The Service contends that Murphy's testimony shows that "Move Update" requirements will have little impact on return-to-sender mail, which stems from bad addresses, not forwarding. *Ibid.* (citing Tr. 33/17707-713).

[5084] With respect to the selection of a benchmark, the Service says Clifton's contention that there is an insufficient volume history for adopting BMM "missed the point," since the benchmark represents a pricing reference point to identify appropriately worksharing savings and is not meant to imply that every piece is from the pool of bulk metered pieces. *Id.* at V-48.

[5085] The Service argues that analysis of Clifton's rates is further clouded by the approach he has taken in developing the revenue consequences of his increased discounts. Specifically, the Service says that because Clifton left flat rates and workshared card rates at current, rather than proposed rates, they are effectively part of his proposal. It says these unchanged rates affect the First-Class Mail rate relationships and, in turn, the forecasts for the rate categories Clifton addresses. The Service says this makes it difficult to isolate the financial impact of the proposal, but contends that the letter rate impact is a significant increase in the Standard A Mail cost coverage, from 167 percent to 177.5 percent. *Id.* at V-49. The Service also notes that Clifton's Appendix D

analysis presents Standard A rates that are uniformly 1.6 cents higher than proposed rates, and thereby more than doubles the rate increase for these mailers. *Ibid.*

[5086] *Standard A Mailers' Criticisms.* In rebuttal to Clifton's adjustments for declining unit attributable costs, MOAA et al. witness Andrew presents an analysis of the mix of mail categories. He contends that this shows that changes in the mail mix are the primary reason for the declining unit costs Clifton cites. Tr. 36/19693. Andrew also claims Clifton's rollforward adjustment is based on an inaccurate projection. Specifically, Andrew says the contention that cost changes have been driven by volume changes from nonautomation into automation is not supported. He notes that Clifton ties his rollforward adjustment to the assumption that declining unit costs for presort letters during FY1994-1996 will continue on a straight-line basis. He also assumes that volume mix changes during this same period will continue. *Id.* at 19690.

[5087] Witness Andrew also notes that the benefits of Clifton's proposed reduction accrue entirely to First-Class business mailers and not to single-piece First-Class. Moreover, he says Clifton's suggested cost coverage adjustments are based on inaccurate definition of cross subsidy and inappropriate contentions regarding the rate designs of First-Class and Standard A Mail. (This aspect of Clifton's proposal is discussed further in the context of the additional-ounce rate, where he also proposes adjusting cost coverages.)

(3) Commission Analysis

[5088] *Overall Approach to Worksharing Discounts.* As Fronk's testimony makes clear, the Service's development of First-Class worksharing proposals is influenced by its interest in promoting automation; in reaching agreement on an appropriate benchmark; in limiting measured costs to those related to the worksharing activity; and in relative discount relationships. The Commission finds that the record supports this approach, and its recommendations are largely an endorsement of the Service's approach to developing worksharing discounts. In particular, the Commission's

First-Class worksharing discounts reflect cooperation with the Service's interest in promoting an automated mailstream.

[5089] The Commission also commends the Service's move to a BMM benchmark, in conformance with the Commission's recommendation in MC95-1. Likewise, the dvelopment of fixed and proportional CRA adjustment factors, also recommended by the Commission in that same decision, is a decided improvement over the Service's MC95-1 presentation.

[5090] Recommended rates and discounts differ primarily because of a lower First-Class revenue burden and rejection of Bradley's proposed costing changes. The Commission accepts both the new benchmark the Service proposes and the type of costs included in the discount models. The Commission has fully considered, but rejected, retention of the single-piece benchmark, expansion of measured costs, and other adjustments to the prevailing methodology for calculating the discounts. It finds that none of these has been found appropriate on this record.

[5091] The Commission also recognizes the Service's interest in the importance of relative rate and discount relationships. Recommended rates and discounts are generally patterned on the Service's approach, although they more closely follow costs. In maintaining cost-based rate design, the Commission recommends retaining the 2.5 cent discount for Basic Presorted mail. This reflects a passthrough of 56 percent of the demonstrated cost savings. The Commission finds that the 2.0 cent discount proposed by the Service does not adequately recognize mailers' worksharing efforts.

[5092] *The Proposed New Benchmark*. The Commission accepts the Service's proposed use of BMM as the benchmark for calculating First-Class worksharing discounts. Fronk's use of BMM responds to the Commission's concern that the current benchmark — all nonpresorted single-piece mail — captures more costs than warranted. As Fronk notes:

> [n]onpresorted mail includes everything from 'clean' mail (uniform pieces featuring typewritten or pre-printed addresses and often mailed in bulk) to 'dirty' mail (pieces featuring handwritten and incorrect or incomplete

> addresses) and all the mail in between. Using all nonpresort letters as a benchmark results in a larger discount than using a benchmark which tends to have all the attributes of presort/automated mail, except for actual presortation or application of the barcode.

USPS-T-32 at 19.

[5093] The Commission has considered witness Clifton's objections to adopting BMM as the benchmark. One reason he cites for retaining the single-piece benchmark is that the errors and confusion associated with the Service's attempted introduction have rendered it unreliable. Clifton notes, for example, Fronk's acknowledgment that the Service's proposed worksharing rates may have been different if accurate unit costs for BMM had been available when he developed his proposal. Tr. 24/12487. Clifton also asserts that the BMM unit delivery cost is arbitrary because the Service does not quantify the actual unit delivery cost, but instead uses the unit delivery cost of non-automation presorted First-Class Mail as a proxy. He contends that this proxy is inappropriate, since BMM is not presorted. *Id.* at 12488.

[5094] Clifton also asserts that there is not enough volume history in BMM to test the premise that this is the mail most likely to convert to worksharing categories and, due to the small volume in BMM and its use primarily by small businesses, it is not the mail most likely to migrate. *Id.* at 12488.

[5095] The Commission finds that Clifton's criticisms do not justify retention of the single-piece as the benchmark.[15] The error in the BMM estimate Fronk originally provided — and used in the development of the discounts — generates confusion and some uncertainty over specific recommendations, but does not alter the validity of using BMM as a benchmark or preclude the Commission from using revised data. Both Fronk and the Service have clarified the impact correction — this error would have had on the initial proposals.[16]

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[15] The Commission notes that MOAA et al. witness Andrew, in the course of his broader testimony, criticizes Clifton's retention of the single-piece benchmark.

[5096] Clifton's arguments suggesting that Fronk has used an inappropriate proxy for one of the elements of the new benchmark — unit delivery costs — also are not well-founded. The Commission believes that quantifying actual delivery costs would be an improvement, but the Service's use of a proxy, in the absence of available data, is reasonable. Although the use of non-automated presort First-Class mail may not be an ideal proxy, the Commission finds it acceptable in this proceeding.

[5097] The Commission also disagrees with witness Clifton's assertion that the use of BMM by small businesses indicates it is unlikely to convert to a worksharing category. In the Commission's view, the fact that BMM is prepared by businesses rather than households increases the likelihood that it may migrate to worksharing categories. In particular, the Commission notes that this mail may be given to presort bureaus for processing.

[5098] In recommending the adoption of BMM as the benchmark, the Commission notes some concern over the narrow difference in the mail processing unit cost of single-piece and BMM (14.10 cents versus 12.58 cents).[17] Both the Service and MMA witness Bentley suggest that this result may be due to the increased number of "FIM" letters in the single-piece mailstream, given certain mail preparation requirements that have been imposed since reclassification. *See, e.g.,* Postal Service Response to P.O. Information Request No. 5, Question 19 (Tr. 14/7519-23). This may be a plausible explanation; however, the Commission urges the Service to review the methodology and underlying assumptions used in calculating BMM unit costs.

[5099] *Worksharing Discounts: Measured Costs.* Fronk limits measured costs to unit mail processing and delivery costs. Witnesses for both ABA/EEI/NAPM and NAPM propose express recognition of "Move Update" and other costs. Witness Clifton affirmatively adjusts costs to include 0.023 cents, based on NAPM witness MacHarg's

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[16] The Service also notes, on brief, that because of the revision to the benchmark, the MMA rate recommendation to increase the Basic Automation letters discount deserves attention. Postal Service Brief at V-51.

[17] Under the Commission's mail processing cost attribution methodology.

proposal that up to 25 percent of the savings should be included. MMA witness Bentley also notes that the estimated costs may be understated by the omission of these types of activities, but he does not propose a specific adjustment.

[5100] On this record, the Commission does not accept intervenors' assertions that the measured costs should include the costs of compliance, such as those associated with "Move Update" requirements and the insertion of prebarcoded "FIM" pieces in outgoing bulk mailings. In particular, the Commission finds that Postal Service witness Murphy provides convincing reasons why the "Move Update" estimates provided on this record may be both overstated and premature, given implementation delays and extensions.

[5101] Similarly, the Commission does not recommend Clifton's two more indirect "corrections" to costs. As the record shows, one of these adjustments is based on a rollforward analysis that uses historical CRA data, rather than a forecast of future costs. MOAA et al. witness Andrew's testimony demonstrates that these data reflect large shifts in the mail mix for presort categories. Given the inability to determine what is driving the cost decrease, it is not clear this trend will continue. Moreover, the CRA breakdown is between single-piece mail and all presort mail. Thus, it reflects the cost characteristics, whether or not they are related to the worksharing activity.

[5102] The Commission's acceptance of the use of MODS cost pools renders witness Bentley's worksharing approach obsolete. As a practical matter, the Commission notes that its recommendations, albeit based on a different set of underlying elements, are close to the absolute amounts Bentley recommended.

[5103] *Worksharing Discounts: Elimination of Heavyweight Deduction.* The Commission has considered the reasons the Service advances for eliminating the heavyweight deduction. On balance, it concludes that it is premature to recommend the requested change. First, although the differential between the first-ounce rate and the additional-ounce rate has increased since the discount was initially introduced, lack of cost data on the processing of additional ounces continues to impede analysis. Thus, a larger differential is not a sufficient reason to eliminate the discount. The fact that letters

now constitute a substantial number of the pieces eligible for the discount is of more significance, given that discussion at the time the discount was introduced focused on flats. However, letters were never excluded from eligibility. Even if the share of letters is growing, this is not a sufficient reason to eliminate the discount, since flats still constitute a significant portion of the relevant volume. Thus, the Commission finds that elimination of the discount at this time could conflict with planned improvements in the automation program. As NAPM witness MacHarg notes, the Service is improving its equipment in a way that will allow barcoded flats to be read. It appears counterproductive to eliminate the discount at this time. Finally, the Commission finds that simplifying the rate structure, which Fronk also cites as a reason for elimination, is not a material concern for worksharing mailers.

[5104] *Automation Flats: NAPM's Proposed Change in the Definition of the Automation Flats Presort Tiers.* The Commission has considered NAPM witness MacHarg's request for reconfiguration of the second presort tier in the Automation Flats category. NAPM, on brief, reiterates MacHarg's request. The Commission finds that there is essentially no evidence regarding the impact of the proposed change. Absent a clear indication of the impact this change would have on postal operations, the Commission does not recommend a change in current requirements.

[5105] The following table shows the recommended discounts and related passthroughs for First-Class letters and cards.

Table 5-6
Passthroughs for First-Class Workshared Letters and Cards at Commission Recommended Rates

Category	Discount	Unit Cost Savings	Passthrough
Letters			
Presorted	2.5	4.5	56%
Automation Basic	6.0	7.2	83%
Automation 3-Digit	0.9	0.9	100%
Automation 5-Digit	1.8	1.8	100%
Automation Carrier Route	0.5	0.5	100%
Cards			
Presort	2.0	4.0	50%
Automation Basic	1.4	1.9	74%
Automation 3-Digit	0.7	0.7	100%
Automation 5-Digit	1.3	1.3	100%
Automation Carrier Route	0.5	1.4	36%

(4) Additional-Ounce Rate Proposals

(a) Participants' Proposals

[5106] Both ABA/NAA and MMA oppose the Service's proposed retention of the 23-cent rate for additional ounces of workshared mail on grounds that it is not cost-justified. Each sponsors proposed reductions targeted at one or more discrete ounce-increments. ABA/NAA's proposal is restricted to workshared mail; MMA's proposal addresses single-piece mail as well.

[5107] *MMA's proposal.* MMA witness Bentley proposes reducing the additional-ounce rate for First-Class letters weighing in the second-ounce increment (those weighing more than one ounce). He asserts that the restriction to the second ounce (the first incremental ounce) meets the Commission's objections to his proposal in

the last proceeding, which extended to the third ounce as well. Bentley does not propose a specific rate, but estimates that postal revenues will be reduced by about $26 million for each penny that the second-ounce rate is reduced.[18] Tr. 21/11173.

[5108] Bentley cites four reasons in support of his proposal. One is that letters weighing up to two ounces can be successfully processed on the Service's automation equipment. Another is inconsistency with the Standard A rate structure, which offers a "flat" rate up to 3.3 ounces. A third is the Service's failure to provide new or updated studies on the cost of additional ounces. The fourth is inconsistency with the implicit assumption by the Service's costing witnesses that processing costs do not change if a letter weighs between one and two ounces. *Id.* at 11174-75 .

[5109] On brief, MMA reviews past Commission opinions addressing the additional ounce rate and several previous cost studies. MMA argues that it is time to begin moving the additional ounce rate closer to "the actual cost pattern" the Commission referred to in PRC Op. R94-1 and urges recommendation of Bentley's proposal as a conservative first step in that direction. MMA Brief at 17 (citation omitted).

[5110] *Clifton's Proposal.* ABA/NAA witness Clifton proposes reducing the additional-ounce rate for the second and third ounces of workshared First Class letters to 12 cents and maintaining this rate at its current level for the remaining ounces. Moreover, Clifton suggests that this reduction be funded by raising the cost coverage of Standard A Mail by 2.8 percent. He indicates that this is equivalent to a 0.4 cent per piece rate increase for all Standard A Mail, but makes no specific rate proposal. Tr. 21/10820.

[5111] In support of this proposal, Clifton contends that the current extra-ounce First-Class rate is not cost-justified. He reviews several existing analyses, which he says document that mail processing and delivery costs due to the second and third ounces of workshared mail are small. Clifton also asserts that "since the zero extra-ounce charge for the second- and third-ounce of Standard A is not cost-justified, the incremental

[18] Bentley does not propose a specific rate or identify how the associated revenue loss would be offset.

extra-ounce cost of this mail is creating an apparent cross-subsidy to Standard A Mail from other mail classes." *Ibid.* He cites a "gross disparity in unit contribution per piece between workshared First-Class Mail (18.04 cents) and Standard A regular and ECR combined (7.91 cents)", as well as "the difference in the cost coverage" between workshared First-Class (283.3 percent) and Standard A (174.2 percent). *Id.* at 10820-21.

(b) Rebuttal

[5112] *Standard A Mailers' Opposition to Witness Clifton's Proposals.* MOAA witness Andrew claims that Clifton's additional-ounce proposal is based on false claims of cross- subsidy, and that Clifton fails to provide economic tests for cross-subsidy. Andrew also asserts that Standard A costs and rates are not germane to the estimation of First-Class workshared costs and discounts. He contends that Clifton's proposed cost coverages fail to consider the higher level of service First Class receives and are not necessary. On brief, MOAA et al. reiterate witness Andrew's assessments, and further emphasize the potential harmful impact of his proposal on single-piece, First-Class Mail. MOAA et al. Brief at 36.

[5113] Witness Haldi, on behalf of Val-Pak Direct Marketing Systems, Inc. (VPDMS), Val-Pak Dealers' Association, Inc., (VPDA) and Carol Wright Promotions, Inc. (VP/CW), does not take issue with Clifton's contention that the 23-cent additional ounce rate in First-Class Mail seems generally high in relation to the Service's costs of handling extra weight. However, he challenges all of Clifton's economic arguments. Tr.32/17312 He maintains that Clifton fails to demonstrate that any part of Standard A Mail receives a subsidy, and acts in a "narrowly arbitrary fashion that lacks justification by singling out rate averaging within the first 3.3 ounces of Standard A Mail." *Ibid.* In particular, he challenges Clifton's assertion that a high implicit cost coverage is, per se, an indication of cross-subsidy to any other class mail and also challenges Clifton's assertion that any subclass of, or rate category within, Standard A Mail is currently being or will be

subsidized under the Service's proposed rates. *Id.* at 17301. In disputing Clifton's position that rate averaging within the first 3.3 ounces of Standard A Mail represents a subsidy from the second and third ounces of First-Class Mail, he says the correct test is a demonstration that some rates fail to cover incremental costs. *Id.* at 17300-301.

[5114] Moreover, Haldi contends that Clifton's proposal should be analyzed in a broader context, since its adoption would likely complicate or be a barrier to alternative changes the Commission might find equally or more desirable. *Id.* at 17306.[19] He specifically warns against "balkanization" of the additional-ounce rate structure and notes that Clifton acknowledges that under RFRA, an increase in the markup on commercial Standard A Mail would cause the markup on nonprofit Standard A Mail to increase in tandem (by one-half). *Id.* at 17300.

[5115] He also claims that the source Clifton cites as authority for his cross-subsidy claim is based on an example that is irrelevant. *Id.* at 17308-10. Haldi says that a high margin — or cost coverage in postal terms — is a good indication that the product is subsidy-free and does not "in any way" prove the existence of a cross-subsidy to some other product. *Id.* at 17309 (footnote omitted). Haldi also says that Clifton's definition of cross-subsidy — that Standard A workshared letters are charged zero cents for the second and third ounce, which is below the marginal cost of these extra ounces — "ignores totally the different rate designs of the two classes." *Id.* at 17310. He says: "In Standard A, rates are simply averaged over the first 3.3 ounces, while in First-Class rates are averaged over each ounce." *Ibid.* Also, Haldi says Clifton is "narrowly arbitrary" both with respect to singling out rate averaging under the breakpoint in Standard A and in singling out the rate for second and third ounces of First-Class Mail. Linking this reduction to a higher coverage for Standard A does not make it less arbitrary. *Id.* at 17312-13.

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[19] Haldi identifies a number of other ways of addressing the problem through alternative rate designs, but he indicates these are simply examples to prove his larger point, which is that the Commission needs to recognize that mailers of 2- and 3-ounce workshared letters are not the only ones disadvantaged by the 23 cent rate, if found excessively high. Tr. 32/17303-306.

[5116] Witness Crowder, on behalf of Advo, also asserts that Clifton's proposal to shift institutional cost from First-Class Presort to Standard A ECR should be rejected. In particular, she rebuts Clifton's criticisms of the Standard A weight cost study; disputes Clifton's claim that the Standard A rate structure below the 3.3 ounce breakpoint is not cost based; and argues that his contention that the Standard A rate structure results in a cross subsidy between Standard A Mail and First-Class Mail is frivolous. Like Haldi, she asserts that Clifton's estimated cross-subsidy bears no relation to accepted economic theory. Tr. 34/18318.

[5117] *The Service's Arguments on Brief.* On brief, the Postal Service argues that neither Clifton nor Bentley have provided a sufficient basis for deviating from "the sound practice of both the Postal Service and the Commission of maintaining a universal, uniform additional-ounce rate structure for all First-Class Mail pieces." Postal Service Brief at V-55. In addition, the Service says Clifton and Bentley have not presented any rationale for the Commission to reconsider its opinion about the establishment of an overly complex additional-ounce rate structure. *Id.* at V-55-V-61.

(c) Commission Analysis

[5118] In repeated Opinions, the Commission has urged the Postal Service and other parties to address the cost of processing additional ounces of First-Class Mail. *See, e.g.*, PRC Op. MC95-1, paras. 5112-5113. Regrettably, the Service has again failed to respond to this request. Instead, it simply notes in passing that in the absence of data, both the Commission and the Service have in the past relied on across-the-board attempts at increasing the differential between the first-ounce rate and the additional-ounce rate.

[5119] However, the alternatives offered by Clifton and Bentley on this record are not acceptable. The Commission agrees with the position, advanced by the Standard A mailers, that ABA/NAA witness Clifton's proposal is based on an incorrect definition of cross-subsidy and inappropriate conclusions about rate design disparities.

[5120] As witnesses Crowder, Haldi, and Andrew explain, the fact that the rate designs are different does not support a finding of cross-subsidy. Although the Commission has expressed concern over the relative cost coverage of both classes, it has established that there is no cross-subsidy between First-Class and Standard as that term is understood in our proceedings. This clearly precludes adopting Clifton's rationale. In addition, the fact that Clifton's alternative is restricted to bulk mailings is also problematic. To the extent relief is appropriate, consideration must be given to whether the rate for ounces of single-piece mail weighing more than one ounce also should be adjusted.

[5121] Despite indications of cost savings for mail, the Commission finds no reasonable basis, at this time, for restricting relief in the ways that have been proposed. However, the Commission finds that it is possible to provide some form of relief on this record. In the absence of reliable data, it recommends a reduction of one-cent per ounce across all incremental ounces. This reduces the rate to 22 cents per ounce. This provides a rate reduction for mail weighing over additional ounces and avoids the potential inequity of not extending the reduction to single-piece mail.

e. Reply Mail Classification Proposals: QBRM, PRM and CEM

(1) QBRM and PRM

[5122] In this proceeding, the Postal Service proposes two new rate categories of First-Class Mail for certain prebarcoded reply mail pieces. One is referred to as Qualified Business Reply Mail (QBRM); the other as Prepaid Reply Mail (PRM). Each is linked to a special postal service. QBRM is paired with traditional BRM service and incorporates its "guaranteed postage" feature. This allows pieces to be returned, without postage, pursuant to the distributor's promise to pay applicable postage and a per-piece service fee. The Service proposes QBRM on essentially the same terms that currently apply to BRMAS BRM distributors, and indicates it effectively replaces this fee category. Thus, as now occurs under BRMAS, the Postal Service will handle counting, rating, and billing

functions for QBRM distributors. USPS-T-32 at 45. Like distributors in the BRMAS category, QBRM distributors would pay a service fee (proposed at 6 cents) for each returned piece. Use of an advance deposit account will be mandatory, at a proposed annual fee of $300.

[5123] PRM, on the other hand, is tied to a new special service, which is also called PRM. This service requires postage to be paid prior to distribution, based on anticipated returns. *Id.* at 5. PRM assigns primary responsibility for related accounting functions (such as piece counts) to the distributor, subject to audit by the Postal Service. *Id.* at 39. Thus, each participating PRM recipient will need to maintain a certified, high-quality, easily-audited system for determining the amount of mail received. Tr. 4/1433. PRM distributors will be assessed a monthly fee of $1,000 to cover expenses related to the Service's auditing and administrative functions.[20] USPS-T-32 at 39.

[5124] Qualifying pieces in both QBRM and PRM are eligible for a 3-cent discount, for effective First-Class postage rates of 30 cents for letters and 18 cents for cards, relative to the Service's proposals in this case.[21] The proposed discount reflects a passthrough of about 75 percent of the Service's mail processing cost savings, compared to a handwritten "reply" piece.

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[20] Fronk says he expects that on approximately a weekly basis, the [Prepaid Reply Mail] account will be debited for the amount of postage the mailer is expected to owe for the week. He says the accounting fee will be debited monthly. USPS-T-32 at 40.

[21] In addition, eligibility for these categories requires compliance with other regulations, such as pre-approval of the pieces, pre-addressing to a Postal Service-designated ZIP Code, automation-compatibility, use of certain markings (indicia), and the placement and wording of certain endorsements. Fronk notes that the Service's PRM proposal does not involve discounts to individuals who apply their own barcodes.

[5125] The following table summarizes the per-piece rates, discounts, and service fees associated with the Service's two reply mail classification proposals.[22]

Table 5-7
Proposed Per-Piece Rates, Discounts and Service Fees

FCM Rate	Accounting Fee		Postage	QBRM/PRM Discount	Effective Postage	Service Fee	Effective (per piece)
QBRM	$300	Letters	33¢	3¢	30¢	6¢	36¢
	annually	Cards	21¢	3¢	18¢	6¢	24¢
PRM	$1000	Letters	33¢	3¢	30¢	None	30¢
	monthly	Cards	21¢	3¢	18¢	None	18¢

Source: Adapted from USPS-T-32 at 33-34 and 44-45.

[5126] *Impetus for the Proposals*. Witness Fronk says both classification proposals grow out of the Service's interest in allowing a broader base of customers to more directly share in the benefits of automation. Tr. 4/1412. However, he also indicates that PRM is a considered response — and preferred alternative — to the Commission's PRC Op. MC95-1 recommendation of the OCA's Courtesy Envelope Mail (CEM) proposal because of its operational feasibility.[23] Among other things, Fronk asserts that a recent survey shows consumer support for a PRM category based on its added convenience, its ability to generate goodwill for the distributor, and its potential for eliciting a quicker response. *See generally* USPS-T-32 at 38 (citing USPS LR H-200). Fronk also says the survey demonstrates that PRM has the potential to generate new volume by converting some in-person payments to the mail, but that three-quarters of the households now

[22] The Service also proposes that QBRM and PRM distributors pay an annual permit fee of $100, the same amount proposed for BRM users.

[23] CEM is the name given to a specific OCA proposal that would allow the mailer to affix discounted postage stamps to courtesy reply envelopes.

using electronic methods would not be likely to switch. He says this suggests that the convenience of PRM is more likely to forestall electronic diversion than reverse it. *Id.* at 39.

[5127] Fronk also suggests that PRM may offer distributors a competitive edge. Tr. 4/1537. However, he asserts: "An overriding factor in developing this [PRM] proposal is operational feasibility, that is, developing a processing and accounting approach that is workable for both mailers and the Postal Service." USPS-T-32 at 40. He states: "The Postal Service views alternatives using differently-rated postage stamps as infeasible. Consequently, it decided upon PRM as a means of addressing these purposes." Tr. 4/1536; 1561. Fronk contends:

> In comparison to other alternatives, Prepaid Reply Mail has the advantage of avoiding administrative and enforcement problems associated with what would happen if the general public were expected to use differently-rated stamps for its First-Class Mail correspondence and transactions.

USPS-T-32 at 6. (footnote omitted)

[5128] Fronk states that PRM is specifically targeted at high-volume users, such as utilities and credit card companies, but says that a choice between PRM and QBRM will depend on a number of factors, including a distributor's willingness to prepay postage and whether a monthly fee or a per-piece fee is more advantageous financially. *Id.* at 7.

[5129] *Volume Projections.* Witness Fronk says the Service expects QBRM and PRM, collectively, to account for up to nearly one billion prebarcoded reply mail pieces in the test year. This projection is based on two assumptions. One is that all BRMAS-eligible test-year volume (527.7 million pieces) will migrate to the new categories, with two-thirds in PRM and one-third in QBRM. *Id.* at 44. Fronk's allocation of total BRMAS volume between QBRM and PRM is based on a "breakeven" calculation comparing the volume needed to make the monthly PRM fee less expensive than the per-piece BRM fee. *Id.* at 43 (citing Workpaper III) and 46. His calculation shows that breakeven volume is 200,000 annually.

[5130] The other assumption is that up to 500 million courtesy reply pieces will convert to PRM. This estimate is based on Fronk's evaluation of Household Diary Study data, the Service's experience with mailer reaction following introduction of the barcode discount in the late 1980s, and an ad hoc adjustment "because of uncertainty" about how many pieces might switch from CRM to PRM. *Id.* at 44.

(2) The Proposed QBRM/PRM Discount

[5131] The proposed 3-cent discount for qualifying letters and cards is based on witness Miller's estimated mail processing cost avoidance of 4.016 cents for QBRM and PRM. *Id.* at 40 (citing USPS-T-23). Fronk asserts that the level of passthrough (about 75 percent) is consistent with past practice for new discounts; provides a hedge against attracting more volume from full-rated First-Class Mail than anticipated, thereby creating a larger-than-anticipated revenue impact; and better aligns rates with costs. *Ibid.*

[5132] Miller's study entails the development of cost models comparing the respective mail flows of a prebarcoded reply piece and a handwritten reply piece from collection to the point where each piece receives its first barcoded sortation on a barcode sorter (BCS). Miller testifies that a prebarcoded reply mail letter generates cost avoidance of 4.016 cents, compared to a handwritten letter.[24] The main cost differences between the two types of mail occur within the originating facility and are related to the fact that handwritten mail must be processed through the Remote Bar Coding System (RBCS) to obtain a barcode. USPS-T-23 at 1; 10-11. Miller states that this estimate can be applied to QBRM and PRM cards since, despite some differences in plant performance statistics, he would use the same benchmark (*i.e.,* a handwritten reply piece) and the same mail flow for prebarcoded pieces that would be used in a cost study focusing on cards. *Id.* at 11.

[5133] Miller says his use of a handwritten benchmark does not mean that prebarcoded reply mail will necessarily migrate from the handwritten reply mail stream,

[24] This estimate reflects a CRA adjustment to account for costs not captured in the models.

but "simply recognizes that the appropriate point of comparison for pre-approved, prebarcoded reply mail generated by reply mail recipients is handwritten mail that would be generated by households." *Id.* at 5. He asserts:

> When customers use pre-approved, prebarcoded reply pieces provided by businesses or other entities, the Postal Service avoids mail processing costs. If no reply mail pieces are provided, households must generate mail pieces that are not postal-certified.

Id. at 2 (footnote omitted).

(3) The QBRM Per-Piece Service Fee

[5134] The proposed 6-cent QBRM service fee is based on a small markup over Postal Service witness Schenk's estimate of 5.54 cents as the test-year cost of counting, rating, and billing for QBRM pieces. Schenk develops this estimate in a special study, which also addresses the costs underlying other reply mail fees. *See generally* USPS-T-27 (including Exhibit USPS-27C) and USPS-LR-H-179. Schenk's study focuses on operations at the destination office, where BRM is held out from the Incoming Primary operation and sent to either the BRMAS operation or to a manual sortation operation. USPS-T-27 at 4.

[5135] Schenk says BRMAS Survey data show the following breakout for secondary sorts for BRMAS pieces: 14.2 percent in a BRMAS operation; 19.3 percent on other barcode sorters, and 66.5 percent sorted manually.[25] She calculates the weighted average cost as the total volume-variable cost for a QBRM/BRMAS piece sorted in two of these operations: the "BRMAS sort" on equipment with BRMAS software and a manual sort. She does not incorporate "other barcode sorter" processing because data are unavailable; instead, she assumes these pieces are manually sorted. *Id.* at 12.

[25] Schenk describes this survey, which took place at five sites over a two-week period in April and May of 1997, at USPS-T-27, Appendix A.

Schenk then adjusts this cost for projected migration to PRM (which reduces the BRMAS operations proportion to 5.87 percent) and for processing costs that BRMAS-sorted pieces avoid. *Id.* at 13 (citing USPS-T-25).

(4) Accounting Fees

[5136] Both QBRM and PRM entail an accounting fee but, given the conceptual differences in each category's corresponding special service, the purpose and activities covered by each differ. Witness Fronk provides the cost support for the PRM fee; witness Schenk provides cost support for the QBRM accounting fee.

[5137] The QBRM accounting fee covers the workload associated with the administration of advance deposit accounts, such as initial setup, determining whether adequate funds are on deposit to cover charges on anticipated returns, notifying the mailer of inadequate funds, and deducting charges from the account. USPS-T-27 at 7. The current annual charge for using an advance deposit account is $205. Witness Needham proposes raising this by $95, to $300, based on witness Schenk's finding that the underlying costs are $276.93.

[5138] Witness Fronk says the PRM accounting fee of $1,000 per month will recover the administrative and auditing costs associated with verifying that mailer-supplied piece counts are correct. USPS-T-32 at 41. He indicates the auditing approach will be modeled after those currently in use for outbound manifests, which generally involve postal personnel at EAS grades 18 and 21. The fee is based on Fronk's calculation of an average hourly salary cost of $51.73 and travel. *Ibid.* He says:

> The Postal Service estimates that to establish a PRM 'system' would involve 14 person-days during the first year at a labor cost of about $5,800. Needed travel costs would be extra. Once established, the Postal Service anticipates that 10 person days would be involved annually at a labor cost of about $4,100. Again, needed travel would be additional.

Ibid. (footnotes omitted).

[5139] Fronk says the fee is sufficient to cover estimated costs and provides a hedge against uncertainty surrounding the administration of any new postal service and the cost estimates. He also says it allows the Service an opportunity to adjust operationally to the new service and to develop expertise and administrative controls while setting up and overseeing a manageable number of PRM accounts.[26] *Id.* at 42.

(5) Consistency of the QBRM/PRM Proposals With Statutory Classification Criteria

[5140] Fronk concludes that QBRM and PRM are consistent with applicable statutory rate and classification criteria. He states that both PRM and QBRM promote fairness and equity considerations by establishing rates that are more closely aligned with costs. *Id.* at 47. Moreover, he says that by recognizing some of the cost savings associated with this mail, the Service is able to permit a broader base of customers to more directly share in the benefits of automation. *Id.* at 47-48.

[5141] Similarly, witness Needham finds that the proposed 6-cent QBRM fee is consistent with the statute. In discussing the effect of the proposed QBRM service fee increase on users (criterion 4), witness Needham asserts that "the magnitude of a 200 percent increase was not considered in isolation, but instead as part of the total postage and fee increase." USPS-T-39 at 18. In this regard, she asserts that since BRMAS BRM is available only in conjunction with First-Class or Priority Mail, it is unreasonable to isolate the fee when considering this statutory factor. *Ibid.* She notes that the related QBRM fee is 30 cents, which is three cents lower than the Service's proposed First-Class Mail first-ounce rate. Thus, she says that when the proposed QBRM fee is added to the proposed postage rate, the result is 36 cents (2 cents more than the current 34-cent total BRMAS BRM mailers are now paying), or a real increase of 6 percent. With respect to criterion 5, Needham further says the impact of QBRM's combined rate and

[26] Fronk indicates that the Service may be able to lower this fee in the future.

fee is mitigated because PRM is proposed in this proceeding as a “lower-priced alternative” to BRMAS BRM for many current customers. *Id.* at 19.

(6) Participants’ Positions on QBRM

[5142] QBRM, as a matter of classification, is unopposed on this evidentiary record. To the extent it has been discussed, interest has focused on the service fee. The Magazine Publishers Association (MPA), through witness Glick, proposes reducing the per-piece service fee from 6 cents to 2 cents. MPA Brief at 2-3. In support of his proposal, Glick contends that Schenk’s analysis includes two inappropriate assumptions about test-year mail processing and fails to take BRM’s delivery profile into consideration. Tr. 27/15000. One of the challenged assumptions is that the test-year migration from BRMAS to PRM consists entirely of pieces processed in a BRMAS operation in the base year. Glick contends this is contrary to an interrogatory response, wherein Schenk says that interest in QBRM or PRM will depend on a number of factors, including willingness to prepay postage and whether a per-piece fee or a monthly fee is more advantageous financially. *Ibid.*

[5143] The other disputed assumption is that all BRMAS mail not processed in the BRMAS operation is processed manually. *Ibid.* Glick says this means:

> Even though the unit cost for a manual sort of First-Class Mail is 4.7 cents higher than the cost per sort for sorting First-Class Mail on a barcode sorter, witness Schenk approximated the cost for sorting Advance Deposit BRM on a barcode sorter (including Postage Due Unit activities) as the cost for manually sorting Advance Deposit BRM (including Postage Due Unit activities).

Ibid. (footnote omitted).

Glick says Schenk acknowledges that she made this assumption because she did not have an estimate of the cost of a barcode sort for QBRM, and that she agrees it would be

appropriate to include the cost of processing BRM in a barcode sorter operation, if costs could be developed. *Ibid.*

[5144] Glick says that in the absence of a "bottom-up estimate" of the cost for sorting Advance Deposit BRM on a barcode sorter and performing all associated Postage Due Unit activities, he develops "a more reasonable" upper-bound estimate of the cost of an automated sort of Advance Deposit BRM by subtracting 4.7 cents — the cost difference between a manual sort and a barcode sort of First-Class Mail — from the cost for manually sorting Advance Deposit BRM. He says this yields a unit cost for a barcode sort of Advance Deposit BRM of 3.56 cents. *Id.* at 15001.

[5145] Glick considers this an upper-bound estimate for two reasons: the depth of sort for a barcode sorter is deeper than the depth of sort of a manual sort, and the estimate assumes that there is only one incoming secondary sort of BRM. He says that if two sorts were required, the cost difference between manual sorting and automated sorting would be "twice as large." *Ibid.*

[5146] In support of his contention that delivery costs should be considered, Glick notes that witness Schenk provides data showing that only 25 percent of BRM, as opposed to 66 percent of First-Class Mail, requires rural or city delivery. For this reason, the BRM delivery cost per piece is smaller than that for First-Class Mail as a whole. Glick calculates a 2.74 cent unit delivery cost difference. *Ibid.*

[5147] Based on these considerations, Glick says it would be more reasonable to assume that test year mail flows will be the same as base year flows. Using this assumption and the delivery cost avoidance he has calculated, he calculates the test year attributable cost difference as 1.28 cents. He says that a 2-cent fee, based on his estimate, yields a cost coverage of 156 percent. He notes that this cost coverage is considerably higher than Needham's proposed cost coverage of 108 percent, and therefore his proposal is reasonable. *Id.* at 15007.

[5148] *Participants' Positions on Brief.* On brief, MPA reviews Glick's analysis. MPA Brief at 2-3. MPA also raises a concern about the potential consequences of a Commission decision not to recommend PRM. Specifically, it says that if this occurs, the

3-cent discount for QBRM should still be recommended. Otherwise, it says the QBRM service fee could be added to the proposed 33-cent First-Class rate, which it notes is a result "not intended or desired by any party to this proceeding." *Id.* at 3. Brooklyn Union also contends that if PRM is not implemented, the existing BRMAS BRM service fee of 2 cents should be retained. Brooklyn Union Brief at 14-16.

(7) Participants' Positions on PRM

[5149] Two participants — Brooklyn Union and the OCA — sponsor witnesses who address PRM. APWU and the Coalition of Mailers Who Provide Courtesy Reply Envelopes (the CRM Coalition) address PRM exclusively on brief. [27]

[5150] *Brooklyn Union Witness Bentley's Proposed Revisions to PRM.* Brooklyn Union witness Bentley supports PRM, but proposes two major revisions. One change eliminates the "prepayment" requirement; the other requires PRM pieces to be addressed to a post office box. In support of his position, Bentley says: "[T]here is no question that the PRM concept provides a rate that appropriately and more closely reflects the actual costs of processing such mail." Tr. 21/11080-81. Moreover, he says: "Brooklyn Union . . . endorses the mailer pre-certification program for determining postage due as well as the $1,000 per month fee to reflect the auditing of accounting procedures performed by the reply mail recipient. *Id.* at 11081. With respect to prepayment, Bentley says: " . . . Mr. Fronk has not explained why postage must be 'prepaid' through what appears to be an elaborate additional accounting procedure." *Id.* at 11089. He contends: "The prepayment requirement appears to conceptually and administratively complicate the role of the new rate category when, in fact, no such complication is needed. PRM is simply QBRM received in bulk where the recipient

[27] The CRM Coalition consists of the American Bankers Association, American Financial Services Association, Direct Marketing Association, Mail Order Association of America (MOAA), Major Mailers Association, National [Postal] Policy Council, and National Retail Federation. With the exception of MOAA, members of the CRM Coalition are signatories, along with other businesses, to a January 16, 1998 letter addressed to Chairman Winters and the Postal Service Board of Governors. *See* USPS-LR-H-342. The letter notes the signatories opposition to PRM and asks that it be withdrawn.

performs all the accounting and billing functions normally performed by the Postal Service." *Ibid.* He says:

> While I recognize there is a theoretical difference in having the recipient receive the PRM mail before postage is actually determined and paid, there is no practical reason to create a new, complicated accounting procedure to accommodate this theoretical difference. Instead, a far more workable requirement would be one that sets a minimum account balance that must be on deposit before the recipient takes delivery of the day's reply mail pieces.

Id. at 11090.

Bentley suggests using the BRMAS BRM advance deposit accounting system as a model noting, among other things, that the Service's analysis indicates that most of the PRM reply mail volume will come from mailers who migrate to PRM service from BRMAS BRM.[28] *Id.* at 11091.

[5151] Bentley also proposes requiring all PRM/BARM pieces to be addressed to a post office box. He says: "[R]eply mail … is almost always addressed to a post office box. Since such mail by definition avoids the carrier delivery system, these additional savings can be safeguarded if such a requirement is implemented." *Id.* at 11082.

[5152] Bentley says another advantage of requiring reply mail to be delivered in large volumes relates to the operational feasibility and administrative efficiency of the PRM program. *Id.* at 11085. He notes that PRM is "limited by design to a subset of the reply mail universe" and therefore generates reply letters that are efficiently processed at low cost and achieve even greater efficiencies for the system because they are received in bulk quantities. *Id.* at 11086.

[5153] *OCA.* OCA witness Willette criticizes PRM, but asserts that she does not oppose it. Instead, she proposes CEM as a "third option," and indicates that her criticism is directed at showing its superiority relative to PRM. *Id.* at 10695-96. Willette's

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[28] Given this proposal, Bentley also proposes that the name be changed to "Bulk Automated Reply Mail" ("BARM").

criticisms include contentions that PRM conversion is more likely to be zero than the 500 million pieces Fronk has estimated; that the prepayment mechanism is complicated, and that PRM requires more enforcement efforts than CEM.[29]

[5154] *APWU.* The American Postal Workers Union (APWU) supports PRM, without change. Noting arguments about the expense of participating in PRM, APWU says market forces should dictate whether a distributor participates in PRM. APWU Brief at 9-11.

[5155] *The CRM Coalition.* The CRM Coalition asserts that PRM is technically and financially impractical. It urges the Commission to defer action on PRM and to direct the Service to form a task force to examine "sensible" alternatives.[30] CRM Coalition Brief at 1. In support of its position, the CRM Coalition notes criticisms in the Service's market survey of businesses (USPS-LR-H-226). *Id.* at 1-2 (citing USPS-T-32 at 42-43). It also asserts that PRM has a number of alleged defects that are so profound that they create "an administrative nightmare." *Id.* at 2.

[5156] The CRM Coalition points to the impracticality of recouping prepaid mailing expense from bill-paying customers, and further notes that some regulated businesses might be precluded from doing so. It also says other companies in highly competitive industries might face similar problems in trying to pass along the expense. *Id.* at 4. The CRM Coalition also cites a potential for more complicated customer relations and expense. It contends that only the very largest businesses could hope to afford these administrative expenses. *Id.* at 2-3. It further claims that many large businesses "could not participate" in PRM and would have to opt out of providing courtesy envelopes.

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[29] However, Willette notes: "If zero volume of CRM pieces converts to PRM, then the Postal Service will have unanticipated revenues of $1.5 million ($0.03 x 500 million pieces). This would offset the CEM revenue loss." Tr. 21/10695.

[30] In connection with this suggestion, the CRM Coalition says notwithstanding the failures of the current PRM proposal, the concept of consumer discounts for reply mail warrants serious consideration, perhaps in an experimental service case, but asserts that the best consumer policy is one that holds down the cost of future rate cases to a level below the rate of inflation and thereby effectively reduces rates in real dollars for all. CRM Coalition Brief at 6.

[5157] Moreover, the CRM Coalition says smaller businesses could not afford to participate in PRM because of the high monthly fees and "density requirements." *Id.* at 3. It warns that although the PRM proposal is pushed as a benefit to consumers, it can have "the opposite result." *Id.* at 4. It contends that if businesses have to incur the "tremendous expense" PRM entails, they ultimately would face losses or decreased profits that would weaken their ability to provide better service at reduced prices. *Id.* at 4-5. It argues that this could cost individual consumers "far more" than the few dollars PRM might save them yearly. *Id.* at 5. In addition, the CRM Coalition argues that by "changing the economics of bill paying by remittance mail," PRM would accelerate business's efforts to divert mail to increasingly attractive electronic alternatives. *Ibid.* For the same reasons, it says PRM would accelerate the drive toward consolidation of remittance payments, "sapping postal revenues." *Ibid.* Finally, the CRM Coalition says that if the Commission recommends adoption of both CEM and PRM, the Governors are likely to put PRM into effect and block CEM, thus "killing CEM's chances forever." *Id.* at 5-6.

(8) The OCA's CEM Proposal

[5158] *OCA's Renewal of CEM Proposal.* The OCA, through witness Willette, renews and refines the Courtesy Envelope Mail (CEM) proposals it has presented in previous proceedings. Willette seeks a 3-cent discount for qualifying pieces, based on the cost study underlying the Service's proposed QBRM and PRM categories. *See generally* Tr. 21/10679 et seq.[31] On brief, the OCA argues that the record supports a 4-cent discount. OCA Brief at 45.

[5159] Willette describes CEM as automation-compatible, pre-approved courtesy reply envelopes that bear a facing identification mark (FIM); a proper ZIP Code; and indicia signifying eligibility for the discount. Tr. 21 at 10683. Her proposal does not extend to cards. *Ibid.*, footnote 1. A key element of the OCA's instant proposal, like its

[31] In Appendix A of her testimony, witness Willette provides a summary of the history of CEM proposals. Tr. 21/10716-10730.

predecessors, is that the consumer affixes a Postal Service-issued stamp in a denomination reflecting the QBRM/PRM discount.[32]

[5160] Willette positions CEM as another reply mail alternative and not as a substitute for the Service's proposed QBRM/PRM offerings. She says: "Rather, the CEM proposal enhances the Postal Service proposal by giving providers a third choice, one in which they can gain good will with customers by taking the trouble to provide certified CEM envelopes that will give their customers the opportunity to use discounted CEM stamps." *Id.* at 10695.

[5161] Willette asserts that CEM is "a simple concept" and asserts that implementation and enforcement can be accomplished without significant effort. *Id.* at 10688. For example, she says a distributor can "transform" a courtesy reply envelope into a CEM piece by signifying on the piece that the consumer can choose to apply a CEM stamp. *Id.* at 10688-89. Businesses will incur the same or substantially the same costs to distribute CEM or courtesy reply mail. *Id.* at 10690.

[5162] Willette evaluates CEM in terms of the Postal Service's stated objectives in this case and its consistency with the Postal Reorganization Act. She concludes that CEM will not only advance the Service's stated objectives, but do so in a way "vastly superior" to PRM. *Id.* at 10696. She notes, among other things, that the Service "seems to have introduced PRM" as a response to the Commission's CEM recommendation in Docket No. MC95-1. She says the two services have substantially similar goals, noting that a "primary concern" of the Service in this proceeding is the threat of electronic diversion. She says CEM also addresses the threat of electronic diversion by providing consumers a convenient, but less expensive, way to return bill payments by mail. *Id.* at 10697. Willette also says a similar goal is encouraging the use of automation-compatible mail, and notes the Service has agreed that the cost avoidance for CRM pieces is the same as the that of PRM pieces. *Ibid.* She asserts that this will allow consumers who

[32] No consumer fees are associated with CEM. Willette provides DMCS language for the OCA's proposal in Section V of her testimony. Tr. 21/10715.

return CEM mail to share directly in the benefits of automation by paying a discounted rate. *Ibid.*

[5163] Willette claims that CEM is superior to PRM in terms of operational feasibility because it is less complicated. *Ibid.* In particular, she notes that CEM distributors must already present automation-compatible pieces, so they would only have to further ensure that the CEM return envelope bears an appropriate stamp indicator. *Id.* at 10697-98. She also asserts that PRM's accounting mechanism will not be needed for CEM; instead, the Service will only have to verify that CEM distributors' return envelopes are appropriately barcoded, "a task that can be done by quick inspection." *Id.* at 10698. In contrast, she contends that PRM inspection costs "appear to be substantial." *Ibid.* Another operational advantage CEM holds over PRM, according to Willette, is that CEM avoids the difficulties of converting from CRM to PRM, since it requires only "slightly altered envelopes." *Id.* at 10705. More importantly, Willette says CEM does not require business mailers to absorb the postage costs of the consumers' return pieces. *Ibid.*

[5164] Willette also criticizes the "thinness" of the CRM conversion estimates; contends that three businesses now using BRM gave "mixed reviews" to the idea of PRM generating faster remittances in response to a business survey the Service conducted; and questions whether PRM will generate goodwill. *Id.* at 10707-708.

(9) Participants' Positions on CEM

[5165] APWU agrees that CEM has some merit, but considers the "two denomination" feature a major disadvantage. APWU Brief at 10-11. It advises the Commission not to substitute the OCA's proposal for PRM. *Id.* at 12. The Postal Service opposes CEM and sponsors four rebuttal witnesses. Witness Ellard (USPS-RT-14) describes a consumer survey the Service conducted in response to the OCA's proposal and its ramifications on the OCA's arguments in favor of its position. Witness Steidtmann (USPS-RT-15) discusses retail pricing trends. He concludes that the OCA's proposal is inconsistent with a prevailing trend toward retail simplicity. Witness Sheehan

(USPS-RT-16) alleges that CEM is inconsistent with the Service's processing technology; challenges witness Willette's estimate of the expenses associated with a public education program; and explains enforcement concerns. Witness Miller (USPS-RT-17) discusses CEM implementation issues, such as public confusion; problems businesses might encounter; and additional Postal Service administration concerns. He also addresses revenue concerns and fairness issues.

(10) Commission Analysis

[5166] Based on an evaluation of the evidentiary record, the Commission recommends both QBRM and PRM as proposed by the Postal Service. The Commission recommends a 3-cent discount for letters in both categories, based on a finding that there is evidence of some savings in both mail processing and delivery. It recommends a 2-cent discount for cards. In line with this recommendation, the Commission recommends PRM's corresponding special service and the proposed conforming editorial changes in the DMCS.

[5167] The Commission recommends a 5-cent QBRM service fee in lieu of the 6-cent fee proposed by the Postal Service. Other related fees, for both QBRM and PRM, are recommended as proposed by the Postal Service.[33]

[5168] The Commission also recommends CEM as a "shell" classification.

[5169] These recommendations, as a whole, are based primarily on the Commission's agreement with and support of the Service's interest in expanding the availability of benefits from prebarcoding savings. However, the Commission finds that the record shows that PRM is not a "preferred alternative" to CEM in all respects. It provides only an extremely limited — and indirect — opportunity for consumers to share in prebarcoding savings. In fact, the record shows that PRM holds more promise as a first step in redressing significant problems with the Service's administration of the

[33] These fees (other than the QBRM service fee) were unopposed on this record.

BRMAS program than as a consumer-oriented initiative. An assessment of each proposal follows.

[5170] *QBRM.* The Commission finds that QBRM, unopposed as a matter of classification on this evidentiary record, is an appropriate response to longstanding concerns that certain BRM distributors have not been given an opportunity to obtain a discount recognizing the costs that pre-approved, prebarcoded pieces save the Postal Service. The Commission welcomes the Service's attention to rectifying this situation. It finds, as did witness Fronk, that this proposal is consistent with applicable statutory classification criteria.

[5171] This favorable classification development is overshadowed by the increase the Service has proposed in the service fee associated with the use of this category. Disappointingly, the Service's own costing testimony indicates the source of this increase is substantial disarray in management of the BRMAS program. Witness Schenk notes, for example, that only 14 percent of BRMAS-qualified pieces were processed with BRMAS software. The BRM Survey underlying Schenk's cost study reveals information that should be of considerable concern to the Service and to participating mailers. Among other things, the Survey indicates that facilities report problems with BRMAS software, unavailability of software, or overburdened equipment.

[5172] *The QBRM Service Fee.* Although the Commission agrees that establishment of QBRM is fair and equitable, it finds that the proposed 6-cent fee is not justified. The Commission recommends a service fee of 5 cents. The Commission acknowledges this appears to represent a substantial absolute increase in the fee, but in combination with the proposed discount, QBRM distributors face a net increase of one cent over current charges. The Commission urges the Service to address aspects of its operations that have contributed to the service fee increase.

[5173] The recommended fee is based on the Commission's acceptance of two of the three major elements of witness Glick's cost analysis, adjusted for the Commission's costing methodology. The Commission accepts Glick's adjustment for the processing of BRMAS on "other barcode sorters." The Commission agrees that a portion of the pieces

not counted in BRMAS operations are counted in an automated operation, at substantially less cost than manual operations. The Service contends that this mail must still be billed and rated manually, but it is not clear that these activities account for much of the cost.

[5174] The Commission also accepts witness Glick's contention that witness Schenk's reduction in the BRMAS coverage from 14.2 percent to 5.9 is faulty. The Service's estimate of the volume of BRMAS pieces that will migrate to PRM is based solely on a breakeven analysis comparing QBRM's per-piece service fee to PRM's monthly accounting fee. Fronk agreed that there are other reasons that could influence a distributor's choice. The cost of in-house counting, the obstacles to recovering postage from customers, and the prepayment feature itself may inhibit migration to PRM. In the absence of a more comprehensive migration estimate, the Commission finds that the coverage factor resulting from the Service's BRM operations study should not be altered.

[5175] However, the Commission agrees with the Postal Service that another element of Glick's analysis — delivery cost savings — should not be included in the service fee calculation. To the extent these costs can be reliably identified with QBRM pieces, the Commission considers them more appropriately associated with the classification discount. PRC Library Reference 10 contains a description of the Commission's fee development.

[5176] The Commission's recommended discounts are 3 cents for letters and 2 cents for cards.[34] The recommended annual QBRM permit fee and advance deposit account fee are $100 and $300, respectively.

[5177] *PRM.* The desirability of PRM as a new classification is not as obvious as QBRM. First, although offered as a response to CEM, it ignores that the longstanding rationale for CEM has been the *direct* savings it offers to consumers. PRM, at best, provides an indirect consumer benefit. Thus, it is clearly not on the same footing as CEM.

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[34] Miller's mail processing cost savings were developed from an analysis of letter costs. The smaller discount for cards reflects the lower processing costs for cards vis-a-vis letters.

[5178] Second, the prepayment mechanism is not only cumbersome, as Brooklyn Union witness Bentley contends, but also appears contrived. Many of the distributors the Service expects to attract to PRM are already users of advance deposit accounts. To the extent revenue protection is a concern with respect to these mailers, it would appear the Service has had ample opportunity to resolve them. Thus, it appears PRM is more "operationally feasible," primarily because of its revenue protection features relative to CEM, and not because it addresses the serious inefficiencies associated with the Service's in-house automated BRM counting, rating, and billing activities.

[5179] However, to the extent it attracts participation, PRM will succeed in extending the savings associated with prebarcoding, which is a goal the Service and the Commission share. The fact that it will be left to the distributor to determine whether, and how, consumers save postage is not a reason to refuse the establishment of this new classification. Instead, this shows that CEM should be considered as a third option.

[5180] MMA witness Bentley's proposal — which would allow mailers to handle bookkeeping activities — provides a pragmatic solution to the serious inefficiencies in the Service's automated system for counting, rating, and billing. However, the record shows that the Service did not primarily offer PRM for this purpose. Therefore, notwithstanding reservations about the efficacy of the prepayment mechanism, the Commission defers to the Service's request that PRM be recommended on the terms it has proposed. However, the Commission believes that MMA's proposal has considerable merit, and it urges the Service to consider it as a future refinement.

[5181] The CRM Coalition's arguments against PRM rest on allegations that PRM will impose severe, and costly, administrative consequences on a wide range of businesses. However, no formal record evidence supports conclusions along the lines the CRM Coalition urges. In fact, Brooklyn Union, which is a utility with a large consumer base, indicates it is prepared to participate in PRM. Moreover, the CRM Coalition's arguments overlook the fact that PRM is voluntary.

[5182] The Commission recommends the proposed monthly PRM fee of $1,000 and the annual permit fee of $100. It agrees with the Service's assessment that both fees are consistent with applicable statutory criteria.

[5183] *CEM.* CEM, like PRM, is a closer classification question than QBRM. The Commission agrees with the Service that consideration of CEM must focus not only on convenience, price, and consumer's freedom to choose, but issues such as implementation costs, fairness and equity, and revenue consequences. As discussed below, the Commission finds, on balance, that CEM withstands most of the arguments the Service raises in opposition to its establishment. Therefore, the Commission recommends CEM as a "shell" classification. As noted below, the Commission's recommendations allow approximately $33 million for educational efforts related to CEM.

[5184] *The Service's New Consumer Research.* The Service contends that the consumer research described by witness Ellard demonstrates "overwhelming consumer support for retention of the current 'one-stamp' postage system for basic First-Class Mail letters, …" and rejection of the OCA's proposed 3-cent discount for CEM.[35] Postal Service Reply Brief at V-24. It argues that it is "uncontested" that CEM is less preferred than the current one-stamp system for the general mailing public. It also contends there is record evidence that household mailers, in their bill payment transactions, do not place as high a value on price as they do on convenience. *Id.* at V-31. Moreover, the Service also argues that paying an "average" price is no different than paying a higher price for roughly half of one's mail and a lower price for the remaining half so, contrary to witness Willette's testimony, 'lower prices' are not really a benefit of CEM because, one way or another, a higher price for other mail results. *Ibid.*.

[5185] The Service further claims: "When informed that the implementation of CEM could have an impact on the rate that they pay for their remaining First-Class Mail, they [bill-paying consumers] oppose CEM by an overwhelming majority." *Id.* at V-32. It also says that its earlier market research on PRM (USPS LR-H-200) had made it clear that a

[35] Ellard says the underlying research was conducted on January 29, 1998, through Opinion Research Corporation's CARAVAN survey, a shared-cost research vehicle. USPS-RT-14 at 2.

PRM distributor might add the cost of postage to the consumer's bill or build it into the overall price of the product or service. Thus, it says that favorable consumer reaction to PRM is premised upon the clear understanding that there is no "'free lunch.'" *Id.* at V-33-V-34.

[5186] The Commission's review of the telephone survey described in witness Ellard's testimony indicates that the Service's contentions regarding "definitive evidence" on the bill-paying public's position on CEM are overstated. First, Ellard acknowledges that responses to an initial question regarding the use of a two-stamp system were affected by whether current or proposed rates were used, despite the fact that the absolute amount of the discount was the same. As witness Ellard states, this is an indication that mention of an increased price and an accompanying discount affects respondent perceptions of convenience more negatively than mentioning a discount without an increase in price. Tr. 35/19072. Ellard notes that this also occurred in response to the second question. Far from finding these results definitive, he says: "In all, these findings illustrate the subjective nature of measures of convenience. " *Id.* at 19073.

[5187] In the next set of questions, Ellard says about three-fifths of the population say they are "very likely" (38 percent) or "somewhat likely" (23 percent) to use two denominations for bill paying, while a third (37 percent) say they are "unlikely" to do so. *Id.* at 19073-74. Thus, instead of definitive rejection, the survey appears to show that a majority of consumers reacted favorably to the CEM concept. When consumers were presented with examples of the potential savings associated with this concept (identified as 22 cents monthly and $2.64 annually), Ellard said the total saying they would be likely to use two denominations remained about the same (at 60 percent), although the proportion "very likely" to use two stamps fell 3 percentage points and the "very unlikely" proportion increased by 5 percentage points. *Id.* at 19074-75. Faced with these results, Ellard offers the following bland interpretation: "We may conclude that while many people can be positive about saving money, the amount they stand to save with the

two-stamp system is, at best, unlikely to enhance these positive feelings, and may even detract from them." *Id.* at 19075.

[5188] Also, the appropriateness of the wording of the final question in the "user preference" series appears doubtful, given that it poses an option for which there is no direct support on this record. Specifically, it asks those who expressed a preference for the two-stamp system (or did not know which approach they preferred), which system they would prefer if the two-stamp system contributed, to some degree, to an increase in the regular rate for First-Class letters. *Id.* at 19076. Not surprisingly, Ellard says "early indications are that any resulting rate increase, like all rate increases, would not be well received by the household public." *Ibid.* He then notes that the proportion of the group preferring the two-stamp system dropped from 100 percent to 30 percent. *Id.* at 19077. He further states that when the possibility is raised that a two-stamp system might contribute to a future increase in the basic rate for First-Class letters, 86 percent of the pubic say they would prefer to stay with the one-stamp system. *Ibid.*

[5189] The Commission notes that witness Ellard acknowledges that "user preference" is a "complex area to pursue." This, alone, may be sufficient reason to consider the responses less than definitive on the issue of CEM's appeal. Far more compelling, however, is the fact that it incorporates an unlikely option, since there is no proof that adoption of CEM would generate costs that would increase the price of the First-Class stamp. Currently, this would require CEM to lose net revenue of about $1 billion, far above even the Service's estimates. Thus, the premise of the question is seriously misleading.

[5190] *Education, Enforcement Efforts and Difficulties Businesses Would Face.* Postal Service witnesses Miller, Steidtmann, and Sheehan review CEM from perspectives the Commission agrees are important to consider. Witness Miller, among other things, asserts that CEM would complicate the mail system; notes that lost revenue and other CEM-related costs would have to be recovered; and asserts that CEM does not "fairly and equitably" distribute postage costs. *See generally* USPS-RT-17. In particular, Miller contends that CEM might undermine the success of PRM and also

encourage the public to investigate other bill payment alternatives. Tr. 33/17447. He challenges witness Willette's assumption that "conversion" to CEM will be a simple task for mailers. *Id.* at 17450-52. He also claims that CEM could impose additional costs to the Service of $33 million initially, for a multimedia campaign, and $83 to $272 million annually. In addition to quantifiable costs related to education and revenue protection, Miller notes that the Service would incur other, less readily quantified costs. Assuming a revenue loss of $134 million associated with CEM usage, he concludes that it does not make financial sense for the Service to incur related costs (estimated at more than $146 million in the first year) for the proposed classification. *Id.* at 17475.

[5191] Witness Sheehan asserts that CEM is inconsistent with the Service's automation and organizational goals. In particular, he contends that given changes in mail processing technology that have occurred since CEM was first proposed in Docket No. R97-1, the Commission should consider whether CEM is "an idea whose time has come and gone." *Id.* at 17370. Sheehan also claims that his experience leads him to believe that educational efforts related to CEM will be more difficult than witness Willette realizes. *Id.* at 17370-71. Moreover, he asserts that short-paid enforcement practices would have to be modified and would undermine customer relations. *Id.* at 17374-75.

[5192] Finally, witness Steidtmann provides several examples of pricing practices in the private sector that support his view of the need for retail simplicity. Tr. 32/17187-89. He asserts that CEM could cause dissatisfaction among the Service's customers and is inconsistent with the trend toward retail simplicity. *Id.* at 17193-95.

[5193] The Commission finds that witness Miller's contention regarding CEM's negative impact on PRM is unfounded. It is also doubtful that adoption of CEM would materially spur electronic diversion or other bill-paying alternatives. The two products are based on quite different approaches: PRM is distributor-controlled; CEM is consumer-based. Moreover, CEM requires the consumer, rather than the distributor, to directly pay applicable postage. Accordingly, CEM is more appropriately viewed as a complementary, rather than competing, option.

[5194] Similarly, the concerns witness Steidtmann raises about the need for retail simplicity seem overstated. Simplicity is an essential consideration in any classification decision, but neither the available consumer research nor Steidtmann's comparisons to the private section seem to support a finding that potential users will find CEM too complex to understand or use.

[5195] The Commission finds it disappointing that witness Sheehan, after years of Postal Service resistance to the CEM concept, now claims CEM's time may have "come and gone." While processing changes undoubtedly have occurred since CEM was initially raised on this record, Miller's data show that a prebarcoded piece generates savings over a handwritten piece.

[5196] Also, while the Commission recognizes legitimate interests in revenue protection, it finds it troubling that the Service emphasizes concerns about attempted manipulation of the "two-stamp" system by CEM users. This is especially the case when overall data show that the mailing public is apparently more likely to "overpay" postage than underpay. Moreover, the Commission agrees with witness Willette's position that CEM users have a direct interest in making sure their bill payments arrive at the intended destination and are unlikely to attempt misuse of the CEM stamp.

[5197] Rather than reject CEM because of potential misuse by consumers or the need for certain adjustments by the Service and distributors, the Commission believes appropriate educational efforts should be undertaken. The Commission's adjustments and recommendations on this record provide $33 million that could be used for these efforts. This amount is provided as a final adjustment in Appendix J. The Commission urges the Governors and the Service to develop an effective campaign to assist consumers and interested mailers in responding to the CEM initiative.

[5198] *The QBRM/PRM Discount.* In considering the discount for the new classifications, the Commission is concerned that witness Miller, by using a handwritten piece as a benchmark, relies on an inappropriate comparison.[36] He considers only the

[36] In all other respects, Miller's study appears reliable.

possibility that a handwritten piece would be substituted for a QBRM/PRM piece. Another possibility is that a courtesy reply piece would be provided. In fact, the Service's own volume projections show that PRM will consist largely of CRM pieces. Also, Postal Service witness Fronk confirms that the single-piece mailstream that would benefit from the proposed discounts for PRM and QBRM is already mostly barcoded and already generating cost savings. Thus, it appears that a more appropriate benchmark is a courtesy reply piece.

[5199] At the same time, there are indications that these pieces save delivery costs because they are predominantly delivered to post office boxes. Given these indications, the Commission recommends, for this proceeding, the 3-cent discount proposed by the Postal Service. The Commission finds that Miller's study would have supported extension of the discount to CEM.

f. Other Reply Mail Fees

[5200] The Service, through witness Needham, proposes changes in the three types of fees associated with Business Reply Mail (BRM) service: the annual permit fee; the annual accounting fee for distributors who use an advance deposit account to pay applicable charges; and the per-piece service fees.[37] Witness Needham says the proposed service fees and annual accounting fee are based on new cost studies prepared by witness Schenk. USPS-T-39 at 16-17.

[5201] *Annual Permit Fee.* Needham proposes increasing the annual permit fee, which is paid by all BRM distributors, from $85 to $100, in line with other permit fees. *Id.* at 17. Needham also proposes that the annual permit for PRM and QBRM distributors be established at $100. *Id.* at 20.

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[37] BRM service is available only in conjunction with First-Class and Priority Mail. It requires the distributor to guarantee that postage, plus a service fee, will be paid when the reply piece is delivered to the designated address. In addition to the postage guarantee, the basic elements of BRM service include separation of BRM pieces from other collection mail, further processing, delivery to the designated addressee, and associated counting, rating, billing and collection activities.

[5202] *Accounting Fee.* Needham proposes increasing the annual accounting fee for users of an advance deposit account from $205 to $300. She says this fee was developed to cover the increased costs shown in witness Schenk's new cost study, plus a small markup. *Id.* at 16.

[5203] *Service Fees.* BRM service fees, assessed on a per-piece basis, cover the costs associated with counting, rating, billing and collecting postage. There are three fee levels, based on specific combinations of BRM processing and payment methods. The lowest fee — currently 2 cents — is available to distributors who participate in the automated Business Reply Mail Accounting System (BRMAS). BRMAS operations generally employ software programs to sort prebarcoded pieces, determine mail volume for individual distributors, and calculate postage and fees. Related verification and accounting takes place manually in the postage due unit. USPS-T-23 at 1; USPS-T-27 at 5. Participating distributors must use a unique Postal Service-assigned barcode on their reply pieces; apply a designated Facing Identification Mark ("FIM C"); meet other mail preparation requirements; and establish and maintain an advance deposit account. The Service proposes increasing the BRMAS BRM fee from 2 cents to 6 cents and changing the name of the fee from "Prebarcoded" to "Qualified." USPS-T-39 at 12.

[5204] The two other service fees are premised on manual or "non-BRMAS" mail processing and accounting activities and are distinguished by whether applicable charges are deducted from an advance deposit account or are collected by a clerk or carrier. Distributors of non-BRMAS pieces also must meet certain mail preparation requirements (including application of a "FIM B"), but barcoding is optional. Non-BRMAS permit holders who use an advance deposit account currently pay a 10-cent fee on each returned piece; those without such an account pay 44 cents per piece.

[5205] The Service proposes reducing the per-piece fee for non-BRMAS BRM without an advance deposit account from 44 cents to 30 cents (a decrease of 14 cents), and reducing the fee for Advance Deposit BRM from 10 cents to 8 cents (a 2-cent reduction).

[5206] The following table summarizes current and proposed BRM/QBRM fees.

Table 5-8
Comparison of Current and Proposed Fees for Reply Mail

	Current	Proposed	Recommended
BRM Service Fee (no advance deposit account)	44¢	30¢	30¢
Other BRM Service Fee (with advance deposit account)	10¢	8¢	8¢
Qualified BRM Service Fee	2¢	6¢	5¢
Annual Permit Fee	$85	$100	$100
Accounting Fee (other than PRM)	$205	$300	$300

Source: Adapted from USPS-T-39 at 12.

[5207] *Cost Support.* Witness Schenk's cost estimates for the proposed service fees are based on the test-year costs associated with counting, rating and billing BRM pieces, apart from costs already attributed to First-Class Mail. They are derived primarily through the development of cost models focusing on operations at the office of destination, where BRM is held out from the Incoming Primary operation and sent either to the BRMAS operation or to a manual sort operation. USPS-T-27 at 1 and 4.

[5208] Witness Schenk relies on two special surveys for data. The BRM Practices Survey, which collected data on BRM-related practices at 441 postal facilities, provides national estimates of several variables; profiles of the methods of collecting fees from BRM permit holders without advance deposit accounts; delivery modes for advance deposit BRM; and the percentages of non-BRMAS pieces (both advance and non-advance deposit) that receive distribution to a finer depth of sort on automation equipment. *Id.* at 8. (*See also* USPS-LR-H-179). The BRMAS Cost Survey collected data at five postal facilities, over two-week periods, on workhours and volumes

associated with all stages of distribution, billing, and accounting of BRM pieces processed with BRMAS software.[38] Schenk says this survey provides average productivity at the five cites. *Id.* at 9-10.

[5209] *Cost Estimate for Fee for BRM that is not Prebarcoded: Other (or "Non-BRMAS" Advance Deposit) BRM.* Schenk says her cost calculations for non-BRMAS advance deposit BRM are affected by two productivities: that for manual sorting, since most pieces are counted and rated manually, and automated sorting, since some pieces get distribution on automation equipment (either on barcode sorters in the Incoming Primary or in a BRMAS operation). Based on her assessment that productivity of an essentially manual operation does not change substantially over time, since the activities do not change, Schenk uses the productivity from Docket No. R90-1, USPS-T-23 in her analysis; however, she adjusts this productivity for the Service's proposed volume variability, using the figure for the Business Reply/Postage Due MODS operation (of 0.797). She derives a net attributable cost of $0.0701.

[5210] *Cost Estimate Underlying Fee for "Non-BRMAS" BRM Distributors Who Do Not Maintain an Advance Deposit BRM Account.* Schenk estimates the cost for this category at 22.5 cents. She says her estimate for non-BRMAS non-advance deposit BRM reflects that in addition to the distribution, rating and billing costs that other non-BRMAS BRM pieces incur, non-advance deposit BRM pieces incur costs associated with postage and fee collection. Schenk says these charges are collected either by carriers or box section clerks, or deducted from Postage Due accounts. Schenk says she relies on the BRM Practices Survey for the distribution of fee collection methods (by

[38] Schenk say the survey sites were selected because they were facilities that have relatively efficient BRMAS operations and therefore have an average BRMAS productivity likely to be similar to the productivity level that could reasonably be expected in an improved BRMAS program. Schenk notes that this survey was conducted when she was concerned that applying the average productivity of all sites using BRMAS as an input would overestimate costs if, as then anticipated, a new version of the BRMAS program was introduced in the test year. USPS-T-27 at 8-9. She says she later learned that a new BRMAS program would not be deployed in the test year, but did not have enough time to do a survey to determine the average BRMAS productivity at all facilities currently using BRMAS. *Id.* at 10.

carrier, box section clerk or via deduction from a Postage Due account). She finds the net attributable cost of a non-advance deposit BRM pieces is $0.2250.

[5211] *Consistency with Statutory Criteria.* Needham finds the proposed fees consistent with statutory criteria. Among other things, she notes that the accounting fee for users of an advance deposit represents a 46 percent increase. USPS-T-39 at 21. However, Needham says that Schenk's cost data shows that the current accounting fee is not covering its costs. The proposed fee covers these costs and provides a modest contribution, in line with criterion 3; however, the increase is kept to a minimum to mitigate the effect on users. *Ibid.*[39] With respect to other criteria, Needham says the fee is simple, maintains a whole dollar rounding constraint, and is of high value to BRM customers because it allows them to take advantage of lower per-piece fees.

[5212] *Participants' Positions.* With the exception of the proposed service fee for QBRM, Needham's proposals have not drawn any formal criticism or opposition. *Id.* at 17. The Commission's recommendation of a 5-cent fee for QBRM, based in part on MPA witness Glick's testimony, was discussed in the preceding section.

[5213] *Commission Analysis.* The Commission recommends the reply mail fees as proposed by the Service, with the exception of the QBRM fee. The Commission finds these recommendations are consistent with § 3622(b) criteria. They recover all attributable costs, in satisfaction of § 3622(b)(3), and make an appropriate contribution to institutional costs. The fees also appropriately recognize the impact on distributors of reply mail by keeping increases, when indicated by the new cost study, to modest levels. Also, when supported by the cost study, per-piece service fees have been reduced. The existing fee design is retained, thereby promoting simplicity and identifiable relationships. The Commission also recommends the proposed nomenclature change, which conforms

[39] BRMAS is premised on automated counting, rating and billing of prebarcoded, automation-compatible BRM pieces. Its distinguishing features are mandatory prebarcoding and mandatory use of an advance deposit. BRMAS distributors pay the lowest of the three per-piece service fees; however, like other BRM distributors, they pay postage on the returned pieces at the full First-Class rate.

the name of the service fee for prebarcoded reply mail pieces with the new QBRM rate category.

g. First-Class Mail Nonstandard Surcharge Proposals

[5214] First-Class Mail weighing one ounce or less that does not conform to certain dimensions is assessed a nonstandard surcharge. The pertinent specifications — on length, height, thickness and aspect ratio — generally define the criteria that render mailpieces nonmachinable on automated letter sorting equipment.[40]

[5215] Witness Fronk proposes increasing this surcharge from 11 cents to 16 cents for single-piece mail and from 5 cents to 11 cents for presorted mail, based on cost estimates of the weighted average of the cost differences between nonstandard pieces and average letter costs. These estimates (of 15 cents for single-piece and 11 cents for presorted) were derived from an update to a study that has been relied on in previous cases. *See generally* USPS-T-32 at 24 (citing USPS-LR-H-112). Questions directed to the sponsorship and reliability of this study led to the provision of a supplemental analysis by witness Daniel during the course of this proceeding. This analysis relies heavily on the earlier study (as revised for certain errors in unit mail processing costs), but also uses newly-available data on test-year unit cost by shape (letters, flats and parcels) and expands the analysis to include presorted pieces. USPS-ST-43 at 2 (citing witness Fronk's response to NDMS/USPS-T32-29, September 9, 1997, and USPS-LR-H-106). Specifically, Daniel says: "The formula develops cost differences between manual letters and the average letter, between all flats and the average letter, and between all parcels and the average letter." *Ibid.* An underlying assumption is that manual letters and all flats and parcels are nonstandard.

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[40] *See* DMCS §§ 221.25 and 221.39. DMM C100.40 defines Nonstandard First-Class Mail as: "Except for Priority Mail, any piece of First-Class Mail weighing 1 ounce or less and not claimed at a card rate is nonstandard and subject to the applicable surcharge if its thickness exceeds 1/4 inch or if, based on the placement (orientation) of the address, its length exceeds 11-1/2 inches, its height exceeds 6-1/8 inches, or its aspect ratio (length divided by height) is less than 1.3 or more than 2.5."

[5216] Daniel says use of the new mix data yields costs of 22 cents for single-piece mail and 15 cents for presorted mail, as compared to the costs originally presented by the Service in this case.[41] However, she cautions that: "One limitation of the analysis presented here is our inability to determine the cost differences of just one-ounce pieces. The mail flow model methodology … can only be used to determine the cost of an average weight letter. Inputs are not available to determine costs by specific ounce increments." *Id.* at 2-3.

[5217] In addition to providing revised cost estimates, Daniels suggests several reasons why the cost difference has increased since Docket No. R90-1. One is that the Service's ability to handle letter mail in increasingly fast and efficient automated operations results in increasingly lower mail processing costs relative to pieces handled in other ways. Another is that as the proportion of sites with automation equipment and technology improve, the proportion of letter mail handled in highly automated operations increases. Daniel also says that greater use of delivery point sequencing (DPS) means that lower carrier in-office costs contributes to an ever-widening difference between the average letter and nonstandard piece costs. Finally, she says that reflecting the change in shape mix tends to increase the cost differential of nonstandard-shaped pieces. *Id.* at 3-4.

[5218] *Participants' Positions.* Four participants — Nashua, District Photo, Inc., Mystic and Seattle Filmworks (NDMS) — jointly oppose the Service's proposed First-Class Mail nonstandard surcharge. NDMS witness Haldi proposes elimination of the discount, but also provides support for alternative relief, pending a comprehensive review, of a discount of no more than 4 or 5 cents. This is based on 50 percent passthrough of 8.8 cents in costs. In support of his position, witness Haldi reviews the history of the nonstandard surcharge; identifies defects in the underlying cost support;

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[41] These costs exceed the proposed surcharges. The Service did not amend its Request. However, Fronk notes that the proposed surcharges no longer represent the minimum needed to cover costs, as originally indicated in his testimony. See USPS-T-32, Appendix A.

discusses equipment now in use, and raises numerous policy concerns. *See generally* Tr. 24/12872-12918.

[5219] *Contention that Rationale for Surcharge May No Longer Hold True.* Witness Haldi asserts that the assumption underlying the Commission's initial recommendation of the surcharge may no longer hold true. *See generally* Tr. 24/12883-12888. He notes that the Service has not submitted any evidence as to the processing of nonstandard pieces and points to significant advances in automation and mechanization. Among other things, he asserts that test results indicate the FSM 1000 can handle flats under one ounce. *Id.* at 12884. In addition, Haldi says the results of a small-scale experiment he conducted contradict witness Daniel's contention that all nonstandard letters would be manually processed, since markings on the 10 pieces he mailed (greeting cards that were square in shape) indicate that all but one were processed on automation. *Id.* at 12884-85. Thus, he says his experiment indicates that a specific question that clearly needs review is whether nonstandard pieces, such as square letters, can be processed efficiently on currently installed equipment. *Id* at 12884. Haldi also observes that there has been no study of the effect of ongoing mechanization on the definition of First-Class nonstandard flats, which has not been changed since the surcharge was introduced. *Id.* at 12888-12889.

[5220] *Costing Defects.* Haldi asserts the Service's costing is fatally flawed, and not easily remedied, given the difficulty of obtaining data. He claims that the Commission's original opinion identified a distortion in the underlying data — namely, the inability to exclude costs of First-Class Mail over one ounce. *Id.* at 12896 (citing PRC Op. R78-1 at 26, fn. 1). He contends that over the past two decades the Postal Service has undertaken no studies to remedy this distortion, but has "simply updated the defective data, with all their shortcomings, aided by mailer inattention, using the flawed analysis and results again and again as the basis for proposed increases, including the current one." *Ibid.* (footnote omitted).

[5221] Haldi states that witness Daniel's "candid admission" that the analysis in her supplemental testimony is limited by the Service's inability to isolate the cost differences

for nonstandard pieces weighing under one ounce proves this defect has never been corrected. *Id.* at 12896-97. Thus, he says the Commission's original critique "remains as applicable and incontrovertible today as it was almost 20 years ago." *Id.* at 12901.

[5222] Haldi says the proxies witness Daniel has used in her analysis are wholly unsuitable, since they introduce an unacceptable degree of distortion. Among other things, he contends that although the average weight of letters used in her study is sufficiently close to that of a nonstandard piece, the assumption that they are processed manually is contradicted by his experiment. He also finds the average weight assumptions seriously off for flats and parcels. *Id.* at 12899.

[5223] Given these deficiencies, Haldi asserts that the additional cost of handling an under-one ounce nonstandard flat or parcel is "almost wholly unrelated to the cost of handling the proxy (i.e., an average weight flat or parcel)." *Id.* at 12900. Since there is no functional relationship between the handling costs of the proxies and the variables for which they purport to stand, he says the analysis based thereon is totally inadequate to support the existing surcharge, much less the proposed increase. *Id.* at 12901.

[5224] *Additional Considerations.* Haldi cites a host of other ratemaking considerations. He notes that letters, flats and parcels make more than an adequate contribution to covering costs, and elimination of the surcharge, which by itself generates an insignificant revenue contribution, would do little to change this. He also says the surcharge is an ineffective "signal" to mailers, especially since some mailers cannot change the dimensions of their pieces. He says concerns about fairness and equity and simplicity of rate structure should play a role, and claims that retaining this element in the First-Class Mail rate structure is inconsistent with the rationale underlying the Service's proposed elimination of the heavy piece discount. Haldi suggests an analytical framework to guide de-averaging, consisting of the following principles: de-average only when a substantial proportion of the volume or revenue can be de-averaged, the cost basis for de-averaging is solid and credible; and the result will greatly exceed any increase in complexity. *Id.* at 12909.

[5225] *Postal Service Rebuttal.* On rebuttal, Postal Service witness Sheehan notes that the Service has attempted to provide a low-cost method of handling a wide range of sizes, and claims the nonstandard surcharge is still a viable incentive for mailers to provide the Service with letters that are compatible with its processing equipment. He challenges Haldi's suggestion that the current DMM definition of nonstandard pieces is obsolete, noting that the Service's equipment requirements continue to be based on it. Tr. 33/17378. Among other things, Sheehan describes how changes in the nonstandard dimensions might negatively affect not only operations, but also other postal costs. He indicates that Haldi's experiment suggests that the Service might want to re-evaluate the automatibility of pieces with low aspect ratio, but contends that the full range of applicable criteria would need to be tested, not simply the one facet that Haldi highlights. *Ibid.*

[5226] *Commission Analysis.* The record does not support elimination of the First-Class nonstandard surcharges, but it does provide compelling reasons for holding them at their current level, pending a comprehensive review of many of the matters Haldi raises in his testimony. These include not only a reassessment of the problem that has long plagued the cost support — the difficulty of isolating data for one-ounce pieces — but also a review of the validity of the assumption that the surcharge is an operational necessity for all types of pieces now subject to it.

[5227] It is well-accepted that the Service's processing equipment is now far more sophisticated than when the surcharge was introduced. Witness Haldi's experiment informally shows that automation capabilities have expanded, at least for low aspect ratio pieces. In addition, the test results for the FSM 1000 show that flats under one-ounce have been successfully handled.

[5228] Second, the cost support is defective. Witness Haldi is correct that the study relied upon in previous cases has not been effectively reviewed prior to this case. The supplemental analysis provided during the course of the proceeding also does not provide a fully acceptable basis for recommending the Service's fees. One of its

drawbacks, as with earlier studies, is that it uses inappropriate "average weight" proxies. It also uses processing assumptions that have been shown to be questionable.

[5229] Third, policy considerations need to be more fully addressed. There is merit to witness Sheehan's observation that the Service attempts to provide a low-cost method of handling a wide range of sizes, and certain limited restrictions are needed if it is to accomplish this objective.

[5230] Given the difficulties associated with the underlying cost study, the Commission recommends no increases in the nonstandard surcharges. The Commission also suggests that if the Service intends to continue to assess these surcharges in the future, it should provide a justification that accurately depicts the current mail processing environment.

h. NDMS Proposal to Increase the Maximum Weight of First-Class Mail From 11 to 13 Ounces

[5231] Witness Haldi, on behalf of NDMS, observes that one effect of the Service's overall First-Class Mail proposal is that it increases from 38 cents to 57 cents the gap between the highest rate in single-piece First-Class and the lowest rate in the Priority subclass.[42] Tr. 20/10292, 10305-06. He asserts that this is an unjustifiably large difference and, as a means of reducing it, proposes increasing the breakpoint from its current level of 11 ounces to 13 ounces. *Id.* at 10307.

[5232] In support of this position, Haldi cites past Commission decisions adjusting the breakpoint to provide a smoother transition between the two subclasses or to avoid rate anomalies.[43] *See generally* Tr. 20/10301-307 (citing Docket Nos. R74-1, R77-1 and R87-1). He also asserts that Postal Service witness Sharkey has not provided a good reason for the gap being as large as it is; that a gap as large as the Service has

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[42] Haldi calculates the gap by subtracting the Service's proposed rate for an 11-ounce piece of First-Class Mail — $2.63 — from the proposed minimum rate of $3.20 for two-pound-and-under Priority Mail.

[43] Haldi acknowledges that anomalous rates are not a concern here. Tr. 20/11167.

proposed is not readily understandable by customers; and that there is no operational bar to handling 12- or 13-ounce pieces. Moreover, Haldi contends that the 11-ounce maximum weight for First-Class Mail may result in "an artificially low two-pound and under Priority Mail rate." *Id.* at 10307. He notes that this rate applies to 80 percent of all Priority Mail volume, and says: "An artificially low two-pound and under rate can have a disastrous effect on rates paid by mailers of zoned Priority Mail due to the relatively small volume of zoned Priority Mail." *Ibid.*

[5233] Haldi estimates a revenue impact of this adjustment, under the Service's filing, as a reduction of $22.5 million, based on estimated migration of about 77 million pieces. *Id.* at 10309.

[5234] *Commission Analysis.* In response to interrogatories on this topic, the Service has noted that a gap between the top rate in the First-Class schedule and the first rate in Priority is "arithmetically inevitable." Tr. 19A/8611. It has also said there is "a rational basis" for the proposed 11-ounce breakpoint and suggests that the significant service differences between Priority Mail and First-Class Mail help explain the gap. *Id.* at 8612. On brief, the Service notes that Priority Mail's service features include delivery within two days between a greater number of origin and destination post offices, a separate sorting and distribution network, and the availability of certain special services. Postal Service Brief at V-106. The Service also takes issue with witness Haldi's characterization of the two-pound Priority Mail as artificially low. *Ibid.*

[5235] The Commission's reading of witness Haldi testimony is that he is not challenging the existence of a gap *per se,* but the Service's seeming indifference to past Commission concerns with providing a smooth transition between the two subclasses. In developing its recommendations, the Commission again has considered the need for a smooth transition. Maintaining the breakpoint at 11 ounces yields a gap larger than appropriate. To provide a smoother transition, the Commission adjusts the breakpoint to 13 ounces, thereby reducing the gap to 23 cents. This change becomes more appropriate because of the Commission's recommended 22-cent extra ounce rate. The gap between the recommended rate for an 11-ounce piece ($2.55) and the initial Priority

Mail rate ($3.20) is 67 cents. The volume and revenue effect of this change are shown in Appendix M.

(1) The Service's Proposed Introduction of Surcharges for Certain Hazardous Materials

[5236] The Postal Service, through witness Currie, proposes the introduction of two new surcharges on hazardous material sent via U.S. Mail. One is a 50 cent-surcharge on mail containing hazardous medical material (HMM); the other is a $1.00 surcharge on mail containing other hazardous material (OHM). Witness Currie identifies current postal regulations on both HMM and OHM; provides his understanding of standard postal and industry practice; and discusses the added operational costs associated with the presence of HMM in the mailstream. He also reviews the consistency of both proposals with the statutory pricing and classification criteria. *See generally* USPS-T-42.

[5237] Witness Currie supports imposition of both surcharges on grounds that they recognize the special costs of handling these materials; improve the alignment of prices with costs; increase the conformity of the Service's price structure with industry standards; and provide a means of improving Postal Service data on hazardous materials. *Id.* at 1.

[5238] The "special costs" Currie refers to include, among others, Service-wide training efforts; preparation and distribution of Management Instructions; special equipment for cleaning up spills; and extra costs generated when restrictions on air transportation are imposed. Currie indicates that he expects many of these costs to increase in the future, based in part on requirements imposed by the Environmental Protection Agency. He also says that to recoup some of these costs, private carriers have imposed a surcharge on commodities that are regulated as hazardous material.

[5239] With respect to the 50-cent HMM proposal, Currie says the Service expects that the "overwhelming majority" of pieces will be clinical or diagnostic specimens that weigh less than a pound and pay $2 to $3 in postage, and that the level of the HMM surcharge was set with these pieces in mind.[44] *Id.* at 8. He also indicates that HMM

pieces appear to have higher processing costs because employees are more cautious in handling them and handling time increases. *Id.* at 9.

[5240] Currie provides no firm cost, volume or revenue estimates for either surcharge, citing a lack of Postal Service data and the difficulty of obtaining private industry data. *Id.* at 7- 8; 17. As to volume trends in general, however, he says: "While the types of hazardous materials that are mailable have not changed significantly, the volume of such materials in the mail appears to have increased in recent years as the need of postal customers have evolved and as other carriers have imposed surcharges." *Id.* at 17. Currie also suggests that the current volume of clinical diagnostic specimens in the First-Class mailstream may be on the order of 10 million pieces annually, with perhaps another 500,000 pieces of Priority medical materials. *Id.* at 17-18. Overall, Currie concludes that the proposed surcharges will not have an appreciable effect on volume or postage revenue in those classes, since the hazardous materials volumes are a modest percentage of the total volumes in the affected mail classes. *Id.* at 18.

[5241] *Participants' Positions.* No intervenors have addressed the OHM surcharge; however, Lab*One* Inc., Osborn Laboratories, Inc., and Clinical Reference Laboratories, Inc. (Lab*One* et al.) jointly sponsor the testimony of four witnesses in opposition to the proposed 50-cent HMM surcharge. Witness Crowley primarily challenges witness Currie's costing and pricing claims. He maintains, among other things, that a surcharge is not economically justified for HMM; that neither the extra costs of this material nor the volume is known; and that Lab*One* et al.'s clinical specimens are not subject to the private industry surcharges or air transport restrictions witness Currie cites. *See generally* Tr. 30/16296-303. He also asserts that a surcharge should not be used as a means of collecting data. *Id.* at 16308.

[5242] The other Lab*One* et al. witnesses generally describe their companies' co-operative efforts with the Postal Service to develop protective packaging; claim that leaks are virtually non-existent in today's environment; contend that their pieces are not

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[44] These include etiologic agents; etiologic agent preparations; clinical or diagnostic specimens; biological products; sharps; and other medical devices.

subject to surcharges or restrictions on transport through private carriers; and urge that clinical specimens should not be grouped with “truly hazardous” materials such as solvents, medical wastes, and etiologic agents. Tr. 30/16337-44. Witness Bourk, among other things, contends that witness Currie may be relying on stale or old information, especially with respect to incidents of leakage. *Id.* at 16340. In particular, he claims that Osborn Laboratories, Inc. has received no reports from the Service that its packages have leaked. *Id.* at 16340-41. He also challenges Currie’s statement that private couriers impose a surcharge, citing present arrangements with Airborne and past dealings with Federal Express. *Id.* at 16341. Witness Rastok also disputes the alleged need for the surcharge, based on Lab*One* Inc.’s experience since 1993. *Id.* at 16365. Witness Schmutzler notes that packaging changes, made at the Service’s request, have increased the expense of making the mailing envelopes used for shipping HMM. *Id.* at 16380. He also contends that the average postage charge of incoming pieces is 68 cents, rather than the $2 to $3 witness Currie says he had in mind when determining the amount of the HMM surcharge. *Id.* at 16381.

[5243] *Commission Analysis.* The Commission finds that witness Currie provides credible evidence that there are additional costs associated with the presence of HMM and OHM in the mailstream, and that these costs may increase in the future. However, his presentation does not make clear why these costs should now be recovered from shippers, through a surcharge. Both witness Currie and the Service, on brief, simply make the conclusory statement that the surcharges will promote fairness and equity — classification criterion 1 — by imposing these costs on the responsible mailers. *See e.g.,* Postal Service Brief at VI-51. The Commission believes that closer examination of the nature of the costs is warranted. For example, it is not clear that these costs would be entirely avoided if the Postal Service categorized mail subject to the proposed hazardous material surcharge as nonmailable and excluded from the system.

[5244] Moreover, there are other evidentiary gaps or conflicts. A major concern is the unquantified cost and volume estimates on which the proposals are based. The Service has not provided any firm estimates. Another deficiency is that certain

assertions Currie has made regarding average postage per piece for HMM, its potential for leakage, and private industry's practice with respect to surcharges may be invalid or outdated, as pointed out by the Lab*One* et al. witnesses. Also, given the nature of the materials involved and the Service's interest in obtaining a high level of cooperation from mailers of hazardous materials, comprehensive consideration must be given to the public policy implications of the proposed surcharges. That has not occurred on this record.

[5245] Given these deficiencies, the Commission does not recommend the proposed surcharges for any classes of mail. The Commission has considered, but rejected, the request for a "shell" classification, given its concern over appropriate classification of the costs associated with hazardous materials.

(2) Niagara Telephone Company's "Local Only" Mail Discount Proposal

[5246] Niagara Telephone Company (Niagara), through witness Peterson, renews a proposal for a discount for First-Class Mail deposited in a post office's "local only" mail depository for delivery in the local area.[45] Tr. 21/10650. Witness Peterson notes that he has amended his proposal to address a concern the Commission expressed in Docket No. MC95-1. Specifically, he says his revised proposal entitles mail deposited in a "local only" box that lists more than one ZIP Code to a discount equal to the one he proposes for mail deposited in a box with only one ZIP Code. Peterson suggests that eligible First-Class Mail pieces receive a discount equivalent to the rates implemented for 5-digit Automation Mail.[46]

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[45] Witness Peterson refers to the distinctions he draws between locally deposited mail and mail that is not deposited locally as subclasses. Tr. 21/10650. The Commission understands his proposal as effectively requesting a destination entry discount.

[46] On brief, Niagara describes the requested rate for "local only" mail as one that includes "a combination of an entered at destination discount plus a presorted rate which is equal to 50% of the USPS's proposed First-Class rates for the same weight article," or other relief the Commission considers appropriate. Niagara Brief at 1-2.

[5247] In support of his proposal, Peterson provides his assessment of how the Postal Service processes monthly mailings deposited by Niagara Telephone Company and Wittenberg Telephone Company; supplies evidence that the Post Office offered a local mailing rate in 1946; and describes his observations of postal processing at more than 150 facilities. He also compares the activities or functions avoided by the deposit of "local only" mail to those associated with First-Class Automation mail. *See generally* Tr. 21/10650-51. Peterson does not provide specific volume or revenue figures, but says that he believes the volume of local mail is significant. However, he also says he expects the revenue consequences to be neutral, given his position that a "'local only' rate is merely reflecting the increased efficiency associated with that service." *Id.* at 10666.

[5248] On brief, Niagara argues, among other things, that the proposed rate system fails to account for efficiencies inherent in "Local Only" mail resulting from the mailer's presort and delivery activities. Therefore, it says "[s]uch a rate schedule is neither reasonable nor equitable …. " Niagara Brief at 2. Niagara also takes issue with the Service's contention that "local drops" are based primarily on service, rather than cost, considerations. *Id.* at 5. It further contends that witness Peterson's evidence regarding on-premises sortation of "local only" mail is unrebutted. *Id.* at 7.

[5249] *Postal Service's Position.* The Postal Service opposes witness Peterson's proposal, arguing that witness Peterson has not provided any record evidence upon which a Commission recommendation can be based. Postal Service Brief at V-97. In particular, the Service asserts that there are no data and information on basic operations, costs, volume, revenue or feasibility. It asserts that Peterson has left to the Service definition of what would be included in "local only" mail, and that he would allow different postal facilities to determine unique applications. *Ibid.* It also claims that witness Peterson's testimony does not provide a means of calculating the specific volume of mail that might qualify for the discount. *Id.* at V-97-V-98.

[5250] The Service also maintains that Peterson's proposal does not respond to the Commission's previous indication that it would need detailed processing information in order to recommend a specific rate. It notes that Peterson uses the same cost

avoidance proxy the Commission has said would not necessarily be applicable to “local only” mail. *Id.* at V-98.

[5251] *Commission Analysis.* In its Docket No. MC95-1 Opinion, the Commission commended Niagara and witness Peterson for identifying a potential improvement in the First-Class Mail structure. It further noted that the “local only” mail proposal was a classification concept worthy of serious consideration, but indicated that other factors rendered further consideration nearly impossible. Among other things, the Commission indicated that problematic aspects included the need to estimate revenue impact; the requirement of a uniform rate; development of firm estimates of mail processing costs, other costs, and volume; and an assessment of implementation and administration. PRC Op. MC95-1, paras. 5087-5091. Given the state of the record on those issues, the Commission rejected Niagara’s proposal. It further suggested that if Niagara pursued its proposal, information responsive to these concerns should be presented, and urged the Service’s cooperation in responding to requests for information. *Id.* at 5091.

[5252] In this proceeding, witness Peterson has helpfully clarified one aspect of his proposal. The Commission appreciates his responsiveness. However, other critical data and information needed to evaluate this proposal are still lacking. The Commission notes that virtually all of this material is within the Service’s exclusive control; thus, the Service’s criticisms that witness Peterson has not provided firm documentation or fully addressed implementation issues are largely misplaced in this situation.

[5253] It is axiomatic that the controlling statute does not require redress for every discriminatory feature that may be found in a rate schedule, such as the absence of a discount for local mail. Logistical complexities and other considerations may justify a finding that disparate rate or classification treatment, while different, does not constitute “undue” discrimination. Regrettably, the Postal Service has not provided a witness to address operational concerns on other pertinent issues, but has chosen to raise sweeping objections on brief to witness Peterson’s proposal. This does little to advance a definitive assessment of a “local only” discount.

[5254] The Commission appreciates witness Peterson's efforts to provide additional support for this proposal, especially in the face of seeming Postal Service indifference. However, the record remains undeveloped on matters critical to a determination on the merits, such as its impact on net revenues, and the Commission cannot recommend Niagara's proposal.

[5255] *Summary.* The Commission finds that recommended rates for First-Class Mail in the Letters and Sealed Parcels subclass are consistent with the factors set out in § 3622(b). Based on the Commission's projected test-year after-rates volume, First-Class Letters and Sealed Parcels revenue will exceed estimated attributable costs of by $14 billion.[47] Thus, recommended rates will recover all attributable costs, in compliance with § 3622(b)(3). They also will make a contribution to institutional costs consistent with the comparatively high value of service (§ 3622(b)(2)) for mail in this subclass, as Postal Service witness O'Hara notes. USPS-T-30 at 22-23.

[5256] The impact of the recommended rate changes is modest, § 3622(b)(4), with mailers of pieces weighing more than one ounce actually receiving a one-cent reduction from the current additional-ounce rate. The average increase for the Letters and Sealed Parcels subclass is 1.7 percent, which is below the overall increase of 2.8 percent.

[5257] Available alternatives (§ 3622(b)(5)) are somewhat limited for mailers in the Letters and Sealed Parcels subclass, but as witness O'Hara notes, nonpostal alternatives are nevertheless available. These include growth in the use of facsimile machines, growing use of the Internet, and increased availability of electronic payment options. *Id.* at 23. The recommendations recognize mailers' worksharing efforts, in accordance with § 3622(b)(6), through presorting and prebarcoding discounts. In particular, mailers of eligible prebarcoded reply letters will now obtain a discount for their automation-ready pieces.

[5258] The addition of new categories for PRM and QBRM adds some complexity to the First-Class schedule (§ 3622(b)(7)), but the Commission finds this development

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[47] *See* Appendix G, Schedule 1.

acceptable, given the subset of mail affected. The recommendation of CEM (on a "shell" basis) also adds complexity to the schedule, but does not unduly complicate the schedule. Its use, like that of PRM and CRM, will be voluntary. The Commission also finds that recommended rates appropriately reflect § 3622(b)(8) considerations, which relate to the informational value of business and personal correspondence, as well as the cultural value of greeting cards. The Commission's overall conclusion is that the recommended rates are fair and equitable (§ 3622(b)(1)). The markup index for First Class Letters and Sealed Parcels is 1.307. This is essentially the same as the 1.311 markup in Docket No. R94-1. The Commission finds that the markup index in this case is appropriate on the record that has been developed in this case.

2. Cards

[5259] Cards that meet certain specified size, weight and aspect ratio limits can be entered in the First-Class Mail Cards subclass.[48] Fronk notes that this subclass generated less than $1 billion, or 3 percent, of First-Class Mail revenue in FY 1996. USPS-T-32 at 12. He further observes that volume growth in this subclass, like Letters and Sealed Parcels, has been dominated by the presort category. *Ibid.*

[5260] The Service proposes increasing the current 20-cent rate for single-piece cards by one cent, paralleling the increase in the First-Class stamp. For workshared card categories, the Service also proposes increases of one cent, or more, as described below. Fronk attributes the Service's proposed percentage increases for cards to the application of the "whole cent" integer constraint. However, he also says the increases reflect the Service's attempt to narrow the gap between the cost coverages for letters

[48] DMCS § 222.12 restricts eligibility for the Cards subclass to cards of uniform thickness that do not exceed 6 inches in length, 4½ inches in length, and 0.016 inch in thickness.

As part of its Request, the Service proposes a nomenclature change for this subclass. The Commission recommends this change.

and cards. The proposals in this case narrow the gap from 38 percentage points to about 16 percentage points. *Id.* at 30.

[5261] *Worksharing cost development.* The Service presents a new methodology for developing unit card costs for workshared cards in this proceeding. In Docket No. MC95-1, a single letter/card differential was subtracted from each modeled letter unit cost to obtain the comparable card cost. In this proceeding, separate letter/card differentials are calculated for each category.[49]

[5262] *Worksharing discounts for cards: presorted nonautomated pieces and automation pieces.* Fronk proposes raising the current 18-cent rate for presorted (nonautomated) cards by one cent, thereby maintaining the current 2-cent discount (from the single-piece rate) for this category. For automated cards, Fronk proposes increasing the Basic automation rate by one cent to 17.6 cents. He proposes increasing the 3-digit rate from 15.9 cents to 17.0 cents, the 5-digit rate from 14.3 cents to 15.9 cents, and the carrier route rate from 14.0 cents to 15.6 cents. *Id.* at 5.

[5263] *Effect on discounts.* Fronk notes that rates (cited above) are consistent with his approach to bulk letters, since he treats the 3-digit card rate, which applies to the largest volume of prebarcoded cards, as the "key" from which the other card bulk automation rates are developed.[50] *Id.* at 32. Given this approach, Fronk says the Service proposes to maintain the current 1.4 cent discount from the nonautomated presort rate for Basic automation. Moreover, Fronk notes that his proposed 3-digit Automation rate is 2 cents below the nonautomated presort rate. *Ibid.* He acknowledges that this is a slight reduction (of 0.1 cents) in the current difference between nonautomated presort and 3-digit cards, but notes that it represents full passthrough of the cost difference with nonautomated presort cards. *Ibid.*

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[49] Estimated card costs are developed by calculating the ratio between the non-carrier route presort letter benchmark and the non-carrier route card benchmark. This ratio is then applied to the model unit letter costs for each rate category. Finally, proportional and fixed CRA adjustments are applied. See *generally* USPS-T-25.

[50] Fronk says 50 percent of bulk automation cards are in this category. USPS-T-32 at 32.

[5264] Fronk says the 5-digit rate represents 100 percent passthrough of the cost difference between 3-digit and 5-digit cards. He notes that the resulting discount (of 1.1 cents) is less than the current 1.6 cent discount; however, he notes that use of this rate category is optional and contends that mailers can be expected to use this rate only when their cost of making the 5-digit separation is less than the rate difference. *Id.* at 33. In connection with the carrier route proposal, which maintains the existing 0.3 cents difference between carrier route rate and 5-digit rates, Fronk says:

> While the card cost data suggest that a larger carrier route discount would be possible, the cost estimates are based on very small amount of data due to the small volume in this rate category. An incremental discount of 0.3 cents would match the incremental discount for letters, where there are considerably more data available.

Ibid.

[5265] *Participants' Positions.* APPA opposes the Service's entire card proposal and, through witness Threadgill, proposes an alternative set of rates. Witness Threadgill also addresses two additional matters affecting cards. These include changes in eligibility conditions for Automated card rates and increasing the card size to 7 inches.

[5266] Witness Threadgill's opposition to the Service's proposal is on several considerations. One is "the long-standing relationship between the 'penny' post card and the historical 2 cent letter rate."[51] Tr. 20/10248. Another is "the inequitable base" established in R90-1. *Id.* at 10253. Threadgill also claims that the new eligibility conditions for the Automated presort categories pose obstacles to post card billers and, coupled with elimination of the 5-digit and carrier presort rate categories, have caused a substantial and unanticipated postal rate increase in 1996. *Id.* at 10247.

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[51] Threadgill contends that Fronk's "abbreviated rate history" — which begins with the 1970 reorganization — "fails to disclose that the 1970 post card/letter relationship was totally out of line with the historical relationship between those two kinds of mail." Tr. 20/10249. He provides a comprehensive comparison, dating from 1886 to the present. *Id.* at 10250.

[5267] Given these factors, Threadgill asserts that since inflation is the driving force behind all increases in postal rates, the proper approach to recovering inflation-driven increases is an across-the-board percentage increase in all rate classes, similar to that implemented in Docket No. R94-1. He contends that the revenue impact of his proposed reductions should be negligible, in the range of about $29,136 million. *Id.* at 10260.

[5268] Threadgill also provides an analysis of how the Service's card proposal is not consistent with the statutory criteria. *Id.* at 10255-59. Based on the Service's use of volume variable costs, he says the projected cost coverage for both workshared subclasses is 267.11 percent, noting it is only slightly below the 282.29 cost coverage for workshared letters, and far above any other category of service, other than Mailgrams. He concludes: "Even if the discounts for worksharing letters can be justified, which appears doubtful, given the much more limited value, and much greater price elasticity, of worksharing cards, the 267.11% cost coverage is totally unjustified." *Id.* at 10259.

[5269] *Commission Analysis.* The Commission finds that the record supports retaining the current single-piece card rate. This rate adequately covers costs, in compliance with section 3622(b)(3), and helps ensure that there is at least one relatively inexpensive postal category that can be widely used by the general public, businesses, and organizations. Witness Threadgill's testimony extensively documents the role that cards have played as a low-cost medium of communication. It also reflects the Commission's determination that the whole-cent integer constraint is a significant consideration in establishing an appropriate single-piece card rate; thus, public convenience will be served by maintaining the single-piece card rate at 20 cents.

[5270] This will in turn keep the workshared card rates largely unchanged and at least partially meet witness Threadgill's concerns. For workshared cards, the Commission retains the existing approach to calculating the discounts, and thus uses the Basic automation category, rather than 3-digit, as the "key." The Commission finds that this approach is more cost-based, and results in reductions in the Automation categories. A comparison of current, proposed and recommended card rates appears in the following table.

Table 5-9
Comparison of Current, Proposed and Recommended Rates and Fees for First-Class Cards

	Current	Proposed	Recommended
Single-piece Cards	20.0¢	21.0¢	20.0¢
Reply Mail Cards:			
Prepaid Reply Mail	N/A	18.0¢	18.0¢
Qualified Business Reply Mail	N/A	18.0¢	18.0¢
Nonautomated Presort			
Basic Automation	16.6¢	17.6¢	16.6¢
3-digit	15.9¢	17.0¢	15.9¢
5-digit	14.3¢	15.9¢	14.6¢
Carrier route	14.0¢	15.6¢	14.1¢

Source: Adapted from USPS-T-32 at 4-5 and Exh. USPS-32A.

[5271] The Commission's recommended rates for the Cards subclass reflect an average increase of 0.2 percent. Based on the Commission's projected test-year after-rates volume, First-Class card revenue will exceed estimated attributable costs by $356 million.[52] Thus, card rates cover attributable costs, as required by § 3622(b)(3). The Commission's recommended 20-cent postcard rate reflects consideration of the somewhat more limited value of service (§ 3622(b)(2)) that cards offer, especially in terms of privacy. Although one intervenor seeks an across-the-board reduction in card rates, the Commission finds that maintaining the single-piece card rate at its current level, rather than lowering it, should not cause a negative impact on mailers (§ 3622(b)(4)).

[5272] The recommended rates also recognize that there are several alternatives for mailers of cards, including Standard bulk mailings. As in the Letters and Sealed Parcels subclass, the recommended rates appropriately recognize the worksharing

[52] *See* Appendix G, Schedule 1.

efforts of mailers presenting bulk presorted or prebarcoded cards (§ 3622(b)(6)). The only structural changes in the Cards subclass are those reflecting the introduction of PRM and QBRM. The Commission finds that added complexity associated with these changes is offset by the interest in extending a discount to mailers who provide prebarcoded reply pieces. In addition, affected mailers are also generally sophisticated users of the postal system. The rate schedule for cards generally provides identifiable relationships. The recommended 18-cent rate for QBRM/PRM cards is identical to that recommended for presorted cards. (§ 3622(b)(7)). The Commission finds that this is an acceptable relationship, given some uncertainty about underlying card costs and the fact that the study underlying the Service's QBRM/PRM proposal addressed letters, not cards. Overall, the Commission finds that the card rates it recommends are fair and equitable (§ 3622(b)(1)). The markup index for Cards is .913. This is somewhat higher than the Docket No. R94-1 markup of .645, but very close to the Docket No. R90-1 markup of .919. The Commission finds the markup index for Cards appropriate on this record, given that reducing the single-piece rate is not justified.

[5273] *Other Card Matters.* With respect to the matters APPA witness Threadgill raises, the Commission notes that the Service disputes the need for an increase in card length. It contends that the problems Threadgill refers to can be overcome by formatting changes. Given this possibility, the Commission urges the Service and the card industry to attempt a cooperative resolution of this issue. It is less clear on this record whether an administrative solution is feasible in the area of reclassification eligibility requirements. However, the Commission also urges joint Postal Service/card industry efforts to find a solution to this problem.

3. Priority Mail

a. Introduction

[5274] Priority Mail is a service available for all mailable items up to 70 pounds in weight that offers somewhat more expedited delivery than First-Class Mail. On this basis, it competes in the two-day document and package market. Priority Mail also constitutes the extension of First-Class Mail service for pieces weighing 11 ounces or more. Consequently, Priority Mail consists both of monopoly letter mail and items that could be delivered by a competing carrier outside the Private Express Statutes.

[5275] Priority Mail rates are unzoned for pieces up to five pounds, with separate 2-pound, 3-pound, 4-pound and 5-pound rates. The rates for heavier mailings are zoned. The 2-pound rate is charged for mailings in a flat rate envelope provided by the Postal Service, regardless of contents. Pickup service is available for Priority Mail; the current fee is $4.95.

[5276] In addition to the single-piece rates described above, there is a presorted category of Priority Mail which currently receives a discount of 11 cents per piece. Postal Service witness Sharkey states that Priority Mail presort has met with little mailer interest since its inception, and he proposes that the category be abolished. USPS-T-33 at 19.

[5277] Although the rate schedule extends up to 70 pounds, 94 percent of Priority Mail weighed less than 5 pounds in FY 1996, and the average postage weight was 2.11 pounds. *Id.* at 18. In the same period, 80 percent of Priority Mail was sent at the unzoned rate for items weighing two pounds and less. Priority Mail makes a contribution to postal revenues that is disproportionate to its volume; while it accounted for only 0.5 percent of total volume in FY 1996, it contributed 6.1 percent of total revenue. *Ibid.*

[5278] One notable development in connection with Priority Mail is the introduction of processing under private contract. Under this arrangement, Priority Mail deposited with the Postal Service will be sorted, processed and transported by contractors in a network of Priority Mail Processing Centers (PMPCs). Contractors will be responsible for

furnishing transportation, facilities, equipment, staffing, distribution and management for all Priority Mail originating or destinating within their PMPC network service area. The Postal Service has executed the first such contract with Emery World Airlines, and Phase I of implementation will be under way during the test year.[53]

b. Postal Service Proposal

[5279] Based on witness O'Hara's proposed cost coverage of 192 percent, USPS-T-30 at 26, the Service proposes a 7.4 percent increase in Priority Mail rates. USPS-T-33 at 24.

[5280] The Service also proposes that the presorted category of Priority Mail be abolished. As noted above, mailers' usage of the category has been light, never amounting to more than 8 million pieces per year, and volume declined by 7 percent from 1995 to 1996. USPS-T-33 at 31. In addition to the lack to mailer response, the Service proposes elimination of the category because presorting will have a diminished value as worksharing in the context of PMPC processing, which will require the contractor to sort Priority Mail to the 5-digit level. *Ibid.*

[5281] The Postal Service also intends to offer the delivery confirmation special service proposed in the testimony of witness Plunkett (USPS-T-40) as part of the basic Priority Mail service. The option to be made available to Priority Mail users at no additional charge—to be called Priority Mail Base Delivery Confirmation (PMB DC) service—will enable them to obtain a package identification number electronically, apply their own barcoded labels to their Priority Mail packages, transmit the identification numbers for barcoded items on the day of acceptance, and make inquiries via a toll-free telephone modem connection to the information service center. Priority Mail users may also opt for an alternative service—Priority Mail Retail Surcharge Delivery Confirmation (PMRS DC) service—that will provide a delivery confirmation identification number on a

[53] A redacted version of the Postal Service's contract with Emery was filed in this docket as library reference LR-H-235. See also Presiding Officer's Ruling No. R97-1/12, August 29, 1997.

USPS-supplied barcoded label at the retail counter, to be applied by the mailer, for an additional per-piece charge. The Postal Service anticipates that the availability of delivery confirmation will lead some users of other subclasses, as well as of non-USPS delivery services, to convert to use of Priority Mail. USPS-T-33 at 27-30.

[5282] Witness Sharkey begins his design of the Service's proposed Priority Mail rates by separating test year before-rates costs among distance-related transportation, non-distance-related transportation, and non-transportation costs. Transportation costs are distributed, summed by zone, and divided by total postage pounds by zone to arrive at a total transportation cost per pound by zone. A weight-related non-transportation charge of 2 cents per pound is then added to arrive at the pound charge by zone. *Id.* at 24-25.

[5283] Witness Sharkey next develops a per-piece cost for Priority Mail by removing the total weight-related non-transportation costs and transportation costs from total test year attributable costs, and dividing by volume. Exhibit USPS-33N. A contingency adjustment is made both to per-pound costs by zone and to per-piece costs.

[5284] The markup of these costs and the percent increase by rate element form the basis for designing Priority Mail rates. As a final adjustment, the base cost for delivery confirmation—approximately $10 million— is added into the cost base for recovery in the test year.

[5285] Witness Sharkey constrains increases for all rate elements to be no more than 16 percent, and rounds each to the nearest nickel. He proposes an increase in the 2-pound rate from $3.00 to $3.20. *Id.* at 26.

c. Proposed Classification Changes

(1) Elimination of Presort Rate Category

[5286] As noted above, the Postal Service has proposed abolition of the presorted category of Priority Mail in this case. No participant objects to this proposal. The only

response to the proposal is provided by Nashua/District/Mystic/Seattle (NDMS), which supports it. NDMS Initial Brief at 58.

[5287] NDMS witness Haldi offers several reasons why the current presort category is little-used, and may in fact be counter-productive for potential users. He notes that presorting by mailers requires extra space, labor, and possibly additional equipment, the costs of which must be offset against the 10-cent discount. After taking account of these costs of presortation, he suggests, net savings may be small or even nonexistent. Tr. 20/10332.

[5288] He also notes that presorting requires that mail be held and "massed" until the collective volume meets the required minimum. The resulting delay may be considered counter-productive by mailers, who choose to use Priority Mail because they want to *expedite* packages to addressees. Inasmuch as mailers with sufficient volume to use the presorted category have probably experienced inconsistent and unreliable delivery performance with Priority Mail, witness Haldi submits that retaining Priority Mail at the point of origin for a mere 10-cent presorting saving will make even less sense to these potential users. "The best way to expedite Priority Mail is to enter it with the Postal Service as soon as possible," he testifies, "not hold on to it to obtain a tiny discount." *Id.* at 10333. Consequently, witness Haldi concurs with the Postal Service's proposal to discount the presort discount for Priority Mail.

[5289] On the basis of the testimonies presented by Postal Service witness Sharkey and NDMS witness Haldi, the Commission agrees that elimination of the presorted category of Priority Mail is supported on the record and consistent with the applicable statutory considerations. The low level of interest among Priority Mail users documented by witness Sharkey (USPS-T-33 at 31, Table 8) and witness Haldi's testimony from the potential user's perspective indicate negative mailer perceptions of desirability and value, which bear on the mail classification factors in § 3623(c)(2) and (5). As witness Sharkey also testifies, with the implementation of the PMPC network the linkage between the "degree of preparation…performed by the mailer" and "its effect upon reducing costs to the Postal Service" — the rationale for worksharing discounts

under § 3622(b)(6)—will be weakened, if not eliminated. This also suggests that the original "justification for [this] special classification" under § 3623(c)(2) may have ceased to exist because of operational changes. In light of this new information, the Commission will recommend that the presorted category of Priority Mail be removed from the classification schedule.

(2) Inclusion of Base Delivery Confirmation Service

[5290] As noted in the summary of the Postal Service's proposal, the Service intends to offer Priority Mail users access to the Delivery Confirmation (DC) special service it proposes in this case. Under the terms proposed in the testimonies of witnesses Sharkey (USPS-T-33 at 27), Treworgy (USPS-T-22 at 5-6), and Plunkett (USPS-T-40 at 19), a basic electronic Delivery Confirmation service would be made available at no additional charge to mailers who communicate electronically with the Postal Service and apply their own DC labels bearing barcoded identification numbers assigned by the Service. The cost of this service, which witness Treworgy estimates to be 14.86 cents per transaction (USPS-T-22 at 17, Table 7), would be "included in Priority Mail costs, and consequently have the effect of reducing the cost coverage of Priority Mail." USPS-T-40 at 18-19. Alternatively, users of Priority Mail could purchase a manual DC service for 35 cents in which a Postal Service window clerk would perform these functions. *Id.* at 19.

[5291] The Postal Service justifies providing the basic electronic service at no additional charge by reference to prevailing practices in the market for expedited delivery services. According to witness Plunkett, all of the Service's major competitors offer piece tracking capabilities, often included in the basic rate. *Id.* at 18. In order to better satisfy customers' expectations regarding expedited delivery services, the Service proposes to provide the basic service to Priority Mail users at no charge and the retail DC service at a surcharge slightly above estimated costs.[54] Additionally, by offering delivery confirmation to Priority Mail users under these terms, the Service expects to attract some

new customers and help maintain its existing customer base, thereby protecting the institutional cost contribution of the associated classifications. *Id.* at 19.

[5292] United Parcel Service opposes the provision of basic delivery confirmation service to Priority Mail at no additional charge, arguing that the proposal "clearly results in an illegal subsidy in favor of certain Priority Mail users of the service, in violation of section 3622(b)(3)." UPS Initial Brief at 53. UPS witness Luciani testifies that, "[f]airness requires that the cost of the delivery confirmation activity be borne solely by those who will use it[,]" and he proposes a fee of 25 cents per transaction for electronic Priority Mail delivery confirmation, the same fee proposed by the Service for the electronic service when provided to Standard B mail.[55] Tr. 26/14331-32.

[5293] The Postal Service responded with the testimony of rebuttal witness Rios, USPS-RT-10. According to witness Rios, the fee structure proposed for Priority Mail delivery confirmation service—including the no-charge electronic service—is consistent with customer preferences as established in extensive market research and necessary to ensure that they use the service. Tr. 35/19033, 35-36. She compares the inclusion of electronic service at no charge to the free boxes provided by the Postal Service for Priority Mail shipments. Although use by customers is by no means universal, she states, both pertain to a feature paid for by all Priority Mail users. Moreover, she claims that the free service will ultimately benefit all Priority Mail users because the information it generates will be used to improve the consistency and reliability of service for all items. *Id.* at 19036-37. Adopting witness Luciani's proposed fees, she testifies, would thwart postal management's goals in meeting customers' needs, could cause many potential

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[54] This is in contrast with witness Plunkett's proposal for Standard B mail, for which he designs fees intended to recover the costs of the service plus an appreciable contribution to institutional costs. He justifies this difference on the ground that, unlike Priority Mail, the Standard B subclasses have markups well below the systemwide average, so that "offering delivery confirmation at fees that are less than or just greater than costs would erode contribution to unreasonably low levels." USPS-T-40 at 20.

[55] Witness Luciani also testifies that the Service's proposed fee for manual delivery confirmation for Priority Mail would produce a cost coverage of 72 percent, and recommends that all volume-variable costs of the scanners used in providing delivery confirmation service be allocated entirely to Priority Mail and Standard B, in proportion to revenue. Tr. 26/14331-34. These arguments are considered in the portion of this decision concerning the proposed Delivery Confirmation special service, infra.

customers to choose a non-postal delivery company and could impair the Service's ability to generate the expected return on its investment in the Mobile Data Collection Device (MDCD) information system. *Id.* at 19033-35.

[5294] On brief, UPS argues that the Service's proposal "runs afoul of virtually every requirement in the [Postal Reorganization] Act[,]" by creating a subsidy in favor of certain Priority Mail users in violation of § 3622(b)(3), by introducing unfair and discriminatory rates in contravention of §§ 403(c) and 3622(b)(1), by setting out to take business away from the Service's competitors in contravention of § 3622(b)(4), and by proposing an unjustified dual fee structure in the face of identical costs contrary to the § 3622(b)(7) factor. UPS Initial Brief at 53-55; UPS Reply Brief at 27-28. The Postal Service responds that its proposal is justified by the testimony of its witnesses, is consistent with the Reorganization Act, and that witness Luciani's proposed alternatives lack merit and should be disregarded. Postal Service Initial Brief at VI-17-VI-21; Postal Service Reply Brief at VI-5-VI-6.

[5295] For the purposes of this proceeding, the Commission will recommend the inclusion of the basic delivery confirmation service in Priority Mail without a separate fee. Delivery confirmation service, and the technology on which it depends, are new to the Postal Service. However, as the Service indicates, track-and-trace services have become standard features in the expedited delivery marketplace and are commonly available at no additional charge to the sender. The Commission is reluctant to recommend the introduction of a service desirable both to users and the Postal Service—and thus responsive to the § 3623(c)(2) and (c)(5) factors—on terms that would tend to discourage its use by Priority Mail users.[56] Furthermore, the potential

[56] United Parcel Service suggests that the Postal Service's declared intention to introduce Delivery Confirmation service to make Priority Mail more attractive to users of competing services is at odds with the § 3622(b)(4) factor. However, that statutory consideration is limited by its terms to "the effect of *rate increases* upon…enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters[.]" 39 U.S.C. § 3622(b)(4). (Emphasis added.) Furthermore, as the Commission recently found in the packaging service case, the Postal Service's intention to stimulate growth in a competitive service by introducing an attractive ancillary service does not stigmatize the proposed new classification, as this is not "an impermissible or suspect goal for the Postal Service to pursue under current law." PRC Op. MC97-5, March 31, 1998, at 55.

value of the information generated through use of delivery confirmation for improving the consistency and reliability of Priority Mail service, cited by rebuttal witness Rios, bears directly on "the importance of providing classifications with extremely high degrees of reliability and speed of delivery[,]" the § 3623(c)(3) factor. This provides an additional important reason for avoiding the introduction of disincentives to using Delivery Confirmation service as an adjunct to Priority Mail service.

[5296] The Commission also finds the Postal Service's proposal to recover the costs associated with the electronic Delivery Confirmation service from the overall pool of Priority Mail costs to be acceptable in this case. Using the proportions contained in witness Sharkey's Exhibit USPS-33R, the Commission projects that there will be approximately seven million electronic Delivery Confirmation service transactions in the test year, with an associated cost of approximately $1 million. At this level of usage, the internalization of transaction costs in the total pool of attributable and institutional costs of Priority Mail has a *de minimis* effect on the rate charged any piece of Priority Mail. However, this treatment may not be appropriate at higher levels of usage, and the Commission expects to revisit this matter in the next proceeding which involves the rates applicable to Priority Mail and the fees charged for services ancillary to Priority Mail.

d. Cost Coverage

[5297] Witness O'Hara proposes a coverage of 192 percent for Priority Mail, in recognition of its high intrinsic value of service, but also its high own-price elasticity and presence in a competitive market for two-day delivery services. USPS-T-30 at 26-27. Two intervenors also offer testimony on the appropriate coverage for Priority Mail: United Parcel Service and NDMS.

[5298] United Parcel Service takes the position that the pre-existing markup relationship between Priority Mail and First-Class Mail should be maintained. UPS Initial Brief at 36-37. UPS witness Henderson recommends a cost coverage of 193 percent, which would represent a 32 percent increase in Priority Mail rates at the Postal Service's

projected cost levels. He notes that this increase is largely driven by his estimate of a 31 percent increase in attributable cost per piece for Priority Mail since Docket No. R94-1. Tr. 25/13568.

[5299] Apart from cost changes, witness Henderson cites several other factors that he believes should be considered in arriving at appropriate Priority Mail prices. He testifies that Priority Mail's superior service standard supports a higher markup than for First-Class letters, and that the addition of delivery confirmation service will add to its quality-of-service advantage. *Id.* at 13568-69. He also cites the substantial increases in Priority Mail volume documented by Postal Service witness Musgrave, and testifies that the growth rate of about 11 percent annually is another indication of the high value of Priority Mail service. In light of this rate of growth, witness Henderson claims that Priority Mail's higher own-price demand elasticity does not seem significant. *Id.* at 13569-70. Finally, witness Henderson testifies that a higher markup for Priority Mail relative to First-Class letters is consistent with the guidance provided in previous rate decisions of the Commission. Following this guidance would not produce an excessive rate increase, he claims, because it is a competitive service of high value, but also one with readily available alternatives. *Id.* at 13570.

[5300] In contrast, NDMS espouses the position that, should the Commission consider a coverage factor different from that proposed by the Postal Service, consideration of the § 3622(b) noncost criteria should lead to a lower coverage. NDMS Initial Brief at 63-72. Witness Haldi testifies that the Service's proposed coverage level is "far higher than circumstances warrant." Tr. 20/10350 (footnote omitted). He offers several justifications for this conclusion.

[5301] First, he questions witness O'Hara's assessment that Priority Mail has a high intrinsic value of service. Based on his analysis of ODIS data for Fiscal Years 1995 through 1997, witness Haldi concludes that Priority Mail always exhibited poorer performance than First-Class Mail within overnight service areas; a higher proportion consistently failed to achieve the two-day service standard more than First Class did; and a higher proportion failed to be delivered within 3 days. *Id.* at 10355-56. He also

observes that a large portion of Priority Mail—33 percent in FY 1997—was unidentified as such and was simply handled as First-Class Mail. *Id.* at 10356-57.

[5302] According to witness Haldi, implementation of the Priority Mail Processing Center (PMPC) network will only serve to further degrade delivery performance, at least during the test year. He notes that the Service's goal under the PMPC Phase I contract is a two-day turnaround time from the Service's tender of a Priority Mail piece to the contractor until the contractor's delivery back to the Service. Given this criterion, he disputes the Service's ability to achieve a high percentage of two-day end-to-end delivery of Priority Mail, and suggests that delivery within overnight service areas within the PMPC Phase I network could well deteriorate to two days, with end-to-end performance elsewhere in the network degrading to three days or longer. *Id.* at 10359-60.

[5303] He also testifies that implementing PMPC processing will have a substantially adverse effect on Priority Mail dropshippers, because they will no longer be able to enter their plant-loaded mail at the nearest Airport Mail Center (AMC), but will instead have to deliver to an intermediate postal facility for transfer to a PMPC processing plant. *Id.* at 10360-61. Inasmuch as 100 percent of the costs of implementing the PMPC network were added to test year Priority Mail costs, witness Haldi submits that Priority Mail will be doubly penalized during Phase I of implementation through higher costs and degraded delivery performance. *Id.* at 10361-62.

[5304] According to witness Haldi, the intrinsic value of Priority Mail is also reduced by the absence of several customer-desired features. Although he acknowledges the proposed delivery confirmation service as a "step in the right direction," he testifies that it is inferior to competitors' track-and-trace programs in several respects. *Id.* at 10362-63. He also claims that Priority Mail suffers in comparison with the competition because of the absence of other valuable features such as inclusion of an insurance coverage minimum in the basic fee; consolidated billing and payment options; guaranteed delivery days and times; and greater variety in available delivery/pricing schedules. Until Priority

Mail becomes more competitive in these areas, Dr. Haldi submits, "it should not be saddled with too high a coverage." *Id.* at 10363.

[5305] Finally, witness Haldi testifies that Priority Mail is not competing very well in the two-day document and package market. He notes that Priority Mail's declining market share has been documented in rate proceedings since Docket No. R90-1, and that its market share continues to decline—to 62.3 percent in calendar years 1995/1996— while the overall market has expanded further. *Id.* at 10364. Priority Mail's own-price elasticity is second only to Express Mail's, he observes, which reflect the highly competitive market conditions for expedited delivery services. He also testifies that there is a disparity between Priority Mail's market share of piece volume (72.2 percent) and its share of revenues (44.0 percent), resulting from Priority Mail's negligible share of heavier-weight pieces, and a growth rate for 5 to 70 pound pieces that is substantially below that for pieces weighing less than 5 pounds. *Id.* at 10365. In conjunction with the other factors identified in his testimony, witness Haldi submits that this "points toward a reduced coverage and a rate increase that is lower than average, most especially for heavier, zone-rated Priority Mail." *Id.* at 10366.

[5306] The Commission recommends a cost coverage of 166 percent for Priority Mail, which represents a markup index of 1.195. The comparable index figure in Docket No. R94-1 was 1.71. In the Commission's opinion, this reduction in the proportional contribution by Priority Mail is not unreasonable, since it continues to bear an above-average markup. Priority Mail is an extension of First-Class Letters and Sealed Parcels, providing service to heavy letters sealed against inspection, and the record indicates the majority of Priority Mail volume can be described in this fashion. Thus, a markup similar to First-Class letters is justified, especially in light of the magnitude of growth in the estimated costs of providing the service. By way of comparison, in R94-1 the Commission's recommended rates produced the cited markup index of 1.71, but also represented an overall rate increase below the systemwide average increase in rates. The Commission found justification for this level of increase in Priority Mail's deteriorating market position:

> [Priority Mail's] share by volume of the second-day package market has declined from 76 percent in 1990 to 72 percent in 1993. Tr. 7A/3100. This decline is a sign of potential market deterioration and supports a below systemwide average rate increase.

PRC Op. R94-1, para. 5116.

[5307] As NDMS witness Haldi notes, Priority Mail's overall market share has continued to decline since R94-1, although in 1995 and 1996 its growth began to exceed that of competitors in the same period. Tr. 20/10364. It would be premature, as he suggests, to conclude that these recent results portend a reversal of the long-term trend of diminishing market share.

[5308] In addition, witness Haldi's testimony in this case raises significant concerns regarding the intrinsic quality and value of Priority Mail service. His analysis of delivery performance suggests that Priority Mail often fails to provide a standard of service superior to, or at times even equal to, that of First-Class Mail. His observations regarding the implementation of processing through the PMPC network do not suggest that prevailing standards of service are likely to be enhanced as a result. Finally, the absence of certain attractive service enhancements offered by competing shippers in a highly-competitive market also tends to support moderation in setting a coverage factor for Priority Mail.

[5309] For all these reasons, the Commission is recommending a somewhat reduced proportional contribution to institutional costs by Priority Mail. However, because of changes in the level of attributable costs, this coverage will result in a 5.6 percent overall increase in Priority Mail rates, which is somewhat above the systemwide average.

e. Rate Design

(1) Basic Rate Design Considerations

[5310] NDMS witness Haldi testifies that, in order to compete successfully for the entire weight spectrum of parcels up to 70 pounds, Priority Mail "needs to have a pricing structure which sufficiently compensates at every weight level and in each zone for its other disadvantages." *Id.* at 10320. In designing the alternative Priority Mail rate schedule proposed by NDMS, witness Haldi incorporates changes in three areas.[57]

[5311] One change he proposes is the elimination of presort discounts, as requested by the Postal Service. *Id.* at 10332-33. Because the Commission recommends the Service's proposed classification change, for the reasons presented above, this aspect of Priority Mail rate design requires no further discussion.

[5312] A second proposed change is to design Priority Mail rates without imposing a markup on the distance-related component of transportation costs. Witness Haldi notes that the Commission rejected the same proposal in Docket No. R94-1, primarily due to the lack of record evidence with which to evaluate the impact of consequent volume losses in the close-in zones against volume increases in distant zones. *Id.* at 10322-23 (citing PRC Op. R94-1, para. 5124). He claims that the Postal Service's direct case in this docket makes it relatively easy to cure this defect, by developing alternative rates and allowing the type of "hold-constant" comparison sought in the Commission's R94-1 decision. With the difference of the uniform $1.10 rate increments he proposes for unzoned 2- to 5-pound pieces, witness Haldi further claims, a comparison of "the Postal Service's rates and my rates reflect the contrast the Commission wanted to see." *Id.* at 10324.

[57] While the proposal of NDMS to increase the maximum permissible weight of First-Class Mail from 11 ounces to 13 ounces nominally applies only to that class, the proposal — which the Commission has discussed above and recommends in this case — also affects Priority Mail volumes, costs and revenues because of the anticipated migration of some pieces under 13 ounces from Priority Mail to First Class.

[5313] On brief, the Postal Service denies that witness Haldi has in fact enabled the Commission to make a "hold-constant" comparison of this rate design change envisioned in the R94-1 decision, and argues that his proposal to eliminate the markup should again be rejected. Postal Service Initial Brief at V-109-V-111. By embedding the results of other recommended changes in the Priority Mail rates he develops—departures from established volume and revenue projection methods, a rise in the breakpoint between First Class and Priority Mail, as well as the proposed uniform $1.10 increment—the Service argues that witness Haldi has failed to isolate the impact of not marking up distance-related costs. *Id.* at V-110. The Service also argues that Dr. Haldi's proposal is undermined by his failure to provide the Commission with any guidance on how to deal with the distance-related costs of other zoned, heavier-weight subclasses, such as Bound Printed Matter and Parcel Post. *Id.* at V-111.

[5314] The Commission agrees with the Postal Service that there is still insufficient available information with which to evaluate the impact of implementing this proposed change in rate design. Witness Haldi has once again noted the inconsistent treatment of distance-related transportation costs in designing rates for different subclasses, and offers plausible reasons for not imposing a markup on these costs in Priority Mail. However, his rate design exercise introduces extraneous variables in the way Priority Mail rates are structured that do not permit an exact "hold-constant" comparison of schedules which differ only in their markup *vel non*. Nor does witness Haldi purport to show what the result of such a comparison would be. Additionally, as the Postal Service notes, this issue has implications not only for Priority Mail, but also for other zoned subclasses containing both lightweight and heavier pieces.

[5315] Faced again with an inadequate basis on the record for evaluating the impact of adopting this proposed change in rate design for Priority Mail, the Commission declines to adopt witness Haldi's renewed proposal. However, to accommodate the concerns he expresses regarding the impact of the current methodology on the rates for heavier pieces of zoned Priority Mail, the Commission's recommended rates constrain the maximum increase in rates for the zones to 15 percent.

[5316] In addition, for reasons presented in Dr. Haldi's testimony, the Commission urges the Postal Service to analyze and address the issue of marking up distance-related transportation costs in the subclasses where this is currently done in preparing its next omnibus rate request. In addition to the issue of impact within individual subclasses, the Commission encourages the Service to explore the inter-subclass effects of this potential rate design change on, for example, the relationships between the resulting rate schedules for Priority Mail and Parcel Post.

[5317] Witness Haldi's third and final rate design recommendation is the retention of a uniform increment between the unzoned rates for Priority Mail up to 5 pounds in weight. Current rates incorporate a $1.00 increment recommended in R94-1; witness Haldi proposes a rate schedule beginning with a 2-pound rate of $3.30 (10 cents greater than the Postal Service's proposed 2-pound and envelope rate), then increasing for each additional pound by an increment of $1.10. Tr. 20/10335.

[5318] On brief, the Postal Service argues that uniform incremental rates are not justified in this case. Postal Service Initial Brief at V-111-V-113. While it notes that the Commission recommended Priority Mail rates with uniform increments—with the approbation of the Governors—in R94-1, the Service argues that in this case the balance weighs in favor of a return to rates that more closely reflect underlying cost differences. *Id.* at V-111-V-112. It also notes that the only "uneven" rate differential proposed by witness Sharkey is the $1.20 differential between the 2-pound and 3-pound unzoned rates, which the Service argues is justified by the importance of moderating the 2-pound rate in recognition that this weight range is mostly likely to contain monopoly-protected letter mail. By contrast, the Service notes, witness Haldi's proposed rate design "would impose a much higher rate increase on the vast majority of Priority Mail users, simply to maintain a non-cost based ideal of even rate increments." *Id.* at V-112. The Service also notes that Dr. Haldi could have used even increments, while leaving the proposed 2-pound rate as proposed by witness Sharkey, and that his proposal to increase that rate adds substantially to the First Class/Priority Mail "gap" problem he also identifies and addresses in his testimony. *Id.* at V-113.

[5319] The Commission accepts Dr. Haldi's proposal to retain even increments in the 2- to 5-pound unzoned rates, and the Commission's recommended rates use the $1.10 increment he suggests. However, because the Commission also recommends a 2-pound rate of $3.20, as requested by the Postal Service, it believes the Service's principal objection to Dr. Haldi's proposal is rendered moot. As the Service concedes, a schedule driven entirely by revenue objectives and cost differences could produce both uneven increments between rates and a 2-pound rate greater than $3.20. However, in the interest of rate simplicity in response to § 3622(b)(7), as well as moderating the impact on the preponderant number of ratepayers who mail at the 2-pound rate, the Commission is recommending rates of $3.20, $4.30, $5.40 and $6.50 for the 2- through 5-pound unzoned rates, respectively.

[5320] The zoned rates that the Commission recommends for heavier Priority Mail pieces follow the design of current rates, using procedures essentially identical to those described in witness Sharkey's testimony. Rates in the 6-10 pound range have been smoothed to increase progressively in the transition from the unzoned to zoned portions of the schedule. In the heavier cells of the zoned portion of the schedule, rate development was constrained so that no recommended rate would either increase, or decrease, more than 15 percent in comparison with the current rate. This procedure is intended to moderate the impact of the above-average rate increase for the subclass overall upon mailers of heavier Priority Mail pieces.

(2) Parcel Surcharge

[5321] United Parcel Service proposes a 10-cent per piece surcharge for Priority Mail pieces that are parcels. Using data from Postal Service Library Reference LR-H-146, UPS witness Sellick derives mail processing costs by shape for Priority Mail and arrives at an adjusted test year cost difference between Priority Mail flats and parcels of 19.5 cents. Relying on this estimated difference in processing costs, UPS witness Luciani proposes a surcharge of 10 cents per piece for Priority Mail parcels,

based on the 19.5-cent cost difference reduced by the 9.3-cent non-transportation weight-related difference between the rates for flats and parcels of average weight already incorporated in the current Priority Mail rate design. Tr. 26/14330. He states that use of a surcharge would encourage the Postal Service to track the separate costs of parcels and flats in the future and would also mitigate the crossover problem between the rates for Priority Mail and Parcel Post. With a Priority Mail parcel surcharge in place, he also suggests, Parcel Post rates would be less likely to exceed Priority Mail rates for the same rate cell. *Id.* at 14330-31.

[5322] Witness Luciani also testifies that the estimated cost difference between Priority Mail parcels and flats is likely to persist under the Priority Mail Processing Center (PMPC) contract. He states that a review of PMPC contract data produced by the Postal Service shows that in the PMPC network there will be a price difference between what the Service will pay for handling flats and handling parcels; he also notes that, on cross-examination, witness Sharkey agreed that this difference in price is likely to reflect difference in costs. Furthermore, because the PMPC contract requires the contractor to separate flats from parcels and deliver each back to the Service in different types of containers, witness Luciani anticipates that the Service will be able to process the Priority Mail in flat trays more easily than parcels, perhaps using a flat-sorting machine such as the FSM 1000, instead of manual sorting. Moreover, he notes, the Postal Service is requesting that retail units segregate Priority Mail by shape prior to transfer to the PMPC in order to assist the contractor. Thus, he concludes, the difference in costs between Priority Mail flats and parcels that already exists in the Postal Service's network will also exist in the PMPC network. Tr. 26/14329.

[5323] The Postal Service opposes witness Luciani's proposed parcel surcharge on several grounds. In its Initial Brief, the Service argues that the rate design of the proposed surcharge cannot be justified as reflecting the actual costs of processing Priority Mail parcels because it ignores the impact on costs of the implementation of the PMPC contract. Postal Service Initial Brief at V-113-V-114. Although the Service later acknowledges the argument of UPS in the Supplemental Brief it filed under seal[58] that

the terms of that contract "in some instances require different payment rates depending on the shape of the mail handled," Postal Service Reply Brief at V-65, the Service maintains that countervailing considerations disfavor a parcel surcharge for Priority Mail.

[5324] First, the Service argues that a surcharge would compromise the relative simplicity of the current Priority Mail rate schedule. The Service cites the Commission's rejection of a proposal to zone all Priority Mail rates in Docket No. R94-1 as recognition that not every cost difference need be reflected in its rate design and argues that the same consideration applies to witness Luciani's proposed surcharge. Moreover, the Service argues, because of the high cost coverage incorporated in Priority Mail rates, there can be no credible claim that Priority Mail parcels pay rates that fail to recover their costs. *Id.* at V-65-V-66.

[5325] Furthermore, the Service argues, the consequences of introducing a parcel surcharge have not been fully explored on the record in this case. In proposing the 10-cent surcharge, the Service notes, witness Luciani did not project the consequences of deaveraging Priority Mail by shape, such as the corresponding decrease in the rate for Priority Mail flats. In the absence of any analysis showing how the parcel surcharge would affect the rates for flats, or how it would affect overall Priority Mail volume, costs and revenue, the Service submits that consideration of a parcel surcharge proposal should be deferred. *Id.* at V-66-V-67.

[5326] In addition, the Service challenges the cost basis of the proposed surcharge. While conceding the similarity of witness Sellick's procedures to the Service's analysis in support of a surcharge for Standard A parcels, the Service argues that application of this method to Priority Mail may be inappropriate. First, the Service notes, with Standard A parcels all weighing under one pound but Priority Mail parcels ranging up to 70 pounds, the weight distributions of parcels in the two subclasses are "grossly dissimilar." *Id.*

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[58] In Presiding Officer's Ruling No. R97-1/62, the Postal Service was directed to produce certain categories of detailed information contained in its PMPC contract with Emery Worldwide Airlines, Inc., subject to specified protective conditions. Representatives of United Parcel Service obtained access to the protected materials, and UPS subsequently filed a Supplemental Brief and Supplemental Reply Brief under seal with the Commission.

at V-67. Second, the Service argues, while there may be a mix of parcels and flats in any given rate cell in Standard A mail, it is highly probable that the zoned, heavier-weight rate cells in Priority Mail are dominated by parcel-shaped pieces, and thus already reflect the costs of parcels. By this reasoning, the Service suggests that the underlying justification for a parcel surcharge would not apply to the parcel-dominated Priority Mail rate cells. *Ibid.*

[5327] The Commission agrees with the Postal Service that a surcharge applicable to Priority Mail parcels is not warranted, at least at this juncture. There may be a measurable cost difference between parcels and other shapes in Priority Mail, as witness Sellick's analysis suggests, but the Service's observation on brief regarding the distribution of parcels in Priority Mail appears valid; the higher zoned rates paid by parcels more than compensate for any shape-related increment in cost. Certainly, as the Postal Service observes, there can be no serious concern that any parcel being mailed at the high-coverage Priority Mail rates is failing to pay its attributable costs.

[5328] Additionally, as the Postal Service observes, the effects of implementing the proposed parcel surcharge, and its implications for Priority Mail of other shapes, have not been adequately explored on the record in this proceeding. Before recommending distinct rate elements for parcels in the Priority Mail subclass, the Commission would prefer to afford all interested parties an opportunity to develop their proposals for the appropriate treatment of Priority Mail of other shapes.

[5329] For these reasons, the Commission is accepting the Postal Service's recommendation to defer consideration of a Priority Mail parcel surcharge at this time. However, in light of witness Sellick's analysis and the information provided in connection with the Postal Service's PMPC contract, the Commission anticipates revisiting this topic and related Priority Mail issues in an appropriate future proceeding.

f. Consistency With Statutory Criteria

[5330] The Commission finds the rates recommended for Priority Mail to be consistent with the statutory considerations contained in the § 3622(b) factors. At the Commission's recommended rates, Priority Mail will recover all attributable costs and make a significant contribution to the institutional costs of the Postal Service, consistent with its intrinsic value under § 3622(b)(2) but also the availability of competitive alternatives under § 3622(b)(5). The level of estimated attributable costs for Priority Mail requires an above-average increase in this case; however, to moderate the impact of the required rate increases on users in response to § 3622(b)(4), the Commission has constrained the maximum rate increase to 15 percent above the corresponding current rate. Because the presorted category of Priority Mail is being abolished in this case, the "degree of preparation" consideration in § 3622(b)(6) no longer is an applicable consideration. The Commission's recommended rates also preserve the comparatively simple structure of Priority Mail rates, in keeping with the § 3622(b)(7) factor.

C. Standard A Mail

1. Introduction and Overview

[5331] Since the MC95-1 and MC96-2 classification cases, Standard A mail has consisted of the following commercial and nonprofit subclasses: Single Piece, Regular, Enhanced Carrier Route, Nonprofit and Nonprofit Enhanced Carrier route. The Postal Service now proposes three classification changes for Standard A mail: (1) elimination of the Single-Piece subclass; (2) a residual shape surcharge of $0.10 per piece, applicable to mail pieces that are not letter- or flat-shaped; and (3) a hazardous materials surcharge.

[5332] The Service also proposes the following Standard A mail average rate changes: 1.9 percent for Regular, 3.0 percent for Enhanced Carrier Route, 11.3 percent for Nonprofit, and -6.3 percent for Nonprofit Enhanced Carrier Route.

[5333] The Service attempts to meet certain goals and constraints with its rate proposals, including: (1) increased automation of the mail stream; (2) moderate rate increases (the Service's goal was to limit proposed rate increases in Regular and ECR to 10 percent or less); and (3) equitable treatment of mailers who adjusted their mailing procedures as a result of reclassification. *See* Postal Service Brief at V-119-V-121.

[5334] Under the Postal Service's proposal, the Standard A class as a whole will generate $13.879 billion in the test year at recommended rates. This revenue constitutes approximately 22.5 percent of total Postal Service revenues.

[5335] While no party opposes the suggested elimination of Standard A Single-Piece mail, several intervenors object to the Service's proposed residual shape surcharge. Intervenors further have raised issues related to the Service's proposals regarding: (1) lowering the pound rate for the ECR subclass; (2) destination entry discounts; (3) the new methodology for computing ECR mail processing cost by rate category; and (4) the level of attributable cost assigned to the Nonprofit subclass. In

addition, one intervenor submits a set of rates for the ECR subclass based upon an alternative rate design methodology.

[5336] In the Sections that follow, the Commission begins with a description of the characteristics of the Standard A subclasses, then turns to a discussion of the Service's proposed modification to the rate design formula underlying current rates. The rate design provides the framework for the residual shape surcharge and pound rate proposals. The Commission then addresses the proposals to lower the pound rate, add a residual piece surcharge and alter destination entry discounts.

[5337] Having dispensed with issues common to all or most of the bulk subclasses, the Commission next discusses each of the subclasses in turn, beginning with the Single-Piece subclass, progressing to the bulk commercial subclasses and concluding with the bulk nonprofit subclasses.

2. Characteristics of the Subclasses of Standard A Mail

[5338] The five subclasses of Standard A mail possess distinct characteristics. Single-Piece standard mail is a small volume subclass (146 million pieces in Fiscal Year 1996) currently used for forwarding or returning small volume or single unit shipments of parcels, catalogs and other printed matter weighing less than one pound, among other things. *See* USPS-LR-H-145 and 187. Single-Piece rates also are charged to mailers for the return of lost or mistakenly retained articles such as hotel keys and identification devices. There is no minimum volume requirement. *Ibid.*; USPS-T-36 at 3. *See also* PRC Op. R94-1, para. 5237.

[5339] Standard A Regular subclass[59] mailings must consist of at least 200 pieces (or 50 lbs) presorted to at least the Basic level, with each piece weighing less than one

[59] In the classification case MC95-1, the former third-class bulk regular rate subclass was split into two new subclasses: Regular and Enhanced Carrier Route (ECR). USPS-T-6 at 12.

pound. DMCS 321.221 and 321.222. Those pieces weighing one pound or more may be sent as Standard B mail. USPS-T-6 at 112.

[5340] Within Standard A Regular mail, there is a distinction between letter and nonletter mail, with nonletter mail consisting of flats, parcels and irregularly-shaped pieces. Ibid. There are five letter and four nonletter rate categories within Regular mail. The five letter categories are: basic, 3/5-digit, basic automation, 3-digit automation and 5-digit automation. The four non-letter categories are: basic, 3/5-digit, basic automation and 3/5-digit automation. In order to qualify for automation discounts, mail must be automation compatible and 100 percent delivery point barcoded. USPS-T-12 at 112-13. *See also* DMCS, § 321.21-23.

[5341] Standard A Regular mail primarily consists of advertising mail targeted to recipients based on demographic, rather than geographic, factors. (In contrast, the ECR subclass is geared toward more geographically-dense advertising.) USPS-T-36 at 7. Typical advertisers using Standard A Regular mail include mail-order firms focusing on specific markets, such as coin collectors or professional uniform buyers. *Ibid*. The Regular subclass accounts for approximately 37.6 billion pieces in the test year after rates, with revenues of approximately 8.0 billion dollars. USPS-T-6 at 5; USPS-T-30 at 43.

[5342] Mailings in the Standard A Enhanced Carrier Route (ECR) subclass[60] must contain at least at least 200 pieces (or 50 pounds) and each piece must be part of a group of 10 or more pieces to one carrier route. USPS-T-6 at 128. Each piece also must weigh less than one pound in order to be sent as Standard A mail. DMCS, § 321.13; USPS-T-6 at 128.

[5343] Within the Standard A ECR subclass, there is a distinction between letter and nonletter mail, with nonletter mail consisting of flats, parcels and irregularly-shaped pieces. Four letter and three nonletter rate categories comprise ECR mail. The four letter categories are: basic, automation, high density and saturation. The three nonletter

[60] The Standard A Enhanced Carrier Route (ECR) subclass replaces the previous mail category of carrier route third-class bulk regular mail. USPS-T-6 at 128.

categories are: basic, high density and saturation. To qualify for automation, letters must be automation compatible and 100 percent delivery point barcoded. DMCS, §§ 321.32-321.35; USPS-T-6 at 128.

[5344] ECR mail primarily consists of geographically targeted advertisements, generally for widely-used products or services. USPS-T-36 at 22. Such advertisers include large department stores and other local service establishments. *Ibid*. While less prevalent than in the Regular subclass, parcel-shaped pieces (such as merchandise samples) may be sent as ECR mail. *Ibid*. The ECR subclass accounts for approximately 28.7 billion pieces in the test year after rates, with revenues of approximately 4.3 billion dollars. USPS-T-6 at 135; USPS-T-30 at 35.

[5345] Standard A Nonprofit mail mirrors the structure of the Regular subclass. Nonprofit mail is sent at reduced rates by authorized charitable organizations, educational institutions and professional associations. The Nonprofit subclasses of mail are used for solicitations, membership-drive activities, alumni mailings and for nonprofit newsletters and magazines with too much advertising to qualify for Periodical rates or which find Standard A Nonprofit rates more favorable. USPS-T-6 at 136. The Nonprofit subclass accounts for approximately 10.6 billion pieces in the test year after rates, with revenues of approximately 1.4 billion dollars. USPS-T-6 at 142; USPS-T-30 at 43.

[5346] Similarly, Nonprofit Enhanced Carrier Route (Nonprofit ECR) is structured to mirror its commercial counterpart, ECR mail. USPS-T-36 at 38. The Nonprofit ECR subclass accounts for approximately 354.6 million pieces in the test year after rates, with revenues of approximately 201.4 million dollars. USPS-T-6 at 148; USPS-T-30 at 43.

3. Rate Design

a. Rate Design History

[5347] Postal Service witness Moeller sketches the recent methods used to develop Standard A rates. USPS-T-36 at 7-8. In Docket R90-1, the Commission

approved the Service's rate design methodology which utilized an equation to calculate the rates for bulk third-class mail. This equation requires several inputs, including: selection of a benchmark category from which discounts will be applied; selection of a breakpoint (defined as the maximum weight for a piece subject to the minimum-per-piece rate, with pieces above this weight subject to the piece/pound rates); a target cost coverage for the subclass; and a piece rate for pound-rated mail. *Id.* at 7. The piece rate for pound-rated mail is theoretically set at a rate which, after all appropriate discounts are applied, would equal zero. *Ibid.* The passthroughs for the various discounts also feed into the equation. The formula ultimately results in the basic undiscounted minimum-per-piece piece rate for nonletters, as well as the undiscounted pound rate. *Ibid.*

[5348] As the Commission recommended an across-the-board, 14 percent increase for third-class bulk regular rate mail in Docket No. R94-1, the aforementioned formula was not used. *Ibid.* In Docket No. MC95-1, in which two new subclasses were approved to replace third-class bulk regular rate mail, the Commission continued to use the Docket No. R90-1 methodology, separately applying the formula to the Regular and ECR subclasses. *Id.* at 7-8. This methodology also was utilized by the Postal Service in its Nonprofit Classification Reform proposal, and adopted by the Commission. *Id.* at 8.

b. Postal Service Proposed Rate Design for R97-1

[5349] The current proposal continues to use the minimum per-piece/per-pound rate structure for all Standard A mail. Mailers would pay a flat rate until the per-piece weight of the mail reaches the breakpoint — approximately 3.3 ounces. At the breakpoint and beyond, the mailer pays a per-piece and per-pound charge. Postage, calculated by either procedure, is the same at the breakpoint.

[5350] The minimum per-piece/per-pound rate structure consists of four fundamental rates prior to consideration of applied discounts (such as destination entry discounts): (1) the minimum-per-piece rate for letters; (2) the minimum per-piece rate for

nonletters; (3) the piece rate for pound-rate nonletters; and (4) the pound rate for pound-rate nonletters.

(1) Rate Design Formula

[5351] The Postal Service submits a rate design using Docket No. MC95-1's approved methodology and rate design formula, with two modifications: (1) a proposed residual shape surcharge (applicable to Standard A mail pieces that are not letter- or flat-shaped), which affects the revenue requirement element of the formula; and (2) a proposal to solve for the piece rate for pound-rated pieces, rather than the pound rate. USPS-T-36 at 8-11. Moeller argues that this formula change allows for direct consideration of the pound rate, and in the case of ECR mail, it permits direct consideration of weight-related costs. *Id.* at 9; Postal Service Brief at V-121.

[5352] According to Moeller, the formula's revenue requirement element accounts for revenue reductions due to discounts. The revenue from the proposed residual surcharge is treated as an offset to the reductions from the discounts. USPS-T-36 at 8.

[5353] VP/CW and NAA comment on the Service's rate design. NAA generally maintains that the Service's proposed change in rate design allows it to arbitrarily set both the Standard A pound rate and saturation piece rate, with neither based directly upon costs, nor derived from cost-based decisions elsewhere in the rate design. Newspaper Association of America Memorandum of Law on the Pound Rate for Standard (A) Enhanced Carrier Route Mail (NAA Memorandum of Law) at 4. Both the Postal Service and MOAA oppose NAA's assertion, arguing that the proposed (versus current) rate design is cost-based[61] and amply reflects the effect of weight upon costs. MOAA Brief at 37-38; Postal Service Brief at V-157-V-58. SMC also disputes NAA's

[61] MOAA points to Service witness Moeller's comments that the current rate design necessarily assumes that there are zero piece handling costs for saturation ECR mail, and only negligible piece costs for basic and high density ECR mail, whereas Moeller's proposed modification recognizes that there are piece costs associated with all ECR mail that are significantly greater than 0.0, 1.0 and 1.8 cents, respectively. MOAA Brief at 37.

arguments, maintaining that Moeller's modified rate design improves upon its predecessor by effectively establishing a piece/pound relationship that more closely reflects the true piece/weight relationship. *See* SMC Brief at 25-29. SMC advocates a rate structure model which adequately accounts for the cost-based relationships of all rate elements. *Id.* at 29. It supports Moeller's proposed rate design, maintaining that the only "arbitrary" or non-cost-based decisions by Moeller were to: (1) adopt rate category passthroughs below 100 percent of the identified cost differences; and (2) select a pound rate that "far exceeds" the low weight-related costs identified in Postal Service witness McGrane and Advo witness Crowder's analyses. *Id.* at 28.

[5354] VP/CW witness Haldi critiques the Service's rate design methodology and proposes an alternative course. While Haldi's proposal applies only to the ECR subclass, the Commission discusses his alternative below, as well as MOAA witness Prescott's rebuttal testimony.

c. Intervenor and Rebuttal Testimony

[5355] VP/CW witness Haldi provides a general analysis of the Service's rate design (theoretically applicable to all Standard A subclasses). He develops bottom-up costs for ECR mail, and alternative ECR rates[62] designed to produce the same revenue and contribution to institutional cost as Postal Service witness Moeller's proposed rates. These rates also reflect the Service's proposed destination entry discounts and revenue burden (with no shift in the burden from letters to nonletters). *Id.* at 47; *see generally* VP/CW Brief at 15-22.

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[62] Haldi's testimony particularly concerns Standard A ECR saturation mail, which he maintains makes a disproportionate contribution to institutional costs within the ECR subclass. Tr. 27/15067. Haldi notes that the cost coverage for the ECR subclass is 228 percent, with ECR saturation letters' cost coverage equivalents from 312 to 316 percent depending upon entry point. Thus, ECR saturation mail pieces- which cost the least for the Service to handle and have the most non-postal alternatives available- make the greatest per piece contribution within the subclass. *Id.* at 15060-75. VP/CW Brief at 29-31. According to Haldi, Postal Service personnel have proposed that high cost coverage (rather than a more preferable lower figure) to mitigate the impact on other rate categories. Tr. 27/15072-73.

[5356] According to Haldi, bottom-up costing involves adding the unit costs for mail processing, delivery, transportation and all other. Tr. 27/15049. This type of costing can explicitly estimate unit costs for separate products, and was used to determine costs for Standard A ECR mail in Docket No. MC95-1, when the new Standard A class and its subclasses were established. *Id.* at 15049-51. Haldi notes that the Service utilizes a top-down approach to rate design for Standard A ECR mail in which unit costs, margins and markups for individual products (rate categories) are never explicitly calculated. He acknowledges that cost differentials should reflect all distinguishing cost characteristics using either approach, but argues that bottom-up rate design for ECR mail offers three advantages: (i) it ensures that every product covers its costs and makes a contribution to institutional costs; (ii) it helps ensure that the rate differential between any two products reflects at a minimum the full difference in the respective unit attributable costs of the two products (*Id.* at 15079-80); and (iii) it explicitly considers the possibility of competition in the delivery function, as well as such other core functions as sortation and transportation. VP/CW Trial Brief at 4-6; VP/CW Brief at 21. Haldi urges the Commission to use bottom-up costs and to set markups that do not excessively burden saturation mail. Tr. 27/15075. He also urges the Commission to consider applying pricing criteria to rate categories. *Id.* at 15085.

[5357] Haldi develops bottom-up costs for ECR letters through the use of the Postal Service's unit costs for: (1) mail processing; (2) delivery; (3) transportation; and (4) other. He sums these figures to develop an average unit attributable cost for each density tier. *Id.* at 15101. Haldi then uses the Postal Service's avoided dropshipping cost from LR-H-111 to transform the average unit costs into unit cost by destination entry point and density tier. *Id.* at 15052-53. These costs are adjusted with a reconciliation factor to ensure that they match the Postal Service's test year costs, with the contingency factor added. *Id.* at 15112-13.

[5358] For nonletters below the breakpoint, Haldi develops cost on a per-piece basis, including pound-related cost, which he simply converts to a per-piece basis. *Id.* at 15055. For costs above the breakpoint, Haldi contends that the Postal Service did not

provide a reliable cost-weight study and he therefore must make two assumptions about the effect of weight on costs, calculating the costs accordingly. He refers to the assumptions as Case 1 and Case 2. *Id.* at 15055-56.

[5359] In Case 1, Haldi assumes that 2.33 cents per piece is weight-related, referring to this assumption as moderately high weight-related cost. *Id.* at 15056. In Case 2, Haldi assumes that 0.5825 cents per piece is weight-related, referring to this as moderately low. *Id.* at 15058. Using these assumptions, Haldi computes the cost for nonletters, with added test year reconciliation and contingency factors. *Id.* at 15056, 15118, 15124.

[5360] Haldi then uses *his* bottom-up costs to develop rates for ECR letters and nonletters,[63] designing the rates to produce the same revenue and contribution to institutional costs as Moeller's proposed rates, as well as to reflect Moeller's proposed destination entry discounts and to ensure that no revenue burden is shifted from letters to nonletters. *Id.* at 15086-88.

[5361] MOAA witness Prescott rebuts VP/CW witness Haldi's proposed bottom-up ECR rates. Tr. 36/19509, 19515. He argues that the rates proposed by Haldi for the ECR subclass are based on an approach containing numerous errors in logic and mathematics, and should therefore be rejected by the Commission. *Id.* 19509; MOAA Brief at 43-44.

[5362] According to Prescott, Haldi's proposed ECR rates reflect an increase to the sortation discounts: ECR high density and saturation mail discounts are increased between 0.4 and 0.8 cents per piece for letters, and 0.6 cents per piece for nonletters above the Postal Service's proposal. Tr. 36/19513. Haldi further increases the Service's proposed base per-piece rate for pound-rated mail by 0.3 cents, in order for his proposal to be revenue neutral. *Ibid.*

[5363] Prescott maintains that Haldi's proposed rates for letters and nonletters are not based on bottom-up costs, as he has not relied on costs representative of the

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[63] For nonletters, Haldi uses bottom-up costs based upon his Case 2 assumption. *See generally* Tr. 27/15118, 15138.

different functions and activities for each rate cell, and has further utilized arbitrary criteria in developing his rate proposal. *Id*. at 19516, 19521-22. According to Prescott, specific data would need to be collected in the Service's cost system reflecting the particular functions and activities of each rate cell in order for rates to be based on bottom-up costs for each rate cell. *Id*. at 19509.

[5364] Prescott further notes that Haldi's rate proposal relies upon his claimed calculation of bottom-up costs for mail delivered to the Bulk Mail Center (BMC). *Ibid*. However, even assuming Haldi's cost procedures are correct, Prescott argues that his proposal is flawed as it ignores the underlying bottom-up costs for other ECR mail, i.e., mail without destination entry or mail delivered to the Sectional Center Facility (SCF) or Destination Delivery Unit (DDU). *Ibid*.

[5365] It is Prescott's contention that Haldi has incorrectly included transportation and other costs in addition to mail processing and delivery costs in his rate differentials, as the Service uses only mail processing and delivery costs in its rate differentials. *Id*. at 19524.

[5366] The Postal Service also objects to Haldi's bottom-up approach to the ECR rate design. Postal Service Brief at V-143. It maintains that the record does not provide a sufficient basis for the determination of the total volume variable costs for individual rate cells, nor does it provide a "firm basis" upon which volume variable costs may be computed for individual rate categories from the ground up. *Id*. at V-144. Consequently, Haldi is forced to adopt numerous assumptions. *Ibid*.

[5367] On Brief, VP/CW argues that Prescott fails to meaningfully and substantively rebut Haldi's proposal. VP/CW Brief at 32. For example, VP/CW maintains that Prescott inaccurately asserts that Haldi relies on overall average transportation and "other" costs for letters and flats combined, and that the particular unit costs which Haldi was forced to interpolate (because the Service failed to provide these costs) actually amount to less than 10 percent of total costs, and consequently have minimal impact on Haldi's final results. *Id*. at 32-34.

[5368] VP/CW further argues that Prescott's assertion of mathematical errors on Haldi's part is "faulty," where Prescott characterizes a transposition error as a mathematical mistake, "exaggerates" Haldi's proposed constant margin and constant mark-up ratio as mathematical mistakes, yet later admits that correction of some of these alleged errors would have minimal impact on Haldi's proposed rates. *Id.* at 35-39.

[5369] In its Brief, VP/CW offers additional detailed rebuttal on Prescott's criticisms of Haldi's rate design. *See* VP/CW Brief at 39-55. Specifically, VP/CW claims that: (1) Prescott unfairly accuses Haldi of error in developing test year ECR pound-rated mail volumes using witness Moeller's percentage distribution, instead of base year weight distribution for pound-rated mail (although there is no evidence that the latter would be more preferable, and Prescott admits that this cost analysis has no bearing on Haldi's ultimate rate design for pound-rate mail); (2) in criticizing Haldi's assumption that shipping costs for piece-rated mail vary in direct proportion to weight, Prescott is actually finding fault with the Service proposal he ostensibly supports (as the Service has neither developed nor presented evidence of the true cost differential in transporting Standard A mail, other than its dropship savings development); (3) Prescott incorrectly criticizes Haldi's selected constant margin per piece, the constant markup ratio and their use in a 90/10 allocation as unsupported (VP/CW concedes that the allocation may be arbitrary), and further offers no reasoned alternative; (4) Prescott takes issue with Haldi's use of the BMC entry point for the development of his proposed rates, but offers no analysis of what differences might result were other entry points used (VP/CW claims the differences would be de minimis); (5) Prescott incorrectly states that Haldi assumes the pound portion of pound-rated mail costs does not vary with sortation or destination entry; (6) Prescott's criticism of Haldi's "truing-up" methodology, while theoretically sound, is empirically insignificant; (7) Prescott completely misunderstands and misconstrues Haldi's use of two alternative cases to illustrate the effect of weight on nonletter piece costs (particularly where the Service has neither developed nor presented adequate information regarding the role of weight); (8) the number of errors Prescott alleges are in Haldi's tables is misleading as the alleged errors are characterized as errors each time

the numbers ripple through subsequent tables; and (9) Prescott is inconsistent and misleading in his criticism that Haldi does not use his developed unit costs in his ultimate rate design for pound-rated mail. *Id*. at 39-55.

[5370] In its Reply Brief, VP/CW maintains that Haldi's proposed rate design would enable the Postal Service to better deal with ECR mail competition. *See* VP/CW Reply Brief at 1-11. VP/CW suggests that the Service does not enjoy a natural monopoly over the delivery function of ECR mail, and Haldi's 90 percent margin/10 percent markup approach (versus the Service's 100 percent margin/0 percent markup approach) allows the needed flexibility for the Service to respond to competition wherever it exists. *Id*. at 9.

[5371] In reply to VP/CW's efforts to "rehabilitate" witness Haldi's proposal, MOAA simply reiterates that it is impossible to perform bottom-up costing with the existing data, and as such, Haldi's efforts produce costs which have no validity. MOAA Reply Brief at 17-18.

d. Commission Analysis

[5372] There are two issues before the Commission: (1) rate design methodology (with both the Service and VP/CW witness Haldi offering alternatives); and (2) the Service's proposed modification to *its* rate design methodology. The Commission logically first addresses rate design methodology.

[5373] The Commission agrees with Haldi's characterization of the present Standard A rate design methodology as a top-down methodology. It begins with the volume variable cost for a subclass, adds institutional costs using a cost coverage factor, and allocates this pool of required revenue to each rate category, taking into account the avoided cost of worksharing activities. Thus, each rate is comprised of both volume variable and institutional cost; but, the difference between the rates of any pair of rate categories equals the difference in the avoided cost between the categories, assuming 100 percent passthrough of avoided cost.

[5374] In Docket No. MC95-1, the Commission addressed the kind of costs that should be included in the avoidable cost calculation used for setting rate differentials within a subclass. The Commission concluded that since the purpose of a worksharing discount is to maximize productive efficiency within the postal markets, cost differentials should reflect only the costs avoided by worksharing. PRC Op. MC95-1, para. 4210. It thus was determined that the worksharing cost should be restricted to mail processing and delivery cost, as the Service had failed to prove that any difference in transportation and "other" costs was due to presort or barcode activities. *Id.* at para. 4293. This continues to hold true. Consequently, as Haldi's bottom-up costs reflect total attributable costs, not simply mail processing and delivery costs, his costs are inappropriate as a basis for setting rate differentials.

[5375] The Commission now turns to the Service's proposal to modify the rate design formula's solution under the current methodology by solving for the piece rate for pound-rated pieces, rather than for the pound rate. There are two solution variables in the current methodology: (1) the minimum-per-piece rate for undiscounted nonletters; and (2) the pound rate. They are called solution variables because they are outputs of the rate design formula. Currently, the piece rate for pound-rated mail is an input to the formula. It must be selected or calculated prior to solving the formula. The Postal Service proposes to select the pound rate and make it an input to the formula, with the piece rate for pound-rated mail as a formula output.

[5376] This is a distinction without a difference. For example, under the current methodology and the Postal Service's original data for the ECR subclass, inputting a piece rate of 5.5 cents for pound-rated mail would produce, as formula outputs, a pound rate of 53 cents and a minimum-per-piece rate of 16.4 cents for basic ECR nonletters. These are the Service's proposed rates. The formula is a means to an end. Selection of which variables will be input variables or output variables does not control the ultimate rates. What is of primary concern to the Commission is how well the rate differences reflect cost differences, in conjunction with the other relevant pricing factors of the Act.

The Commission therefore accepts the Postal Service's modification to the current methodology.

[5377] The Postal Service's proposal to lower the pound rate is addressed in the next section. After the Commission has deliberated on that matter and others, it can produce a set of recommended rates through the use of the Postal Service's proposed formula consistent with Commission findings.

4. The Pound Rate

a. Postal Service Proposal

[5378] In this docket the Postal Service proposes to lower the pound rate in the commercial subclasses and the Nonprofit ECR subclass of Standard A mail, while raising the pound rate in the Nonprofit subclass. In all cases, the proposed breakpoint incorporated into the Service's rate design formula is 3.3 ounces.[64] USPS-T-36 at 16, 27, 34, 39. Each subclass will be addressed in turn.

(1) Regular Subclass

[5379] The Postal Service proposes a reduction in the pound rate for the Regular subclass from 67.7 cents to 65 cents. *Id.* at 15. In the past, the Service had advocated a higher pound rate based on the changing shape mix between flats and parcels as weight increases. *Ibid.* However, with the advent of the residual shape surcharge, the pound rate need not increase as a proxy for the changing shape mix. Witness Moeller cautions that as the 10-cent residual shape surcharge does not fully account for the cost

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[64] Examination of Moeller's workpapers shows the following breakpoint weights in ounces for Regular, ECR, Nonprofit and Nonprofit ECR mail, respectively, which result from the rounding of rates to the first decimal place: 3.2985; 3.2906; 3.2873; and 3.2914. USPS-T-36-W/P-1 at 16, 19; USPS-T-36-W/P-2 at 21, 22. The current breakpoints for Regular, ECR, Nonprofit and Nonprofit ECR mail are, respectively: 3.3087; 3.3062; 3.3407; and 3.3384 ounces. DMM 52, Ratefold; USPS-T-36 at 27, 34.

difference between flats and residual-shaped pieces, the pound rate still functions as a proxy, albeit to a more limited degree. *Ibid*.

[5380] A recent Postal Service cost study indicates that weight is not as significant a cost driver as the pound rate implies. The study, formerly lodged as Library Reference LR-H-182 and now sponsored by Service witness McGrane, estimates the volume variable unit cost by ounce increment for Regular and ECR subclass mail. USPS-ST-44 at 4. Clerk and Mailhandler mail processing cost and window service cost, and city carrier in-office cost are distributed to ounce increments on the basis of IOCS. While the study concludes that costs demonstrate only a slight upward trend with weight, Service witness Moeller nonetheless advocates just a modest decrease in the pound rate, as further reduction would increase other rates. *Id*. at 16; Exhibit USPS-44B at 2.

(2) Enhanced Carrier Route Subclass

[5381] The Postal Service proposes to reduce the pound rate for ECR mail from 66.3 cents to 53 cents. USPS-T-36 at 24. Moeller contends that this significant reduction is warranted because: (1) the current rate design results in inequitable rates. The current piece rate of $0.00 for pound-rated saturation mail produces revenue from two 4-ounce pieces equal to the revenue from one 8-ounce piece. Presumably, the cost for the two package mailing is higher than that for the single piece. Only by setting a piece rate greater than $0.00 can the Service obtain additional revenue from such “split packages;” (2) with the advent of the ECR subclass with a pound rate separate from that of the Regular subclass, weight per piece is now about the same for flats and parcels;[65] (3) the proposed residual shape surcharge mitigates the need for the pound rate to act as a proxy for shape; (4) the new cost study demonstrates very little increase in cost per piece as the weight per piece increases; and (5) a lower pound rate allows the Postal

[65] When carrier route was a part of the bulk regular rate subclass, there was one pound rate for the entire subclass. USPS-T-36 at 25. The rationale for the steeper pound rate was its generation of a higher revenue per piece from parcels where, on average, parcels were heavier than flats for the subclass. *Ibid*.

Service to offer a more competitive price, as the rates for alternative advertising media are not as sensitive to weight. *Id*. 24-26.

(3) Nonprofit Subclass

[5382] The Postal Service proposes to raise the pound rate for full rates from 48.4 cents to 55 cents, a 14 percent increase. *Id*. at 34. Moeller testifies that the increase is necessary in order to meet the RFRA requirements, and also serves to temper the increase in the piece rate that would otherwise occur. *Ibid*. The proposed pound rate increase is approximately the same as the overall increase, thereby avoiding upward pressure on piece rates that would accompany a lower pound rate increase. *Ibid*.

(4) Nonprofit Enhanced Carrier Route (Nonprofit ECR) Subclass

[5383] The Postal Service proposes to reduce the pound rate in the Nonprofit ECR subclass from 45.1 cents to 35 cents, which is a decrease of similar magnitude to that proposed for the ECR subclass. *Id*. at 39; Postal Service Request, Attachment B at 20. A higher pound rate would lead to further reductions in the minimum-per-piece rates than those proposed. USPS-T-36 at 39.

b. Intervenor and Rebuttal Testimony

(1) Effect of Postal Service Proposal on ECR Saturation Mail

[5384] Several parties comment on the purported effect of the Service's proposal to lower the ECR pound rate on ECR saturation mail. AAPS witnesses Green and Bradstreet, along with NAA, oppose the reduction as an anti-competitive measure,[66] while AISOP witness Otuteye, SMC witness Buckel and MOAA, et al. witness Andrew support the Service's proposal, citing the changes in the nature of the ECR saturation mail marketplace over the past two decades. *See generally* Tr. 23/11987, 11991;

Tr. 23/11957; Tr. 27/14495-96; Tr. 32/17240-41; Tr. 36/19716. Advo witness Crowder also testifies to the reasonableness of the Service's proposed ECR pound rate. *See* Tr. 34/18317. On Brief, VP/CW asserts its opposition to what it characterizes as Bradstreet's proposal to increase the Standard A ECR pound rate, citing Crowder, Andrew and Buckel's arguments (which follow) as support. *See* VP/CW Brief at 74-76.

[5385] AAPS members compete with the Postal Service for the delivery of high density and saturation mail. Tr. 23/11981. Both AAPS witnesses Bradstreet and Green argue that the Service's proposal to lower the pound rate for ECR mail is anti-competitive. *See id.* at 11987, 11991, 11957. Bradstreet contends that the Service chafes under regulation and views itself as an aggressive competitor. *Id.* at 11991. Bradstreet maintains that saturation mail, in particular, has been targeted for special treatment with favorable rate proposals; to wit, the First-Class letter rate has increased 113 percent since 1978, while the saturation pound rate has increased only 53 percent. *Id*. at 11986. Under the current proposal, the First-Class letter rate will have increased 120 percent since 1978, while the saturation pound rate will have increased only 17 percent. *Ibid.*, Table A. Likewise, NAA argues that Postal Service's proposed reduction in the pound rate is based upon a competitive rationale that is inappropriate for a public service, particularly as it apparently ignores the effect on the private sector. NAA Memorandum of Law at 20-21.

[5386] Bradstreet testifies that incremental weight is a major consideration for publications deciding whether to use the Postal Service or alternate delivery, as typical publications such as free distribution newspapers and shopping guides weigh 3 to 6 ounces while shared mail packages weigh 4 to 10 ounces. Tr. 23/11987. Thus, the pound rate (versus the piece rate) can affect the competitive balance. It is Bradstreet's contention that the Service's proposal would significantly harm AAPS members who

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[66] In its Brief, AAPS reiterates that it opposes the significant decrease (18 percent) of saturation mail rates proposed by the Service, but is not advocating an increase in the rate to enable its successful competition with the Postal Service. AAPS Brief at 1. Rather, AAPS advocates maintaining the present equilibrium in the competitive market for saturation advertising by setting the pound rate no lower than its present value. AAPS Reply Brief at 2.

compete for delivery of items weighing 4 or more ounces per piece. *Id.* at 11982. Bradstreet maintains that the Postal Service exploits its unique legal monopoly advantage by favoring "competitive" mail at the expense of "captive" mail. *See generally* Tr. 23/11977-12024.

[5387] Both SMC witness Buckel and MOAA, et al. witness Andrew contend that AAPS witnesses Bradstreet and Green misinterpret historical rate trends and/or fail to account for the changing position of saturation mail in the marketplace relative to competitors over the last 25 years. *See* Tr. 32/17240; Tr. 36/19716. For instance, according to Buckel, saturation mail today constitutes a smaller portion of Third-Class mail than before the R87-1 rate case. Tr. 32/17243. He testifies that over the last 25 years, the saturation mail industry has changed from being a major competitor for the distribution of heavier-weight preprints at solo mail rates to an industry primarily confined to distributing lighter-weight preprints as inserts in a shopper publication or shared mail package. *Ibid.*; SMC Brief at 16.

[5388] Witness Andrew notes that ECR saturation did not exist in 1978. Tr. 36/19717. He states that legitimate comparison should start with 1991 rates, when ECR saturation mail came into existence. On this basis, the change in First-Class and ECR rates are comparable – 9 percent increase for saturation mail dropshipped at the DDU versus 10 percent for First-Class Mail. *Id.* at 19717-18. Andrew further argues that Bradstreet fails to recognize the cost trends and worksharing savings underlying the rates. *Id.* at 19718. According to Andrew, from 1978 to 1996, the average cost for First-Class Mail has increased 52 percent, while the average cost for Standard A commercial mail has decreased 10 percent. *Ibid.* In light of these critiques, SMC maintains that the AAPS witnesses' argument that the Service's pricing of ECR saturation mail (with a reduced pound rate) is unfair to competitors is flawed. Tr. 32/17240-41.

[5389] Both SMC witness Buckel and AISOP witness Otuteye testify about the nature of saturation mail programs in support of the Service's proposal to lower the ECR pound rate, with witness Buckel maintaining that the long-term viability of his industry

depends upon the extent to which it can compete with newspapers and private delivery companies for distribution of retail advertising preprints. *See generally* Tr. 32/17244-48; Tr. 27/14495-508. According to Buckel, the cost disadvantage of mail distribution vis-a-vis newspaper or hand delivery services is primarily due to the current rate structure of ECR mail; specifically, the high pound rate above the 3.3 ounce breakpoint. *Id*. Postage for pieces above the breakpoint increases in a direct 1-to-1 ratio with increased weight under the current ECR saturation mail rates, with postage doubling as weight doubles. *Id*. Buckel testifies that this high pound rate affects his company's ability to compete for inserts because the preprint insert rates of his nonpostal competitors increase only moderately as weight increases. *Id*. at 14-15. The Service's current proposal serves to moderate, but not eliminate, the disparity, and will allow Buckel's company to retain its preprint business and let it compete at the margin for some portion of the lighter weight preprint business. *Id*. at 15. Witness Otuteye, an executive of a saturation mail advertising business with numerous franchisees and licensees, likewise testifies that a reduced pound rate would augment his company's ability to offer the prices demanded by big businesses for their media. Tr. 27/14508.

[5390] Advo witness Crowder also advocates the Service's proposed pound rate for ECR mail as both "fully justified" and very conservative. Tr. 34/18316. She notes that the difference between the unit cost for a 2.5 ounce piece and that for a 16-ounce piece implies a pound rate of 18.1 cents, which is a fraction of the proposed 53-cent pound rate. *Id*. at 18317.

[5391] In its Brief, MOAA offers support to the Service's proposal to lower the ECR pound rate, maintaining that witness Bradstreet's testimony provides no basis for rejection of the Service's ECR mail rate design, particularly where he fails to demonstrate the competitive harm theory he propounds in the absence of substantiating financial data. MOAA Brief at 21-27. MOAA further urges the Commission to reject NAA's contention that the Service is inappropriately acting as a market competitor, rather than fulfilling its public function, in propounding its ECR pound rate proposal.[67] *Id*. at 29. According to MOAA, NAA noticeably fails to argue that the Postal Service is out of line

with industry practice. *Id*. at 30. It is suggested that this omission is due to the fact that for alternate delivery competitors, weight has little influence upon costs and consequently, by extension, upon rates charged to users. *Ibid*. MOAA asserts that the Service must take account of "competitive realities" both for its own financial interest as well as for its advertising mail customers, and does so in proposing a reduced pound rate for ECR mail. *See* MOAA Brief at 29-32. SMC is in accord with this proposition. SMC Brief at 6-10. It characterizes NAA's view of the Postal Service mission as self-serving. *Id*. at 23.

[5392] To this argument, the Postal Service adds that no opposing intervenor has demonstrated that the Service's proposal would undercut its prices, or even offered testimony about the prices against which the Postal Service is alleged to be unfairly competing.[68] Postal Service Reply Brief at V-72-V-73. Moreover, despite its complaints, NAA has failed to show on the record that the Service's prices for pound-rated pieces would not be fully compensatory or would not make a substantial contribution. *Id*. at V-72. MOAA, et al. witness Andrew also argues that both Regular and ECR mail cover their costs and make a contribution to institutional costs, as evidenced by the Service's proposed cost coverages. Tr. 36/19715. Likewise, SMC testifies that saturation mail makes a major contribution to institutional costs, with ECR mail having one of the highest institutional cost coverages of any subclass and a high unit contribution. SMC Brief at 4. SMC additionally contends that ECR's true contribution is understated, as both the costs attributed to ECR are overstated in several respects, and

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[67] MOAA voices general objection to NAA's various proposals for Standard A commercial mail, citing NAA's "conspicuous failure" to show the effects of the adoption of its proposals upon either Standard A Regular or ECR rate design. *See* MOAA Reply Brief at 14-15. SMC likewise maintains that NAA's "over-the-top" rate and rate structure proposals would "eviscerate" reclassification. SMC Reply Brief at 1-2.

[68] AAPS responds that provision of actual financial data was unnecessary as: (1) AAPS did not claim that its members were suffering harm from the *present* pound rate; (2) ample evidence of financial harm nonetheless was presented by intervenors who testified that a lowered pound rate would shift business from non-postal to postal delivery; (3) those intevenors in favor of the Service's reduced pound rate proposal presented no supporting information about their own pricing; and (4) the Postal Service itself denied the parties information about the private delivery industry by refusing to provide the results of the SAI study which it had commissioned. *See* AAPS Reply Brief at 2-5.

the Service's projected ECR revenues understate the incremental pound-rate revenues that will be generated by the proposed lower ECR pound rate through a higher proportion of pound-rated pieces, and a higher average weight and more total pounds of pound-rated mail.[69] *Id.* at 4, 44.

(2) The Potential Effect of Weight on Cost

[5393] ABA/NAA witness Clifton, AAPS witness Bradstreet and VP/CW witness Haldi maintain that the Service's cost study supporting its proposal to reduce the ECR pound rate fails to adequately reflect the impact of weight on costs. *See generally* Tr. 21/10857-58; Tr. 23/12009-016; Tr. 27/15875-76. NAA argues that the Service's study largely *assumes* its result that costs of above-breakpoint Standard A mail are mostly piece-related by assuming that most costs are piece-related, rather than weight-related. NAA Memorandum of Law at 17-19. Advo witness Crowder and SMC witness Buckel, in contrast, minimize the effect of weight on cost. *See generally* Tr. 34/18308, 18325-31; Tr. 32/17244-45; SMC Brief at 16, 18-19. SMC further declares that, to the limited degree weight affects costs, NAA ignores the huge disparity between that minimal effect and the high proposed pound rate. SMC Brief at 39.

[5394] Haldi contends that the Service did not provide a reliable cost-weight study, causing him to make assumptions about the effect of weight on cost. Tr. 27/15875-76. Clifton maintains that it is not credible to argue that unit costs do not increase as weight increases because heavier mail is bulkier and takes up more room. According to Clifton, a tray will hold fewer 2 ounce letters than one ounce letters; therefore, more trays have to be handled and processed for a given volume of 2 ounce pieces. And processing more trays implies more costs. *Id.* at 10847-48.

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[69] NAA claims that the proposed pound rate reduction will actually reduce, rather then increase, the Service's net revenue, in light of commercial ECR mail's demand elasticity of less than one. NAA Memorandum of Law at 24. Moreover, a saturation mailer's mere addition of another insert to a mailing, making it heavier, would produce no new volume for the Service. *Ibid.*

[5395] Bradstreet argues that the Postal Service's supporting study was preordained to demonstrate that weight has little effect on cost. He testifies that the Service studied mail processing costs, which are mostly piece-driven (versus weight-driven), but failed to examine carrier street cost, which is mostly weight-driven. Tr. 23/12009-14. Bradstreet maintains that street time is dependent upon weight and bulk: "The only question concerning whether this carrier can accomplish his normal loops is whether he can carry all the load to complete each loop or whether he will have to make extra trips due to extra weight or bulk." *Id.* at 12012. Bradstreet highlights that, when asked to explain why city carrier street costs are distributed to weight increment in proportion to mail volume, Postal Service witness Moeller replied "[t]his assumption was made in interests of simplifying the analysis. Although there may be some weight related costs in city carrier street time, it is believed that the majority of costs are piece related." *Ibid.*, (citing Tr. 7708). Moeller further admitted that weight has some effect on carrier street cost. *Id.* at 12013.

[5396] Advo witness Crowder maintains that Bradstreet's conclusion that street time costs are weight-related is based on misconceptions about: (1) route characteristics; (2) the delivery weight capacity in the system; (3) factors that affect the number of loops and workload; and (4) carrier flexibility to defer mail delivery when faced with unexpectedly high volume.[70] Tr. 34/18308. She testifies that Bradstreet incorrectly assumes a significantly greater number of stops on a loop than Postal Service data from a representative sample indicate, and fails to consider that routes are made up of many small loops. *Id.* at 18325-26. Further, CCS data demonstrate that the average weight per stop allows ample capacity to accommodate weight increases. *Id.* at 18326.

[5397] Finally, it is Crowder's contention that Bradstreet incorrectly implies that *other* ECR delivery costs are weight-related. *Id.* at 18330. For instance, rural carrier costs (accounting for 41 percent of ECR delivery cost) are piece- and shape-related, city

[70] SMC witness Buckel echoes this argument, maintaining that carriers have flexibility to deal with unexpected volume increases and can defer certain mailings if necessary. Tr. 32/17244-45. According to Buckel, these deferrals typically are not due to the weight of the mail to be carried, but rather the extra in-office time to sort and prepare the larger volume of mail pieces. *Id.* at 17245.

carrier out-of-office cost (accounting for 59 percent) varies with piece volume, and 25 percent of routes are motorized and have no weight constraints. *Id.* at 18330-31. (According to SMC, rural carrier costs are entirely piece-related. SMC Brief at 35. The Postal Service also states rural carrier costs are directly related to pieces. Postal Service Brief at V-155.)

[5398] In its Brief, AAPS rebuts Crowder's critique as relying upon conjecture and assumptions rather than fact. AAPS Brief at 4. Specifically, AAPS asserts that Crowder's conclusion that the system can absorb more weight than Bradstreet contends is speculative where Crowder fails to provide the percentage of loops where additional weight causes additional costs. *See* AAPS Reply Brief at 9-10.

[5399] NAA also disputes Crowder's defense of the merits of the Service's cost study, highlighting that Crowder's testimony offers no independent cost data, but rather manipulates the Service study data. NAA Memorandum of Law at 20. However, according to NAA, these efforts are to no avail, because "[i]f a study's data are unreliable, those data remain unreliable no matter how they are manipulated." *Ibid.*

[5400] On Brief, SMC assails NAA's criticisms of the proposed pound rate as without merit, where NAA superficially addresses witness McGrane's analysis and virtually ignores Crowder's effective rebuttal of the Service's cost study's alleged shortcomings. SMC Brief at 22, 34-39. The Postal Service likewise finds NAA's criticisms of the Service proposal wholly lacking substance. *See generally* Postal Service Brief at V-152-V-158.

(3) Other Comments on the Service's Supporting Cost Study

[5401] AAPS witness Bradstreet claims that the Service cost study is flawed, as the underlying data are thin and result in no discernible graphic trend. Tr. 23/12014, 12016. Both Bradstreet and ABA/NAA witness Clifton argue that the study produces anomalous costs: 7.1 cents to handle a 4-ounce piece of mail, 6.6 cents to handle a 13-ounce piece and 13.0 cents for a 14-ounce piece of mail. *Ibid.* Tr. 21/10847. Also, the cost per piece

for ECR mail declines from one ounce to two ounces to three ounces, and the cost for a 6-7 ounce piece is less than a one ounce piece. Tr. 21/10847. On Brief, NAA characterizes the study as a "cost allocation exercise which depends upon an excessive thinness of tallies in the very weight ranges affected by the proposal, and turns upon the per piece nature of several of its underlying assumptions." NAA Brief at 5. *See also* NAA Memorandum of Law at 11-20. NAA maintains that the study is further flawed where routine statistical analyses for accuracy such as standard errors of estimates cannot be conducted on the mail processing cost data, and the one statistical test which can be performed — the calculation of coefficients of variation for the costs- results in "quite large" coefficients of variation for above-breakpoint weight increments. NAA Memorandum of Law at 15. Consequently, these parties question how the Commission can rely on the study results. *See*, *e.g.*, Tr. 21/10847.

[5402] Advo witness Crowder rebuts these allegations, maintaining that the Service's cost study reflects the actual mail makeup and cost characteristics, and that witness McGrane's costs were appropriately adjusted to separately reflect letters and flats. Tr. 34/18310-11. Crowder testifies that the decline in unit cost over the first three ounces arises from two factors: (1) flats under one ounce are flimsy and difficult to handle in piece-related processing and delivery operations; and (2) non-workshared basic letters have a low address density which, when coupled with a light-weight piece, leads to less efficient containerization causing less efficient handling and extra-bundle/piece handlings. *Id.* at 18311-12. While acknowledging that the pattern of costs above the breakpoint has two anomalies,[71] she notes that the deviations account for only 0.3 percent of total ECR flat volumes. *Id.* at 18313. Moreover, ECR costs below the breakpoint demonstrate a flat or declining relationship with weight, which is consistent with the proposed minimum-per-piece rate structure. *Ibid*. Crowder states this pattern is consistent with data patterns in earlier Standard A cost studies. *Id.* at 18314-15.

[71] Those anomalies are a drop at the 12 to 13 ounce bracket and a sharp increase in the 15 to 16 ounce bracket. Tr. 34/18313.

[5403] Postal Service witness McGrane echoes this testimony on past Standard A cost studies. Postal Service Brief at V-154. The Postal Service minimizes the variation of cost estimates across individual weight cells, with McGrane testifying that the cost study "was not intended to measure specific cost relationships between individual weight cells, but rather to provide the overall relationship between weight and cost for Standard Mail (A)." Tr. 15/7657. *See also* Postal Service Brief at V-154-V-155.

[5404] NAA disputes the validity of McGrane and Crowder's "cost pattern" theory, asserting that there is no evidence that the prior studies were "any better" or based on any greater number of tallies. NAA Memorandum of Law at 16. Further, NAA points out that the prior IOCS studies made no attempt to account for carrier costs. *Ibid*.

[5405] In response to NAA's assertions, SMC accuses NAA of ignoring the "big picture" by focusing on individual weight increments, and argues that the alleged data thinness in higher weight increments does not lessen the reliability of the results. SMC Brief at 31. According to SMC, a less disaggregated analysis would produce an even flatter cost curve. *Ibid*. SMC states that "[i]f the data were truly as 'unreliable' as NAA claims, one would expect wildly random variations with no discernable overall cost pattern above the breakpoint." *Id*. at 32.

[5406] On Brief, the Postal Service further defends its cost-weight study against NAA's criticisms. Postal Service Brief at V-152-V-153. According to the Service, its study includes all cost segments (not only in-office cost segments), and is well-designed to measure the cost-weight relationship, as one of the main sources of data for the study is the IOCS, whose fundamental purpose is to measure the time required to handle mail. *Ibid*. Thus, if heavier mail costs more to handle than lighter mail of the same subclass, the relationship would be apparent in IOCS costs. *Id*. at V-153.

[5407] On Brief, MOAA supports the Service's cost-weight study as valid evidence for the proposed rate design, citing witness Crowder's testimony as effective rebuttal to NAA's claim that the study constitutes an unreliable basis for the proposed reduced ECR pound rate. MOAA Brief at 32-33. MOAA contends that "even if the cost-study represents an enormous understatement of the relationship of weight to costs for pound

rated material, a proposition for which there is no support, the rates which have been proposed produce revenues so far in excess of the pound related costs shown by the study that there can be no reasonable basis for arguing that the rates are too low." *Id.* at 33. SMC supports this premise, and further argues that the relationship between shape- and weight-related costs and the letter/flat cost differential additionally proves that the current pound rate is greatly excessive in relation to weight-related costs. SMC Brief at 20. SMC cites witness Crowder's testimony in MC95-1 for the proposition that the Service's then-proposed lower pound rate substantially exceeded the maximum ECR mail weight-related costs even under the extreme assumption that the total average cost difference between ECR letters and nonletters is due exclusively to weight, rather than shape. *Ibid.* According to SMC, in this case witnesses Crowder and Haldi determine the Service's proposed pound rate as still high in relation to true weight-related costs (which are substantially over-covered), with Haldi "effectively conced[ing]" that the proposed pound rate alone would more than cover the entire letter/flat cost differential, even without a separate shape-based letter/flat rate differential. *Id.* at 21.

(4) NAA's Discrimination Argument

[5408] NAA claims that the Service's proposal to lower the pound rate for Standard A Regular and ECR mail is selective and unreasonably discriminatory in nature, where rates for First-Class mailers are proposed to increase. NAA Memorandum of Law at 7-10. It contends that the Service has failed to provide a cost basis for the lowering of the Standard A ECR pound rate. *Id.* at 25-26. NAA suggests that the Service goes one step further in unjustified selectivity by favoring ECR flats, which benefit from the reduced pound rate, over ECR letters, despite the Postal Service's denial of any distinction among letters, flats and parcels in the competitiveness of commercial ECR mail. *Id.* at 22. Consequently, the Service's action in this instance violates §§ 403(c), 3622(b)(1), (4) and (5) of the Postal Reorganization Act. *Id.* at 8, 27.

[5409] In response, MOAA argues that NAA's identification of alleged rate design problems within First-Class mail does not refute the need to improve the Standard A rate design. MOAA Brief at 34. According to MOAA, the solution does not lie in shifting massive amounts of the revenue burden from First-Class to Standard A mail. *Id.* at 35, 44-45.

[5410] SMC characterizes NAA's discrimination argument as "misdirected," and points out that the policy considerations underlying the First-Class rate structure (i.e., protecting "Aunt Minnie") do not apply to business-oriented Standard A mail. SMC Brief at 24. Focusing on ECR mail, SMC states that consequently there is no need to perpetuate a non-cost-based rate structure or to maintain artificial cross-subsidies between mailers in this subclass. *Ibid.*

[5411] DMA argues that NAA's opposition to the Service's proposed reduction in the Standard A pound rate "is motivated not by its stated goal of benefiting First Class mailers, but by a selfish interest in assuring that Standard (A) mailers suffer rate increases that drive them to use the services of NAA's members. NAA's position should be rejected for that reason alone." DMA Reply Brief at 13, n.7.

[5412] Finally, the Postal Service maintains that ECR pound rate determination has no effect on the rates for First-Class mail, and a higher proposed ECR pound rate would not, in light of witness O'Hara's target cost coverages, result in lower First-Class Mail rates. Postal Service Brief at V-158. Further, witness Moeller's proposed usage of the formula results in a positive per-piece rate for saturation pieces, which more realistically recognizes the piece-related costs for this mail. *Id.* at V-157.

c. Commission Analysis

[5413] The Postal Service proposal to lower the pound rate for the Standard A commercial classes, particularly ECR, has generated much controversy. On the other hand, the suggested pound rates for the nonprofit subclasses have gone unchallenged. The Commission therefore first addresses the Nonprofit and Nonprofit ECR pound rates.

[5414] The current full rate is 48.4 cents per pound. The Service has proposed to increase this to 55 cents. No alternative rates have been advanced. The Commission finds 55 cents to be justified, and recommends it. It is consistent with the overall increase necessary to cover attributable costs, provide a contribution consistent with RFRA requirements, and moderate upward pressure on piece rates. *See* USPS-T-36 at 4.

[5415] In the case of Nonprofit ECR, the Commission recommends a pound rate of 29 cents, which is a reduction from the current rate of 45.1 cents (and below the Service's proposed 35-cent pound rate). The reduction to 29 cents is necessary to accommodate the recommended presort and letter passthroughs and rate design considerations discussed in Section C.11. of this Chapter. Given the Commission's cost-based passthroughs for worksharing discounts, use of the Postal Service's proposed pound rate would have the undesirable effect of producing a piece rate for pound-rated saturation mail of -0.4 cents.

[5416] Turning to the Standard A commercial subclasses, the Commission recommends maintaining the Regular and ECR pound rates at their respective 67.7 and 66.3 cent levels, thereby rejecting the Service's proposal to lower those pound rates.

[5417] The Postal Service submits its cost-weight study, Standard Mail (A) Unit Volume Variable Cost by Weight Increment (Exhibit USPS-44B), sponsored by witness McGrane, as justification for lowering the Standard A Regular and ECR pound rates, further arguing that the lowered rates are necessary to enable the Service to be a viable competitor in the marketplace. As previously noted, several intervenors rebut these contentions.

[5418] The Act requires that the Commission consider fairness and equity factors in setting rates, such as the use of the appropriate cost measure to determine rate and fee levels. 39 U.S.C. § 3622(b)(1). As discussed below, review of the evidence suggests that the Service's cost-weight study is not sufficiently reliable to support a substantial reduction in the pound rate, nor is the Service's pricing argument persuasive.

[5419] The cost-weight study contains mail processing costs based on IOCS tallies. The thinness of the tallies supporting the distribution of mail processing cost by weight increment presents a serious problem. For the ECR subclass, all weight cells over 8 ounces contain 10 or fewer tallies, with the 13-ounce increment containing only one tally. Tr. 15/7651-53. As the table below shows, this thinness of data results in erratic variation from increment to increment, with the unusual outcome (for example) of a one-ounce piece and a 13-ounce piece costing the same. *Id.* at 7657.

Table 5-10
FY 1996 Attributable Unit Cost
by Weight Increment
Standard (A) Bulk Mail
Carrier Route

Weight Increment (ounces)	Unit Cost (cents)
1	6.6
2	5.8
3	5.1
4	7.1
5	5.1
6	5.5
7	5.9
8	9.1
9	7.8
10	9.9
11	9.5
12	9.0
13	6.6
14	13.0
15	13.7
16	18.1

Table 5-10
FY 1996 Attributable Unit Cost
by Weight Increment
Standard (A) Bulk Mail
Carrier Route

Weight Increment (ounces)	Unit Cost (cents)

Exhibit USPS-44B, Table 1. The thinness also results in a large coefficient of variation for heavier weight pieces, exceeding 100 percent for the 13-ounce increment for the ECR subclass. Tr. 15/7750. The thinness problem is not surprising, as IOCS is not designed to produce costs below the subclass level, particularly to the level of disaggregation required in the Service's cost presentation.

[5420] Crowder's effort to salvage Postal Service witness McGrane's data by arguing that past studies have shown similar results is unsupported by specific record evidence demonstrating that "thinness" was not an issue with those studies. NAA Memorandum of Law at 16. Moreover, while Crowder's adjustments to McGrane's costs reduce the erratic variation to a certain degree, and although she provides possible explanations for the remaining anomalies, Crowder's reasoning is speculative.

[5421] Another problem with the cost-weight study is that it contains no comprehensive study of cost-causing factors. The non-IOCS related costs are assigned to weight increment on the basis of various volumetric measures. As NAA correctly highlights, "… [the cost-weight study] contains no attempt actually to observe or measure costs; nor it is a time/weight analysis. It does not arise from a comprehensive analysis of the cost-causative characteristics of Standard Mail A pieces of various weight of the type long requested by the Commission. Nor is it a simulation study or even an econometric regression analysis." *Id.* at 12. This problem is manifested when AAPS

witness Bradstreet and Advo witness Crowder offer plausible, yet conflicting, rationales for a causal relationship between carrier street costs and weight, as well as carrier street costs and pieces. While Crowder provides some support statistics (*e.g.,* average weight per loop of 20 pounds), her proposed rationale is as speculative as Bradstreet's.

[5422] The Postal Service sheds no light on the subject as it assumes that delivery costs are piece-related. *Id.* at 18. Where the Service has failed to test these rationales or its own theories, there is no sound basis on the record for distributing carrier street costs to ounce increments. This is a serious shortcoming as elemental load time accounts for approximately one-half of city carrier street attributable cost. Intuitively, one might expect elemental load time to vary with the weight of a piece, but there is only speculation on the record. *See* PRC-LR-14 (Base Year Costs). In light of these considerations, the Commission finds that the cost-weight study contained in Exhibit USPS-44B does not provide a cost basis for reducing the pound rate.

[5423] The Commission finds the lack of a reliable cost-weight study to be singularly frustrating. The Service has submitted the same basic cost study to the Commission since 1982, despite Commission requests for a more comprehensive analysis. Tr. 34/18315. In Docket No. R87-1, the Commission requested that the Postal Service conduct a study of the cost effect of changes in weight per piece. PRC Op. R87-1, Appendix K, para. 001. In Docket No. R90-1, the Commission repeated the request, emphasizing that this area of inquiry remained largely unexplored. In fact, the Commission stated, "For example, no cost study underlies the pound rate, a fundamental component of rate design." PRC Op. R90-1, Appendix K, para. 104. Yet, as Crowder shows, the Service continues to introduce the same type of limited study. Tr. 34/18322. In light of the recurrent Service cost study weaknesses, it may be instructive for the Service to consider VP/CW witness Haldi's comments on the issue of more effective study design. *See* Tr. 27/15152-62.

[5424] Significantly, pricing considerations also militate against recommending a substantial reduction in the pound rate. Criterion (b)(4) of the Act requires that the Commission consider "the effect of rate increases upon the general public, business mail

users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters." 36 U.S.C. § 3622 (b)(4). In drafting such specific language, Congress clearly conveyed its concern that the Commission particularly consider the effects of rate increases on enterprises that are in competition with the Postal Service. The Postal Service and saturation mailers led by SMC favor the proposed lower *ECR* pound rate as a way to compete with alternative media. AAPS, one of the alternative media, claims the proposal is anti-competitive and would harm businesses vying with the Postal Service.

[5425] The evidence suggests that the Postal Service has targeted the ECR subclass for special consideration for competitive reasons. *See*, *e.g.*, NAA/R97-1 LR-2 (United States Postal Service 1998 Marketing Plans). As the degree of competition was the reason for recommending a separate ECR subclass in Docket No. MC95-1,[72] this action by the Service is not unexpected. PRC Op. MC95-1, paras. 5454 and 5460. However, rate reductions not firmly supported by reliable cost evidence that may jeopardize the visibility of small businesses, such as the alternative delivery services represented by AAPS, are not consistent with 39 U.S.C. § 3622(b)(4). While it is unknown how a substantial decrease in the pound rate will affect the "bottom line" of these businesses (i.e., their ability to survive), the record indicates that the impact may be severe. *See*, *e.g.*, Tr. 23/11982. In light of this circumstance and the inherent weaknesses of the Service's cost-weight study, the Commission finds that it should not alter Regular or ECR pound rates. At the same time, the Commission shall confine rate increases to the per piece rates in recognition of the need to retain the Postal Service's position in the saturation delivery market.

[72] The degree of competition is different for the ECR subclass as compared to the Regular subclass.

5. Residual Shape Surcharge

a. Postal Service Proposal

[5426] The Postal Service responds to the Commission's concern about the "serious equity problem…[that] the average revenue for the proposed Standard mail regular parcels is less than the average cost for those pieces … [with] other mailers … covering the shortfall in revenues for parcels" (*see* PRC Op. MC95-1, para. 5559) by proposing a surcharge of 10-cents per piece for all Standard A mail residual shape pieces — *i.e.,* not letters or flats. USPS-T-36 at 11.

[5427] Moeller testifies that, in order to mitigate the impact on parcel mailers, the 10-cent surcharge represents a passthrough of less than one-third of the cost difference between flats and residual-shaped pieces. *Id.* at 12. The Postal Service contends that the proposal is supported by the analysis of witness Crum, who develops the total volume variable costs for Standard A mail by shape. Postal Service Brief at V-162.

[5428] Crum utilizes the IOCS for separating costs by shape, and allocates those CRA costs not captured in the IOCS to shape using selected volume measures. USPS-T-28 at 11. *See* generally USPS-LR-108 at 8-9. Commercial and nonprofit subclasses are combined to allow Crum to calculate the weighted average unit cost for Standard A. USPS-T-28 at 11. As the costs reflect FY1996, Crum updates the figures to the test year level by applying the test year/base year adjustment factor. Finally, because the cost difference reflects not only the difference in shape, but also the presort and dropship differences, Crum adjusts the cost difference to remove the non-shape factors, which results in a difference of 35.1 cents per piece. USPS-T-36 at 12.

[5429] Moeller supports applying a single flat-rate surcharge to all residual (nonletter, nonflat) pieces, contending that it fairly acknowledges the costs associated with the shape difference while avoiding the creation of a more complex rate schedule. USPS-T-36 at 13; Postal Service Brief at V-160. Multiple rates are not called for since less than 8 percent of the Regular subclass nonletters are residual-shaped pieces

subject to the surcharge. Less than one percent of ECR nonletters would be surcharged. USPS-T-36 at 13. Likewise, there are relatively few parcels in the Nonprofit and Nonprofit ECR subclasses. *Id.* at 35, 40. By limiting the surcharge to 10 cents per residual-shaped piece, the Service effectively: (1) tempers the rate impact on mailers already receiving above average increases for nonletters; and (2) responds to concerns that some parcels are no more costly to process than flats. *Id.* at 13-14.

[5430] The Postal Service maintains that the proposed residual shape surcharge is consistent with the classification criteria of the Act, as: (1) it enhances fairness and equity by partially deaveraging higher cost residual pieces from letters and flats; (2) the majority of Standard A mail users will bear less of the additional costs of residual-shaped pieces, as rates for letter- and flat-shaped advertising mail will be priced more appropriately; and (3) the surcharge is simple and achieves the goal of reasonably deaveraging without adding significant complexity to the Standard A rate structure. *Id.* at 14-15; Postal Service Brief at V-160-V-161.

b. Intervenor and Rebuttal Testimony

[5431] PSA witness Jellison, RIAA, et al. witness Andrew and NDMS witness Haldi testify against the Service's proposed residual shape surcharge of 10 cents, maintaining that the surcharge figure exceeds any amount which can be justified by the evidence. *See generally* Tr. 24/12964-74; Tr. 22/11651-75; Tr. 23/12144-75. Their primary criticism of the proposal centers on witness Crum's cost study. These intervenors characterize the study as flawed because, among other reasons, it ostensibly does not consider the effect of weight on either costs or the revenue produced by parcels.

[5432] Postal Service McGrane rebuts the intervenors' contentions, maintaining that the proposed 10-cent surcharge is justified, and that the underlying cost study appropriately considers parcel processing costs and revenues. *See* Tr. 35/18958, 18962.

(1) Impact of Weight Upon Parcel Cost and Generated Revenue

[5433] RIAA, et al. witness Andrew testifies that the Postal Service's underlying analysis for the surcharge shows a cost difference between the average flat mail and average parcel mail in Standard A of 33.4 cents per piece. Tr. 22/11651-52. However, this analysis ignores that, on average, parcels weigh 8.35 ounces while flats weigh 3.32 ounces. *Id*. at 11655. Andrew maintains that the weight difference contributes to the difference in revenue between parcels and flats, and that the Service's surcharge recommendation ignores the 24.6 cents per piece that parcel revenues exceed flat revenues.[73] *Id*. at 11656. Thus, the correct difference is 8.8 cents. *Ibid*. NDMS witness Haldi also takes exception to the Service's failure to determine the degree to which weight, as opposed to shape, is a causative factor in parcel handling cost, and its current focus on only the cost difference between flats and parcels in its rate design.[74] Tr. 23/12153; NDMS Brief at 81-84. Finally, PSA witness Jellison testifies that, given that the average weight of a parcel is 8.9 ounces and the average weight of a flat is 3.74 ounces, "weight is every bit as distinct a cost causing factor as shape," and that the current rate structure accounts for this by charging more for parcels on average. Tr. 24/12972.

[5434] Jellison further argues that the proposed residual shape surcharge is premature, as the Service has not established the effect of the surcharge on the cost coverage of Standard A parcels. *Id*. at 12969. According to Jellison, the Service is unaware of whether the average revenue per piece for Standard A parcels, absent the surcharge, would be equal to or greater than the average per piece cost. *Ibid*.

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[73] RIAA, et al. maintains that the Postal Service effectively concedes that there was an "elemental mistake" in witness Crum's cost analysis underlying the surcharge, as Crum failed to consider the net revenue effects to the Service resulting from the fact that parcels yield, on average, greater revenues than flats. RIAA, et al. Brief at 1. The Postal Service denies such an admission, and notes that witness Crum's rebuttal testimony effectively demonstrated that, even using RIAA, et al.'s criteria for a surcharge, the proposed 10-cent surcharge is warranted. Postal Service Reply Brief at V-101.

[74] NDMS asserts that there is still no record evidence that parcels are systematically more costly to handle than flats. NDMS Brief at 81.

Moreover, the Service's combining of the Standard A subclasses to determine a parcel surcharge based on revenue and costs further "obfuscates the true picture," as Regular subclass parcels account for 88.5 percent of total Standard A parcels. *Id*. at 12972; PSA Brief at 29-30. According to PSA, it is improper to require mail within the same rate category to meet exactly the same implicit cost coverages. PSA Brief at 37. PSA urges the Commission to find that as a matter of policy such an approach is contrary to the necessary cost averaging that occurs not only within subclasses, but particularly within rate categories. *Ibid*. It therefore follows that should Standard A Regular parcels be determined as fully covering their attributable costs, then the Commission should decline recommending a surcharge of any amount for Standard A parcels merely to allow for the implicit coverage for those parcels to be closer to the implicit coverage for Standard A flats. *Id*. at 38.

[5435] Jellison testifies that Standard A parcel revenues cover costs. Postal Service figures indicate that a 10-cent surcharge will produce an average revenue of 56.45 cents for the Regular subclass parcels compared to a 49.9 cent cost, resulting in a net revenue of 6.55 cents. Tr. 24/12973. Thus, according to Jellison, only a 3.45 cent surcharge is required for Regular parcels to cover cost (the difference between the 46.45 cent average revenue and the 49.9 cent average adjusted cost).[75] *Ibid*.

[5436] On Brief, NDMS argues that the Postal Service's proposed surcharge does not address the alleged "below-cost rate problem" which the surcharge was ostensibly designed to solve, when the Service focuses on costs and effectively ignores the Commission's past concern that revenues from parcels were less than the costs attributed to parcels. NDMS Brief at 75; NDMS Reply Brief at 38. NDMS highlights witness Moeller's testimony that "the 'difference between revenues and costs'" incurred by parcels "is not relevant to the rate design" underlying the surcharge because "[t]he

[75] In its Brief, PSA notes that, when applying costs as suggested by witnesses Crum and McGrane (and therefore not using Crum's adjustment of parcel costs without adjusting for revenues), a 10 cent surcharge would produce 56.45 cents per piece, versus an average cost of 51.3 cents. Thus, PSA submits that a 5-cent surcharge would allow the parcels in the base year to cover their costs. PSA Brief at 31.

point of the surcharge isn't to assure cost coverage or that the revenues exceed the costs; it is to recognize cost differences between these two groupings of mail."[76] NDMS Brief at 75 (citing Tr. 6/2816-17, Tr. 6/2948, ll. 19-22); (emphasis omitted). According to NDMS, Service witness McGrane likewise appears to focus on whether Standard A parcels make the same contribution to institutional costs as are made by Standard A flats. *Id*. at 76. As such, both witnesses fail to acknowledge that the "below-cost rate problem" of both Standard A Regular and ECR mail has consistently diminished over the past few years. *See* NDMS Brief at 76-78.

[5437] The Service disputes NDMS claims that it is indifferent to whether parcels cover their cost. Postal Service Reply Brief at V-91. It maintains that NDMS misinterprets witness Moeller's testimony that "'what percentage 10 cents is of the 'difference between revenues and costs' is not relevant to the rate design.'" *Id*. According to the Service, Moeller was simply stating that rate design does not have such a percentage as an input, but instead attempts to assign a rate differential that takes into consideration the cost difference between shapes. *Ibid*.

[5438] The Postal Service takes exception to NDMS's assertion that its proposal does not address the Commission's identified "below-cost rate problem," arguing that the absence of a proposed surcharge would constitute a failure to acknowledge the problem. *Id*. at V-91-V-92. Further, there is no evidence to suggest a trend that will enable parcels to one day cover their costs. *Id*. at V-92. The Service notes that a solution to the below-cost rate problem need not result in costs exactly equal to revenue. *Id*. at V-100. It argues that the fact that parcels don't cover their costs highlights the need for a surcharge, but a rate differential is not contingent upon whether a certain mail grouping is covering its costs (*i.e.,* the implementation of shape-based rates in R90-1 was not because nonletters were not covering their costs). *Id*. at V-101.

[5439] The Postal Service also acknowledges PSA's criticism regarding the propriety of comparing implicit coverages within a subclass. *Id*. at V-102. While

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[76] "These two groupings of mail" presumably refer to Standard A flats and parcels.

agreeing with this principle, the Service highlights that PSA itself proceeds to use implicit cost coverages within the subclass in arguing against the proposed surcharge. *Ibid*. Specifically, PSA suggests that there is a substantial disparity in the implicit coverages for letters and nonletters (versus those for flats and parcels). *Ibid*. The Service maintains that this disparity actually supports a residual shape surcharge which would help the situation to the extent nonletters have too low of a coverage vis-a-vis letters. *Ibid*.

(2) Issue of Shape in Parcel Identification and as the Cost-Causing Factor

[5440] PSA witness Jellison comments that the Postal Service measured the shape-related cost difference between parcels and flats to be 20 cents in the recent, withdrawn parcel reclassification case, yet now claims the difference to be 40 cents. Tr. 24/12965. In the earlier cost study, upon which Service witness Moeller bases his rate design, Postal Service witness Crum identified cost differences between Standard A flats and parcels, but did not establish shape as the cost-causing factor. *Ibid*.; PSA Brief at 23-24. *See also* NDMS Reply Brief at 44.

[5441] Jellison further highlights that the volumes and costs associated with handling Standard A parcels and flats do not align because the definition of flats and parcels is different in the Permit system (which bases shape determination on the mailing statement) and the IOCS system. The IOCS is subject to additional error, as Service data technicians may mistakenly miscategorize shapes on occasion. Tr. 24/12965-66; PSA Brief at 25. NDMS witness Haldi also voices concern that the definition of a Standard A parcel is open to interpretation, as identical size and shape mail pieces can be flats or parcels. Tr. 23/12156. NDMS additionally notes that the Service's proposal fails to address the fact that some parcels have shapes that are far closer to the shape of flats than to the shape of other parcels. NDMS Brief at 84; NDMS Reply Brief at 43.

[5442] Another issue for NDMS is that the Service's proposal ostensibly lacks adequate identification of the different procedures (and resultant costs) for machinable and nonmachinable parcels, and consequently fails to create any financial incentive for mailing parcels which are machinable or otherwise easier to handle. NDMS Brief at 86.

[5443] In its Reply Brief, the Postal Service addresses intervenors' concerns. It claims that the record conclusively demonstrates that parcels cost more than flats, and that therefore shape is a dominant cost influence. Postal Service Reply Brief at V-94. It further notes that the definition of a parcel is clear in IOCS, where if an item does not fall fully within the definition of a letter or a flat, then it is a parcel of some type. *Id*. at V-95. Likewise, the "refined" DMCS language proposed by the Service on this issue ensures that identical pieces are not being treated differently, as where the supplemental phrase "or *prepared* as a parcel" clearly identifies which pieces are subject to the surcharge and offers the mailer the option to avoid the surcharge on those pieces that could be prepared as flats. *Id*. at V-94-V-96.

[5444] The Postal Service maintains that it did consider the machinability of parcels in its proposal, and as to the extent machinability reduces costs, the cost differential upon which the surcharge is based is narrowed. *Id*. at V-96. It must be considered, however, that machinable parcels may possess other characteristics resulting in higher cost in non-sortation activities. *Id*. at V-96-V-97.

(3) Determination of Mail Processing Costs

[5445] RIAA, et al. witness Andrew argues that Crum erred in estimating mail processing costs, improperly overstating the 2.3 cents per piece difference in costs between parcels and flats. Tr. 22/11660-62; *see also* RIAA, et al. Brief at 2-6. According to Andrew, Postal Service witness Bradley assumed that the overall variability for MODS offices, 78.7 percent, was applicable to non-MODS offices. Tr. 22/11660. Andrew maintains that there are two problems with this approach: (1) the Postal Service presents no evidence showing that system variability applies to Non-MODS offices, even

in the aggregate; and (2) the accuracy of cost by shape depends on computing the variable cost at the pool level. *Id.* at 11661. Use of the system-wide variability loses the individual and proper weighting of the distribution key by cost pool variability, rendering the shape cost meaningless. *Id.* at 11662. Andrew therefore restates the Service's mail processing costs by shape by re-aggregating the non-MODS office costs and redistributing to shape on the basis of the distribution of pieces by shape, with the following results:

Table 5-11

	Cents per Piece		
Shape	**Witness Crum**	**Restated**	**Difference**
Parcels	28.35¢	25.73¢	(2.62¢)
Flats	4.94¢	4.65¢	(.29¢)
Difference	23.41¢	21.08	(2.33¢)

Id. at 11664, Table 5.

[5446] NDMS witness Haldi maintains that the Service's mail processing costs (shown in the table below) exhibit such wide differences as to render the data worthless, with the across-the-board surcharge imposing an unjust burden on parcels whose costs differ only slightly from the cost of flats. Tr. 23/12163, 12166.

Table 5-12

Subclass	Mail Processing Unit Costs	Delivery Unit Cost	Average Weight (Ounces)
ECR	14.62¢	28.43¢	2.77
Nonprofit ECR	36.72¢	**99.42¢**	**3.06**
Nonprofit	37.05¢	22.29¢	6.40
Regular	29.01¢	**12.61¢**	**8.90**

Id. at 12163; Table 3. Furthermore, Haldi notes that presort discounts are based on the cost of flats, and consequently underestimate the presort savings for parcels. *Id.* at 12164.

[5447] Postal Service witness McGrane responds to witness Andrew's contention that the proposed residual shape surcharge is excessive, arguing that an inappropriate comparison of underlying costs and revenues has been made. Tr. 35/18959. Specifically, McGrane contends that actual revenue, reflecting presort and dropship discounts, is compared to Service witness Crum's adjusted costs, which exclude the effects of presortation and dropshipment. *Ibid.* McGrane characterizes Andrew's analysis as illogical, and testifies that a proper comparison should use either adjusted revenues and adjusted costs, or unadjusted revenues and unadjusted costs. *Id.* at 18958; *see also* Postal Service Brief at V-163. McGrane's comparison of actual revenue differences to actual cost differences (*i.e.,* unadjusted figures) for FY 1996 demonstrates that the Service's proposed surcharge is reasonable, and effectively rebuts the contention that the residual shape surcharge is excessive. Moreover, comparison of adjusted revenue differences to adjusted cost differences (*i.e.,* with both figures

excluding the effects of presortation and dropshipping) also rebuts intervenor testimony on the matter, and supports the Service's surcharge proposal.

Table 5-13

Unadjusted Parcel			Adjusted Parcel		
Revenue	Cost	Revenue less cost	Revenue	Cost	Revenue less cost
24.6¢	40.3¢	-15.7¢	17.8¢	33.4¢	-15.6¢

Tr. 35/18958, 18962.

[5448] On Brief, the Postal Service argues that witness Andrew is mistaken in his assertion that cost distribution within the non-MODS pool is flawed, leading to incorrect cost estimates. Postal Service Brief at V-164. The Service maintains that witness Degen effectively demonstrates that if Andrew's recommendation that operation-based pools are defined within the non-MODS office is followed, neither the overall variability estimated for non-MODS offices, nor the cost distribution to subclass, change to any great extent. *Ibid*. Moreover, Andrew's proposed remedy of redistributing non-MODS costs in proportion to piece volume ignores mail processing operational reality by assuming that each shape has the same unit cost within non-MODS offices. *Id*. at V-165.

[5449] RIAA, et al. contends that Degen does not effectively rebut Andrew's analysis. RIAA, et al. Brief at 6-7. Degen's focus is limited, relying on the fact that the subclass distribution is different. *Ibid*. Thus, as it is the "fallacious distribution to shape based upon average MODS office shape distributions" to which Andrew objects, rather than a redistribution of non-MODS mail processing costs by subclass, Degen's analysis is not relevant. *Id*. at 7.

[5450] Moreover, RIAA, et al. contends that while it is appropriate for the Service to adjust its cost differential analysis to reflect the extent to which flats are more deeply dropshipped and finely sorted than parcels, it is impossible to make a similar adjustment to the revenues produced by the two shapes of mail. *Id.* at 8. RIAA, et al. argues that witness McGrane's methodology for adjusting revenue due to dropshipment ignores the fact that pieces below the breakpoint, which significantly are of unknown quantity, receive a discount equal to that accorded to a piece at the breakpoint. *Ibid*. Thus, the Service's adjustment of revenue is unreliable, as is its presortation discount analysis (for the same reason). *Id*. at 8-9; *see also* RIAA, et al. Reply Brief at 2-3.

[5451] RIAA, et al. highlights that while the Service "quibbles" about which numbers should be compared to others in order to calculate the most meaningful flat/parcel differential, "there is no contest with the conclusion that revenues as well as costs must be included in the calculation." RIAA, et al. Reply Brief at 2. Moreover, the net costs associated with parcels are much closer to those associated with flats than the Service concedes. *Ibid*.

[5452] On Brief, PSA argues that during rebuttal testimony witness McGrane did concede that utilizing witness Jellison's calculations of Postal Service data (if accurate) results in a difference between a 51.3 cent cost for a Standard A parcel, versus 46.45 cents in revenue generated. PSA Brief at 32. Thus, a shortfall of only 4.85 cents per piece exists, which would be covered by a 5-cent surcharge. *Ibid*. Moreover, were witness Andrew correct in his contention that costs have been over-attributed to parcels by 5.6 cents per piece, then base year Standard A parcels would be covering 100 percent of their attributable costs. *Id*. at 33.

(4) Transportation Costs Used in the Service's Cost Study

[5453] RIAA, et al. witness Andrew offers extensive critical testimony on the transportation costs used in Crum's cost study. According to Andrew, the Service's analysis contains errors in the sampling procedures which impact the allocation of costs

to parcels. The errors overstate the difference in costs between parcels and flats for transportation and vehicle service driver costs by 3.3 cents per piece. *See* Tr. 22/11665-74; RIAA, et al. Brief at 2-3.

[5454] Andrew notes that in Crum's cost study, transportation costs are distributed to shape on the basis of cubic feet. Tr. 22/11665. For each shape, cubic feet equal average weight divided by average density. *Ibid*. The average density for letters and flats comes from a Postal Service study in Docket No. MC95-1. However, the average density for parcels comes from a Postal Service Study prepared for Docket No. MC97-2. *Ibid*. The MC95-1 study contained an average density for parcels of 14.9 pounds per cubic foot while the instant study reflects an average density of 8.1 pounds per cubic foot. *Ibid*. In MC95-1, a sample consisted of weighing a container with known volume and a specific shape for the volume. According to Andrew, this is straightforward and reflects actual packing behavior. *Ibid*.

[5455] In contrast, Andrew maintains that the MC97-2 density study, now used in the Postal Service's proposed parcel surcharge analysis, suffers from three flaws: (1) the instructions on how to measure parcels vary on interpretation, leading to biased estimates; (2) the instructions direct the data collector to "superficially" look at a mailing to determine the most common piece. A superficial look will encounter only parcels on the top; and (3) any comparison of a sample unit from the MC95-1 study (a container of parcels) to the MC97-2 study (a single parcel) must consider the difference in sample size. *Id*. at 11668-69.

[5456] It is Andrew's position that the MC97-2 study's sampling scheme should not be used, as it is biased towards less dense pieces (consequently resulting in higher calculated transportation costs associated with parcels and therefore a higher cost differential between parcels and flats). *Id*. at 11671, 11674. He explains that studies on the physics of granular material show that large volume objects move to the top of a container. This is due to the vibration of transporting materials and a trapping effect that happens to large volume objects that, having moved to the top, are then unable to move down. *Id*. at 11670. Due to the one-pound limitation on Standard A mail, parcels at the

top of a container will have lower average density. Use of the sampling scheme from MC97-2 in this circumstance will result in bias. *Id*. at 11671.

[5457] Andrew submits that examination of the parcel density of fourteen RIAA, et. al. mailers' packages results in a density estimate substantially higher than the Service's estimate using the MC97-2 sampling scheme. *Id*. at 11672-73. He testifies that mailers' current data show a parcel density of 29.9 pounds per cubic foot. *Id*. at 11672. Part of the difference between this estimate and the Service's estimate is due to the difference in weight, and Andrew adjusts his density estimate to account for the difference. *Ibid*. This reduces his density estimate to 21.92 pounds per cubic foot, a figure significantly higher than the Service's estimate of 8.1 pounds per cubic foot. *Id*. at 11673. Andrew concludes that the Postal Service's MC95-1 density estimate is better than the MC97-2 estimate. Substitution of this estimate results in a reduction of the cost differential between parcels and flats of 3.28 cents (from 7.83 cents per piece to 4.55 cents per piece). *Id*. at 11674.

[5458] NDMS witness Haldi also is particularly critical of the "uncertainties and inconsistencies" associated with the transportation costs used by Crum. Tr. 23/12167. Like Andrew, Haldi advocates use of the MC95-1 density figure, which would result in a transportation/vehicle service driver cost 4 cents per piece lower than that now utilized. *Id.* at 12169. Haldi further notes that Crum's study deaverages transportation cost by shape. The destination entry avoidable cost study is based on average cost. Haldi maintains that the studies should be consistent, as it is unfair to charge parcel mailers on the basis of high transportation cost, while denying them discounts based on the same exact estimate. *Id.* at 12170. Using averaged transportation costs in Crum's study reduces the cost of parcels by 6.6 cents. Where the difference between average cost and revenues for parcels had been 8.2 cents, that figure would now shrink to 1.6 cents. *Id.* at 12171.

[5459] In reply, the Postal Service argues that witness Andrew's criticisms of the parcel density used in the Service's determination of the residual shape surcharge and his proposal for use of substitute data are unfounded. Postal Service Brief at V-166.

The Service asserts that Andrew's granular theory doesn't apply to mail in containers because the underlying studies were performed on disks, beads, poppy seeds, brass spheres, sandpiles, cereal grains, and other small, smooth, semi-round particles. *Id.* at V-168. The Postal Service also contends that the MC95-1 study advocated by Andrew did not focus on measuring density for parcels as evidenced by the small sample size, while the MC97-2 study was conducted exclusively for parcels, with a large sample tailored to parcels. *Id.* at V-166-V-167. It is further maintained that RIAA, et al.'s informal study is unreliable, as: (1) it lacks a minimal acceptable survey design, where uncorrected-for sampling and nonsampling bias is introduced into the data, increasing variability and uncertainty; (2) the survey data are not statistically sound, as they do not represent the Standard A parcel population or all Standard A mailers; (3) Andrew incorrectly compared the survey data from 1996 and 1997 to data that spanned only one year; and (4) while adjusting average density for the weight difference between the survey's average weight per piece and that of the average parcel as reported by the Postal Service, Andrew fails to make an adjustment for any cubic differential (where density is a function of both weight and cubic feet). *Id.* at V-168-V-170.

[5460] RIAA, et al. responds that the MC95-1 density data are indeed preferable to those yielded from the MC97-2 study (resulting in densities close to the long-calculated density for parcel post), as there is no record evidence demonstrating the comparability of Standard A parcels and parcel post. RIAA, et al. Reply Brief at 3-4. It further argues that the Postal Service offered no concrete contrary evidence to Andrew's granular theory. *Id.* at 5. Finally, RIAA, et al. clarifies that it did not offer Andrew's informal survey for actual use of its results, but rather, when taken in conjunction with its other criticisms, for the proposition that the study upon which witness Crum relies was "not terribly reliable." *Ibid.*

(5) Miscellaneous Criticisms of the Service's Proposed Surcharge

(a) The Haldi Repackaging Scenario

[5461] NDMS witness Haldi argues that the Service proposal represents "a staggering added expense" to many industries and would provide an incentive for mailers to repackage parcel-shaped items to conform to the flat dimensions where the item only exceeds the surcharge's thickness dimension of ¾ inches.[77] Tr. 23/12144, 12146-47. Haldi maintains that mailers might repackage items that are "parcel-shaped" by using side-by-side placement, with the resulting package being either a rigid box or a compartmentalized envelope. *Id.* at 12147-49. These two repackaging options could result in increased costly manual sortation and more cumbersome and time-consuming rural mail box delivery of the packages. *Ibid.*

[5462] In its Brief, the Service acknowledges witness Haldi's "doomsday scenario" of mailer repackaging as unlikely for the following reasons: (1) the potential for the repackaging to be more expensive; (2) the higher mail preparation costs associated with repackaging (i.e., where the machine parcel preparation requirements are much easier than those for flats); (3) the increased rates if the repackaged flat mailing is not of significant density to qualify for the 3/5-digit presort discount; (4) the possibility that customers may prefer to receive parcel-shaped pieces; (5) customers' potential objections to the new containerization if it results in unsuccessful delivery of the piece; and (6) the potential for the Service to change the definition of a flat if "perversely" reconfigured flat pieces became unduly cumbersome. Postal Service Brief at V-170-V-173. The Service hastens to add that despite the additional cost of the surcharge, the resulting rates are still "a bargain" in comparison to alternatives. *Id.* at V-173.

[77] The proposed residual shape surcharge would apply to a mail piece exceeding any of the following dimensions: height of 12 inches, width of 15 inches or thickness of ¾ inch. NDMS-T-3 at 7.

(b) The Issue of the Market Characteristic Analysis

[5463] NDMS highlights that the Service has failed to present its analysis of market characteristics which the Commission in MC95-1 expected would illuminate the need (or lack thereof) for a parcel surcharge, and which presumably would lend support to the Service's expectation of a 22 percent increase in volume in Standard A residual shape mail pieces over two years. NDMS Brief at 79-80; NDMS Reply Brief at 43. Absent such support, and in light of the substantial rate increase, NDMS maintains that the Service's volume and revenue estimates from the surcharge appear to be grossly inflated. NDMS Brief at 79.

[5464] The Service responds that establishment of a "simple surcharge," versus a new subclass for a group of parcels, does not mandate that the group possess distinct market characteristics. Postal Service Reply Brief at V-92. But, were that the case, the Service argues that "there could hardly be a more obvious, distinct grouping within Standard (A) Regular than parcels." *Id.* at V-93.

(c) The Issue of a Parcel Barcode Discount

[5465] PSA argues that there is no justification for denying the barcode discount of 4 cents to Standard A parcels (as it is recommended for Standard B parcels), where such barcoding promotes similar cost avoidance for the Postal Service and Standard A parcels either now fully cover their attributable costs, or will do so upon Commission imposition of a surcharge to meet any coverage deficit. PSA Brief at 8, 36. NDMS also emphasizes the alleged injustice of the Service's focus on parcel cost, but general ignorance of parcel cost avoidance. *See* NDMS Brief at 91-94. Thus, while the Service does consider some cost avoidance from presortation (of nonletters), it fails to propose Standard A parcel presortation discounts which recognize cost avoidance based on the actual cost of handling Standard A parcels. *Id.* at 92. NDMS maintains that "the focus on costs incurred by shape, while ignoring costs avoided by shape, by refusing to permit dropship discounts, is inconsistent, unfair and inequitable." *Id.* at 98.

[5466] The Postal Service responds that there are sound reasons for the absence of a proposed Standard A mail barcode discount, and that the residual shape surcharge recognizes that absence. Postal Service Reply Brief at V-97. Among the reasons cited: (1) implementation of a surcharge in conjunction with an offsetting discount defies simplicity; (2) at least 72 percent of Standard A parcels would have been eligible for such a discount, thereby requiring that the Service adjust the surcharge rate; and (3) it may not be possible to machine sort some parcels even though the parcels meet the definition of machinable parcel. *Id.* at V-97-V-98.

[5467] As to the issue of dropship discounts by shape, the Service urges the Commission to avoid additional layers of complexity by recommending such a measure. *Id.* at V-98-V-99.

(d) Statutory Standards for Mail Classification and Rate Design

[5468] In its Brief, NDMS argues that the Service's proposal does not meet the statutory standards for mail classification and rate design. NDMS Brief at 105. Specifically, the surcharge does not promote a fair and equitable classification system for all under 39 U.S.C. § 3623 (c)(1), where the surcharge effectively creates a classification which combines parcels from four separate subclasses, and the costs incurred by one subclass of mail may dictate the rates paid by a separate subclass of mail (in violation of 39 U.S.C. § 3622(b)(3)). *Id.* at 106; NDMS Reply Brief at 44-47. NDMS also contends that the Service has failed to demonstrate the desirability or justification for this new classification under 39 U.S.C. § 3623(c)(2), as the surcharge does not respond to the "below cost-rate problem" and there is no clear evidence that an increase in mailers' postage and mailing costs (i.e., the separation of flats from parcels) provides commensurate benefits to the Postal Service. NDMS Brief at 106-107; NDMS Reply Brief at 50-51. Nor has any mailer offered support for the surcharge. NDMS Brief at 107; NDMS Reply Brief at 50.

[5469] The Postal Service maintains that the residual shape surcharge proposal complies with and furthers the classification criteria of the Act, as the proposal: (1) promotes fairness and equity through de-averaging costs, thereby allowing the majority of Standard A mailers to bear less of the additional costs associated with residual shape pieces; (2) is desirable from both the Service's and customers' perspectives, as it reduces the burden borne by letter- and flat-advertising mail of the additional costs associated with residual, predominantly non-advertising pieces; and (3) serves the Service and its customers' common interest in simplicity in the classification schedule while still achieving the goal of de-averaging. Postal Service Brief at V-160-V-161.

(6) Intervenors' Proposed Residual Shape Surcharge

[5470] While the intervenors oppose the Service's proposed 10-cent residual shape surcharge for the reasons contained herein, each does identify a maximum surcharge amount deemed acceptable.

[5471] PSA witness Jellison argues that a surcharge of 3.45 cents per piece will cover average attributable costs for the Regular subclass based on a comparison of average revenue and average costs for parcels. Tr. 24/12973.

[5472] NDMS witness Haldi maintains that the Service's proposal is so riddled with shortcomings that the Commission should not recommend a surcharge based on it. However, should the Commission feel compelled to act on the issue, Haldi advocates that a shell classification be instituted pending a new Service proposal. If these two alternatives are deemed insufficient, Haldi then recommends a parcel surcharge no greater than 2 to 3 cents, as based on Service witness Crum's de-averaged bottom-up costs. Tr. 23/12174-75. Haldi argues that the Commission should also de-average the destination entry discounts for parcels, using the same density as applied in the calculation of transportation costs. *Id.* at 12171; NDMS Brief at 102. Thus, separate parcel destination entry discounts should be recommended which "reflect parcels'

avoidance of the same shaped-based costs the incurrence of which were relied upon by witness Crum to justify the parcel surcharge." NDMS Brief at 111 (footnote omitted).

[5473] Haldi otherwise suggests that the Service's proposed surcharge be reduced to 3.4 cents, as derived from average costs and revenues. *Ibid*. Haldi maintains that the estimation of parcel costs using average transportation costs for letters, flats and parcels combined is consistent with the average transportation costs utilized by the Service in developing its destination entry discounts. Tr. 23/12171. The 3.4 cent figure is reached by combining 1.6 cents — the difference between the average cost of parcels and the average revenue generated — and 1.8 cents — the Service's "margin," or difference between the proposed 10-cent surcharge and purported deficit of 8.2 cents. *Ibid*. According to Haldi, the 3.4 cent surcharge option has four advantages: (1) it leaves the method underlying destination entry alone; (2) it avoids the calculation of destination entry discounts for different shapes; (3) it avoids controversy over density estimates; and (4) a modest surcharge may reduce unintended consequences. *Ibid*.

[5474] RIAA, et al. witness Andrew submits two different surcharge figures: adjusted and unadjusted. Andrew's adjusted proposed surcharge reflects a modification of his maximum justified surcharge (3.2 cents) to avoid altering Service witness Moeller's proposed base rates for Standard A Regular and ECR mail. Tr. 22/11674-75. Both Andrew's adjusted and unadjusted surcharges are calculated using his cost adjustments (reductions of 2.3 cents per piece for mail processing costs and 3.3 cents per piece for transportation and vehicle service driver costs) and recognizing the additional revenue generated by parcels. *Id*. at 11665-69, 11674-75.

[5475] While RIAA, et al. submits alternative residual shape surcharge figures, it is its position that there is "some doubt" as to the proper surcharge level, as different comparisons and calculations using adjusted or unadjusted figures produce varying differentials ranging from 3.2 cents to 10.1 cents. RIAA, et al. Brief at 10. RIAA, et al. urges the Commission to request a "substantially more rigorous" study of the actual net cost/price differential between parcels and flats, and to set any interim surcharge at the

lowest allowable level consistent with the maintenance of revenue neutrality. *Id.* at 10-11.

c. Commission Analysis

[5476] The Commission recommends the Service's proposed residual shape surcharge of 10 cents per piece for Standard A mail.

[5477] The Postal Service proposed shape-based rate differentials for the first time in Docket No. R90-1. As a result of the cost evidence, the Commission recommended separate rates for letters and nonletters. PRC Op. R90-1, paras. 5801 and 5815. In MC95-1, the Postal Service continued to propose separate rates for letters and nonletters, although UPS submitted that a separate rate category for parcels also should be established and demonstrated that average revenue for parcels was less than the corresponding average cost. PRC Op. MC95-1, paras. 5522 and 5558. The Commission declined to recommend separate rates for parcels because the record did not contain sufficient evidence to determine, among other things: (1) that shape is a dominant influence on the cost difference between flats and parcels; (2) that parcels are systematically more expensive than flats; and (3) the difference in cost between machinable and non-machinable parcels. *Id.*, paras. 5540, 5544, and 5566. However, the Commission agreed with UPS that there was a serious inequity since other mailers were covering the revenue shortfall attributable to parcels. *Id.*, para. 5559. The Commission also noted that action was warranted to comply with the Act and to avoid unreasonable discrimination, and it expected the Postal Service to resolve this problem promptly. *Id.*, paras. 5561 and 5556.

[5478] In response to the Commission's concern, the Postal Service has proposed a 10-cent per piece surcharge in each of the four Standard A subclasses, based on an implicit passthrough of 28.7 percent of its calculated cost difference between flats and parcels. PSA, RIAA, et al. and NDMS raise issues that fall into five general areas: (1) does the proposed rate category satisfy the classification criteria; (2) how is a parcel

defined in the mailstream; (3) what are the correct costs; (4) are revenues relevant and, if so, which revenues; and (5) what is the appropriate level of the surcharge (which includes the issues of dropship adjustments and whether there should be subclass-specific residual shape surcharges).

[5479] *Classification Criteria*. The Commission agrees with the Service that the proposed rate category is consistent with the classification criteria of 39 U.S.C. § 3623. The proposal meets the fair and equitable criterion (criterion 1) by deaveraging the cost of parcels from the cost of flats, thereby setting the stage for rates that reflect cost differences. The proposal also satisfies criterion 5, the desirability of the classification from the perspective of the Postal Service and users, because it will reduce cross-subsidization of parcel mailers by letter and flat mailers.

[5480] NDMS's argument that the residual shape surcharge may cause unintended consequences such as increased handling cost to the Service is speculative and an insufficient reason to reject the proposed classification. The Postal Service rightly points out that any undesirable outcomes from the unlikely prospect of mailer repackaging can be handled as they arise.

[5481] *Parcel Definition*. The Commission agrees with the Postal Service that the definition of flats and parcels is sufficiently clear for the purpose of applying the surcharge. According to the Service, pieces prepared as parcels will be handled as parcels, with the associated cost of parcels, not the cost of letters or flats. Therefore, these pieces will properly be subject to the surcharge. There should be no confusion on this matter. Similarly, the IOCS definitions on shape are clear for costing purposes.

[5482] *Shape Costs*. RIAA, et al. and NDMS raise several costing issues related to density, mail processing, transportation and the effect of shape. RIAA, et al witness Andrew and NDMS witness Haldi both argue that the Service should have used a parcel density figure from MC95-1. The Commission is persuaded that the Postal Service's figure taken from MC97-2 is a better estimate. Specifically, the granular theory does not apply to mail in containers for the reasons that the Postal Service espouses; therefore, the sample piece selections from MC97-2 should not be biased. The Commission finds

the larger sample size available in the MC97-2 study and the fact that the study focused solely on parcels to be improvements over the MC95-1 study. Thus, the density figures from the MC97-2 study are the best evidence of record.

[5483] Witness Andrew questions the distribution of mail processing cost by shape. This has been discussed in the section on mail processing cost and was rejected. Also, Haldi's proposal that the shape costs should be based on average transportation cost or, alternatively, that destination entry discounts should be deaveraged by shape must be rejected at this time because of a lack of record data with respect to destination entry cost by shape. However, there is merit in Haldi's proposal and the Service's only rebuttal is that the rate schedule would become complex. The Postal Service should study this issue before the next rate case, as the base rate should be consistent with the discount subtracted from it. Further, the Commission is not adverse to considering a rate schedule with all discounts on a shape basis, regardless of the apparent added complexity to the rate schedules in Standard A. Presort and barcode discounts are currently shape-based and Standard A is used by bulk mailers who can be expected to cope with some slight increased complexity.

[5484] Witness Crum's cost study shows that parcels cost more than flats; however, opposing parties believe the study does not demonstrate that shape is a more dominant cost-causing characteristic than weight. Because the average weight of ECR flats and ECR parcels is essentially equal, the difference between the ECR flat cost and the ECR parcel cost cannot be due to difference in weight. Further, the cost gap is large even after adjusting for presort and dropship differences between parcels and flats. The Commission therefore agrees with the Service that the cost gap between ECR flats and parcels is predominantly shape-related. This leads to the conclusion that the large gap in cost between flats and parcels in the Regular subclass must be somewhat attributable to the difference in shape even though the average weight is substantially different. While the evidence does not dispose of this issue completely, it is sufficient to allow the Postal Service's cost study to be used for rate setting.

[5485] *Revenue*. There remains a serious equity problem where the Service has demonstrated that letters and flats cross-subsidize parcels. However, the record does not provide sufficient evidence to determine whether revenue should be included because no party has discussed this issue within the overall context of shape differentials within Standard A mail. Clearly, reducing the cost difference between flats and parcels by the corresponding revenue difference departs from the traditional procedure for setting the rate differential between letters and nonletters. Departing from tradition is not a sufficient cause to reject the consideration of revenue as, generally, the theory of setting Postal rates at the rate category level has evolved over time. Further, this issue arose because parcels revenues were not compensatory and continue to be non-compensatory. Consequently, the Commission cannot permanently rule out the use of revenues; however, in the instant case, there is not a sufficient theoretical basis justifying its use. Accordingly, the Commission will use the traditional method of treating the surcharge as a passthrough of shape-related cost differences.

[5486] *The Level of the Surcharge*. Using the Commission's average, unadjusted costs, the cost differential between flats and parcels is 61.2 cents, compared to the Postal Service's estimate of 51.7 cents.[78] This cost differential is reduced to 41.6 cents after adjustment to remove differences due to presort level and dropship proportions. *See* PRC-LR-14. The Commission thus passes through 24 percent of this cost differential to recommend a 10-cent surcharge on residual shape pieces for each Standard A subclass under the traditional approach recognizing shape differences in rates.

[5487] Were the Commission to consider the effect of parcel revenue when developing this surcharge, comparison of Haldi's average parcel revenue figure of 43.4 cents (which includes presort and dropship effects) and the Commission's average unadjusted cost of 61.2 cents demonstrates that parcel revenues fail to cover cost by

[78] The Commission's average cost must be unadjusted, thereby including presort and dropship effects, in order to make a meaningful comparison with Haldi's average revenue figure.

17.8 cents on average. Thus, even with the 10-cent surcharge, there is a 7.8 cent cost deficit on average.

[5488] PSA witness Jellison contends that there should be a differential surcharge by subclass because the average revenue and cost vary by subclass. Tr. 24/12973. The Commission recognizes that the single surcharge does not reflect the variation in average cost or the cost differential between flats and parcels by subclass; however, the recommended surcharge is only a beginning step. Under current rates, no parcels in any of the subclasses cover their cost. *Id.* at 12971. Therefore, the need to begin to cover costs is the Commission's most important concern. By this action, the Commission is not closing the door on future differential surcharges by subclass. Further, given the high costs for parcels, the implicit cost coverage is low for parcels in each subclass; thus, parcels are not disadvantaged compared to letters and flats, which have higher implicit cost coverages. *Ibid.*

[5489] While recommending the surcharge, the Commission advocates further Postal Service exploration of this issue, including consideration of how to set shape differentials within the Standard A subclasses, with attention to both the similarities and differences between worksharing and shape-based differentials.

6. Destination Entry Discounts

a. The Postal Service's Proposal

[5490] Postal Service witness Moeller testifies that the cost study utilized to develop destination entry discounts measures savings for all the Standard A subclasses combined.[79] USPS-T-36 at 41. Consequently, the destination entry discounts do not vary by subclass. *Id.* at 36.

[79] The cost study is contained in USPS LR-H-111. Postal Service witness Smith submitted supplemental testimony sponsoring LR-H-111. USPS-ST-46 at 1.

[5491] In both the Regular and ECR subclasses, the savings due to destination entry have increased. The Service's proposed rates maintain the discounts at current levels by passing through 80 percent of measured cost savings. *Id.* at 30. According to Moeller, the basic rates would increase with any higher passthrough, thereby frustrating the Service's efforts to mitigate substantial increases for individual rate categories. *Ibid.*; Postal Service Brief at V-177. In the Nonprofit subclasses, the proposed destination entry discounts are slightly higher than the current discounts, thereby applying additional upward pressure on the base rates. USPS-T-36 at 36.

[5492] The current and proposed destination entry discounts for all Standard A subclasses are shown in the table below, along with the discounts recommended by the Commission:

Table 5-14
Standard A Destination Entry Discounts

Entry Point	Current Discount (cents)	Proposed Discount (cents)	Recommended Discount (cents)
Per Piece			
BMC	1.3	1.5	1.6
SCF	1.8	1.8	2.1
DDU	2.3	2.3	2.6
Per Pound			
BMC	6.4	7.2	7.9
SCF	8.5	8.8	10.0
DDU	11.1	11.0	12.6

b. Intervenor and Rebuttal Testimony

[5493] AMMA witnesses Schick and Andrew oppose the proposed reduction in the BMC/SCF destination entry discount differential from 0.5 cents to 0.3 cents. Tr. 27/15236-37; Tr. 20/10135-36; *see* AMMA Brief at 11-13. Schick contends that this differential strongly influences whether mailers find it worthwhile to enter at destination SCFs or simply to enter their mailings at the BMC. Mailers will base this decision on the total cost of the job (including mail preparation and transportation costs). Tr. 27/15237. According to Schick, it is worth $2 per thousand less to dropship to a SCF under the proposed rates than at current rates. *Id*. at 15238; AMMA Brief at 13. Consequently, numerous mailers may look for means to offset the reduced savings, such as reducing the volume of their mailings or mailing less frequently. *See* Tr. 27/15238.

[5494] Schick testifies that maintaining the BMC/SCFdiscount differential may be accomplished while still achieving the Service's goal of creating a greater discount for BMC entry. *Id*. at 15239-40. He proposes that the Standard A destination entry discounts be based on a 100 percent passthrough of cost savings (versus the Service's suggested 80 percent passthrough). This would be consistent with the Commission's decision in MC95-1 and further the goal of maximizing productive efficiency within postal markets. Tr. 20/10129; AMMA Brief at 11-12.

[5495] Andrew maintains that increasing the passthrough to 100 percent will have little impact on base rates, with the base rates for the Standard A Regular and ECR subclasses respectively increasing by 0.2 and 0.5 cents per piece. Tr. 20/10139. He argues that this approach avoids sending a false price signal, implying to mailers that the marginal cost of BMC entry is 1.5 cents, when it is actually 1.86 cents. *Id*. at 10136; *see* MOAA Brief at 22.

[5496] MASA opposes Andrew's proposal to increase basic rates in order to expand the discount differential, claiming the Service could achieve the desired differential without increasing the Regular basic rate. MASA Brief at 6-7. In the alternative, MASA submits that the Commission has the flexibility to achieve this goal

with no rate increase in light of the Service's profitable test year and over-estimation of its revenue requirement. *Id.* at 8.

[5497] The Service argues that witness Andrew's proposed destination entry discounts result in a significant rate increase for nondestination entry mail, while offering little or no relief to piece-rated dropshipped mail. Postal Service Brief at V-178. According to the Service, Andrew's contention that dropshipped mail will have a greater contribution to institutional costs than mail that is not dropshipped is directly contradicted by VP/CW witness Haldi, who demonstrates that under the proposed rates, the contribution per piece for ECR mail decreases as the level of dropship increases under the proposed rates. *Ibid.*

[5498] The Postal Service suggests that the Commission consider the following alternatives presented by witness Moeller that would maintain the current BMC/SCF differential while having minimal or no effect on the other proposed rates: 1) institute an 80 percent passthrough for SCF and DDU entered mail while decreasing the BMC passthrough to 70 percent of actual savings; or 2) increase the current discounts by 0.1 cent in each of the dropship entry categories. *Id.* at V-179; AMMA Reply Brief at 1-2.

[5499] NAA generally supports the Service's proposed destination entry discounts, opposing Andrew's larger discounts as excessive (and not cost-based) for mail pieces weighing less than the breakpoint.[80] NAA Brief at 35-36, 39. NAA maintains that cost savings below the breakpoint would have to be understated by more than 60 percent in order for Andrew to justify his proposed discount of 2.8 cents per pound at the SCF and DDU (which results from 100 percent passthrough of cost savings), but no record evidence exists to this effect, and Andrew himself concedes that the cost savings below the breakpoint are unknown. *See id.* at 38. Consequently, Andrew's contention that the Service's proposed discounts fail to "maximize productive efficiency" is unfounded. *Ibid.*

[5500] AMMA reiterates its support for witness Andrew's proposal, arguing that witness Moeller's SCF and DDU discounts are economically unsound. In contrast, it

[80] NAA suggests that the record actually supports the premise that the current destination entry discounts for mail pieces below the breakpoint are too high, rather than too low.

contends that Andrew's proposed discounts rely on the Service's own cost savings and passthrough 100 percent of the savings. AMMA Reply Brief at 1-2. AMMA criticizes NAA's contention that pieces weighing less than the breakpoint will be over-rewarded by increased discounts under Andrew's proposal. *Id.* at 3. This proposition is based on the premise that savings from dropshipping are likely to be largely weight-related. AMMA maintains that there is no good evidence to this effect. *Ibid.*

c. Commission Analysis

[5501] The Commission recommends destination entry discounts based on the Postal Service models adjusted to reflect mail processing costs as developed by the Commission. The discounts reflect a passthrough of 85 percent, which maintains the discount differentials for both BMC/SCF and SCF/DDU at current levels, thereby recognizing worksharing and encouraging mailer dropshipping. A lower passthrough would have the undesirable effect of decreasing the BMC/SCF and DDU/SCF differentials, while a higher passthrough would increase basic rates.

7. Standard A Single Piece Mail

[5502] The Postal Service proposes elimination of the Single-Piece subclass, which currently generates only one-fifth of one percent of Standard A mail volume. USPS-T-36 at 4. Since 1975, single-piece volume has fallen about 85 percent, from 952 million pieces in FY1970 to 146 million pieces in FY1996. *Ibid.* Postal Service witness Moeller testifies that the before-rates test year estimated cost coverage for Single-Piece mail is 67 percent. This figure indicates that Single-Piece mail fails to cover its costs, as required by § 3622(b)(3). Moeller states that to cover costs, Single-Piece rates would have to be substantially higher than the rates for First-Class Mail. *Ibid.* Yet, First-Class Mail, the likely substitute in the event of Standard A Single-Piece elimination, offers an "all-encompassing" higher level of service, including free forwarding and return, air

transportation, better service standards and fewer content restrictions. *Id*. at 6. Given the greater quality of service that First-Class Mail affords, the resulting rate relationship would be an anomaly and contrary to the Postal Reorganization Act classification criteria. Further, higher rates for an inferior service would result in the continued decline of Single-Piece volume. *Id*. at 5.

[5503] The Postal Service expects that much of the mail volume currently sent as Single-Piece mail will migrate to First-Class Letters and Sealed Parcels, with pieces weighing more than 11 ounces shifting to Priority Mail. *Ibid*. According to Moeller, returned items will be subject to First-Class Mail rates, or, if eligible, to those fees applicable to the recently approved Bulk Parcel Return Service. *Ibid*. Keys and identification devices will become subject to the appropriate First-Class rate based on the particular piece's weight, plus the applicable fee for Business Reply Mail items without an active advance deposit account. *Ibid*.

[5504] Moeller submits that elimination of the Standard A Single-Piece subclass is supported by the classification criteria of the Postal Reorganization Act. *Ibid*. Elimination promotes fairness and equity by preserving a logical relationship between Standard A Mail and First-Class Mail. Customers receive the superior service offered by First-Class Mail, including greater reliability and speed of delivery, at rates which are lower than would otherwise be applicable were Standard A Single-Piece retained, with its consequent substantial rate increase. *Id*. at 5-6. Moeller further maintains that the Postal Service also benefits from Single-Piece elimination, as its administrative burden associated with maintaining a subclass would be reduced and credibility in rate and service level relationships would be preserved. *Id*. at 6. Finally, the proposed elimination is responsive to the Postal Rate Commission's recommendation in Docket No. R94-1 that the Service consider merging Standard A Single-Piece with First-Class Mail. *Id*. at 5. *See also* PRC Op. R94-1, para. 5254.

[5505] The Commission recommends that the Standard A Single-Piece Subclass be eliminated. The Postal Reorganization Act (Act) requires that every mail class cover its direct and indirect attributable costs. 39 U.S.C. § 3622(b)(3). In order to obtain a

compensatory Single-Piece cost coverage, a substantial rate increase is required, which would result in Standard A Single-Piece rates higher than those of First-Class. Given the superior service offered by First-Class delivery, this phenomenon would create an illogical relationship between Standard A mail and First-Class Mail and would not be in conformity with the fairness and equity considerations mandated by § 3623(c)(1) of the Act. The Commission further notes that reasonable, alternative mail service (i.e., First Class or Priority Mail) is available for current Single-Piece mailers, should this subclass be eliminated, thus satisfying § 3623(c)(2) of the Act.

8. Standard A Regular Mail

[5506] *Cost Coverage Overview*. The Postal Service proposes rates with an average increase of 1.9 percent, resulting in a cost coverage of 155 percent. USPS-T-30 at 32; P.O. Information Request No. 18, Question 3. Postal Service witness O'Hara testifies that the proposed figures comply with the Postal Reorganization Act, as: 1) this average percentage increase is well below inflation, with only a small impact on mailers; and 2) the average percentage increase is slightly below the system wide average rate increase of 4.5 percent, suggesting that competitors of the Regular subclass are not being unfairly targeted. USPS-T-30 at 33.

[5507] The characteristics of Standard A Regular mail, according to Postal Service witnesses Tolley and O'Hara, indicate that Regular mail possesses intermediate intrinsic value of service and economic value, higher than those of ECR mail, but not at the level of First-Class Mail. *See* USPS-T-6 at 115-16; USPS-T-30 at 33. The intrinsic value of service for Standard A Regular mail is low because: 1) Regular mail is deferrable; 2) the Postal Service uses ground (versus air) transportation for its delivery; and 3) Regular mail lacks access to the collection system. USPS-T-30 at 32-33. While the Postal Service attempts to meet mailer needs for specific delivery dates, it requires much planning and coordination by the mailer. *Ibid*.

[5508] Regular mail's price elasticity (-0.38) is higher than that of First-Class letters (-0.23), but lower than that of ECR mail (-0.60), suggesting an intermediate economic value of service. USPS-T-30 at 33; USPS-T-31 at 37. Due to its use of demographic targeting, the Regular subclass faces less alternative delivery service competition than the ECR subclass. USPS-T-30 at 33. Major competitors for Regular include special interest magazines, cable television channels and internet web sites. *Ibid*.

[5509] O'Hara maintains that the proposed rate level for the Standard A Regular subclass is fair and equitable because it appropriately balances the Act's relevant criteria, including the effects on both users and competitors. *Id*. at 34.

[5510] This is the first case in which the Commission has set coverages and markup index levels for Standard A Regular and Standard A ECR. Prior to Docket No. MC95-1, this mail was combined as Third-Class Bulk Rate Regular. As such, it bore an institutional burden at or slightly below systemwide average. In several recent cases, the Commission expressed the view that the relationship between First-Class letters and Third-Class bulk was getting out of balance — that the First-Class markup was getting too far above the markup for Third-Class bulk. *See* PRC Op. R94-1, paras. 1018-20; PRC Op. R90-1, Executive Summary at i-ii.

[5511] The Postal Service has responded to those concerns in this case. Its Request proposes rates that would narrow the gap between the markup of First-Class and the combined markup of Standard A Regular and ECR. Witness O'Hara distinguishes these new subclasses and proposes that Standard A Regular rates should reflect a lower cost coverage than First-Class Mail, while Standard A ECR should bear a higher coverage than First Class.

[5512] The several organizations representing Standard A mailers in this case have not strongly attacked O'Hara's rationales. The coverage he proposes for Standard A Regular is similar to that applied to Bound Printed Matter, another subclass used for bulk national mailings of (among other things) advertising materials. The Commission will generally follow the relative coverage suggestions put forward by witness O'Hara. In

subsequent cases, as more information specific to Standard A Regular and ECR becomes available, these relative coverage levels may be adjusted as warranted.

[5513] The Commission recommends an average rate increase of 1.2 percent for the Standard A Regular subclass (which is less than the 1.9 percent increase the Service proposed). The costs for this subclass reflect an adjustment in the roll-forward procedure to take into account reclassification.[81] The rate level also reflects a lowered average rate increase due to a decreased Postal Service revenue requirement.

[5514] The recommended 1.2 percent average rate increase results in a cost coverage of 135 percent for Regular mail. These figures comply with the Act as the average percentage increase: 1) will likely have a small impact on mailers and is well below inflation (criterion 4); and 2) also is below the Commission's system wide average rate rise of 2.8 percent, thereby indicating that Regular subclass mailers are not unfairly treated. Further, the cost coverage of 135 percent reflects: 1) Regular mail's intermediate intrinsic value of service and economic value (§ 3622(b)(2)), which are greater than those of ECR but less than those of First-Class Mail; 2) Regular's somewhat limited direct competition with alternative delivery due to demographic targeting (§ 3622(b)(5)); and 3) Regular's extensive system of worksharing discounts that reflect mailer preparation (§ 3622(b)(6)). Rates and passthroughs for the Regular subclass reflect increased recognition of worksharing and shape-based differences, and therefore are more cost-based (§ 3622(b)(3)).

[5515] As is discussed in greater detail in the ECR subclass analysis, the two Standard A commercial subclasses each cover their attributable costs and make an appropriate contribution to institutional cost, as required by § 3622(b)(1). The markup index for Standard A Regular is 0.626. This is closest to the markup index for Standard B Bound Printed Matter (0.643), a subclass with content and own price elasticity that are quite similar to Standard A Regular.[82] *Compare* USPS-T-6 at 119 and 162.

[81] Because reclassification for the Standard A Regular and ECR subclasses went into effect in July 1996, the billing determinants do not reflect its effects for the full fiscal year. Consequently, the Postal Service used FY1997 Quarters 1 and 2 billing determinants to develop rates for these subclasses. See Appendix D for further discussion.

[5516] It must be noted that the Commission's recommended rates reflect the adjustments to the Postal Service revenue requirement discussed in Chapter II. The Commission's costs reflect its cost attribution and cost distribution findings described in Chapter III, as well as a correction made to the Postal Service's roll-forward procedure to take into account reclassification. These changes have the effect of increasing unit mail processing costs, and the cost differentials between wordshare rate levels. MASA's concerns about the decreased value of worksharing accordingly are addressed without the necessity of unconventional (i.e., over 100 percent) passthroughs.

[5517] *Letter/Nonletter Differential*. The Postal Service proposes Regular mail rates which continue the rate differential based on shape, first introduced in 1991. USPS-T-36 at 9. The current rates reflect only 37 percent of the cost difference between letters and flats at the basic presort level and 18 percent at the 3/5-digit presort level. *Ibid*. The Service proposes rates which increase the shape-based passthroughs to 41 percent in both presort tiers and more effectively recognize the cost difference between shapes. *Id*. at 10, 48. Witness Moeller notes that two considerations argue against a further expansion of the rate difference between letters and flats: 1) the proposed residual shape surcharge; and 2) the Postal Service's desire to mitigate the impact of rate increases. *Id*. at 10.

[5518] Moeller explains that the residual shape surcharge applied to nonletter/flat pieces serves to lower the rates for all other pieces in the Regular subclass. *Ibid*. By limiting the letter/nonletter passthrough, more of the "revenue benefit," some of which would flow to letters, could be directed to flats.[83] Thus, according to Moeller, the process effectively deaverages nonletters. *Ibid*.

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[82] The markup index for Bound Printed Matter declined in Docket Nos. R90-1 and R87-1 in recognition of the entry of books into the subclass (§ 3622(b)(8)). The record in this case does not indicate that books are a significant portion of Bound Printed Matter.

[83] Witness Moeller maintains that although letters share the surcharge benefit, the benefit is offset by virtue of the lower shape differential than would otherwise be proposed between letters and flats. USPS-T-36 at 10.

[5519] Moeller states that any greater passthroughs than those proposed would result in an even higher percentage increase in the proposed rates for minimum-per-piece 3/5-digit presorted automation flats, which already is subject to the highest percentage increase under the current proposal. *Id*. at 10-11.

[5520] The Commission recommends rates that passthrough 50 percent of the cost difference between letters and flats at the basic presort level and 40 percent at the 3/5-digit presort level. These figures increase the recognition of shape-based cost, as is the Commission's policy. Moreover, in order to foster automation, there must be a certain hierarchy among the basic ECR letter rate, Regular 5-digit automation rate and basic ECR automation rate, with the basic ECR automation rate at the lowest level. The recommended passthroughs facilitate this relationship.

[5521] *Presort Tiers*. The Postal Service proposes a presort letter passthrough of 165 percent, resulting in a discount representing 80 percent of the current discount. USPS-T-36 at 17, 48. The passthrough for nonletters is 78.3 percent, producing a discount that is 74 percent of the current discount. *Ibid*.

[5522] Moeller concedes that the passthroughs are "unconventional," explaining that they result from the significant changes in the Service's costing methodology. *Id*. at 16. He chose these passthroughs to balance several goals, including: 1) recognition of the value of worksharing activity; 2) avoidance of major changes in the level of discounts; and 3) limitation of individual rate category percentage increases. *Id*. at 16-17. Moeller testifies that he attempted to limit the proposed rate increases in Regular and ECR mail, if possible, to 10 percent or less. *Id*. at 17. He also strives to maintain discounts at or above 80 percent of their current level. *Ibid*. These guidelines were selected in consideration of the many mailers who modified their mail preparation practices in response to the significant changes in worksharing incentives, implemented with Classification Reform in July 1996. *Ibid*.

[5523] While recognizing that the 165 percent passthrough for letters is high, Moeller maintains that any reduction in the passthrough also would lead to a lower passthrough for nonletters, ultimately causing the presort discount to fall even further

below the guidelines. *Id*. at 17, 48. Thus, the high passthrough for letter presort permits a higher presort passthrough for nonletters. *Id*. at 17-18.

[5524] The Commission recommends a 100 percent passthrough for letters. The implied flat presort passthrough is 76.3 percent. These passthroughs result in 3/5-digit letter and flat discounts of 2.8 cents and 6.4 cents, respectively.

[5525] As discussed in R90-1, the Commission's longstanding approach to presort passthrough is marked by: 1) uniform passthrough for the recognized presort level; and 2) gradually increasing levels of passthrough as improved cost estimates become available. PRC Op. R90-1, para. 5946. The recommended presort passthroughs reflect the standard underlying the current rates, and recognition of the Service's interest in having mailers continue to presort mail. The discounts comply with the fairness and equity criterion of the Act, 39 U.S.C. § 3622(b)(1), as the recommended rates are cost-based. Thus, while the letter discounts are less than both the current and Service-proposed letter discounts, they still reflect 100 percent of the cost savings associated with worksharing.

[5526] *Automation: Letters*. Postal Service witness Moeller notes that the Postal Service's new costing methodology has reduced the value of worksharing. *Id*. at 18. In order to avoid extreme changes in pricing signals, yet reflect the decline in worksharing value, witness Moeller adopts passthroughs which limit the reduction of the discounts. *Ibid*. Accordingly, the passthrough for basic, 135 percent, was chosen to keep the discount at 80 percent of its current value, while the respective passthroughs for 3-digit automation and 5-digit automation — 120 and 135 percent — maintain their respective discounts at 90 percent of their current values. *Id*. at 18, 48.

[5527] MASA generally supports the Postal Service's request for recommended Standard A rates in this case, particularly the Service's proposed worksharing discounts that passthrough more than 100 percent of cost savings to mailers.[84] *See* MASA Brief at

[84] MASA notes that the greater than 100 percent passthrough of cost savings is proposed for the following worksharing categories: basic automation, 5-digit presort, 3-digit automation and 5-digit automation letter categories in the Regular subclass and automation letters in the ECR subclass. MASA Brief at 3.

1-5. MASA encourages the Commission to increase automation discounts even more to reward the investment of the mailing industry. *Id*. at 9.

[5528] *Automation: Flats*. Witness Moeller proposes 103 percent passthroughs for the basic and 3/5-digit barcode discounts, in conjunction with the rate design guidelines and unit costs based on the "constant mail approach" described by Postal Service witness Seckar. USPS-T-36 at 19, 48. This approach isolates the effect of adding a barcode by calculating unit costs using the same mail characteristics for both barcoded and non-barcoded mail. USPS-T-26 at 14; USPS-T-36 at 18. Drawing also on Postal Service witness Moden's testimony on the processing environment for flats, Moeller indicates that this area is moving toward a greater degree of mechanization and automation. USPS-T-36 at 19. This circumstance, when combined with the differences between barcoded and non-barcoded mail characteristics, makes it difficult to assess the savings associated with barcoding. *Id*. at 18-19. Seckar's constant mail approach helps isolate the effect of mailer-applied barcodes. *Id*. at 19.

[5529] According to Moeller, the proposed passthrough, in conjunction with the new costs, causes a significant rate reduction for the basic automation tier without a corresponding increase in other rates, due to the low volume in this category. *Ibid*. The passthrough also results in a more reasonable presort differential for automation flats. *Ibid*.

[5530] The Commission recommends 100 percent passthroughs for Regular letter and flat automation discounts. The resulting discounts reward worksharing and foster increased automation. Postal Service costing proposals reduced the value of worksharing, and to compensate, witness Moeller increased passthroughs to more than 100 percent. Because the Commission has rejected those costing proposals, the Commission does not need to passthrough more than 100 percent of savings to fairly compensate mailer worksharing.

[5531] *Other*. As discussed in detail in subsections 5 and 6 of this Chapter, the Commission recommends a residual shape surcharge and destination entry discounts for all Standard A mail. The recommended pound rate for each Standard A subclass is discussed in Section 4.

[5532] The current, proposed and recommended rates for Standard A Regular are as follows:

Table 5-15
Regular Subclass Rate Schedule

	Rate (cents)		
	Current	Proposed	Recommended
Schedule 321.2A - Presort Category			
Letter Size			
Piece Rate			
Basic	25.6	24.7	23.5
3/5-Digit	20.9	20.9	20.7
Destination Entry Discount per Piece			
BMC	1.3	1.5	1.6
SCF	1.8	1.8	2.1
Nonletter Size			
Piece Rate			
Minimum per Piece			
Basic	30.6	30.0	30.4
3/5-Digit	22.5	24.0	24.0
Destination Entry Discount per Piece			
BMC	1.3	1.5	1.6
SCF	1.8	1.8	2.1
Pound Rate	67.7	65.0	67.7
Plus per Piece Rate			
Basic	16.6	16.6	16.4
3/5-Digit	8.5	10.6	10.0
Destination Entry Discount per Pound			
BMC	6.4	7.2	7.9
SCF	8.5	8.8	10.0
Schedule 321.2B - Automation Category			
Letter Size			
Piece Rate			
Basic Letter	18.3	18.9	18.3
3-Digit Letter	17.5	17.8	17.6
5-Digit Letter	15.5	16.0	16.0
Destination Entry Discount per Piece			
BMC	1.3	1.5	1.6
SCF	1.8	1.8	2.1
Flat Size			
Piece Rate			
Minimum per Piece			
Basic Flat	27.7	24.3	24.5
3/5-Digit Flat	18.9	20.7	20.3
Destination Entry Discount per Piece			
BMC	1.3	1.5	1.6
SCF	1.8	1.8	2.1
Pound Rate	67.7	65.0	67.7
Plus per Piece Rate			
Basic Flat	13.7	10.9	10.5
3/5-Digit Flat	4.9	7.3	6.3
Destination Entry Discount per Pound			
BMC	6.4	7.2	7.9
SCF	8.5	8.8	10.0

9. Standard A Enhanced Carrier Route Mail

[5533] *Cost Coverage Overview*. The Postal Service proposes a 3.0 percent average rate increase for Standard A Enhanced Carrier Route (ECR) mail, which results in a cost coverage of 228 percent. USPS-T-30 at 34; P.O. Information Request No. 18, Question 3. Postal Service witness O'Hara states that this rate increase is somewhat below the system wide average increase, reflecting the Service's efforts to lower the very high cost coverage of this subclass. USPS-T-30 at 34. As with the Regular subclass, O'Hara maintains that the proposed figures comply with the Act, as: 1) the average rate increase is well below the rate of inflation, limiting its effects on mailers; and 2) in light of the substantial ECR cost coverage, the rate increase does not result in unfair competition. *Ibid*.

[5534] According to O'Hara, ECR mail possesses a relatively low intrinsic value of service, since it lacks access to the collection system, receives ground transportation and may have delivery deferred. *Id*. at 34-35. The Postal Service attempts to meet mailer needs for specific delivery dates, but this requires mailer preparation, coordination and planning. *Id*. at 35. In the high density and saturation rate categories, this is facilitated by the regularity with which many of the mailings are deposited. *Ibid*. ECR mail's price elasticity (-0.60) is higher than that of First-Class letters, Periodicals and Standard A Regular subclass mail, suggesting a relatively low economic value of service. USPS-T-6 at 129; USPS-T-30 at 35. Due to its geographic concentration, ECR is subject to a comparatively high degree of competition from alternate delivery firms and newspaper inserts. USPS-T-30 at 35. O'Hara further notes that the degree of mailer preparation for ECR mail is high; even the basic rate category must be line-of-travel sequenced and the saturation and high density categories are walk-sequenced. *Ibid*.

[5535] Although these factors indicate a lower cost coverage than that proposed, O'Hara argues that two considerations weigh against a further decrease: 1) a lower cost coverage for ECR mail would impose higher cost coverages on the other subclasses; and 2) a lower ECR cost coverage would present difficulties in designing rates resulting

in a Regular subclass automation 5-digit rate below that of ECR basic, which encourages movement of ECR letters into the automation mail stream. *Id.* at 36. Given these circumstances, O'Hara maintains that the proposed level is fair and equitable in light of the modest average ECR rate increase of 3.0 percent, and the even smaller proposed increases for the more highly workshared rate categories within the ECR subclass. *Ibid.*

[5536] A number of parties address the cost coverage proposed by the Service for ECR mail, and Standard A mail's contribution to institutional costs, particularly in comparison to First-Class Mail's contribution. ABA/NAA witness Clifton proposes a shift in institutional cost from First-Class Presort to Standard A ECR mail, while other intervenors offer general comments on cost coverage and unit contribution.

[5537] ABA/NAA witness Clifton testifies that Standard A mail is subsidized by First-Class Mail.[85] An extra-ounce charge is collected for the second and third ounces of First-Class Mail, but not from those of Standard A mail. Tr. 21/10820. Clifton maintains that the Standard A rate structure is based on the unsubstantiated presumption that there are no costs incurred for its workshared letter mail stream due to extra weight until after 3.3 ounces. *Id.* at 10827. He cites to the similar processing and delivery costs for the two mail classes, given their "identical physical nature," claiming that "the processing costs of [Standard A letter mail] are virtually identical to those of workshared First-Class letter mail for the same operations." *Id.* at 10827-28. Clifton proposes a reduction in the second and third ounce rates for workshared First-Class letter mail, with the lost revenue recovered by raising the average cost coverage of Standard A Regular and ECR mail by approximately 2.8 percentage points (from 174.2 to 177 percent). *Id.* at 10820, 10833. This adjustment would partially remedy the cross-subsidy issue and also reduce the "glaring equity" problem due to the much higher cost coverage and unit contribution of workshared First-Class Mail. *Id.* at 10823-24; NAA Brief at 22-24.

[5538] While acknowledging the "exceedingly high coverage" of the First-Class additional-ounce rate, VP/CW witness Haldi argues that Clifton's proposal is based on a

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[85] Clifton's proposal is discussed in detail in Chapter V.B. (First-Class analysis).

flawed rationale, as high implicit cost coverage of a rate category is no indication per se of cross-subsidy to any other subclass or rate category. Tr. 32/17311-13; VP/CW Brief at 56-63. Rather, it is first necessary to demonstrate that some rates fail to cover incremental costs and that subsidization exists, which Clifton has not accomplished.[86] Tr. 32/17312. VP/CW adds that Clifton neither addresses the statutory noncost criteria to justify his proposed changes, nor discusses the "balkanizing effect" which his proposal may be expected to have on First-Class rates, nor the impact of his proposal on Standard A nonprofit rates. *See* VP/CW Brief at 63.

[5539] Advo witness Crowder also disputes Clifton's claim, arguing that his concept of cross-subsidy bears no relation to economic theory. Tr. 34/18304, 18318-19. She maintains that comparison of the respective costs of a two to three ounce ECR mail piece and a 16 ounce mail piece clearly demonstrate that implicit contributions and cost coverages of saturation mail substantially exceed those of basic mail:

Table 5-16

	2.5 ounces	16 ounces
ECR Basic, No Dropship		
Unit Cost	9.58¢	27.70¢
USPS Proposed Rate	16.40¢	58.50¢
Implicit Cost Coverage	171%	211%
ECR Basic, 100% Dropship		
Unit Cost	3.34¢	10.75¢
USPS Proposed Rate	11.80¢	45.20¢
Implicit Cost Coverage	353%	420%

Id. at 18316.

[5540] Finally, MOAA, et. al. witness Andrew explains that Clifton's second and third ounce rate proposal is based on false claims of cross-subsidy. Tr. 36/19705;

[86] AMMA concurs that Clifton fails to support his assertion of a cross-subsidy. AMMA Brief at 6.

MOAA Brief at 40. Using Postal Service witness Takis' incremental costs, Andrew argues that both the Standard A Regular and ECR subclasses pass the incremental cost test with respective test year revenue to incremental cost ratios of 1.5 and 2.16. Tr. 36/19707. He states that Clifton's use of incremental costs and revenues for testing the second and third ounce is incorrect, because the test applies to products only, not subsets of a product.[87] *Id.* at 19708. DMA also argues that Clifton's isolation of subgroups of mail for comparison of coverages (or markups) is inappropriate. DMA Brief at 39, footnote 32. Rather, the appropriate comparison is the relative contribution to institutional costs of First Class as a whole with Standard A as a whole. *Ibid.*

[5541] NAA counters that the point of Clifton's proposal is to highlight that the huge disparity between the cost coverage for the first two ounces of First-Class Mail and that for Standard A mail of equal weight signals a problem and that cross-subsidy could exist in mismeasurements of incremental costs for Standard A mail, or in low institutional cost contributions, or in both. NAA Reply Brief at 12-14.

[5542] On a more general note, ABA/EEI/NAPM, MMA and AAPS urge the Commission to move Standard A and First-Class Mail's respective cost coverages closer together and closer to the systemwide average, arguing that First-Class pays a disproportionate share of institutional costs. AISOP, DMA, MASA, MOAA and SMC counter that Standard A now contributes its appropriate share of institutional costs, in light of the relevant statutory pricing and non-pricing factors (such as service commitments, deferred delivery and mail preparation), and is not cross-subsidized by First-Class.

[5543] AAPS witness Bradstreet maintains that First-Class mailers pay a disproportionate share of institutional cost (63 percent, while accounting for 51 percent of volume), while third class (now Standard A) mailers pay a meager share (21 percent, although they are responsible for 41 percent of volume). Tr. 23/12006, 12008.

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[87] Witness Andrew further testifies that Standard A costs and rates are not germane to the estimation of First-Class workshared costs and discounts, as the costs of the two classes are different, and Clifton fails to consider the higher level of service First-Class Mail offers. Tr. 36/19702-703, 19705.

ABA/EEI/NAPM argues that bringing Standard A and First-Class Mail's respective cost coverages closer together comports with the pricing criteria of 39 U.S.C. § 3622(b), as it: 1) promotes fairness; 2) considers the effect of rate increases upon the parties, where the disproportionate impact of the Service's proposed increases for First-Class and Standard A mail would be somewhat ameliorated; and 3) more appropriately considers the higher educational, cultural, scientific and informational value of First-Class Mail to the mail recipient. ABA/EEI/NAPM Brief at 5-6. Finally, MMA contends that the differences in Standard A and First-Class Mail's "cost factors," cited by others as justification for the disparate cost coverages, actually are reflected in attributable costs. Consequently, it is unfair to dun First-Class Mail twice by higher institutional costs, effectively making First-Class Mail subsidize Standard A mail. MMA Reply Brief at 8. MMA concedes that some discrepancy in contributions between the classes is authorized by "non-cost" factors, but not to the degree the Service seeks. *Id.* at 9.

[5544] MASA states that the Commission should not increase cost coverages for Standard A mail beyond the levels proposed by the Postal Service. MASA Brief at 10. According to MASA, any significant deviation from those cost coverages in order to bring Standard A mail more in line with First Class would result in a disproportionate increase in Standard A rates, both on a system-wide and absolute basis. *Id.* at 11. MOAA argues that any comparison of relative markups or cost coverages between First-Class Mail and Standard A mail is misleading, unless it includes a comparison to the ECR subclass, which has a higher cost coverage than First-Class both currently and under the Postal Service proposal. MOAA Reply Brief at 7-8. SMC suggests that applying, or even moving toward, equal unit contributions for the First-Class and Standard A classes would be tantamount to treating Standard A as a discount category of First-Class Mail, effectively ignoring its lower service standard and much higher price sensitivity. SMC Reply Brief at 8.

[5545] DMA likewise cites the statutory pricing factors as support for its position that Standard A mail should bear a smaller share of institutional costs than that proposed by the Service (and significantly smaller than First-Class). DMA Brief at 37-41; DMA

Reply Brief at 11. It highlights several factors under § 3622(b) standards which weigh against closer movement of First-Class and Standard A cost coverages, including: 1) the expanding alternatives available to First-Class mailers, thus eroding the basis for the special protection accorded that class; 2) increased worksharing through automation for both Standard A and First-Class mailers, with resulting significant discounts; 3) a changing Postal Service methodology for cost attribution to mail classes; and 4) new evidence bearing on incremental costs which will allow the Commission to perform objective tests to ensure against cross-subsidization. DMA Brief at 45-46.

[5546] DMA further argues that analysis of unit contribution, an approach taken by several intervenors in support of an increase in Standard A's institutional burden, has no proper bearing on the relative institutional cost burdens of Standard A and First-Class in this case. *Id*. at 46. DMA notes that the Commission has referred to unit cost contribution only as a check against extreme outcomes as a result of the Commission's judgmental application of the non-costing pricing factors interacting with the cost basis to which coverages and/or markups are to be applied. *Id*. at 47. Thus, a class's unit contribution to institutional costs is considered only to ensure that the contribution provided by an average piece of mail of a particular class is more than minimal and less than excessive. *Ibid.*

[5547] The Commission recommends a 2.2 percent average rate increase for Standard A ECR mail (which is less than the 3.0 percent increase that the Service proposed). The costs underlying the ECR rates reflect the Commission's costs, including those adjustments described in the Regular subclass analysis.

[5548] The recommended 2.2 percent average rate increase results in a 203 percent cost coverage for ECR mail. As discussed in the Regular subclass analysis, this is the first rate case in which the Commission has set separate coverages for the Regular and ECR commercial subclasses since the third-class bulk regular rate mail subclass was divided in MC95-1. Prior to MC95-1, the cost coverage for the combined Standard A commercial subclasses generally was set near, but below, that of First-Class

Mail, reflecting the different mail characteristics of the classes in conjunction with the Act's § 3622 rate and fee criteria.

[5549] The Postal Service Request proposes retaining that relationship. USPS-T-30 at 43. The Standard A Regular rates it suggests would have produced a cost coverage of 155 percent, compared to First-Class Mail's cost coverage of 200 percent. USPS-T-30 at 20, 32.

[5550] The proposed ECR rates were designed to produce a 228 percent cost coverage for ECR mail, higher than any other subclass of mail, despite its low value of service. *See* 39 U.S.C. § 3622(b)(2). The Commission agrees with the Service that even though several of the statutory factors might indicate a low ECR cost coverage, on balance the record supports an ECR cost coverage that is well above average.

[5551] The major distinction between the two Standard A commerical subclasses highlighted on this record is that Standard A ECR includes a signficant volume of mail not subject to the private express statutes; that is, in direct, and relatively intense, competition with "enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters" (§ 3622(b)(4)). This competition accounts in part for the higher price elasticity of Standard ECR, but its most important effect is to justify the high coverage the Postal Service suggests for Standard A ECR. Both AAPS and NAA represent private enterprises concerned that the Service will compete unfairly and argue for even higher coverage.

[5552] The Commission is aware that one of its responsibilities is to assure, to the extent possible, that the Postal Service and private enterprises compete on a level playing field. The increase recommended for Standard A ECR is small. In percentage terms, it is smaller than the Postal Service requests. The high coverage assigned Standard A ECR also recognizes that reasonably priced alternatives are available (§3622(b)(5)), and that rates reflect significant worksharing (§ 3622(b)(6)). This should assure private competitors that Standard A ECR mail is paying a fair share of postal overhead costs.

[5553] Additionally, as described in Chapter IV, the unit contribution of ECR has been reviewed in light of the heavy use ECR makes of the delivery function. This area of analysis is not yet fully developed, but the Commission is satisfied on the basis of this review that ECR will provide adequate unit contribution to institutional costs. Standard A ECR will make a 7.6 cent unit contribution to institutional costs. This is well below the 14.7 cent unit contribution made by First-Class letters, but it is certainly not inconsequential.

[5554] ABA/NAA witness Clifton's proposal to increase ECR cost coverage and unit contribution even higher to offset an alleged cross-subsidy by First-Class is unfounded. The Commission has never compared intrinsic cost coverages of rate cells within different subclasses. Although Clifton raises an interesting § 3622(b)(7) issue (simple relationships between rates for various classes), the solution does not lie in changing cost coverages. Clifton's general theme, that ECR coverage should be high in relation to First-Class, was met by the Postal Service's Request, and it is satisfied sufficiently by the rates recommended by the Commission.

[5555] The Commission likewise rejects intervenors' arguments that First-Class pays a disproportionate share of institutional cost compared to Standard A. In R94-1, the Commission recommended rates which produced a markup index of 1.311 for First-Class letters and 0.897 for Standard A commercial mail (prior to reclassification). PRC Op. R94-1, para. 5287. The recommended rates in the instant proceeding produce a slightly reduced markup index of 1.308 for First-Class letters and an increased markup index of 0.949 for the combined ECR and Regular subclasses, which narrows the gap between the classes' respective cost coverages. This comports with the specific pricing criteria of 39 U.S.C. § 3622(b), as well as the more general policy criteria of the Act such as "to bind the Nation together through the … correspondence of the people." § 101(a). *See, for example*, Hallmark Brief flyleaf.

[5556] *Shape Recognition*. In Docket No. MC 95-1, the Commission rejected the Service's proposal to eliminate all letter rates in ECR, where the Service's own cost studies showed a cost difference by shape. USPS-T-36 at 27. The Postal Service now

proposes to use a zero percent passthrough on the cost differential (based on avoidable costs) for the basic ECR tier. While this results in the same rate for basic ECR letters and flats, Postal Service witness Moeller maintains that the Service is not suggesting elimination of the rate category. *Ibid*. Passthroughs of 60 and 80 percent at the high density and saturation levels are proposed. *Id*. at 27, 48. Moeller claims that this approach balances the Commission's concern about reflecting cost differences with the Service's interest in its letter automation program. *Id*. at 27-28. Furthermore, Moeller asserts that there is no cross-subsidy of nonletters by letters because of the high cost coverage (228 percent). *Id*. at 28.

[5557] By equating the basic rate for letters and flats, the Postal Service hopes to encourage mailers with this density to barcode the mail and enter it as ECR basic automation or 5-digit automation in the Regular subclass. *Ibid*. It is expected that 3.3 billion letters will migrate from the basic ECR letter rate to 5-digit automation. As recounted by Moeller, Postal Service witness Moden testifies that the value of basic carrier route presortation has diminished for letters and will continue this course in the future. *Ibid*. Moden further states that the Service frequently barcodes ECR letter mail so that it can be sorted to delivery point using automation. USPS-T-4 at 8. This action allows the Service to eliminate manual casing by incorporating these letters into the carrier's delivery point sequence package. *Ibid*. The zero percent passthrough is expected to encourage letter mailings of this density to be entered by mailers directly into the Service's automation mail system. USPS-T-36 at 28.

[5558] NAA states that although it finds the Service's proposal of a zero passthrough of letter/flat differences at the basic ECR level inconsistent with recognition of shape-based differences, it nonetheless recommends the proposal's adoption if necessary to promote automation. NAA Brief at 40. However, NAA notes that this rationale for ignoring shape-based differences does not apply at the higher ECR tiers, where barcode sorters routinely process high density and saturation letters. *Id*. at 41. Consequently, it urges the Commission to recognize and passthrough the cost differences between letters and flats at those tiers to the maximum extent possible. *Ibid*.

[5559] SMC supports the Service's proposed letter/flat differentials as cost-based (although high). SMC Brief at 45-46; SMC Reply Brief at 33. In response to NAA, it argues that the letter/flat rate differentials for saturation and high density mail represent relatively high passthroughs of the estimated cost differences, with the differentials reflecting the cost effects of not just shape but weight. Further, SMC maintains that NAA ignores the interrelationships between the ECR pound rate, letter/flat rate differential and density-related rate differential in its proposals (i.e., if density-related discounts were to be reduced, then the letter/flat differential should be correspondingly decreased). SMC Reply Brief at 35-36.

[5560] The Commission recommends a passthrough of zero percent on the letter/flat cost differential for the basic tier and respective passthroughs of 65 and 95 percent at the high density and saturation levels. The zero percent passthrough eliminates the letter/flat distinction at the basic level and represents a departure from the Commission's recognition of the letter/flat cost difference in MC95-1, when it recommended retaining the letter-rate categories in the ECR subclass. However, the Commission accepts the Service's rationale for its proposal — to encourage basic letter mailers to barcode their mail and enter it as ECR basic automation or Regular 5-digit automation. Consequently, these passthroughs balance the Commission's interest in cost-based rates and the Service's interest in fostering automation. In light of the high cost coverage of the ECR subclass and the recommendation of the residual shape surcharge, it is unlikely that cross-subsidy of nonletters by letters is an issue. The Commission's recommendation of higher passthroughs at the high density and saturation levels reflect greater recognition of shape-based cost differences. These passthroughs are higher than both the current and Service-proposed passthroughs.

[5561] *Automation*. The Postal Service proposes to retain the rate category for basic ECR automation letters, with Moeller recommending moderate rates resulting in a 110 percent passthrough for this category. USPS-T-36 at 28-29, 49.

[5562] The Commission recommends a 100 percent passthrough, which is consistent with cost-based rates.

[5563] *Density Tiers*. The Service recommends the continuation of the high density (125-piece per carrier route minimum) and saturation (with mailings required to go to 90 percent of the stops on a residential route, or 75 percent of the stops on a mixed route) tiers in ECR. *Id*. at 29.

[5564] In past cases, the cost differentials by tiers have reflected only differences in delivery cost, since the Service assumed that the mail processing cost difference by tier was zero.[88] *Ibid*. However, in this case, Postal Service witness Daniel has used a new study[89]to develop mail processing costs for walk-sequenced (high density) mail and nonwalk-sequenced (basic ECR) mail for letters and flats separately.[90] USPS-T-29 at 11; Exhibit USPS-29D at 1.

[5565] Moeller recommends rates which result in a 95 percent passthrough of the cost savings for letter tiers. USPS-T-36 at 29, 49. Given the selected letter-flat and letter-density tier passthroughs, the passthroughs for the flat density tiers are 39.8 percent of the savings between basic and high density nonletters and 72 percent of the savings between high density and saturation nonletters. *Ibid*. It is argued that these lower than full passthroughs are warranted because a greater passthrough would result in more significant increases in the basic tier. *Id*. at 29.

[5566] NAA witness Donlan maintains that ECR presortation discounts should remain the same. He argues that the discount increases proposed for ECR high density and saturation mail are not justified as: 1) the Service fails to demonstrate that its ECR mail processing cost analysis reliably measures cost differences among ECR presort

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[88] The Postal Service's rate design for ECR mail is challenged by VP/CW witness Haldi, who submits an alternative rate design based upon bottom-up costing principles. Haldi's bottom-up rate design approach is addressed in detail in the Standard A Rate Design Section.

[89] Postal Service witness McGrane has filed supplemental testimony sponsoring this study. The study separates ECR mail processing for walk-sequenced mail from nonwalk-sequenced mail. *See* USPS-ST-44 at 3-4; Exhibit USPS-44A at 2-3.

[90] Postal Service witness Daniel adds the dropship savings to the mail processing unit cost, thereby removing any difference in unit cost between tiers associated with dropshipping pattern variations. USPS-T-29 at 11-12. The dropship savings, originally including both mail processing and transportation costs, were subsequently revised, appropriately, to include only nontransportation (mail processing) costs. Tr. 5/2492-93, 2498.

tiers; 2) the Service's analytical approach accounts for delivery point sequencing (DPS)-related mail processing costs for ECR basic letters, but ignores offsetting delivery cost savings (thereby overstating the actual cost difference between basic and high density/saturation letters);[91] and 3) the base year ECR processing costs from the CRA do not accurately reflect the effects of classification, as the base year 1996 cost analysis data uses 10.5 accounting periods of FY1996 data collected prior to the effective date of reclassification. Tr. 27/14676-80; NAA Brief at 27-35. Specifically, Donlan maintains that there is a substantial difference in ECR unit cost for mail processing nonwalk-sequence (basic) and walk-sequence (high density and saturation) mail between the pre- and post-classification periods, reflecting a 0.7 cent per piece decline in costs for nonletters. Tr. 27/14677-78. This claim of mail processing cost differences due to reclassification initially was confined to nonletters, but was expanded to include letters by NAA on Brief. *See* NAA Brief at 28.

[5567] Both the Postal Service and Advo witness Crowder dispute Donlan's contentions.[92] *See generally* Tr. 34/18336-44; Postal Service Brief at V-135-V-143; Postal Service Reply Brief at V-73-V-88. The Service maintains that: 1) Donlan's conclusion that classification reform resulted in a narrowing of mail processing cost differentials lacks evidentiary support, particularly with regard to nonletters, where the only significant change specific to the basic ECR category was line-of-travel sequencing, which is unrelated to unit ECR mail processing cost differentials for nonletters; 2) Donlan's reliance on comparison of partial year data to reach his conclusions is unreliable and contrary to accepted practice; 3) mail processing cost estimates are not unreliable; 4) even accepting Donlan's criticism that mail processing cost differentials are overstated for nonletters in light of classification reform, the nonletter passthroughs are sufficiently low (40 percent between basic and high density and 72 percent between high

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[91] On Brief, NAA argues that in-office delivery cost differences are overstated for both ECR letters and nonletters. NAA Brief at 30, footnote 30.

[92] VP/CW and SMC also lend support to the Service's ECR density discount proposal. *See* VP/CW Reply Brief at 12-18; SMC Reply Brief at 19-33.

density and saturation) as to negate entirely the effect of any reclassification change in nonletter mail processing costs; and 5) the lower delivery costs reported by IOCS data account for DPS savings, and the record lacks qualitative support for Donlan's assumptions that DPS savings exist for nonautomation basic letters and that nonautomation basic letters and high density/saturation letters exhibit different DPS delivery cost savings characteristics. Postal Service Brief at V-136-V-143. According to the Service, the delivery cost differential alone is sufficient to maintain the proposed saturation discount. *Id*. at V-139. Advo witness Crowder concurs, citing a R97-1 delivery cost difference of 2.353 cents versus the proposed basic to saturation rate differential of 2.3 cents. Tr. 34/18337.

[5568] Crowder finds additional flaws and inconsistencies in Donlan's critique of the Service's proposed presortation discounts. She disputes Donlan's claim that witness McGrane's base year mail processing cost data are unreliable, instead maintaining that the data are reliable and appropriate, since: 1) they reflect a full year; and 2) the dropship characteristics are identifiable for normalizing unit mail processing cost among letter categories. *Ibid*. Crowder notes that despite his claims of unreliability, Donlan nonetheless disaggregates McGrane's data further to develop pre- and post-classification costs. *Id*. at 18344. This inconsistency aside, he fails to adjust for seasonality or differences in density and dropship levels, or to ensure that volumes and costs for the two-period (partial year) data are matched. *Ibid*. Thus, according to Crowder, the partial year data are less reliable than the base year data. *Ibid*.

[5569] Crowder further maintains that Donlan is incorrect in his conclusion that the walk-sequence and nonwalk-sequence cost difference has declined 0.7 cents per piece since reclassification, as he ignores the absolute decline in cost levels. *Id*. at 18337. She notes that letter mail processing costs for nonwalk-sequenced mail have increased (unlike the nonletter costs which have decreased) since reclassification.

[5570] Finally, with regard to DPS delivery cost savings, Crowder testifies that since base year mail processing costs include letter automation savings, it follows that automation-related delivery cost savings associated with that volume are included in

base year delivery costs. *Id*. at 18341. She argues that Donlan ignores the fact that Postal Service witness Hume calculates additional DPS-related delivery cost savings for automation ECR letters, and therefore Donlan errs in his assertion that DPS delivery savings have not been attributed to ECR letters. *Id*. at 18342.

[5571] In its Reply Brief, NAA reiterates its argument that presortation discounts in Standard A ECR should not be increased. NAA Reply Brief at 18. NAA contends that the Service's testimony that it accounted for offsetting savings in delivery for DPS for nonautomation ECR letters is in direct contradiction to its own witness, McGrane, who stated that he was "unaware of any Postal Service witness whose testimony addresses city carrier in-office cost savings due to delivery point sequencing of ECR basic mail." *Ibid*. (citing Tr. 15/7681). It explains that while cost savings may be implicitly captured in ECR letter mail average costs, these savings are not included in the cost differentials for the different tiers of ECR letter mail. *Ibid*. Consequently, as discounts are based upon cost differences, not upon average costs, the proposed discounts do not reflect these savings. NAA Brief at 33.

[5572] The Commission recommends 100 percent passthroughs of cost savings for the Standard A ECR letter tiers. Given the recommended letter-nonletter and letter tier passthroughs, the passthroughs for nonletters are 36 percent between basic and high density, and 65 percent between high density and saturation. The cost differentials by tiers reveal differences in both delivery and mail processing costs, reflecting a new Postal Service mail processing cost study that indicates that the mail processing cost avoidance by tier is not zero (as was assumed by the Service in past cases).

[5573] NAA witness Donlan challenges the validity of the Service's mail processing cost study underlying the ECR presortation discounts and, consequently, the proposed discounts themselves. (He maintains that the discounts should remain the same.) Donlan disputes that the base year ECR processing costs from the CRA accurately reflect the effects of reclassification. Both the Service and Advo witness Crowder respond that the base year data are reliable for use. The Commission agrees with the Postal Service and witness Crowder.

[5574] According to the Service, reclassification changes affect the last 2.5 accounting periods in the base year. Donlan shows that the cost differentials for that period are different than those of the first 10.5 accounting periods. However, as noted elsewhere, the Postal Service: 1) adjusted the roll-forward procedures to reflect reclassification changes for the purpose of generating a test year that fully reflects reclassification's annualized effects;[93] 2) modified the unit costs by shape used in its model mail processing costs to reflect the effects of reclassification on an annualized basis; and 3) used billing determinants for the first two quarters of FY1997 to reflect the annualized effect of changes in reclassification for the purposes of its proposed rate design. The Postal Service made these three adjustments rather than rely exclusively on base year data.

[5575] Application of the data from only the 2.5 post-reclassification accounting periods in presort discount determination is inappropriate and less accurate than the full year data for the following reasons. First, the data would not reflect annualized dropship patterns. Using its avoidable cost study on dropshipping, the Postal Service adjusted the base year ECR costs to remove the effects of differences in dropship proportions. The use of only 2.5 accounting periods as a basis for costing would ignore month-to-month variations that annual data incorporate. Therefore, base year data are better in this instance.

[5576] Second, Postal Service witness Daniel inflates McGrane's base year ECR mail processing costs to the test year level using test year costs from LR-H-106. *See* Exhibit USPS-29D, p.1, n.2. The test year costs in this library reference are adjusted to reflect the Service's annualized reclassification adjustment from its roll-forward procedure. *See* LR-H-106, pp. VI-8,Col.6 and VI-5 and LR-H-126 (the source for the adjustments in LR-H-106).

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[93] The Commission corrected an error in this adjustment, but the correction has little impact on Standard A ECR costs.

[5577] In light of the Service's aforementioned adjustments to the base year data to reflect reclassification, the Commission finds the data sufficiently reliable for the determination of ECR rate differentials.

[5578] Donlan also argues that the delivery costs used for setting rate differentials do not adequately reflect DPS savings. The Commission does not agree. Rather, the Commission is persuaded by Advo witness Crowder's argument that Service witness Hume does calculate additional DPS-related cost savings for basic ECR automation mail, reflected in the base year data. Consequently, the delivery costs are sufficiently reliable for setting rate differentials.

[5579] The current, proposed and recommended rates for Standard A ECR follow:

Table 5-17
Enhanced Carrier Route Subclass Rate Schedule

	Rate (cents)		
	Current	Proposed	Recommended
Schedule 321.3			
Letter Size			
Piece Rate			
Basic	15.0	16.4	16.2
Basic Automated Letter	14.6	15.7	15.6
High Density	14.2	14.3	13.9
Saturation	13.3	13.4	13.0
Destination Entry Discount per Piece			
BMC	1.3	1.5	1.6
SCF	1.8	1.8	2.1
DDU	2.3	2.3	2.6
Nonletter Size			
Piece Rate			
Minimum per Piece			
Basic	15.5	16.4	16.2
High Density	14.7	15.3	15.1
Saturation	13.7	14.1	14.0
Destination Entry Discount per Piece			
BMC	1.3	1.5	1.6
SCF	1.8	1.8	2.1
DDU	2.3	2.3	2.6
Pound Rate	66.3	53.0	66.3
Plus per Piece Rate			
Basic	1.8	5.5	2.5
High Density	1.0	4.4	1.4
Saturation	0.0	3.2	0.3
Destination Entry Discount per Pound			
BMC	6.4	7.2	7.9
SCF	8.5	8.8	10.0
DDU	11.1	11.0	12.6

10. Standard A Nonprofit Mail

[5580] *Cost Coverage Overview*. Enacted in 1993, the Revenue Forgone Reform Act (RFRA) mandates that the full rates of the two Standard A nonprofit subclasses, Nonprofit and Nonprofit ECR, reflect one-half the markup of the comparable commercial subclass. PRC Op. MC96-2 at 12; USPS-T-36 at 32. RFRA established a six-step phasing schedule, which required the markup in the first step to equal 1/12 of the corresponding commercial markup. USPS-T-36 at 32. The full rates, Step 6, reflect 6/12 of the commercial markup. *Ibid*. The Test Year 1998 represents Step 5, with a Nonprofit markup equal to 5/12 of the corresponding commercial subclass which, for Nonprofit, is the Regular subclass. *Id*. at 32-33. The Nonprofit rate structure mirrors the Regular subclass; however, due to the relatively high cost for the Nonprofit subclass, an overall increase of 11.3 percent is requested for the subclass. *Id*. at 2, 33-34; P.O. Information Request 18, Question 3.

[5581] Several intervenors challenge the Service's proposed Nonprofit rates. NFN witness Emigh contends that the Service's proposed rates represent discriminatory pricing for Standard A Nonprofit mail, where in almost 90 percent of the categories, the proposed rates for change for Nonprofit and comparable commercial mail are asymmetrical. She urges the Commission to "recommend approximate symmetry in the rate of increase or decrease between nonprofit and commercial rates in the same rate category," absent a satisfactory explanation from the Postal Service regarding the disparate treatment (such as legitimate cost differences between rate categories). Tr. 28/15976.

[5582] According to Emigh, the asymmetrical differentials in rate "appear to circumvent the policy objective that Congress intended in the Revenue Forgone Reform Act, namely that changes in nonprofit rates would track changes in the comparable commercial rate." *Ibid*. Emigh contends that because the handling — hence costing — characteristics are almost identical for nonprofit and commercial mail within a particular

rate category, the proposed asymmetrical rate increases discriminates against nonprofit Standard A mail in favor of comparable commercial pieces. *Id*. at 15973.

[5583] The Service maintains that its proposed Nonprofit rates adhere to the requirements of RFRA. Postal Service Brief at V-179. It notes that although witness Moeller tries to mitigate individual rate cell increases, the overall rate change for the nonprofit subclasses is a function of the reported volume variable costs, as well as the RFRA-prescribed markups. *Id*. at V-180.

[5584] While appreciating witness Emigh's frustration at the relatively high increases in rates proposed for Nonprofit mail, the Postal Service nonetheless finds her criticisms lacking foundation. *Id*. at V-181-V-183. Specifically, it contends that Emigh's tables demonstrating asymmetrical rate changes are misleading in that the percentage differences are not volume-weighted, most of the changes actually *favor* nonprofits and not all rate categories are included (i.e., noticeably absent were those categories for which the percentage change was nearly equal for commercial and nonprofit mail). *Ibid*. The Service further maintains that Emigh apparently misunderstands RFRA by suggesting that increases in nonprofit rates are being used to fund a "rollback" of commercial rates. *Id*. at V-182. It explains that a rollback in commercial rates would lead to lower revenue, contribution and coverage (all else being equal), with lower commercial cost coverage translating to a reduced cost coverage for the Nonprofit subclass, by virtue of RFRA. *Ibid*. Thus, a suppression of commercial rates would benefit nonprofit rates. *Ibid*.

[5585] NFN responds that the Service is using RFRA requirements as a substitute for valid, verified data. NFN Reply Brief at 1. NFN states that RFRA's only impact in this case is on institutional contribution, and if the Service's proposed attributable cost increases were small, as with Standard A commercial mail, the additional institutional contribution for nonprofit mail would likewise be small. *Ibid*.

[5586] According to NFN, the Service has effectively conceded that its attributable cost methodology used to produce Standard A Nonprofit rates is significantly flawed, since witness Moeller admittedly attempts to mitigate the increases for individual rate

cells. *Ibid*. NFN offers several other criticisms of the Service's determination of Nonprofit rates, among them that: 1) the Postal Service's arguments about past pricing errors (i.e., R94-1 costing methodology producing an insufficient Nonprofit rate increase) are outside the scope of this proceeding; 2) while the Service critiques witness Emigh's percentage-differential charts as not volume-weighted, it computes essentially the same percentages; and 3) the Service misconstrues witness Emigh's suggestion that increases in nonprofit rates are proposed to fund a rollback of commercial rates. *Id*. at 2-3. On this point, NFN notes that rollbacks may be from current or proposed rates. *Id*. at 3. It further states that suppressing commercial rates has only a *partially* beneficial effect on nonprofit rates. *Ibid*. NFN charges that the Postal Service is attempting to diminish the revenue requirement ascribed to commercial mail by allocating too much of it to nonprofit mail. *Id*. at 4.

[5587] CRPA witness Stapert urges the Commission to consider the "problematic nature" of the Service's Standard A Nonprofit costs and to "seek a more solid empirical foundation" upon which to base any significant rate increases. Tr. 22/11737, 11744. Stapert's reservations about the cost data upon which the proposed Standard A Nonprofit mail rates are based stem from the period during which the data were collected: immediate post-reclassification, which even Postal Service witness Talmo agrees might serve to "skew these figures." *Ibid*. (citing Tr. 7930).

[5588] Finally, ANM witness Haldi objects to the Service's proposed rates for Standard A Nonprofit mail as inflated and disproportional to those proposed for Regular mail, Nonprofit's commercial counterpart. Tr. 22/11774-75. Haldi notes that under the Postal Service's proposal, Nonprofit letter rates increase 19 percent, while the corresponding Regular subclass letter rates decrease 3.5 percent. *Id*. at 11776-77. This rate disparity cannot be attributed to a difference in markups, since the nonprofit rate level (i.e., markup) is directly related to the corresponding commercial subclass, as mandated by RFRA. *Id*. at 11777. Rather, Haldi suggests that the deviation in rates is related to an abnormal increase in the costs for Nonprofit mail in FY1996. *Id*. at 11778-79. Haldi further maintains that: 1) these differences in attributable cost cannot

be explained by changes in mail characteristics;[94] 2) it is likely that the labor costs assigned to nonprofit mail may suffer from Stralberg's automation theory; 3) there are several nonsensical IOCS tallies which cast doubt on the integrity of the IOCS; 4) some nonprofit mail may be correctly reported in the RPW system as commercial mail but recorded as nonprofit in the IOCS system, thereby skewing the underlying attributable cost estimates and ultimately the proposed nonprofit rates; and 5) the TRACS system tends to attribute too much cost to nonprofit mail.[95] *See generally* Tr. 2/11774-75; ANM Brief at 13-15. In light of the significant attributable cost data problem and because they feel the Service's case suffers from an overall failure of proof, Haldi and ANM argue that the Service's proposed Nonprofit rates be rejected. ANM Trial Brief at 1-2; Tr. 22/11774-75.

a. The ANM Survey on Potential Misidentification of Nonprofit Mail in the IOCS and RPW Systems

[5589] Due to legislation passed in 1990 and 1993, the Postal Service issued new regulations on nonprofit mail eligibility at the beginning of FY1996, the base year. Tr. 22/11808. Haldi testifies that this change in some mail eligibility requirements has led to situations where Standard A Regular mail could be misidentified as Nonprofit in the IOCS system. As a result, the Postal Service cost systems would improperly associate tallies with Nonprofit mail, and Nonprofit costs would be overstated. *Id.* at 11808-811.

[5590] A survey of ANM member organizations was taken to determine the extent to which revenue and cost data may be out of synchronization. *Id.* at 11811; ANM Brief

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[94] Haldi states that the average weight for the Nonprofit subclass increased from 1.07 ounces to 1.08 ounces per piece during FY 1996, while the Regular subclass experienced a 3.6 percent decrease in average weight from 2.23 ounces to 2.15 ounces. *Id.* at 11791. He concedes that this may account, in part, for restraining unit costs for the Regular subclass. *Ibid.*

[95] The TRACS system is the Postal Service's sampling system used to develop a key for distributing volume variable transportation costs to the individual classes and subclasses of mail. *Id.* at 11817. On Brief, the Postal Service disputes Haldi's criticisms of the TRACS system. *See* Postal Service Brief at III-171-III-175; Postal Service Reply Brief at III-136. A complete discussion of this issue appears in Section III.E. of this opinion.

at 20. Of the 49 respondents, 38 had put Nonprofit indicia on mail that eventually paid Standard A Regular rates. Tr. 22/11812. Haldi estimates that 7.85 percent of mail entered with nonprofit markings actually paid commercial rates. *Id.* at 11814. He consequently recommends that the Commission shift 7.85 percent of the nonprofit tallies (and associated costs) to the Standard A commercial subclasses. Haldi maintains that this is a reasonable approach because the IOCS is a random sample. *Ibid.*; ANM Brief at 21.

[5591] In the alternative, ANM suggests that the Commission limit the Service's proposed increase in unit attributable mail processing costs for Standard A nonprofit mail "to the ratio of nonprofit and commercial unit attributable mail processing costs that has prevailed in recent years before FY 1996." ANM Brief at 21. ANM identifies the ratio of Standard A Nonprofit unit cost to the Standard A Regular unit cost as 0.79 for FY1996, compared to the FY1995 ratio of 0.71. *Ibid.* ANM maintains that between FY1995 and FY1996, Standard A Nonprofit costs increased more than 8 percent, while the corresponding cost for Standard A Regular dropped about 2 percent. *Ibid.* ANM advocates using the FY1995 ratio of 0.71 to calculate a base year unit Clerks and Mailhandlers cost for Standard A Nonprofit mail of 3.8 cents, 8.6 percent less than that proposed by the Service. *Id.* at 22.

[5592] Postal Service witness Schenk rebuts ANM witness Haldi's contention that nonprofit unit costs are inflated because the Postal Service failed to synchronize nonprofit cost and volume data.[96] Tr. 36/19591. Schenk maintains that: 1) ANM's survey is not representative of the population of nonprofit mailers; 2) ANM did not use appropriate statistical survey methodology; 3) any inconsistency in nonprofit mail volumes and costs is negligible; and 4) consequently, Haldi's proposed adjustment to nonprofit costs is unwarranted. *Id.* at 19595-98, 19609-610; *see also* Postal Service Brief at III-132-III-137; Postal Service Reply Brief at III-112-III-114. The Service also

[96] On Brief, MOAA cites witness Schenk's critique of Haldi's position in support of the proposition that no adjustment be made to the Service's submitted costs for the Standard A commercial and nonprofit subclasses. MOAA Brief at 41-42.

claims that Haldi's volume estimation methodology (by which he produced his projected growth rate for nonprofit volume) is flawed and overestimates the volumes of mail affected by "mismatching" (i.e., the volumes sent at Regular rates with Nonprofit indicia). Postal Service Brief at III-136-III-137.

[5593] Schenk notes that the survey was sent only to ANM members, and no evidence demonstrates that ANM members are representative of all nonprofit mailers. Tr. 36/19595. In fact, one-third of the responses came from the American Association of Museums, which probably does not account for one-third of all Standard A nonprofit mail. *Id*. at 19598. ANM's survey results were not based on a random sample, so no inferences about the population can be derived. Moreover, the suggestive wording of the survey was likely to elicit biased responses. *Id*. at 19595-19596.

[5594] Schenk also criticizes the 15 percent (or less) response rate, which is "considerably lower than what is generally considered necessary to produce statistically valid estimates." *Id*. at 19597. Schenk characterizes Haldi's claim that the responses show the problem to be widespread because they come from all major geographic areas as fallacious, because geographic dispersion does not imply magnitude. *Ibid*. Further, originating nonprofit mail is concentrated in the Midwest and East, thus making Haldi's claim unjustified. *Id*. at 19598.

[5595] Based upon her analysis of the survey responses, Schenk submits the following criticisms of the survey: 1) 45 of the 108 responses are on a second, less detailed form. These results really reflect a different survey and should not have been combined with the results of the first survey form; 2) for 26 of the 108 responses, the data recorded in Exhibit ANM-T1-1 do not match the survey forms. (Most of these responses denote that the mail sent Regular rate was entered with a Nonprofit permit, but also indicate that the indicia used on the mailpiece was for Regular rate. Therefore, there was no discrepancy as ANM alleges.); and 3) 22 of the 108 responses are marked with two numbers. *Id*.

[5596] ANM responds that the Service's criticisms of Haldi's study are unfounded, particularly as Schenk failed to prove that Haldi's nonprofit organization respondents

possessed mail rejection rates not representative of the universe of nonprofit mailers. Moreover, while Haldi did not indicate how the volumes for the aforementioned mailings were recorded in Postal Service databases, he was unable to do so as only the Service possesses this information. ANM Brief at 34-36. ANM argues that Schenk's critique smacks of a double standard because Schenk's analogous study (described in the next section) suffers from the same non-response or selection bias as alleged in Haldi's, and Schenk likewise did not provide standard errors or confidence intervals for the given estimates. *Ibid*.

b. The Schenk/Postal Service Survey

[5597] According to Postal Service witness Schenk, the extent to which Standard A nonprofit mail volume and costs are not consistent is limited. She describes three ways by which cost and volumes may not align, as follows: 1) disqualification after acceptance; 2) reversals; and 3) disqualification during acceptance. Tr. 36/19601-605, 19616-18. Schenk attempts to quantify these effects using a survey performed while this case was in progress.

[5598] In disqualification after acceptance, mail is accepted with nonprofit indicia, pays nonprofit rates, but is disqualified as ineligible for nonprofit rates during processing or delivery. *Id*. at 19601-602. The revenue deficiency goes into a general revenue account and not into the permit revenue system. This avoids double counting of revenue. Both the volume and the revenue remain recorded as nonprofit. *Id*. at 19602-603. These revenue deficiencies amounted to $12.8 million in FY1996 or 0.04 percent of stamped and metered revenue. Schenk maintains that the impact is therefore negligible. *Id*. at 19603.

[5599] In reversals, which rarely occur, mail is disqualified soon after entry, and the volumes are re-recorded as commercial volumes. *Id*. at 19604. An estimated 6.1 million pieces were moved from nonprofit to commercial under this reversal procedure. This was 0.05 percent of FY1996 nonprofit volumes. *Id*. at 19604-605.

[5600] Finally, in disqualification during acceptance, mail is assessed at (and pays) commercial rates but bears nonprofit indicia. *Id*. at 19605. The only way to determine the degree to which this occurs is to examine the "disqualification logs" at acceptance units, since the information is not centralized. *Ibid*.

[5601] Schenk's estimates are taken from responses to a survey of 30 post offices selected from the universe of sites with Standard A nonprofit bulk permit imprint revenues in FY1996. *Ibid*. Survey results showed that the most common respondent comment concerning nonprofit mailings in FY1996 was that the disqualifications tapered off after the first quarter of FY1996, as mailers learned the rules. *Id*. at 19618-19. Results indicated that the volume of mail paying commercial rates with nonprofit indicia was 30.9 million pieces or 0.25 percent of all Standard A nonprofit volumes in FY1996. Thus, even in a period where, as Haldi claims, there was increased enforcement, the mailings are negligible. *Id*. at 19619.

[5602] Schenk demonstrates the limited effect of disqualified nonprofit mail on IOCS costs for FY1996 through the following table:

Table 5-18

Summary of Disqualified Volumes	
Disqualification after acceptance (revenue accounts)	0
Reversals	6,129,920
Disqualification at acceptance	30,322,956
Total Disqualifications	36,452,876
Total Standard A Commercial Volumes in FY 1996	59,339,000,000
Percentage of commercial volumes with nonprofit indicia	0.061%

Id. at 19608. According to Schenk, IOCS costs for Standard A commercial mail amounted to $1.024 billion in FY1996. *Ibid*. Adding 0.061 percent to this cost to account for the misidentified mail with nonprofit indicia adds $0.0006 billion for a total of $1.0246 billion in FY1996. *See ibid*.

[5603] Schenk testifies that there are also reversals for mail with commercial indicia paying nonprofit rates, so volumes are shifted from commercial to nonprofit after the fact. *Id*. at 19609. Those reversals amounted to 12.9 million pieces in FY1996, or 0.1 percent of nonprofit Standard A volume. This means that there are some costs in the commercial category that should be in the nonprofit category. *Ibid*. Also, IOCS costs for Standard A nonprofit mail amounted to $0.228 billion in FY1996. Adjusting the cost to reflect misidentified commercial volumes would add $0.0002 billion to the cost of Standard A nonprofit mail. *Ibid*.

[5604] According to Schenk, the net effect is that $0.4 million (i.e., $400,000) is in nonprofit cost that should be in commercial cost. This amounts to 0.18 percent of Standard A nonprofit costs, compared with Haldi's estimate of 7.85 percent of mail processing costs. *Ibid*. As such, no adjustments to nonprofit costs (and, consequently, nonprofit rates) are warranted. *Id*. at 19610. *See also* Postal Service Brief at III-137-III-143.

[5605] In both its Brief and Reply Brief, ANM counters that Schenk's study does not provide credible evidence of the extent of the IOCS/RPW mismatch, although it does serve to "confirm[] that a substantial volume of mail in FY96 bore nonprofit markings yet paid regular Standard Mail (A) rates and was recorded as regular Standard Mail (A) in the RPW system." ANM Reply Brief at 23; *see also* ANM Brief at 22. Specifically, ANM criticizes the Schenk study for relying on "guesswork and multiple hearsay" involving Schenk, her coworkers and multiple Service respondents, who frequently relied on "sheer memory" to provide volume estimates (at those sites where disqualification logs — the prime source recording mailing problems — or other business records were unavailable). ANM Brief at 23. Moreover, at a number of sites, the volume estimates given by Service employees were for a single accounting period in FY1998, not FY1996.

Ibid. A multitude of purported problems associated with the disqualification logs and their completion is detailed by ANM in both its Brief and Reply Brief. *See* ANM Brief, Attachment A; ANM Reply Brief at 3-23.

[5606] ANM offers a number of additional general criticisms of the Schenk study, including that: 1) where respondents did not provide specific volume figures for rejected mailings, Schenk arbitrarily assumed that the average number of pieces of each mailing within a given size range equaled the unweighted midpoint of the range; 2) the study suffers from respondent bias, where easily identifiable Service employees answering the survey questionnaire had an "obvious incentive" to underreport the extent to which their site accepted mail with nonprofit markings at commercial rates (a violation of the Domestic Mail Manual); 3) the study suffers from the same non-response or selection bias alleged to weaken Haldi's effort; 4) Schenk did not provide standard errors or confidence intervals for the given estimates; and, most significantly 5) the study overlooked mail with nonprofit markings that was voluntarily entered at commercial rates (without any attempt by the mailer to enter the mail at nonprofit rates, and without any action by the Service to disqualify the mailings for such rates). ANM Brief at 24-26. According to ANM, Schenk's survey response forms "allude to the existence of this phenomenon as widespread," yet Schenk made no attempt to measure it. *Id*. at 28. ANM acknowledges that Schenk later testified (on her subsequent return to the stand to respond to questions about her data source) that the survey term "disqualified mail" included both disqualified mail and mail entered voluntarily at commercial rates, thereby providing some accounting and quantification of the problem. *Id*. at 29. However, it is ANM 's position that Schenk's most recent testimony on the interpretation of the term is unsupported, with no acceptable indication (and in fact contrary documentation) that Schenk's colleagues and/or Service employees shared Schenk's understanding. *Id*. at 30, 32. ANM also maintains that the "most telling evidence against Dr. Schenk's interpretation of the disqualification logs is their failure to indicate the voluntary entry of mail with nonprofit markings at commercial rates *even at sites where the survey forms indicate that this practice is widespread*." *Id*. at 33.

[5607] In light of these criticisms of Schenk's studies, and where Haldi's study is based on mailing statements or other contemporaneous records, ANM argues that Haldi's proposed adjustments should be accepted by the Commission as the best evidence of record. *Id*. at 34. In the alternative, should the Commission find Haldi's proposed adjustments insufficiently documented to warrant adoption, ANM then submits that the only lawful option for the Commission is to reject any rate changes for Standard A Nonprofit mail, because the Service has failed to prove that the proposed increases are justified. *Id*. at 36. Specifically, the Service is unable to meet the burden of proof that the level of costs attributable to the Nonprofit subclass is justified, where the attributable cost data "are corrupted with tallies from other subclasses," and the Service has offered no valid data setting an upward bound on the magnitude of the overstatement. *Ibid*.; *see also* ANM Reply Brief at 1-2, 22-23.

[5608] In reply to ANM's arguments, the Postal Service notes that, contrary to ANM's claims, the Service does concede the possible existence of witness Haldi's "mismatch problem," but disputes that ANM has demonstrated the magnitude of the problem. Postal Service Reply Brief at III-101. Rather, the Service argues that witness Schenk more accurately quantifies the limited amount of nonprofit mail for which costs and volumes do not align. *Ibid*.

[5609] The Service disputes ANM's criticisms of the Schenk survey, maintaining that: 1) Scheck and her colleagues are well-versed in bulk mail entry procedures; 2) Schenk gathered survey information from informed, reliable sources and used appropriate filter questions; 3) her use of the midpoint of the ranges of the volumes provided in survey responses to estimate the number of mailings in her survey is sound. Moreover, Schenk's determination that conservative estimates result from that midpoint value is supported by nonprofit mail characteristics reported in LR-H-195; and 4) ANM overstates Schenk's survey's susceptibility to respondent bias. *Id*. at III-103-III-107, III-110. The Service also contends that ANM's analysis critiquing the disqualification logs used in the Schenk survey is "ill-timed and full of errors." *Id*. at III-116.

[5610] The Postal Service claims that its survey fully accounts for "voluntary mail," although the survey form wording does not precisely specify and segregate mailings which are voluntarily entered with nonprofit markings at commercial rates. *Id.* at III-107-III-108. The omission on the survey form is negligible because: 1) the sheets were used by Schenk and her colleagues for telephone responses, rather than sent directly to respondents; 2) it was unnecessary to make any distinction since the forms elicited the information sought, whether or not the mail was sent at Regular rates with nonprofit indicia, and no distinction is made as far as acceptance procedures are concerned; and 3) the acceptance logs affirm the survey's estimates and indicate that the voluntary mailings were included. *Id.* at III-108. According to the Service, Haldi's own testimony does not, in fact, indicate a pervasive problem with voluntary entry of mail with nonprofit markings at commercial rates. *Id.* at III-109. It states that only 15.3 percent of the total number of pieces reported by ANM respondents were voluntarily entered at commercial rates, which hardly qualifies as "the most significant cause" of witness Haldi's phenomenon. *Ibid.*

[5611] In response to ANM's proposed alternative adjustments to rectify the problem of IOCS/RPW mismatches, the Postal Service maintains that ANM has failed to demonstrate that the Service's attributable cost data are tainted with tallies from other subclasses and, consequently, no adjustment in rates is merited.[97] *Id.* at III-115-III-116.

[5612] The Commission recommends an average rate increase of 9.6 percent for Standard A Nonprofit mail (which is less than the Service's 11.3 percent increase). The costs underlying the rate level reflect an adjustment in the roll-forward procedure to take into account reclassification, as well as those considerations discussed in the Regular subclass cost coverage analysis.[98] The rate level further reflects a one percent shift of

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[97] In its Reply Brief, the Postal Service contends that ANM's newly proposed adjustment resulting in a Commission base year unit Clerks and Mailhandlers cost for Standard A Nonprofit mail of 3.8 cents, 8.6 percent less than that proposed by the Service, was improperly applied. Postal Service Reply Brief at III-115. While discounting the entire proposal, the Service nonetheless points out that ANM errs in its calculation and that the actual cost figure derived from its new methodology is 4.3 cents (not 3.8 cents). *Ibid.*

total attributable costs from Nonprofit to Regular mail, Nonprofit's commercial counterpart, in recognition of the issue of misclassified mail.

[5613] Review of the extensive evidence submitted by both the Service and ANM convinces the Commission that Nonprofit mail's attributable cost data are not wholly accurate. Witness Haldi submits several different hypotheses as explanations, all of which the Postal Service disputes. The Commission finds one hypothesis particularly persuasive: that some nonprofit mail may be correctly reported in the RPW system as commercial mail, but recorded as nonprofit in the IOCS system. Both the Service's disqualification logs and respondents to ANM's survey substantiate this theory.

[5614] However, while identification of the problem is confirmed, quantification presents a greater challenge. The Service concedes that some mail has been misidentified, but maintains that the net effect — which includes adjustments for costs associated with mail with commercial indicia paying nonprofit rates — is negligible, amounting to $400,000 or 0.18 percent of Standard A nonprofit costs. Haldi and ANM argue that 7.85 percent of mail entered with nonprofit markings actually paid commercial rates and, consequently, recommend that the Commission shift 7.85 percent of nonprofit costs to the Standard A commercial subclasses. Haldi derives this figure based upon ANM survey results and his mail volume growth rate estimates.

[5615] Both studies are significantly flawed and may not be relied upon for quantitative assessment. Extensive criticism of each study by the opposing party raises several particularly troublesome aspects worth mentioning. Specifically, Haldi's survey is not representative of the nonprofit mailer population, since one-third of his responses came from members of the American Association of Museums. Additionally, his mail volume growth rate figure is completely speculative since he did not attempt to quantify volume shifts in his study. With regard to Schenk's survey, the Commission notes the significant potential for a large non-sampling error, where in numerous instances Schenk

[98] Because reclassification for the Standard A nonprofit subclasses went into effect on October 6, 1996, the billing determinants do not reflect its effects for the full fiscal year. Consequently, the Postal Service used FY1997 Quarter 2 billing determinants to develop rates for the nonprofit subclasses. See Appendix D for further discussion.

relies upon the memories of Postal employees, some of whom were totally unable to provide reliable estimates to quantify the mismatch at sites missing disqualification logs. The evidence also indicates that the Schenk study did not account for mail with nonprofit markings that was voluntarily entered at commercial rates, although there is no accurate quantification of the degree of this problem.

[5616] It is unfortunate that the Service did not expend significant efforts to evaluate the matter until after the Commission's final ruling on the issue directed it to do so, as discussed in the procedural history of this case. The Commission can neither ignore this cost allocation problem, thereby penalizing nonprofit mailers with unjustifiably high rates, nor reject any nonprofit rate increase, thereby penalizing other mailers by making them "pick-up" the known costs of nonprofit mail. After examination of the record evidence, including nonprofit mail volume, the Commission estimates that one percent of total nonprofit attributable costs should have been associated with Standard A commercial mail and has adjusted Standard A mail costs accordingly. This modification is implemented as a final adjustment in Appendix J. The shift has virtually no effect on the unit attributable cost of the commercial subclasses, as the unit cost for the Standard A Regular subclass increases by only 0.032 cents and the unit cost for Standard A ECR increases by 0.005 cents.

[5617] *Shape Recognition: Letter/Nonletter Differential*. The Postal Service proposes rates which serve to reduce the letter/flat passthroughs from the current 62 percent to 56 percent for basic and 55 percent for 3/5-digit. USPS-T-36 at 34, 49. Moeller maintains that the resulting passthroughs are similar to the current passthroughs underlying the present Nonprofit rates. *Id*. at 34. He proposes that the nonautomation rate categories experience similar percentage changes in full rates. *Id*. at 34-35.

[5618] As discussed in the Regular subclass analysis, Commission costing adjustments increase the value of worksharing compared to the Service's cost presentation. The Commission recommends letter/flat passthroughs for Nonprofit basic of 50 percent and 3/5-digit mail of 40 percent. The decrease from the current 62 percent level reflects the Commission's effort to use the same percentage passthroughs for the

Nonprofit and Regular subclasses and is necessary to meet the Postal Service's goal of encouraging letter mailers to barcode their mail, with which the Commission concurs. Thus, the 5-digit automation letter rate must be less than the basic ECR letter rate but greater than the basic ECR automation letter rate.

[5619] *Presort Tiers*. The Postal Service advocates a 90 percent presort passthrough for letters, versus the 100 percent passthrough underlying the current rates. *Id*. at 35, 49. The implied flat presort passthrough is 65.6 percent, and this passthrough combination produces similar percentage changes for the presort tiers. *Id*. at 35.

[5620] The Commission recommends a 100 percent passthrough for letters. The implied flat passthrough is 70.9 percent. The recommended passthrough reflects the Commission's consideration of the effect on mailers by moderating the rate increases for individual categories, in conformance with § 3622(b)(4) of the Act, as well as the Service's interest in having mailers continue to presort mail. These passthroughs result in 3/5-digit letter and flat discounts of 2.7 cents and 6.8 cents, respectively.

[5621] *Automation: Letters*. The Postal Service proposes a 93 percent passthrough for basic barcoded letters, arguing that: 1) the passthrough adequately reflects the cost differential; 2) the percentage rate increase is in accord with other increases in the subclass; and 3) the percentage rate increase is equal to or less than those for the nonautomation rate categories. *Id*. at 35, 49.

[5622] The proposed passthroughs for 3-digit and 5-digit automation are 125 percent and 160 percent, respectively. According to Moeller, these figures are justified because: 1) the resulting discounts are similar to those in the Regular commercial subclass; 2) the discounts "help achieve the rate relationship between 5-digit automation and Nonprofit Enhanced Carrier Route Basic Letters;" and 3) the structure of the commercial subclass is appropriately "mirrored," including rate relationships fostering automation compatibility. *Id*. at 35-36.

[5623] *Automation: Flats*. The Postal Service proposes a 100 percent passthrough for 3/5-digit barcoded flats, which is equivalent to the commercial passthrough, but

nevertheless results in a significant rate increase. *Id*. at 36. A 95 percent passthrough is suggested for basic barcoded flats, producing a comparatively low rate increase. *Ibid.*

[5624] The Commission recommends 100 percent passthroughs for Nonprofit letter and flat automation discounts. In advocating these passthroughs and resulting discounts, the Commission recognizes the Service's goal to encourage automation and reward worksharing.

[5625] The Commission's recommended rate schedule is found in Appendix One.

11. Standard A Nonprofit Enhanced Carrier Route Mail

[5626] *Cost Coverage Overview*. The Postal Service states that under RFRA, the Nonprofit ECR subclass is required to have a markup equal to one-half that of commercial ECR for full rates, or a 164 percent cost coverage. USPS-T-30 at 36. Step 5 rates apply in the test year, with a markup equal to five-twelfths that of commercial ECR. *Ibid*. Application of this markup to Nonprofit ECR costs results in a 6.3 percent decrease in average rates for the subclass, with full step 6 rates imposed for those rate cells where step 5 rates fall below the RFRA phasing-period rate-floor for nonletters. *Id*. at 36-37; P.O. Information Request No. 18, Question 3.

[5627] Postal Service witness Moeller notes that, unlike in the Nonprofit subclass, where the prescribed markup and volume variable costs result in large rate increases, the proposed Nonprofit ECR rates decrease. USPS-T-36 at 39. Consequently, Nonprofit ECR passthroughs are generally similar to ECR passthroughs. *Ibid*.

[5628] The Commission notes that Nonprofit ECR mail is essentially subject to the same constraints discussed in the Commission analysis for Nonprofit mail and, therefore, directs focus to that analysis for details.

[5629] As the ECR subclass has a cost coverage of 203.1 percent, Nonprofit ECR cost coverage is 143 percent in the test year. Applying the coverage to Nonprofit ECR attributable costs permits the Commission to recommend an average rate decrease of 10.4 percent for Nonprofit ECR mail (which results in lower rates than those proposed by

the Service). The average rate decrease in Nonprofit ECR mail allows passthroughs which are quite similar to the ECR passthroughs.

[5630] *Letter/Nonletter Differential*. The Postal Service proposes rates which result in a zero percent passthrough for the basic tier and 65 and 75 percent passthroughs for the high density and saturation tiers, respectively. *Id*. at 40, 49. Moeller testifies that the basic tier rate design aids in establishing a rate relationship between basic Nonprofit ECR and 5-digit automation, which mirrors the proposed relationship for the corresponding commercial subclasses.[99] *Id*. at 40.

[5631] The Commission recommends rates and passthroughs which foster the Service's goal of increased automation, recognize the value of worksharing to both the Service and mailers, and consider the effect of the resulting rates on mailers. For the letter/nonletter differential, the Commission-recommended rates result in a zero percent passthrough for the basic tier and 100 percent passthroughs for high density and saturation tiers.

[5632] *Density Tiers*. The Service proposes passthroughs of 95 percent between the basic and high density tiers and 100 percent between the high density and saturation tiers, equivalent to the proposed commercial passthroughs. *Id*. at 40, 49. Given the letter-nonletter and letter-density tier passthroughs, the passthroughs for density for nonletters are 41.6 percent between basic and high density, and 76.9 percent between high density and saturation. *Ibid*. These figures are similar to those suggested for ECR mail, thus resulting in a relationship between the basic carrier route tier and 5-digit automation which mirrors the proposed relationship in the corresponding commercial subclasses. *Id*. at 40-41.

[5633] The Commission recommends respective passthroughs of 100 percent between the basic and high density tiers and high density and saturation tiers. Given the recommended letter-nonletter and letter-density tier passthroughs, the passthroughs for

[99] Witness Moeller is referring to his proposal to use a zero percent passthrough of the letter/flat cost differential at the basic tier. Increasing the basic Nonprofit ECR letter rate facilitates a set of rates whereby the Nonprofit 5-digit automation rate is less than the basic Nonprofit ECR letter rate, thus fostering increased automation.

nonletters are 25 percent between basic and high density[100] and 100 percent between high density and saturation.

[5634] *Automation*. The Postal Service proposes a 120 percent passthrough for the automation discount which, while higher than its commercial counterpart, is argued as necessary in order to establish a meaningful differential between the basic Nonprofit ECR automation rate and the 5-digit automation rate at step 6. (full rates). *Id*. at 41, 49. Nonprofit ECR automation is the only rate category within this subclass proposed to receive a rate increase. *Id*. at 41. However, witness Moeller maintains that this increase is tempered by the high passthrough. *Ibid*.

[5635] The Commission recommends a 200 percent passthrough for the automation discount, which is necessary in order to establish a meaningful differential between the basic Nonprofit ECR automation rate and the 5-digit automation rate at full rates under RFRA.

[5636] The Commission's recommended rate schedule is found in Appendix One.

[100] The low passthrough is a mathematical result of using a zero percent letter/flat passthrough at the basic level.

D. Standard B Mail

1. Parcel Post Subclass

a. Introduction

[5637] Parcel Post includes mailable matter weighing 16 ounces or more, but not exceeding 70 pounds in weight or 108 inches in combined length and girth. In general, Parcel Post is used for matter not eligible for mailing in any other Standard Mail subclass, and consists primarily of merchandise.

[5638] The current rate structure for Parcel Post is based on the weight and machinability of the piece, the distance between origin and destination three-digit ZIP Codes as measured by zones, and whether the parcel is mailed and delivered within a bulk mail center (BMC) or auxiliary service facility (ASF) service area. At present, the rates applicable to Parcel Post are contained in Rate Schedule 401, which applies only to mailings within a destination BMC or ASF, and Rate Schedule 400, applicable to all other Parcel Post mailings.

b. Postal Service Proposal

[5639] The Postal Service proposes extensive revisions in Parcel Post classification and rate design, most of which are carried forward from the Postal Service's withdrawn parcel reclassification request in Docket No. MC97-2. These proposed revisions include:

- Establishing a discounted Origin BMC (OBMC) rate category for 50 or more parcels entered at a Bulk Mail Center (*not* the destination BMC) and presorted to the destination BMC.

- Establishing a discounted BMC presort rate category for 50 or more parcels presorted to the destination BMC and separated into machinable and nonmachinable parcels.
- Establishing a discounted Destination Sectional Center Facility (DSCF) rate category for 50 or more parcels entered at the SCF which serves the recipients of the parcels, presorted to the 5-digit level.
- Establishing a discounted Destination Delivery Unit (DDU) rate category for 50 or more parcels entered at the Delivery Unit which serves the recipients of the parcels.
- Establishing a discounted rate category for barcoded parcels (but not parcels in the DSCF or DDU categories) which can be processed on BMC parcel sorters equipped with barcode readers.
- Increasing the maximum allowable length and girth of Parcel Post pieces, from 108 inches to 130 inches, and charging the 70-pound rate for oversize pieces, but with the restriction that such pieces could constitute no more than 10 percent of total pieces in a single mailing.
- Reinstating the “stop-loss” or “balloon” rate, whereby a parcel exceeding 84 inches in combined length and girth and weighing less than 15 pounds is charged the 15-pound rate for its zone.

[5640] For Parcel Post rates overall, the Postal Service proposes an average increase of 10.2 percent, based on the Service’s cost estimates and witness O’Hara’s recommendation of a 104 percent cost coverage. USPS-T-30 at 37. General rate design features of the Service’s proposed rates include adjustments to eliminate crossover with Priority Mail rates; limitation of the rate increase for any cell to a maximum of 30 percent; constraint of rates for zones 7 and 8 in the intra-BMC schedule so that rate decreases do not occur; and a cap on certain high-zone DBMC rates to keep them from exceeding corresponding intra-BMC rates. With respect to ancillary charges, the Service proposes a decrease in the nonmachinable surcharge from $1.75 to $1.35, based on an updated study of processing cost differences; reintroduction of the “stop-loss” or “balloon rate,” to recover additional cube-related costs; and an increase in the pickup fee from $4.95 to $8.25, based on the testimonies of witnesses Sharkey (USPS-T-33) and Nelson (USPS-T-19).

[5641] The cost methodologies underlying the development of the Service's proposed Parcel Post rates differ somewhat from those used in prior proceedings. As in past cases, the Service treats all Alaskan air transportation costs as potentially volume variable, consistent with its cost analysis. However, one major innovation is the analysis of transportation costs presented by witness Hatfield in USPS-T-16. For the first time, he includes Postal Service-owned vehicles in his general analysis, and recognizes a separation of terminal and line-haul costs within commercial air transportation. He also proposes a new method for separating transportation costs into rate-category components; a change in the prior Postal Service approach to distance-related costs; and a more disaggregate relation between cubic volume and weight.

c. Cost Coverage

[5642] United Parcel Service witness Henderson testifies that the overall rate level for Parcel Post should be set to incorporate a cost coverage of 107 percent. Tr. 25/13570. He bases his recommendation on several factors. First, he cites value of service and competitive considerations, and finds no intervening development since the R94-1 proceeding that would indicate a significant change in Parcel Post since the last omnibus rate case. *Id.* at 13571. Second, he claims that the Service's proposed markup of 104 percent is so low that Parcel Post rates will probably be below attributable costs for much of the time the rates established in this case will be in effect. Moreover, he states that the Service's proposed 1 percent contingency allowance—which is "quite small by historical standards"—"provides further support for maintaining Parcel Post's cost coverage at the level established by the Commission in Docket No. R94-1." *Id.* at 13572. He also cites Parcel Post's status as a competitive service with readily available alternatives as an applicable pricing consideration.

[5643] United Parcel Service reiterates witness Henderson's recommendation on brief, and argues that the record shows that certain aspects of Parcel Post service have improved since Docket No. R94-1, and that its volume has increased recently. UPS

Initial Brief at 37-38. In order to avoid the cross-subsidy of Parcel Post by other subclasses of mail, and to ensure fair competition in the parcel market, UPS "recommends that 107 percent be the absolute minimum cost coverage for Parcel Post." *Id.* at 38.

[5644] Parcel Shippers Association argues, to the contrary, that witness O'Hara's proposed coverage of 104 percent is reasonable under the criteria of the Act. PSA Brief at 17-18. PSA also argues that competitive factors and Parcel Post's low value of service dictate application of a low coverage factor. *Id.* at 21-22.

[5645] The Commission recommends Parcel Post rates which incorporate a cost coverage of approximately 109 percent. In the Commission's opinion, a relative markup roughly equivalent to the level recommended in Docket No. R94-1 remains appropriate for Parcel Post. The markup index for parcel post is .162, a slight increase from R94-1.

[5646] The Commission has thoroughly reviewed the costs properly attributable to Parcel Post, and our analysis results in estimated cost increases somewhat higher than those projected by the Postal Service.[101] For this reason, at the recommended level of coverage Parcel Post rates will increase on average approximately 12.4 percent. The Commission is confident that the recommended rates will be fully compensatory in the test year, in response to the § 3622(b)(3) requirement. Furthermore, given the modest level of cost increase experienced by the Postal Service overall since Docket No. R94-1 — which has been well below the rate of inflation in the economy as a whole — the Commission finds no cause for concern that Parcel Post rates incorporating a 109 percent coverage will fail to recover attributable costs soon after the test year.

[5647] Nor has there been any appreciable change in relevant circumstances that would warrant a reduction in Parcel Post's relative contribution to institutional costs. Witness Henderson notes that Parcel Post is a competitive service with readily available alternatives, but states he is "not aware of any major difference in the intensity or nature

[101] The Commission projects a higher level of costs attributable to Parcel Post in the test year notwithstanding an adjustment to remove Alaska air costs from those attributable to Parcel Post, unlike the Postal Service's treatment of these costs, which UPS witness Henderson adopts. Tr. 25/13571.

of this competition since the last rate case." Tr. 25/13571. On brief, UPS cites the testimonies of PSA witness Jellison and CTC Distribution Services witness Clark as evidence that certain aspects of Parcel Post service have improved since Docket No. R94-1, and that its volume has increased recently. UPS Brief at 37. UPS also cites witness Jellison's testimony and a portion of the FY 1996 Household Diary Study as establishing that Parcel Post's share of the volume sent by mail order shippers to residences has increased dramatically due to improved service and the DBMC rate discount, and that the Postal Service appears to have a dominant position for all package deliveries to residences. *Id.* at 37-38. However, this testimony does not indicate any significant change in the value of Parcel Post service or its position in the parcel delivery market. While Parcel Post service has apparently improved in some respects, the intrinsic value of its deferred standard of delivery remains the same. Also, as witness Jellison observes, growth in Parcel Post's share of shipments appears to be due in large part to decisions of competitors such as UPS to charge higher rates for residential delivery than for deliveries to businesses. Such decisions would naturally tend to enhance the Postal Service's position in the residential delivery market, but this apparently does not constitute a significant change in competitive position. As witness Jellison testifies, "[t]his does not mean that USPS is in a position to challenge UPS for a more significant market share." Tr. 24/12951.

d. Rate Design Issues

[5648] *General Rate Design Considerations*. The extensive reconfiguration of Parcel Post rates proposed by the Postal Service raises numerous rate design issues, and the Commission will address those which are specific to individual proposals separately below. As a general matter, however, the Commission recommends the five major structural changes proposed for the Parcel Post subclass as responsive to the mail classification considerations set out in § 3623(c).

[5649] As the Postal Service notes on brief, the only step previously taken to encourage worksharing by Parcel Post mailers has been the DBMC discount, established in Docket No. R90-1. The Postal Service regards the DBMC category as "a tremendous success[,]" Postal Service Brief at V-190, and CTC witness Clark testifies from a shipper's perspective that "[t]he DBMC entry rate has made it possible to expand the price range of offerings through catalogs and advertising mail." Tr. 20/10171. Parcel Shippers Association witness Jellison likewise refers to the "critical role that DBMC … play[s] in allowing the USPS to provide innovative and competitive service." Tr. 24/12953. Witnesses Jellison and Clark also testify to the desirability of extending additional worksharing discounts to Parcel Post users as the Postal Service proposes. Id. at 12953-55; Tr. 20/10164, 10181.

[5650] The Commission agrees that recognition of the § 3622(b)(6) "degree of preparation" factor, as well as the desirability of introducing these new categories to both the Postal Service and potential users, support their recommendation under § 3623(c)(2) and (c)(5). While the inevitable result will be further complications in an already-complex rate schedule, the likely users of the new worksharing categories are sophisticated commercial shippers; individual Parcel Post users will continue to pay rates within the schedules already in place.

[5651] A number of additional ratesetting issues have been raised in regard to Parcel Post. Some of these apply to several rate categories or discounts, and some bear more on overall approach than to specific rates. These may be dealt with in series, without extended discussion.[102]

[5652] *Passthroughs*. UPS witness Luciani has proposed that the passthroughs associated with worksharing discounts should be set in the 70 percent to 80 percent range in order to recognize uncertainties associated with the new rates and their

[102] One issue not treated below is Witness Luciani's position that the Commission does not normally recommend rate decreases for particular rate cells of Parcel Post when the subclass as a whole is receiving an increase. Tr. 26/14320. This is more of an outcome than an input. Particular situations require attention to a range of factors, such as the need to accommodate changes in rate structure, to recognize costs in fair ways, and to give appropriate signals to mailers.

associated cost analyses. Tr. 26/14312-17. On the other hand, PSA witness Zwieg believes that the discounts should not be “watered down” and that if they are, the benefits of competition will not be realized. Tr. 25/13444,13453. The passthrough issue is important in all of the discounts, many of which are discussed in detail above.

[5653] Although limited passthroughs may be in order in specific cases, the Commission rejects a blanket recommendation of low passthroughs as general guidance. Cost based rates are important, and there has been a trend in reclassification generally and in this case to recognize cost evidence to a greater degree. Signals to mailers are also important, and most worksharing programs are supportive of the Service’s automation programs and of general efficiency in using the postal system.

[5654] The Commission notes in addition that DBMC discounts have been in place now for over 6 years, so that a considerable degree of experience with them exists. Many of the new discounts in this case are not operationally dissimilar from the DBMC discount. It is true that all cost studies are estimates, which can be too high or too low. The ones used in this case have been examined and changed when warranted. They will be reviewed again in future cases.

[5655] *Revenue Recovery.* As outlined below, certain constraints have been used in the development of recommended parcel rates. For example, one is to avoid conflict with Priority Mail rates, and another is to avoid DBMC rates that are higher than related intra-BMC rates. Whenever specific rate cells, which invariably exist within specific rate categories, are capped at levels below the levels that might result otherwise, it is usually necessary to “make up” the revenue lost. In regard to the revenue lost when the low-volume zones 4 and 5 rates in the DBMC schedule were capped at the level of the corresponding intra-BMC rates, witness Luciani has argued that the lost revenue should be made up from other DBMC rates and not from any other parcel post rates. Tr. 26/14324. He does not bring up this question in regard to any other categories, even though others are also constrained.

[5656] The rule proposed by witness Luciani is too rigid. The Commission considers making up lost revenue from related and relevant rates, which are often in the

category of the caps. Revenue requirements and cost coverages, however, exist for subclasses and not for rate categories. Within this framework, other possibilities for recovering revenue should also be evaluated. In this case, some of the lost revenues are made up from the category in question, but the extent of this is necessarily limited because of the need to maintain identifiable relationships between rates.

[5657] *Witness Hatfield's Intermediate Transportation Costs*. In this case, witness Hatfield develops the transportation costs for all parcel post categories. His intermediate costs are those for transporting parcels within BMC areas, primarily between SCFs and BMCs. Inter-BMC parcels incur these costs when moving from an SCF to a BMC. Intra-BMC parcels incur these costs going from an SCF to a BMC and then from the same BMC back out to another SCF. DBMC parcels incur these costs in going from the destination BMC out to an SCF, or similar facility, for further processing or delivery.

[5658] Witness Hatfield explains that the level of these costs for inter-BMC and intra-BMC parcels should not depend on the zone of the parcel because the zone of the parcel contains little or no information on how far the parcel travels on intermediate transportation. For example, a parcel going a short distance could travel to and from a BMC that is several hundred miles away. Similarly, knowing that a parcel goes to zone 8 contains no information relating to how far the parcel goes to get to the first BMC, or how far its delivery point is from the final BMC.

[5659] Witness Mayes uses the Hatfield costs in the development of rates for the various parcel categories. For DBMC parcels, she recovers these costs according to the zone of the parcel, because the distance is clearly known. For intra-BMC parcels and inter-BMC parcels, however, she recovers these costs using an average that is independent of distance, for the reasons explained by Hatfield. This treatment has drawn considerable attention. *See* Tr. 26/14320-24 and FGFSA Brief at 14.

[5660] Witness Luciani explains that the intermediate transportation costs "are at least partially distance related." He further explains that the treatment of these costs results in the need to cap DBMC rates so that they do not exceed intra-BMC costs, from which they are viewed as discounted rates. Tr. 26/14323-24. The reason for this

anomaly is that DBMC rates are zoned, and in high zones can have high rates due to high intermediate transportation costs.

[5661] The Commission has considered these issues, and concludes that witness Hatfield's analysis represents an improvement. The number of DBMC parcels that go to high zones is very low. All rate design procedures involve averaging of one kind of another, and this one is not severe. The rates as proposed undoubtedly relate more closely to costs than those under the current procedure. Any anomalies that arise can be dealt with by adjusting rates. Such adjustments are preferred to making costing changes that would less fairly reflect costs.

[5662] *Two Cents Per Pound*. Existing rates contain an add-on of 2 cents per pound to account for non-transportation costs that are pound related. This add-on exists in all categories of parcel post. Whether or not improvements can be made in the implementation of this allocation has been discussed by several parties. *See* witness Luciani's testimony at Tr. 26/14325-27; FGFSA Brief at 9-10; and USPS Brief at V-109-V-111. The parties are correct that questions can be raised on this point. The existing procedure is not grounded in the kind of cost study that would be preferred by the Commission. For this case, however, no alternative has been well developed and the opinion of the Commission is that the current procedure should be maintained. The argument of the Service on this point seems to be that if the 2-cent-per-pound procedure is changed, then it would no longer be a 2-cent-per-pound procedure. This argument does not have content, especially when the question includes the basis for the 2-cent figure. This is an area where the Commission has recommended further study in the past, and continues to do so in this case.

[5663] Florida Gift Fruit Shippers Association (FGFSA) witness Ball proposes that *all* non-transportation costs be recovered from piece rates, and that the per-piece contribution (in dollars per piece) should be the same for all parcels, regardless of weight or zone. Both of these proposals are contrary to the Commission's established rate design methodology, and are not used in this case. As a general matter, some non-transportation costs are certainly weight-related, and the Commission's rate design

is aligned with that reality. However, making the per-piece contribution the same on all parcels would be a major disruption to the existing rate schedule, and is not justified. FGFSA witness Davis, on the other hand, accepts that a portion of non-transportation costs are weight-related, and proposes that they be distributed on a cube basis instead of a weight basis. This is a potentially worthwhile suggestion that should be explored further in subsequent proceedings, but the record does not support making such a change at this time.

[5664] UPS witness Luciani reviews much of the costing and rate design detail underlying the Service's Parcel Post proposal in his testimony, UPS-T-4, and on the basis of his analysis proposes a number of changes in the proposed discounted rates. The Commission finds many of his proposals to be meritorious, and has made a number of specific adjustments as he recommends. Details concerning his suggestions and the Commission's responses are contained in the following sections, which address specific rate design issues and related considerations.

[5665] In other general areas of Parcel Post rate design, the Commission's recommended rates largely follow the approaches and procedures used by the Postal Service in designing its proposed rates. Where necessary, rates have been adjusted to eliminate crossover with Priority Mail rates. Higher-zone DBMC rates have been capped so they do not exceed corresponding intra-BMC rates. Rate increases have been limited to a maximum of 30 percent to limit detrimental impact under § 3622(b)(4). However, in order to recognize some cost differences more fully, rather than constraining rates to allow no decreases, as the Postal Service proposes, the Commission allows some rate elements to decrease from current levels, but by no more than 5 percent.

[5666] *Proposed BMC Presort Discount*. The Service proposes a 12-cent discount from inter-BMC rates for mailings of at least 50 pieces, separated into machinable and nonmachinable pieces, that are presorted by destination BMCs or to the secondary sort operations. USPS-T-37 at 8-9. The proposed discount is based on mail processing cost savings estimated by witness Crum at 13.9 cents per piece for machinable parcels, and 12.5 cents per piece for nonmachinable parcels. USPS-T-28 at 8-9. No party has

challenged this proposed discount. Based on a weighted average of updated costs for machinable and nonmachinable parcels, and on the Commission's revisions to the Postal Service's cost attributions, the estimate of cost savings is 22.2 cents, and the Commission recommends a discount of 22 cents.

[5667] *Proposed DBMC Discount — Per-Piece Portion*. In this docket the Postal Service proposes a Destination Bulk Mail Center (DBMC) discount of 46 cents per piece, based on witness Crum's non-transportation cost avoidance estimate of 46.9 cents and a passthrough of 98 percent of the avoided costs. The estimated cost avoidance includes 9.2 cents per piece in window service and platform related costs and 37.7 cents per piece in mail processing costs. The window service and platform avoided costs are calculated from MODs cost pool data, while the mail processing cost avoidance utilizes witness Daniel's engineering models.

[5668] The current comparable non-transportation discount is 19 cents. Docket No. R94-1, PRC-LR-12, p. 18. Thus, the Service proposes an increase of 142 percent in this discount.

[5669] Witness Luciani opposes the magnitude of this increase. He argues that the Service overstates the avoided costs by inappropriately including origin AO and SCF costs, and by failing to make an adjustment for ASF costs.

[5670] He contends that DBMC parcels incur platform and acceptance costs similar to costs incurred at AO and SCF facilities, and that these costs should be excluded from the cost avoidance calculation. He relates that as recently as Docket No. MC97-2 these costs were removed from the calculation. He also notes that premium pay adjustments were made in prior proceedings. Tr. 26/14292. Luciani further claims that platform acceptance cost savings are already reflected in the window service and platform portion of the estimated cost avoidance. Not excluding the cost of these operations from the mail processing portion of the estimate constitutes a "clear, double-count" and "inflates the proposed discount." *Id.* at 14293.

[5671] According to witness Luciani, the proposed discount is further inflated by the Service's failure to exclude any ASF costs from the estimated cost avoidance. *Id.* at

14294. ASFs are facilities that operate as both SCFs and BMCs. When acting as BMCs they incur substantial outgoing mail processing costs. He contends that since outgoing mail costs are not avoided by DBMC parcels at BMCs, they are not avoided at ASFs when the ASF is acting as a BMC. Therefore, these outgoing mail costs should be removed from the cost avoidance calculation. *Id.* at 14295.

[5672] Adjusting for these claimed errors, Luciani calculates a revised non-transportation cost avoidance of 36.6 cents. *Id.* at 14297.

[5673] The Postal Service responds to witness Luciani's claims in the testimony of witness McGrane. McGrane claims that outgoing platform and acceptance costs at AOs and SCFs are avoided by DBMC parcels because these parcels do not pass through AOs and SCFs. He argues that in prior dockets the cost avoidance calculations were "extremely conservative," and that continuing to exclude these costs result in inaccurate cost avoidance estimates. According to witness McGrane, Luciani's basic argument for excluding these costs is simply that they have always been excluded. Tr. 35/18950.

[5674] Witness McGrane also challenges Luciani's revised ASF parcel costs, claiming that they are overstated. He acknowledges that outgoing mail processing cost at ASFs should be excluded from the cost avoidance calculation, but claims that only 46 percent of the parcel post volume in outgoing operations at the ASF is treated as if the ASF were acting as a BMC. Based on this percentage, McGrane calculates that only $918,000 of outgoing ASF costs should be excluded from the cost avoidance rather than the $3,371,728 identified by Luciani. *Id.* at 18957.

[5675] On brief, UPS argues that although DBMC parcels do not pass through AOs and SCFs, they incur platform and acceptance costs at DBMCs. UPS Brief at 40. UPS also claims that witness McGrane's lower ASF cost estimate of $918,000 cannot be used because it was not subject to inspection by the parties as the data are "masked" by the Postal Service. *Id.* at 42.

[5676] In its Reply Brief, the Service acknowledges that DBMC parcels may incur platform and acceptance costs at the DBMC. However, it claims that UPS' platform and acceptance argument is moot because all BMC costs are excluded from the cost

avoidance calculation. The Service also claims that because Luciani's calculation vastly overstates the ASF outgoing mail costs incurred by DBMC parcels, either witness McGrane's ASF cost estimate or witness Crum's original testimony must be accepted. Postal Service Reply Brief at V-108.

[5677] The Commission recommends a 40 cent DBMC discount, based on a non-transportation cost avoidance of 40 cents and a 100 percent passthrough. The cost avoidance estimate includes 10 cents in window acceptance and platform costs and 30 cents in mail processing costs. PRC-LR-12.

[5678] The Commission agrees with witness Luciani that DBMC parcels incur platform and acceptance costs, and that these costs should be excluded from the cost avoidance calculation. The Service's argument that DBMC parcels do not pass through AOs and SCFs fails to recognize that these platform and acceptance costs are incurred at the DBMC. The Commission finds unconvincing the Service's contention that the exclusion of all BMC costs from the cost avoidance estimate renders these platform and acceptance costs moot. The Service's examination of this issue avoids focusing on the key question: how does the cost of accepting and inducting DBMC parcels compare with the cost of inducting parcels at destination BMCs that enter the BMC on postal-controlled transportation from origin or intermediate facilities? Until such a comparison is made, the platform and acceptance costs should be treated as if they occurred at the AO and SCF, like those incurred by non-DBMC parcels, and therefore excluded from the cost avoidance calculation. Excluding the cost of these operations eliminates any double-counting of platform acceptance cost savings.

[5679] The Commission also agrees that an adjustment for ASF outgoing mail processing costs should be made. The Service makes a convincing argument that only 46 percent of the DBMC parcel post volume at ASFs is treated as if the ASF were acting as a BMC. The Commission's estimate of ASF outgoing mail processing costs for DBMC parcel post is based on this percentage.

[5680] *Proposed DBMC Discount — Per-Pound Portion*. The DBMC rates, though viewed as involving a *discount*, are contained in a separate rate schedule and are

different from the intra-BMC rates by virtue of both a per-piece cost difference, discussed above, and a per-pound cost difference. The per-pound difference is based on transportation costs, which are developed by witness Hatfield and used by witness Mayes.

[5681] Witness Luciani reviewed the process used by witness Mayes, and explains that since the Hatfield costs are developed independently for both DBMC and intra-BMC, and since witness Mayes used a 15 percent markup factor to assure alignment of rates with the revenue requirement, then it follows that witness Mayes applies a markup to the transportation cost differences. Tr. 26/14318. This markup, Luciani explains, is incompatible with the view that the DBMC rates are based on a discount. On cross examination, witness Mayes indicated that she believed her approach to be "appropriate," but did not provide a reason for deviating from the discount approach to DBMC rates. Tr. 8/4116-17. The Commission agrees with witness Luciani, and has not applied a markup in its own cost development.

[5682] *Proposed OBMC Discount*. The Service proposes a discount for parcels entered at a BMC, but not at the destination BMC. This is referred to as the origin BMC (OBMC) discount. These parcels are lower in cost because they do not have to be handled at facilities such as AOs and SCFs, which would normally handle and forward the parcels to an associated BMC. There is a requirement that these parcels be presorted to the BMC level, so that the origin BMC can put the containers on outbound transportation without sorting the individual pieces. The cost avoidance for these parcels, as proposed, is a presort savings of 10.3 cents plus the avoidance for DBMC entry. The discount proposed for these parcels is 57 cents.

[5683] UPS witness Luciani presents the only testimony to address this discount. He accepts the Service's savings for the presort portion of the discount, but argues that his revised savings for DBMC entry should be used for the remaining portion, which would result in a 10.3-cent reduction in the discount. Tr. 26/14297-98.

[5684] The Commission agrees with the Service that this proposed category is fair and equitable, in response to § 3623(c)(1), and thus is consistent with the classification

guidance in the Act. Following adjustments to the Postal Service's proposed treatment of mail processing costs, the Commission has found the presort savings to be 17.1 cents per piece. This plus the DBMC savings of 40.1 cents yields a total savings of 57.2 cents. A passthrough of 100 percent is recommended, with a resulting discount of 57 cents. Though calculated differently, this recommended discount is equal to that proposed by the Postal Service.

[5685] *Proposed DSCF Discount*. The Postal Service proposes rates that recognize the savings associated with parcels entered at the destination SCF (DSCF). These parcels are referenced to those entered at the DBMC. Under the Service's proposal, SCFs would receive two flows of parcels. One would come from the associated BMC and the other would come directly from mailers, who would be prepare the parcels in the same way as those prepared by the BMC. The costs for the mailer-entered parcels would be lower because they bypass handling at the BMC, and are not transported to the SCF. The discount proposed is 31 cents (relative to DBMC parcels). The cost basis includes both transportation costs and non-transportation costs. No discount for DSCF parcels is currently offered, even though it appears that some mailers whose mail originates and destinates in the same specific geographic area naturally enter these parcels by taking them to the SCF serving the area.

[5686] UPS witness Luciani raised several questions on the Service's proposal. Specifically: 1) he questioned the number of pieces per sack and pieces per container used by witness Crum in a flow study supporting the non-transportation portion of the discount; 2) he questioned an assumption made by Crum that trucks transporting DSCF mail would be unloaded by mailer rather than Postal Service personnel; and, 3) he questioned the interpretation of certain mail flows used by witness Hatfield to develop average transportation costs figures for mail entered at various locations.

[5687] On the first question, Luciani suggests that witness Crum should have used average-pieces-per-container figures developed by witness Daniel for all Parcel Post. He shows that if these average figures were used, the savings for DSCF parcels would decrease by 4.8 cents. Tr. 26/14299. On the second question, having to do with

unloading trucks, Luciani presents an alternative analysis showing that the cost avoidance could be reduced by 1.9 cents per piece. *Id.* at 14301. On brief, the Service explains that the parcels per container figure used should be the one pertaining to the parcels involved, and that the averages for all parcel post do not apply. It further argues that the regulations applicable to the entry of DSCF parcels will be aligned with the mail-handling procedures used by witness Crum in his cost analysis. Postal Service Brief at V-109.

[5688] The question of interpreting the mailflows of witness Hatfield is more complex. Witness Hatfield recognizes in his analysis that nearly 12 percent of the parcels at a BMC are sent directly to a delivery office, and thereby avoid a two-step linkage going from the BMC to the SCF and then from the SCF to a delivery office. This influences his estimates of savings, since DBMC parcels will be charged the same rates regardless of the particular path they take in going from the BMC to a final delivery office. Witness Luciani argues that recognizing this 12 percent leads to higher costs per actual parcel carried on links from SCFs to AOs, and that *all* DSCF parcels travel on these links. If the cost from SCF to AO is higher, then the cost of DSCF processing is higher, and the cost difference between DBMC parcels and DSCF parcels is lower. The Service acknowledges on brief that the transportation cost figures can be questioned, but that part of the 12 percent figure relates to parcels going to delivery units that are co-located in the SCF. Thus, the Service argues, even if it were clear that witness Hatfield's costs should be adjusted, the adjustment should be much smaller than that suggested by Luciani.

[5689] The Commission has not made the specific cost adjustments discussed by witness Luciani. The issues surrounding the pieces-per-sack issue are not clear. Certainly the averages for parcel post as a whole might not apply, and the actual savings will depend on the regulations implemented and on mailers' response to them. The Commission accepts the Service's interest in encouraging efficiency through worksharing, and believes witness Crum's estimate is a reasonable estimate of mail flows and savings from worksharing. The question about unloading trucks is a minor one

that might be resolved by Postal Service personnel doing what seems most effective for the Service at the time. It is addressed here by lowering the passthrough somewhat.

[5690] As noted above, the questions surrounding witness Hatfield's transportation analysis are more complex. The Service concedes that some adjustment might be needed, possibly in the neighborhood of 2 to 3 cents per cubic foot, but the actual portion is unknown. Postal Service Brief at V-201. Witness Crum's estimate appears to be substantially correct, and will be used here. The final cost avoidance is 48.7 cents per piece. The Commission is recommending a discount of 45 cents per piece. But for the questions raised by witness Luciani, the passthrough on this discount would be higher. This implements the Commission's objective of recommending rates that are fair, equitable, competitive, and cost-based. The mailers who enter parcels in their own geographic areas should not be required to help pay for the delivery of parcels that go longer distances and that require extensive processing.

[5691] *Proposed DDU Discount*. The Service proposes a reduced rate for 50 or more parcels entered at the destination delivery unit (DDU), sometimes referred to as the delivery office. These delivery offices could be carrier stations or Associate Offices, or they could be larger facilities, such as SCFs, out of which carriers operate. Relative to the DBMC rates, the discount proposed for these parcels is 45 cents per piece. No such discount exists currently. Since there are many delivery units, and few mailers with significant numbers of parcels for such small areas, the usage of this discount is expected to be light. Such an expectation is consistent with experience with similar discounts for other subclasses of mail, especially in Periodicals.

[5692] The only party to question th*e* costs or the procedures associated with this discount is UPS. Witness Luciani examined both the cost study of witness Crum and the development of the discount by witness Mayes. His analysis raises two questions. The first concerns an assumption made by witness Crum that mailers bringing qualifying parcels to the DDU would shake out the sacks in lieu of postal personnel performing this work. The comparison made by Crum is between parcels arriving at the DDU from an associated SCF or AO and parcels arriving on mailer-provided vehicles. Normally, the

mailer would containerize the parcels for ease of handling and transport, often in a sack provided for this purpose by the Postal Service. It is clear that Postal Service personnel will shake out sacks that arrive on postal-controlled transportation, whether from an AO, an SCF, or a BMC. Witness Luciani presents an analysis showing that shaking out the sacks would reduce Postal Service savings by about 1.1 cents per piece. Tr. 26/14305.

[5693] The second question raised by Luciani concerns witness Mayes' discount development procedure. Luciani explains that the cost study relates DDU costs to DSCF mail, as explained above, but that the rate development ties the rates to intra-BMC rates. Luciani believes this to be inconsistent. On cross examination, witness Mayes explains this "inconsistency" by noting that the DDU volume was developed from intra-BMC volume. Tr. 8/4171-72.

[5694] The Commission has considered the DDU discount as proposed, and has reviewed the supporting cost studies. Witness Luciani appears to have a valid point regarding sack shakeout. The delivery units are small facilities with limited resources. It is not uncommon for personnel at such sites to perform multiple functions, and for schedules to be tightly controlled. Most of the mail to be delivered from these facilities is delivered on postal vehicles, and is prepared by the parent facilities in ways that allow effective unloading and distribution to carriers. Mail brought in by mailers would not be part of this flow, and would require separate attention, including the unloading of sacks.

[5695] The Commission has made the recommended adjustment to witness Crum's cost study. The resulting cost avoidance is 72.4 cents per piece, at the level of cost attribution the Commission estimates for Parcel Post. A discount of 72 cents per piece is recommended. This discounted category is fair, equitable, and cost based. It recognizes the interests of mailers and promotes worksharing.

[5696] The Commission has also considered the rate development procedure, and concludes that the appropriate procedure is to use the DSCF rates as a reference point. The recommended rates are developed in this way.

[5697] *Proposed Barcode Discount*. Barcode discounts have been common for letter-size and flat-size pieces for a number of years. They are clearly in line with the

interests of the Postal Service and of mailers in the economies resulting from automation. The Service proposes in this case for the first time to offer a barcode discount for Standard B parcels. The savings calculated by witness Daniel is 4 cents per piece, which is also proposed by witness Mayes as the amount of the discount.

[5698] The savings estimated by witness Daniel are based on the assumption that if the mailer does not place a barcode on the parcel, the Service will. Accordingly, she calculates the savings for prebarcoding as the difference between the cost of keying the address information and the cost of scanning a barcode that has already been applied. This difference is 2.16 cents. She then multiplies this cost difference by a non-modeled cost factor of 1.621 to arrive at a savings of 3.5 cents. Finally, she adds a ribbon cost of 0.5 cents to obtain a total savings of 4.00 cents per piece. *See* USPS Exhibit 29E at 6.

[5699] UPS raises two questions regarding this proposal. First witness Luciani claims that Daniel should not apply the non-modeled cost factor in her analysis. Tr. 26/14306-308. Witness Luciani reasons that the keying and scanning operations are narrow and well understood, and that the full operation is modeled. He believes that in situations where the relevant operations can be isolated no adjustment is necessary. After making certain corrections and revisions, Luciani finds the savings to be 2.66 cents per piece. Id. at 14308. The second question concerns the ribbon savings of 0.5 cents. On brief, but not in testimony, UPS claims that this figure is unsupported. UPS Brief at 46.

[5700] The Commission has reviewed the relevant costs, and has made certain adjustments to conform with the Commission's treatment of mail processing costs. The relevant cost savings are found to be 3.3 cents and a discount of 3 cents is recommended. This represents a passthrough of about 91 percent. The ribbon costs seem reasonable, and the record contains no alternative estimates. Because the Service's engineering models are unable to capture all relevant costs, a CRA adjustment factor is necessary. While the keying and scanning operations may be narrow and well-understood, the concept of a non-modeled cost factor has been used throughout for all mail processing engineering models in order to tie these models to CRA mail

processing costs. Therefore, the Commission has applied a non-modeled cost factor here. This is consistent with costing procedures widely applied in treating other subclasses of mail.

[5701] The Commission finds the recommended discount of 3 cents to be fair. The Commission notes that the costs mailers incur in worksharing activities generally are not recognized by the Commission as considerations bearing on the cost justification of the fairness of the discount. It is important, however, that discounts be large enough to create an incentive to mailers, so that the benefits of worksharing may be realized.

[5702] *Proposal for Oversize Parcels*. One specific Postal Service proposal involves the mailability of parcels having a length plus girth of between 108 inches and 130 inches. The Service proposes to allow these parcels to be mailed if they make up no more than 10 percent of a mailing, and has proposed applying the 70-pound rate to them. OCA argues that this proposal is unduly discriminatory because it would only be available to high-volume mailers. OCA Brief (Second Section) at 108. The Commission agrees that extending mailability to such parcels would be beneficial to users of Parcel Post, but also concludes that the 10 percent limit proposed by the Postal Service would be unduly and unnecessarily discriminatory. Acccordingly, the Commission recommends the proposal without the limit.

[5703] However, certain errors have been found in the Postal Service's costing workpapers on this proposal. After correction, the surcharge needed to recover the costs associated with these parcels is found to be much higher than the Service proposed. This new level renders the volume assumptions in the Service's direct case unusable. Since the volumes will be much smaller at the recommended rates, the Commission accounts for financial effects by developing Parcel Post rates without including the volumes or costs for parcels over 108 inches. The surcharge for oversize parcels is based entirely on unit costs. Thus, it is assumed that the increase in revenue from the surcharge will approximate the increase in costs, and that the overall financial effect will be negligible.

[5704] *Reduction in the Nonmachinable Surcharge*. Under the rates currently in effect for Parcel Post, inter-BMC parcels that are physically incompatible with mechanical processing in Bulk Mail Centers are charged a surcharge of $1.75. In this case, witness Mayes proposes that this surcharge be reduced to $1.35, a decrease of nearly 23 percent. USPS-T-37 at 20.

[5705] Witness Mayes bases the proposed reduction on witness Daniel's cost study in USPS-T-29, which concludes that the measured difference between the cost of processing a machinable inter-BMC Parcel Post piece and the cost of processing a nonmachinable inter-BMC piece has declined since it was last modeled in Docket No. R90-1. Relying on this result, witness Mayes proposes that the surcharge applicable to the approximately 8.7 percent of inter-BMC parcels categorized as nonmachinable because of their weight, contents or packaging, be reduced to $1.35. Witness Mayes states that the Postal Service is not proposing that the surcharge be extended to nonmachinable intra-BMC or DBMC Parcel Post pieces at this time. USPS-T-37 at 20.

[5706] The Commission recommends a reduction in the nonmachinable surcharge from the current level of $1.75 to $1.65 The Commission's recommendation is based on witness Daniel's analysis of processing costs, adjusted for differences in the Commission's attribution of mail processing costs.

[5707] *Reinstatement of the "Stop-Loss" or "Balloon Rate"*. Witness Mayes proposes re-introduction of the "stop-loss" rate applicable to Parcel Post pieces which exceed 84 inches in combined length and girth but weigh less than 15 pounds. She proposes that such pieces be charged the 15-pound rate, as was the case prior to the Commission's decision in Docket No. R80-1. *Id*. at 16-17.

[5708] Witness Mayes reviews the history of this rate, with particular attention to Docket No. R80-1. She notes that the Commission's decision in that docket recommended that the stop-loss rate be eliminated because, in the Commission's view, the Postal Service's newly-proposed nonmachinable surcharge would recover all exceptional handling costs caused by irregular parcels, including those of so-called "balloon" parcels. *Id.* at 11-12.

[5709] In this proceeding, witness Mayes testifies that scrutiny of transportation costs suggests that this conclusion should be reconsidered. Citing the Commission's recognition of the principle that transportation costs are incurred on the basis of volume, or "cube," rather than weight, she suggests that this is "the most important area in which the balloon parcels could be demonstrated to incur costs above and beyond those of the average piece of Parcel Post for any given weight." *Id.* at 12. How much transportation cost is incurred by a given parcel is determined, she states, primarily by how much space it occupies in the truck or rail van. When a parcel is particularly bulky compared to pieces of similar weight, she suggests that "the rate paid for the piece is less likely to cover the transportation cost of the piece because the rate is tied to the average cube for that weight increment." *Ibid.* Thus, at any given weight, less dense "balloon" parcels incur more transportation cost than the average piece. In light of this cost phenomenon, witness Mayes concludes that, "[I]t is reasonable to design rates for such pieces that acknowledge this cost incurrence." *Id.* at 13.

[5710] According to witness Mayes, there may be areas other than transportation where cube plays an important role in cost incurrence. She suggests that the costs of certain functions used in mail processing flow models like those of witness Crum (USPS-T-28) and Daniel (USPS-T-29)—such as dumping containers or sacks, and crossdocking containers—may be affected by cube. Although the cost associated with such an activity is the same regardless of the number of pieces, witness Mayes posits that high-cube pieces may result in higher cost per piece because fewer of such pieces will fit in the container. USPS-T-37 at 13. Even in the absence of explicit cost analyses in other areas, such as delivery costs, witness Mayes submits on the Postal Service's behalf "that cube is, in fact, an important cost driver for Parcel Post." *Id.* at 14.

[5711] If costs are incurred on the basis of cube, witness Mayes further suggests, "density (pounds per cubic foot) is a crucial determinant of financial viability." *Ibid.* According to a chart she includes in her testimony, the average density of Parcel Post has declined since implementation of the Docket No. R80-1 rate structure. While the Service cannot state conclusively that the decline in density has been due solely to the

discontinuation of the stop-loss charge, witness Mayes submits that the decline indicates that the charge was, in fact, an appropriate means by which to recognize the extraordinary costs associated with low-density pieces, and provide an appropriate signal to parcel mailers. *Id.* at 14-15. She notes that United Parcel Service continues to incorporate a charge comparable to the proposed stop-loss rate into its ground parcel service rates. *Id.* at 15.

[5712] The Commission recommends re-introduction of the "stop-loss" rate for bulky but lightweight Parcel Post pieces at the 15-pound rate level, as proposed by the Service. While additional analysis of density-related patterns of cost incurrence would be desirable to address this issue with more quantitative precision, and the Commission encourages the Postal Service to pursue the question of cube-related costs, witness Mayes' testimony provides adequate support for an inference that the structure of current Parcel Post rates—including the nonmachinable surcharge—does not reflect cost increases resulting from abnormally low density, particularly in transportation.

[5713] As witness Mayes notes, the Service's proposal is also responsive to the concerns expressed in the Commission's Notice of Inquiry No. 1 in Docket No. R94-1. *Id.* at 17. By proposing a rate structure which includes both the nonmachinable surcharge and the stop-loss rate, the former will recover mail processing cost differences caused by a parcel's nonmachinability, while the latter will recover additional transportation costs imposed by large parcels of low density.

[5714] *Increase in the Pickup Fee*. The Commission also recommends that the current pickup fee of $4.95, applicable to Express Mail, Priority Mail, and Standard B subclasses, be increased to $8.25, as proposed by the Postal Service, based on witness Sharkey's analysis in Exhibit USPS-33J.

2. Bound Printed Matter Subclass

[5715] *Introduction*. The Bound Printed Matter subclass is available for pieces of mail weighing at least one pound and consisting of printed advertising, editorial,

promotional or directory material, or any combination thereof. Content in the nature of personal correspondence or stationery are precluded from mailing as Bound Printed Matter. Items commonly mailed as Bound Printed Matter include catalogs, books, telephone directories, and similar bound volumes.

[5716] Physically, pieces of Bound Printed Matter must consist of securely bound pages, of which at least 90 percent must bear printing. Prior to Docket No. MC97-3, Bound Printed Matter was limited to pieces weighing no more than 10 pounds. In that proceeding, the Commission recommended, and the Governors approved, an increase in the weight limit to 15 pounds.[103]

[5717] Bound Printed Matter rates, like those of Parcel Post, are zoned and increase with the weight of the piece. There are two distinct sets of rates, one for single pieces and another for bulk mailings of 300 pieces or more. A carrier route presort discount is available for bulk bound printed matter; currently, the discount is 6.3 cents.

a. Postal Service Proposal

[5718] The Postal Service proposes to increase existing rates by 5 percent on average, employing the same rate design methodology the Postal Service and the Commission have used in the past. USPS-T-38 at 9-11. Based on witness Crum's cost analysis in USPS-T-28, witness Adra proposes an increase in the carrier route presort discount to 6.7 cents per piece. He also proposes a 4-cent per piece barcode discount for the Single-Piece and Basic Bulk rate categories,[104] based on cost savings developed by witness Daniel in USPS-T-29. Finally, the Delivery Confirmation service proposed by

[103] In the portion of his testimony concerning Bound Printed Matter, Postal Service witness Adra discusses the Service's proposal to increase the weight limit from 10 to 15 pounds in this case. USPS-T-38 at 4-6. Because the Postal Service's proposal in its Request of July 10, 1997, has been overtaken by intervening events, there is no need to address this feature of the Service's proposals for the Bound Printed Matter subclass.

[104] Because Bound Printed Matter pieces presorted to carrier route should bypass parcel sorting at a BMC, barcoding such pieces would not be likely to result in cost savings. USPS-T-38 at 6.

witness Plunkett would be available to mailings of Bound Printed Matter. USPS-T-40 at 16-20.

b. Positions of Other Participants

[5719] No party opposes the Postal Service's proposal for Bound Printed Matter. The Association of American Publishers (AAP) argues on brief that the record in this case supports an increase in BPM rates no greater than that proposed by the Postal Service, and in no event should higher rates be recommended. AAP Brief at 1, 6. The Mail Order Association of America (MOAA) states that it supports the Service's proposed rates "only reluctantly" because, in its view, the proposed higher-than-average rate increase results in rates that are "excessive." MOAA Brief at 21-22.

[5720] According to MOAA, the Service's proposed BPM rates are "far in excess of economical[ly] efficient rates[,]" *id.* at 22, and also "do not accord with the fact that BPM now consists primarily of books, which should result in lower rates under criterion 8 because of the ECSI value of books." *Id.* at 46. Consequently, MOAA submits that the Service's proposal "should not be regarded as establishing rate level relationships which will be accorded any presumption of validity in future proceedings[,]" and asks the Commission to "signal its strong concern that future prices proposed by the USPS should not differ so drastically from those which have been shown to be economically efficient." *Id.* at 21-22.

c. The Commission's Recommendations

[5721] The Commission recommends rates for Bound Printed Matter that incorporate an average increase of 5 percent, as the Postal Service proposes. At the level of attributable costs estimated by the Commission, the recommended rates will produce a coverage of approximately 136 percent, which represents a markup index of 0.643.

[5722] The recommended rates will produce a contribution to the institutional costs of the Postal Service that is, in the Commission's opinion, consistent with the applicable statutory policies and factors. With an own-price elasticity coefficient of -0.355,[105] Bound Printed Matter is a relatively inelastic subclass; therefore, pricing at the level the Commission recommends does not violate any reasonable interpretation of § 3622(b)(2) on the ground of consequent economic inefficiency. The below-average markup also reflects the presence of some matter which merits consideration on § 3622(b)(8) grounds, in the form of books that are mailed as Bound Printed Matter.[106]

[5723] The recommended level of coverage is also consistent with the Commission's recommendations in recent omnibus rate proceedings. After recommending a reduction in the markup index from an above-average level of 1.02 to a somewhat below-average level of 0.891 in Docket No. R90-1, the Commission declined to recommend rates at the price level proposed by the Postal Service in Docket No. R94-1, which would have produced a further reduction in the index to 0.528. PRC Op. R94-1, paras. 5388-89. The Commission's recommended BPM rates in R94-1 reflected a markup index of 0.644, close to the level implicit in the rates recommended in this case.

[5724] As the Postal Service requests, the Commission recommends rates which retain the current structure of the Bound Printed Matter rate schedules, together with the proposed pre-barcode discount. The recommended level of this discount is 3 cents, based on the Commission's analysis of Postal Service witness Daniel's study of processing costs in USPS-T-29. The Commission also recommends an increase in the

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[105] USPS-T-6 at 162, Table 17.

[106] MOAA cites no evidence in support of the statement in its brief that "BPM now consists primarily of books," MOAA Brief at 46, and the Commission is unaware of evidence to this effect in the record of this proceeding. To the contrary, in the direct case of the Postal Service filed with its Request on July 10, 1997, witness Adra states that, "mailers have indicated to the Postal Service that the weight limit for Bound Printed Matter is so low that it inhibits them from using the…subclass to fulfill many book and directory orders because the shipments would have to be split in order to keep individual pieces under the ten-pound limit." USPS-T-38 at 4.

carrier route presort discount, from 6.3 cents to 7.7 cents, on the basis of adjustments to witness Crum's estimate of mail processing cost savings in USPS-T-28, Exhibit H.

[5725] The Commission finds the rates recommended for Bound Printed Matter to be consistent with the statutory factors in § 3622(b). They will recover all costs attributable to the subclass, as § 3622(b)(3) requires, and make a reasonable contribution to institutional costs, as found above. No participant has claimed that a rate increase of this level will produce an unduly adverse effect that would warrant concern under § 3622(b)(4). Nor has any concern been expressed under § 3622(b)(5) regarding available alternative means of sending the kinds of items mailed as Bound Printed Matter. Both the newly recommended pre-barcode discount and the carrier route presort discount recognize mailer worksharing activities, in response to the § 3622(b)(6) "degree of preparation" factor. In the Commission's opinion, introducing one new worksharing discount will not disserve the "simplicity of structure" consideration in § 3622(b)(7), inasmuch as likely users consist of commercial mailers of bulk quantities of Bound Printed Matter. Finally, as noted above, the recommended contribution to institutional costs recognizes that a portion of the matter mailed as BPM warrants beneficial consideration under § 3622(b)(8).

3. Library Subclass

[5726] *Introduction*. Library Mail is a preferred subclass subject to the provisions of the Revenue Forgone Reform Act (RFRA) of 1993. According to the ratemaking provisions specified in RFRA, rates are to be phased upward in steps over a period of six years, at the end of which period the markup for Library rates is to be set at half the markup recommended for Special Standard rate mail.

[5727] Eligibility to mail at Library rates is restricted both by content and permissible use. In keeping with its educational purpose, Library Mail is limited to books, printed music, bound volumes of academic theses, museum and herbarium materials, scientific or mathematics kits, audio and video recordings on film and other media, and also

catalogs, guides or scripts for these materials. Use of the Library Mail subclass is limited to mailings sent to or from schools, colleges, universities, libraries, museums, or nonprofit organizations or associations of specific types.

[5728] The rates applicable to Library Mail are comparatively simple in structure, and are unzoned in compliance with 39 U.S.C. § 3683. There is an initial rate element applicable to the first pound of Library Mail, which currently is $1.12; a rate applicable to each additional pound through the seventh pound, currently 42 cents; and a third rate applicable to each additional pound in excess of 7 pounds, which is 22 cents under the current schedule.

[5729] The rates for Library Mail have increased significantly since passage of the Revenue Forgone Reform Act. In Docket No. R94-1, the Postal Service proposed Library rates which incorporated an increase of 73.7 percent, driven almost entirely by an analysis which estimated that the costs attributable to Library Mail had increased dramatically. The American Library Association understandably opposed the Service's proposed rate increase. Following a thorough review of record evidence — including the response of a Postal Service witness to a Presiding Officer's Information Request seeking an explanation for the precipitous increase in estimated costs — the Commission recommended a 69.9 percent increase with great reluctance.

a. Postal Service Proposal

[5730] Postal Service witness Adra proposes rates for Library Mail which incorporate an average increase of 14.3 percent. His development of rates proceeds by first deriving a per-pound rate element designed to recover transportation costs, plus a 2-cent add-on cost to reflect weight-related nontransportation cost, and a per-piece rate element designed to recover all other nontransportation costs. Witness Adra believes that "[a]n important benefit from this exercise is that it reveals the underlying costs behind the rate elements." USPS-T-38 at 20. Using this approach, he arrives at a first-pound cost of $1.43 for Library Mail, which leads him to conclude that the current

first-pound rate of $1.12 is not compensatory. On the contrary, he testifies, "when costs are computed in this manner, the first-pound rate has not been compensatory since at least 1987." *Id.* at 21. (Footnote omitted.) Applying the markup factor he uses to the $1.43 cost yields rates of $1.71 for the first pound, and 25 cents for each additional pound.

[5731] Witness Adra recognizes that recommending these results would cause "rate shock" among Library Mail users, and for this reason he proposes a first-pound rate of $1.44, one cent above his cost estimate. Distributing the resultant revenue shortfall on a per-pound basis to the two-to-seven pound segment, he proposes a rate of 52 cents for this weight bracket. He proposes a 25-cent rate for each additional pound in excess of 7 pounds. *Ibid.*

[5732] The Postal Service also proposes that a new prebarcode discount be made available to Library Mail at the 4-cent level, which equals estimated cost savings. Id. at 19. The Service also proposes that Library Mail users have access to the proposed Delivery Confirmation service on an optional basis. *Id.* at 19-20.

[5733] In projecting the financial impact of the changes proposed for Library Mail, witness Adra relies on an unusual but apparently realistic assumption: that 95 percent of Library Mail will abandon the subclass for Special Standard mail. Noting that the proposed rates for Library Mail "are generally higher than those proposed for Special Standard," he testifies that "it is reasonable to expect that Library mailings eligible to migrate to Special Standard will do so." *Id.* at 22. On this basis, he concludes that only 5 percent of eligible Library Mail will pay the proposed Library rates, because the content will not be eligible for mailing as Special Standard mail.[107] *Ibid.* However, his financial analysis for Library Mail includes eligible pieces that will actually be mailed as Special Standard and pay rates under the schedule for that subclass.

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[107] In response to an interrogatory from limited participant David Popkin, witness Adra cited Domestic Mail Manual sections DMM52, E620.4.0, and E620.5.0 as support for his statement that, "content eligibility for Special Standard and Library Mail are not the same." Tr. 8/4276. As an example, witness Adra states that, "mathematical kits will be eligible for Library rate mail but not Special Standard." *Ibid.*

b. OCA's Proposed Alternative

[5734] The Office of the Consumer Advocate proposes an alternative approach to setting cost-based rates for Library Mail. OCA witness Collins testifies that the recent history of another relatively small preferred subclass — Classroom publications — provides guidance for solving the problem presented by the Postal Service's Library Mail proposal in this case.

[5735] Noting that the low volume of Classroom mail resulted in a small number of IOCS tallies, which witness Degen cited as a source of wide fluctuations in unit cost estimates in Docket No. MC96-2, witness Collins cites witness Degen's acknowledgment in this docket that the insufficiency of the IOCS sample is at least as severe for Library Mail as it is for classroom publications. Tr. 24/13089. The Postal Service's proposed solution to this problem of cost reliability in MC96-2, witness Collins observes, was "a phased combining of Classroom Mail rates and cost with that of Nonprofit Mail[,]" justified in the Service's view by operational and rate-related commonalities between the two subclasses. *Id.* at 13090. The Commission's recommendation in that docket was to apply the existing Nonprofit Periodicals subclass rates to Classroom mail as an interim measure, deferring a decision on a permanent merger to the next omnibus rate proceeding. The Governors concurred in the Commission's recommendation that the full rates for Classroom publications be set using the full rates previously established for Nonprofit Periodicals.

[5736] Witness Collins states that the Postal Service's proposal in this case is tantamount to a *de facto* merger of two separate subclasses, Library Rate and Special Rate. However, she notes, the circumstances of these subclasses and their inter-relationship are somewhat different than those of Classroom and Nonprofit Periodicals. In particular, under the terms of RFRA the cost coverage of Library Rate is to be set at half the coverage applicable to Special Rate, and witness Adra states he has observed this requirement. However, witness Collins testifies, applying this level of markup to what she characterizes as the "flawed costs" estimated for Library Rate

produces rates so high that virtually all of the supposedly “preferred rate” Library mail will migrate to the nonpreferred Special Rate subclass, where all such pieces will pay the coverage of that subclass, twice the level prescribed by RFRA.

[5737] To avoid this anomaly, witness Collins recommends that the estimated attributable cost of the Special Standard subclass be used as a proxy for Library Mail’s costs. While she concedes that the relationship between the two subclasses is somewhat different from the Classroom/Nonprofit pairing in MC96-2, witness Collins cites several rationales relied upon by the Commission and the Governors in that docket as applicable here. These include the Library and Special subclasses’ identical rate structure, closely similar composition, and similarity of processing. As with Classroom publications, Library Mail’s largest cost components are “volatile,” due to small volumes and high coefficients of variance, and less stable than the estimates for Special Standard. Use of the latter as a proxy for Library Mail, witness Collins testifies, would ameliorate the problem of its unreliable cost estimates and allow the cost coverage prescriptions of RFRA to be met with reasonable rate results. *Id.* at 13093-94.

[5738] Using Special Standard costs as a proxy for those of Library Mail, and the same rate-development methodology as witness Adra, witness Collins proposes pound rates of $1.13, 40 cents, and 19 cents. These rates, she testifies, will yield revenues approximately $9 million less than those proposed by the Postal Service. *Id.* at 13097.

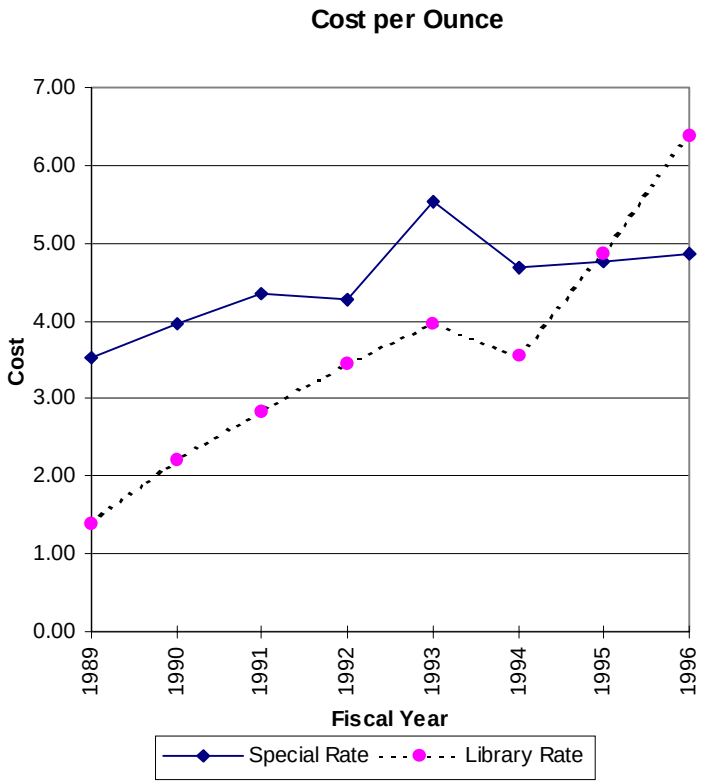
[5739] On brief, the American Library Association endorses witness Collins’ attributable cost methodology for Library Mail. Brief of American Library Association (April 1, 1998). The Postal Service opposes her cost proxy recommendation. While it states “the Postal Service is quite sympathetic with the motivation underlying the proposal,” the Service labels the use of such a proxy “an extreme treatment of the Postal Service’s mail processing cost estimates for Library Rate[,]” and claims “it is an inappropriate course of action.” Postal Service Brief at V-213-214.

c. The Commission's Recommendation

[5740] The Postal Service's proposal for Library Mail in this proceeding illustrates an unfortunate potential consequences of cost-based ratemaking: the *de facto* abolition of a mail category by rate increase. Witness Adra is certainly not to be faulted for implementing the logical rate implications of the cost inputs provided for his use. However, the results of recommending the rates he develops would be anomalous, especially for a statutorily-favored classification limited to inherently educational materials and uses.

[5741] An analysis of the cost per ounce of Library Mail and Special Standard for the period 1989-1996, derived from the Postal Service's Cost and Revenue Analysis reports for those fiscal years, shows a trend of moderate increases in costs, with the cost of Library Mail consistently below the cost of Special Standard through 1994. However, beginning that year the indicated cost of Library Mail rises sharply, overtaking that of Special Standard in 1995 and exceeding it in 1996. These results are depicted below:

Figure 5-1



The Postal Service evidently has not studied the potential causes of these results, Tr. 24/13091, and can offer little explanation other than witness Degen's statement that "Library rate costs, like Classroom, suffer from some instability due to the small volume and the nature of the IOCS sampling procedure[,]" and his suggestion that Special Standard mail may enjoy lower unit costs and higher productivities, notwithstanding his understanding "that the operating plan does not segregate Library rate mail from Special rate mail[.]" Response of USPS Witness Degen to Presiding Officer's Information Request No. 2, September 2, 1997.

[5742] However, in the circumstances of this case it is not apparent that use of a cost proxy to arrive at distinct Library Mail rates would be either justified or necessary. Special Standard is sufficiently different from Library Mail — most notably, in having a bulk rate category component — that the Commission cannot recommend using the

costs of the former as a proxy with a reasonable level of assurance. Additionally, as the Commission notes elsewhere in this section, at the levels of attributable cost estimated for Special Standard mail, an appreciable overall reduction in the rates for that subclass is justified. For the vast majority of Library Mail, these rates will provide an attractive alternative.

[5743] Consequently, rather than recommend discrete Library Mail rates on the basis of highly questionable cost estimates of the Postal Service or an uncertain assumption of resemblance to the costs of another subclass, the Commission recommends access for all matter currently eligible for mailing as Library Mail to the Special Standard subclass. The Commission proposes to implement this remedial change through recommendation of a mail classification provision which will effectively provide a “bridge” between qualifying Library Mail and eligibility for Special Standard rates.

[5744] The Commission anticipates, as did witness Adra in arriving at his assumed migration proportion of 95 percent, that the recommended classification change will affect only a small segment of current Library Mail. To the extent this matter does not meet the current content restrictions specified for Special Standard mail, the Commission also finds that the enriched educational value of qualified Library Mail clearly merits its eligibility in the nonpreferred subclass. Applicable mail classification considerations are discussed at greater length in the Commission’s recommendations for Special Standard mail, *infra.*

[5745] The Commission’s recommended solution should not be considered a proposal to abolish Library Mail as a recognized mail classification. In the Commission’s opinion, because of the legislatively-favored status of Library Mail, abolition is beyond the Commission’s authority to recommend and the Board of Governors’ power to order. By declining to recommend distinct rates for the subclass, the Commission intends to offer the Postal Service an opportunity to focus special scrutiny on Library Mail with a view to developing a permanent solution to the rate anomaly posed in this case. In the interim, the Commission will recommend a rate schedule for Library Mail that directs the

attention of mailers to the availability of the rates recommended by the Commission for Special Standard mail.

4. Special Subclass

[5746] *Introduction*. Special Standard Mail, formerly Special Rate Fourth-Class Mail, is a content-limited subclass available only for mailing materials of an educational or informational character. Eligible matter includes: books; films and catalogs of films; printed music and objective test materials; sound and video recordings; playscripts and manuscripts for books, periodicals, and music; printed educational reference charts; loose-leaf papers and binders consisting of medical information for distribution to doctors, hospitals, medical schools, and medical students; and computer-readable media.

[5747] The rate schedule for the Special Standard subclass, like that of Library Mail, incorporates a comparatively simple three-tier structure. As required by 39 U.S.C. § 3683, the rates are uniform for mail of the same weight and do not vary with the distance transported. There is a rate element for the first pound, a separate lower rate for additional pounds up to 7, and a yet lower pound rate for all additional weight above 7 pounds.

[5748] Based on the Commission's finding of lower attributable costs than those estimated by the Postal Service for Special Standard mail, and a cost coverage that maintains a modest contribution similar to those recommended in past rate proceedings, the Commission recommends a rate decrease averaging 9.6 percent for the Special Standard subclass.

a. Postal Service Proposal

[5749] Postal Service witness Adra proposes rates for Special Standard which incorporate a slight overall decrease of 0.4 percent. His development of rates proceeds

by first deriving a per-pound rate element designed to recover transportation costs, plus a 2-cent add-on cost to reflect weight-related nontransportation cost, and a per-piece rate element designed to recover all other nontransportation costs. Witness Adra believes that "[a]n important benefit from this exercise is that it reveals the underlying costs behind the rate elements." USPS-T-38 at 14-15. Using this approach, he arrives at a first-pound cost of $1.12 for Special Standard. Applying the markup factor he uses to the $1.12 cost yields a first-pound rate of $1.54, and 21 cents for each additional pound.

[5750] In order to mitigate the potential "rate shock" of increasing the first-pound rate from $1.24 to $1.54, witness Adra holds that rate element at its current level — which he notes is still compensatory — and distributes the resultant revenue loss on a per-pound basis to the 2 to 7 pound segment. His adjustments result in proposed rates of $1.24 for the first pound, 51 cents for additional pounds through the seventh, and 21 centers for additional pounds above the 7-pound level.

[5751] Witness Adra also proposes a 12-cent per piece discount for mailings of at least 500 pieces presorted to a Bulk Mail Center, based on witness Daniel's updated cost study (USPS-T-29, Exhibit USPS-29F), which estimates a cost saving of 11.7 cents per piece due to this worksharing activity. USPS-T-38 at 16. On the basis of the same study's estimate of a 33.5-cent cost saving from presortation to 5-digit ZIP Codes, witness Adra proposes a 34-cent per piece discount for mailings of at least 500 pieces in the 5-digit presort category. *Ibid.*

[5752] As the Commission notes in the discussion of Library Mail in this section, witness Adra assumes that the consequence of introducing Library rates at the levels he recommends will be that "Library mailings eligible to migrate to Special Standard will do so." *Id.* at 22. Accordingly, his financial calculations assume that 95 percent of Library Mail volume will be eligible to migrate to the Special Standard subclass and will pay its rates. No current user of the Special Standard subclass or any other participant in this proceeding has objected to this anticipated development.

[5753] The Postal Service also proposes that the new prebarcode discount be made available to the single-piece and BMC presort categories of the Standard Special subclass, but not to the 5-digit presort category because such mailings bypass the parcel sorters at Bulk Mail Centers. *Id.* at 13. Witness Adra proposes a 4-cent discount, which equals estimated cost savings. *Id.* at 19. The Service also proposes that Standard Special mailers have access to the proposed Delivery Confirmation service on an optional basis. *Id.* at 13-14.

b. Cost Coverage

[5754] The predecessor of Special Standard mail, Special Rate Fourth Class, has been assigned a coverage much below average in past rate proceedings. There are three primary bases for this level of contribution. First, mail in this subclass has a low value of service as a consequence of receiving nonpreferential processing and transportation. Second, it merits special consideration under the § 3622(b)(8) factor because of the intrinsic educational, cultural, scientific and informational value of the prescribed content of the subclass to recipients of these materials. Finally, the § 3622(b)(5) "available alternative means" factor applies because this subclass constitutes the primary service for delivering books sent by individuals, who often find it the most convenient and affordable means of doing so. PRC Op. R94-1, para. 5370.

[5755] In this proceeding, there is no evidence that would lead the Commission to depart from these bases for pricing the subclass that has become Special Standard mail. While witness Adra apparently could not provide highly detailed information regarding the patterns of Special Standard mail's usage, in responding to an OCA interrogatory he did note that the subclass can be used by individual mailers, and cites results of the Postal Service's Household Diary Study for Fiscal Year 1995 that show households sending 52.8 percent of their Special Standard mailings to friends or relatives, and 47.2 percent to businesses. Tr. 8/4295-96. In light of these established pricing considerations, the Commission is recommending rates for the Special Standard

subclass that incorporate a cost coverage of 106 percent, which is the same percentage coverage recommended in the last omnibus rate proceeding. PRC Op. R94-1, para. 5371.

c. Rate Design

[5756] No participant has suggested that the current design of Special Standard rates be altered in any way, and the Commission has designed rates using essentially the same procedures used by witness Adra. The Commission's recommended rates are $1.13 for the first pound, 45 cents for each additional pound through 7 pounds, and 28 cents for additional pounds beyond the 7-pound level.

[5757] For the Level A category of bulk Standard Mail presorted to 5 digits, the Commission recommends a first-pound rate of 64 cents, which incorporates a per-piece discount of 49 cents. For the Level B category of bulk mailings presorted to Bulk Mail Center, the Commission recommends a first-pound rate of 95 cents, reflecting an 18-cent per-piece discount. These recommended discounts are based on adjustments to the cost results of witness Daniel's study produced by differences in the Commission's cost attribution methodology for mail processing costs and reflect a 100 percent passthrough of estimated cost savings.

[5758] The Commission also recommends a 3-cent discount for the proposed prebarcode category in Standard Special mail. The recommended level of this discount is based on the Commission's analysis of Postal Service witness Daniel's study of processing costs in USPS-T-29, and adjustments to her estimates of cost savings.

[5759] The Commission finds the recommended rates to be compatible with the ratemaking factors in § 3622(b). They will recover all costs attributable to Special Standard mail, as required by § 3622(b)(3), and make an appropriate contribution to the institutional costs of the Postal Service. Because an overall rate decrease is recommended, there is no cause for concern regarding impact under § 3622(b)(4). As noted earlier, the recommended level of coverage takes into account the "available

alternative means" factor, § 3622(b)(5). The recommended prebarcode discount recognizes mailer worksharing, in response to § 3622(b)(6). Considerations of rate simplicity and identifiable relationships between rates are served by preserving the existing, relatively uncomplicated structure of current Standard Mail rates. Finally, as noted above, the ECSI value of Standard Mail under § 3622(b)(8) is recognized in the modest markup assigned to the subclass.

d. Recommended Classification Changes

[5760] The Commission recommends the two new features the Postal Service proposes to add to the Standard Special subclass, the prebarcode discount and the optional Delivery Confirmation service. The former is a worksharing discount of a familiar type, based on the "degree of preparation" ratemaking factor in § 3622(b)(6). The Postal Service's study of potential users establishes the desirability of this category to mailers, and its cost analysis demonstrates its desirability to the Service, in response to § 3623(c)(2) and (5). Similarly, the Service has shown that the proposed Delivery Confirmation service is desirable to mailers and will enhance the value of delivery service to users.

[5761] As noted in the discussion of Library Mail in this section, the Commission is also recommending a supplemental classification provision for Standard Mail that will make the subclass available for all mailings that currently qualify under Library Mail eligibility standards. As witness Adra's testimony states, the Postal Service anticipates that 95 percent of current Library Mail will migrate to the Special Standard subclass for rate relief. The remaining 5 percent, witness Adra assumes, will be stranded because the content of the mailing — he cites the example of "mathematical kits" — does not fall within the precise content prescriptions for the Special Standard subclass contained in DMCS § 323.11 and the Domestic Mail Manual. USPS-T-38 at 22; Tr. 8/4276.

[5762] In the Commission's opinion, materials eligible for mailing under the generally more restrictive Library Mail requirements partake in at least equal measure

with Special Standard mail of the educational, cultural, scientific and informational value recognized by § 3622(b)(8). Therefore, considerations of fairness and equity operate strongly in favor of the inclusion of all mail now in Library Mail into the Special Standard subclass..

[5763] In Docket No. MC84-1, the Commission recommended an expansion of Special Rate Fourth-Class Mail to include computer-readable media and books of between 8 and 24 pages. PRC Op. MC84-1, October 23, 1984. In that decision, the Commission reviewed the historical background of the Special Rate subclass and found "that the purpose of this favored subclass [is] to promote 'educational, cultural, scientific, and informational value'" responsive to § 3622(b)(8). *Id.* at 9. The Commission also found that expansion of the Special Rate subclass to include materials of recognized value under § 3622(b)(8) is consistent with the statutory requirement in § 3623(c)(1) of maintaining a fair and equitable classification system for all mail, as well as other factors contained in § 3623(c). *Id.* at 9-10. This analysis is equally applicable to the contents of Library Mail.

[5764] For much the same reason, the § 3623(c)(2) factor — "the relative value to the people of the kinds of mail matter entered into the postal system" — also favors inclusion because of a close parity in the values of materials eligible for Library Mail and Special Standard. Especially at the level of rates the Commission recommends for the Special Standard subclass, the desirability of a special classification allowing its use for Library Mail matter is evident from the user's perspective. Neither the Postal Service nor any other participant in this case has voiced any concern regarding the migration of 95 percent of Library Mail to Special Standard, so there is no factual basis for an inference that inclusion of all Library Mail would be undesirable from the Service's perspective. Therefore, considerations of desirability under § 3623(c)(2) and (c)(5) also support opening the Special Standard subclass to all eligible Library Mail materials.

[5765] To accomplish this change, the Commission recommends addition of a new subsection k to section 323.11 of the Domestic Mail Classification Schedule that would

extend eligibility for mailing at Special Standard rates to “any mailing eligible to be entered as Library subclass mail.”

E. Periodicals

1. Introduction and Summary

[5766] In this proceeding, the Postal Service proposes a moderate increase in the rates for most Periodicals class mail, which is predominantly magazines, newspapers, newsletters, and bulletins. The average increases proposed for the Regular, Within County, and Nonprofit Periodicals subclasses, respectively, are 3.8 percent, 2.4 percent, and 3.5 percent. The Classroom subclass receives an average increase of 7.5 percent. These increases are based on a cost coverage of 107 percent for the Regular subclass. *See* Postal Service Response to P.O. Information Request No. 19, Question 2.

[5767] The Request includes only one classification change, which entails the establishment of separate presort categories for 3-digit and 5-digit mail in all subclasses. In all other respects, the underlying Periodicals rate structure remains intact. The Request proposes several changes in the way certain individual rate elements are developed. These affect calculation of the flat editorial pound rate, development of the discount for letter-sized automation mail, and selection of the benchmark for discounts applied on a per-piece basis. In general, the Request is heavily guided by concern over the effects on mailers of increases in specific rate elements, as evidenced by the adoption of a constraint of plus or minus 10 percent on rate changes. Tr. 10/4928-29.

[5768] *Intervenors' Response.* Virtually all participants who address the Service's Periodicals proposals accept the moderate nature of the rate increase; however, they urge that the Commission view the proposed rates as a ceiling. They emphasize that the small size of this increase does not alleviate their concern that serious costing issues have the potential to cause substantial and permanent harm to Periodicals. These intervenors have joined together to address recent increases in Periodicals costs and to provide analysis of the Service's new methodology for distributing mail-processing costs. They are also concerned over the actual level of service being provided and the impact of reclassification on their costs of doing business with the Postal Service. There is no

opposition to the establishment of an additional presort tier, and the Service's rate design changes generate little comment. *See* Trial Brief of Alliance of Nonprofit Mailers (ANM), American Business Press (ABP), Coalition of Religious Press Associations (CRPA), Dow Jones (DOW Jones), Magazine Publishers Association (MPA), National Newspaper Association (NNA), McGraw-Hill (McGraw-Hill), and Time Warner (Time Warner).[108]

[5769] Only one intervenor — NNA — proposes additional classification changes. Its proposals expand eligibility for destination entry discounts and for high density rates.

[5770] *Summary of Commission Recommendations.* Upon consideration of the rates proposed by the Service, the positions of the parties, and issues related to Periodicals costs and service, the Commission recommends a cost coverage of 101 percent. Applying this coverage to projected test year costs requires average rate increases for Regular, Within County, Nonprofit, and Classroom of 4.6 percent, 1.1 percent, 8.0 percent, and 12.1 percent.[109] The proposal for four presort tiers in all subclasses is accepted. The Commission does not accept the proposed change in the way the flat editorial pound rate is developed. A wide range of worksharing and automation discounts is recommended. Some of these recognize worksharing efforts by mailers in greater degree than the proposed discounts, and some are close to those proposed. The Commission's Periodicals workpapers are contained in PRC Library Reference 11.

[5771] The Commission points to the need for studies of the Within County subclass and of the proportion of revenue that should be obtained from the pound rate as opposed to the piece rates. The Commission acknowledges and supports the plans of the Postal Service to work with Periodicals mailers on questions relating to Periodicals costs. The Commission approves the Service's proposal to apply Nonprofit rates to Classroom mail and is pleased that the Service is planning a study of Classroom costs.

[108] CRPA members include American Jewish Press Association; Associated Church Press; Association of State Baptist Papers; Catholic Press Association; Episcopal Communicators; Evangelical Press Association; General Commission on Communication, United Methodist Church; and Seventh-Day Adventist Publishers.

[109] For the preferred categories, the increases are based on a step 5-to-step 5 comparison.

[5772] The remaining discussion focuses first on the identification and evaluation of several issues that are important to more than one subclass. It then addresses specific subclasses of Regular, Nonprofit, Within County, and Classroom, and the science of agriculture rate category. The final section addresses NNA's classification proposals.

2. Background

[5773] The Periodicals class — formerly referred to as second class — consists of four subclasses: Regular Periodicals; Nonprofit Periodicals; Classroom Periodicals; and Within County Periodicals. USPS-T-34 at 4. The Regular subclass dominates in both volume and revenue: in FY 1996, it accounted for 7.0 billion out of 10.1 billion of total Periodicals pieces and $1.6 billion out of $2.0 billion in Periodicals revenue. The three subclasses that collectively account for the remaining volume and revenue — Nonprofit, Classroom and Within County — are referred to as preferred subclasses because by statute they receive special rate treatment. One category in Regular rate — science of agriculture — also receives special treatment, but this is limited to reduced pound rates on advertising content within zones 1 and 2.

[5774] Eligibility for the Periodicals class requires, among other things, that publications have a minimum amount of editorial — or nonadvertising — content.[110] It is the presence of editorial content that entitles all Periodicals publications to special ratesetting consideration, as evidenced in statutory recognition of educational, cultural, scientific, and informational value. *See* 39 U.S.C. § 3622(b)(8). The nature of the special consideration given to the preferred subclasses and to the science of agriculture rate category is dictated largely by the *Revenue Forgone Reform Act of 1993* (RFRA). P.L. 103-123, 107 Stat. 1267, 39 U.S.C. section 3626(a). Under RFRA, the Within County, Nonprofit, and Classroom subclasses are to have full rates set at one-half the

[110] Both in this Opinion and in everyday usage, nonadvertising content is commonly referred to as "editorial" content.

markup of Regular Periodicals, with the increase phased in over six annual steps. In addition, Nonprofit and Classroom advertising rates are to be set equal to Regular advertising rates, and science-of-agriculture rates are to be set at three-quarters of the corresponding Regular rates.

[5775] *Common Rate Structures.* In general, the Periodicals subclasses share a similar rate structure, consisting of per-piece and per-pound charges. The piece charges reflect several worksharing options (such as presortation, barcoding, and entry at a designated facility) and, with the exception of the Within County subclass, are also adjusted to recognize the proportion of editorial content in the publication. The per-pound charges, again with the exception of Within County, are tied to content. The advertising pound charge in Regular, Nonprofit, and Classroom varies by postal zone and entry point, such as the destination sectional center facility (SCF) or delivery office. In the same subclasses, the editorial pound charge is held to a reduced level and does not vary with zone or entry point; hence, it is often referred to as the “flat” editorial pound rate. Within County rates, unlike those in the other subclasses, are not zoned and have no rates that depend on the proportion of editorial content.

[5776] *Rate Development.* Rate development for the preferred subclasses is directed at full rates. The rates currently in effect are step 5 rates; step 6 rates (which by definition are full rates) will apply during Fiscal Year 1999, which begins on October 1, 1998. For volume forecasting purposes, the Commission’s development of step 5 rates reflects the development used by the Postal Service in its proposal.

[5777] The Service’s rate proposals reflect several considerations, apart from those imposed by RFRA. One is data limitations. Uncertainty over the reliability of reported costs leads the Service to pattern Classroom rates after those for Nonprofit. In addition, the small number of letter-sized pieces in Periodicals leads the Service to adopt certain related costs from studies of Standard A Mail. The Service also proposes Within County rates based on the Nonprofit cost avoidance study.

[5778] The Service also makes *ad hoc* adjustments in certain rate elements (or rate cells) to mitigate the increases it proposes. In most cases, the Service limits increases in

rate elements to 10 percent, about three times the average increase proposed for Regular Periodicals. The focus is on the changes in specific rate elements and not on the resulting overall postage increase for the mailings involved, which is the net result of the rate changes for many rate elements.[111]

3. Classification Change Providing Separate Recognition for 3-Digit and 5-Digit Mail

[5779] Currently, the Regular, Nonprofit, and Classroom subclasses have three presort tiers: basic, 3/5-digit, and carrier route. The Within County subclass has two: basic and carrier route. In this proceeding, the Service proposes that all subclasses have four presort tiers: basic, 3-digit, 5-digit, and carrier route. Under this proposal, the 3-digit tier is comprised of unique 3-digit pieces formerly in the 3/5-digit tier and non-unique 3-digit pieces formerly in the basic tier. USPS-T-34 at 6.

[5780] In supporting this change, Postal Service witness Taufique refers to MPA witness Cohen's testimony in the Docket No. MC95-1 (the reclassification case) and to Commission observations in the same case. Id. at 7. He also argues that the proposed restructuring is fair, reflects worksharing, is desirable from the point of view of mailers, and benefits the Postal Service.

[5781] *Commission Analysis.* The Service's classification proposal is responsive to observations made by the Commission in Docket No. MC95-1. *See* PRC Op. MC95-1, para. 5324. The Commission recommends the 4-tier proposal, since it appears to allow rates to follow costs more closely and therefore is likely to send improved signals to mailers. Also, the Commission notes that the 4-tier proposal appears to avoid the complexities associated with the old definition for the combined 3/5-digit tier, in which some 3-digit areas qualified for the discount and others did not. The Service has presented transition matrices showing the volumes of mail that will qualify for each of the

[111] Mailers pay postage on a per mailing basis, reflecting pieces sent to different destinations. Thus, moderating individual rate cells has little effect and may send misleading signals to mailers.

new tiers. ABP witness Cavnar suggests that some of these volumes might not have been estimated properly, but he does not provide any explanation concerning the details of this failure and does not present alternatives. Tr. 28/15345-44. Since Periodicals mailers are already required to presort to the maximum extent feasible, further inquiry does not seem warranted.

[5782] The Commission agrees with witness Taufique's assessment that establishment of discrete presort tiers for 3- and 5-digit mail is consistent with applicable statutory criteria. *See* USPS-T-35 at 5-7. In particular, the Commission notes that the fairness and equity of the classification schedule, section 3623(c)(1), is met by making appropriate distinctions between mailers' worksharing efforts.

4. Changes in Rate Development

a. The Flat Editorial Pound Rate

[5783] Currently, the editorial pound rate for the Regular, Nonprofit, and Classroom subclasses is set at 75 percent of the advertising pound rates for zones 1 and 2. In this proceeding, witness Taufique proposes a new method for developing this rate that is entirely independent of the advertising pound rate. Citing a Commission concern that the implicit coverage on editorial matter is below 100 percent, he suggests that the editorial pound rate be set equal to an estimate of the average transportation cost, with no markup. However, in view of the effects on mailers, he proposes to implement only a portion of the increase this method implies. *See* USPS-T-34 at 13-15. Witness Kaneer presents a similar proposal for Nonprofit and Classroom.

[5784] McGraw-Hill witness Hehir is the only witness to address the Service's proposal for a new method to calculate the pound rate for editorial matter. He does not specifically oppose the change, but expresses "concern that the proposed disproportionate increase in the editorial pound charge should not become a precedent … that would undermine the historical commitment (embodied in the Postal

Reorganization Act) to promote the widespread dissemination of editorial content through the mail." Tr. 27/14708.

[5785] *Commission Analysis.* Witness Taufique's justification for this change is a reference to Commission expressions that attention should be focused on the implicit cost coverage of editorial matter. Aside from this reference, little other justification is provided, no discussion is provided of other merits associated with the change, and virtually no attention is given to where this change might lead in future cases.

[5786] The concerns previously noted by the Commission about implicit coverage relate to a composite mailpiece, which does not represent any particular mailing. Therefore, implicit cost coverages are often of limited value unless they are considered within the broader context of rate design. Moreover, they should not overly constrain other features that are also important in achieving a result that is fair to all mailers within a subclass.

[5787] The implicit coverage on editorial matter is substantially determined by two separate editorial-benefit features in the rate structure. One is the editorial pound rate, which the Service proposes changing; the other is the per-piece editorial benefit, for which no change is proposed.[112] When asked about this omission, witness Taufique responded simply that no changes were proposed. Tr. 19E/9873-74.

[5788] The Commission views the Service's proposal as unbalanced.[113] First, it makes the level of benefit given to editorial matter, relative to advertising matter, depend in substantial degree on the markup selected for the subclass. If the coverage of the subclass is low, as it is in this case, the corresponding benefit is small. Second, this approach has the potential to set the editorial pound rate *above* the advertising pound

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[112] However, the Service proposes increasing the *level* of per-piece benefit from 5.7 cents to 5.9 cents.

[113] The Commission notes that the basic per-pound transportation cost calculated by witness Taufique for Periodicals is influenced in substantial degree by an assumption made about the proportion of total Periodicals costs that are pound related. As discussed infra, evidence on this proportion is weak and has not been given attention by the Service, even though the Commission has highlighted it as an important concern in previous cases.

rates for the lower zones. This result seems inappropriate. The Commission also believes that witness Hehir's concern that the new approach for calculating the editorial pound rate might diminish the "widespread dissemination of editorial content through the mail" could become a reality. For these reasons, the Commission rejects the Service's change. The rates recommended by the Commission maintain the existing approach for developing the editorial pound rate.

b. Barcode Discount for Letter-Sized Pieces

[5789] Currently, letter-sized pieces of Periodicals mail are eligible for a barcode discount. Given the small number of letter-sized pieces in Periodicals, this discount has been based on the barcode savings for similarly-situated Standard A mail. The Service continues the practice of relying on Standard A costs; however, it also proposes to include the letter/flat cost difference, derived by comparing Standard A letter costs with Periodicals flat costs, in the discount calculation.

[5790] *Commission Analysis.* It is generally assumed that barcoded letter-sized pieces are lower in cost for two reasons. The first is the mailer's application of a barcode, and the second is shape differences. The Service proposes in this case, for the first time, that the barcode discount reflect the cost differences resulting from *both* of these reasons. This increases the discount substantially. Although no party has addressed this aspect of the Service's proposal, two issues warrant comment. First, fairness questions seem to arise when letter-sized pieces with a barcode obtain a discount for being a letter, while letter-sized pieces without a barcode do not. The Service's position is that the number of letter-sized pieces without a barcode is small and that data are not available which would allow further discounts to be given. Tr. 10/4959.

[5791] Second, the cost information the Service relies on for this discount comes from analyses of separate mailstreams and may not, therefore, be fully compatible. *See* USPS-T-34 at 18. It seems preferable that the costs be developed in a unified study that focuses on the specific subclass of mail in question. This would assure that the resulting

cost difference is actually related to shape, and not due to other factors. For these reasons, the Commission moderates the passthroughs on these discounts.

c. Selection of a Benchmark for Per-Piece Discounts

[5792] The Postal Service's proposal references all per-piece rates (and implied discounts) to the rate for basic presort pieces, whereas the Commission's prevailing approach develops discounts based on costs avoided by each additional level of worksharing. For example, the rate for 5-digit pieces — which are one step below 3-digit pieces — is referenced, in the Service's proposal, to basic pieces, as is the rate for 5-digit barcoded pieces. Under this approach, the barcode discount for 5-digit pieces becomes the difference between the two rates. In the past, for both cost and discount purposes, the Commission has viewed barcoded 5-digit pieces as related to 5-digit pieces that are not barcoded.

[5793] *Commission Analysis.* Rate differences, such as between barcoded and nonbarcoded 5-digit pieces, play a key role in influencing mailer behavior, especially since Periodicals mailers have no choice but to presort to the maximum extent feasible (short of carrier route presort). Under these conditions, it seems indirect at best to base the rate for the barcoded and the non-barcoded 5-digit piece on the distantly related basic presort piece, and then to let the discount be the difference between these two rates. It seems more appropriate to base the barcode discount on the difference in cost between 5-digit pieces that are barcoded and 5-digit pieces that are not barcoded.

[5794] Accordingly, when identifying cost savings and deciding on the extent to which savings are passed through into rate differences, the Commission uses the relevant, nearby benchmark and not one basic reference point for the entire subclass. This focuses attention on the relevant difference and on the magnitude and reasonableness of the signal involved.

d. Proportion of Revenue Derived From the Piece Rate

[5795] The Postal Service proposes obtaining 59 percent of the revenue of Regular Periodicals, and 70 percent of Nonprofit revenue, from the per piece rates. These are both reductions from the current level. Except for observations that the reductions for Regular and Nonprofit will help smooth the effect of the rate changes on mailers, no justification for the changes is given. The proportion for Within County is proposed to remain at the current level of 60 percent.

[5796] *Commission Analysis.* The proportion of revenue obtained from the piece rates has been an issue of long-term importance and contention. This proportion has been increasing over time for Regular Periodicals and left basically the same for Within County, Nonprofit, and Classroom. In Docket No. R87-1, the proportion for Regular was increased to 60 percent based on evidence that an even higher proportion might be in order. In Docket No. R90-1, there were arguments supporting an increase in the proportion but, in the absence of new evidence, it was left at 60 percent. In Docket No. MC95-1, the 60 percent proportion was retained. In this case, the Service proposes to reverse the direction of the past and to reduce the proportion to 59 percent. No study, however, has been done to support this change. The only justification, presented in response to question 4 of P.O. Information Request No. 3, was that using 59 percent would have a more balanced effect on mailers. Tr. 10/4928-29. That response also indicates that the use of the 59 percent figure does not represent a change in the Service's position.

[5797] In the case of Nonprofit, the proportion was stable at 76 percent for a number of rate cases, but was reduced to 71.8 percent in Docket Nos. R94-1 and MC96-2. This was done to further the across-the-board nature of the former case and was carried forward to help maintain a neutral effect in the latter case. As shown in the workpapers of witness Kaneer, the current proposal reduces the proportion for Nonprofit to 70 percent. No justification is given. USPS-T-35, Workpaper D, p.1.

[5798] Changes in the proportion of revenue from the piece rates have substantial effects on the levels of the piece rates relative to the levels of the pound rates. And since publications vary widely in weight, such changes can have substantial effects on the rate increases experienced by heavy-weight periodicals relative to those experienced by light-weight periodicals. Similarly, the Periodicals subclasses have different average weights. If the proportions of revenue from the piece rates in the subclasses do not reflect properly these differences in average weight, the rate relationships between the subclasses will be skewed. This would not only be unfair to mailers, it might cause crossover problems. The situation is more acute under RFRA than it was before, because the advertising pound rates in Regular are carried over and used in Nonprofit and Classroom. The Commission has asked for a study of these proportions in the past. *See* PRC Op. R90-1, paras. 5260-65 and PRC Op. R94-1, para. 5170. The Service has been unresponsive.

[5799] The proportions proposed in this case are not based on cost studies or structural arguments. The Commission finds no basis for changing the proportion in Regular Periodicals from its current level of 60 percent. The situation in Nonprofit is a little different, because maintaining the 76 percent figure of long standing would have significant effects on mailers of light-weight pieces. Accordingly, the Commission recommends a proportion of 70 percent. The question of the appropriate proportions should be studied.

e. The Editorial Piece Discount

[5800] Part of the recognition given to editorial matter is a per-piece discount based on the proportion of editorial content. Currently, this discount is 5.7 cents per piece in the Regular subclass and 4.2 cents per piece in both Nonprofit and Classroom.[114] Witness Taufique proposes to increase this discount for Regular proportionate to the

[114] The actual discount received by any piece is 5.7 (or 4.2) cents times the proportion of editorial content.

"overall increase in revenue per piece (not including fees) for the regular subclass." USPS-T-34 at 19. After rounding, the proposed discount is 5.9 cents. The Service proposes to increase the discount for Nonprofit to 4.4 cents.

[5801] *Commission Analysis.* No party has addressed these discounts. The Postal Service's proposals appear reasonable under the circumstances. The Commission recommends them as proposed.

5. Final Adjustments

[5802] In the rate design for Regular Periodicals, witness Taufique proposes removing 1.2 cents from the pound rate for advertising in zones 7 and 8. He also proposes removing 0.1 cents per piece from the basic piece rates. Witness Taufique indicates that the purpose of both adjustments is to minimize the impact on customers mailing in the affected rate cells. *Id.* at 15-16.

[5803] *Commission Analysis.* Since the Commission has made various adjustments to the Service's proposal, such as in costing, presort passthroughs, and proportions of revenue from the piece and pound rates, it is not faced with the same set of final results as the Service. For these reasons, Taufique's adjustments are moot.

6. Rate Proposals

a. Regular Periodicals

[5804] The Service, through witness O'Hara, proposes a cost coverage for Regular Periodicals of 107 percent. O'Hara says the proposed coverage was selected by considering all of the factors in the Act, with special emphasis on the educational, cultural, scientific, and informational content of Periodicals Mail. He cites an interest in mitigating the effect of the proposed rate increase on mailers. Witness O'Hara also

mentions the rate increases experienced by some mailers as a result of recent classification reform. *See* USPS-T-30 at 29-32.

[5805] A special issue discussed by witness O'Hara as a reason for mitigating cost coverage is recent cost increases for Periodicals. He states:

> The Postal Service is undertaking an analysis to understand what factors may have contributed to increases in flats mail processing costs, especially for Periodicals. Rather than mechanically reflecting the full cost increase in rates, I believe it is appropriate to first see whether these cost trends can be reversed as a result of the additional equipment deployment and operational changes that are expected over the next several years.

Id. at 30-31.

[5806] Witness Taufique develops detailed rates consistent with the coverage proposed by witness O'Hara. With the exceptions and adjustments noted in the preceding section, the rate design for Regular Periodicals follows the design the Commission recommended in Docket Nos. R94-1 and MC95-1. However, passthrough of cost savings varies widely in the Service's proposal because the discounts were selected to "dampen significant increases in any of the rate cells." USPS-T-34 at 16.

[5807] *Participants' Positions.* Eight witnesses presented testimony on ratesetting in Periodicals. None of the testimony relates specifically to Classroom or to Science of Agriculture; most relates to Regular rate levels, with the understanding that the markup for Nonprofit is established by RFRA to be 50 percent of that of Regular. Witness Little is jointly sponsored by eight intervenors, MPA, ANM, ABP, CRPA, Dow Jones, McGraw-Hill, NNA and Time Warner. With the exception of ANM, this same group sponsors the testimony of witness Crain. Witness Hehir presents testimony on behalf of McGraw-Hill. Witnesses Heath and Speights testify for NNA. Witnesses Cavnar and McGarvy and Wendler testify on behalf of ABP. Witness Stapert is sponsored by CRPA.

[5808] Although some of these witnesses address issues that others do not, there is a great degree of uniformity in their positions. All the Periodicals witnesses argue that the cost coverage of 107 percent proposed by the Postal Service is the highest that

should be considered and that no specific Periodicals rates should be higher than those proposed. Witness Little says: “I’m not a ratemaking expert, but it seems to me that the proposal for a low coverage — and a modest rate increase — is certainly reasonable, not only in light of the ‘ECSI’ factor, but also in light of a decade of serious, unanswered questions about mail processing cost increases for Periodicals.” Tr. 27/14549. Witness Hehir urges that the proposed rates are “the maximum appropriate rates under the circumstances presented.” *Id.* at 14707. Witness Speights believes that “[e]ven with the moderate increases proposed in this case, small newspaper publishers are overpaying when they receive no value because angry subscribers drop the paper.” *Id.* at 14899. Witness Heath argues that with the service decline, “even this modest cost coverage is too high.” *Id.* at 14749.

[5809] One reason mentioned in support of the Service’s proposed cost coverage of 107 percent, which virtually every witness acknowledges is low by historical standards, is that the level of service being received by Periodicals, with the possible exception of Within County, is low and has been declining. According to witness Speights: “We have chronic and persistent problems in achieving consistent mail service for our readers, particularly in mail destined for addresses outside our county.” *Id.* at 14893. In support of this statement, she presents the results of a survey of her out-of-town customers. Similarly, witness McGarvy presents data on the service received by 65 publications monitored by the Red Tag News Publications Association, and concludes: “Periodical delivery is inconsistent and does not meet published delivery standards.” Tr. 28/15299.

[5810] Witness Hehir presents data derived from his participation in a now-defunct effort by the Postal Service to develop a measurement system for the service received by Periodicals, designated the EX2C Mail Monitoring System. Tr.27/14713-14 and 14719-20 (Exh. 1). Witness Heath believes some of the decline in service has been due to changes in regulations and associated processing patterns that came with Reclassification. *Id.* at 14746-49. Noteworthy, however, are reports that the Postal Service has recognized the service problem and, in cooperation with the Periodicals

industry, is beginning a program that may lead to an improvement. *See*, for example, *Id*. at 14714-15.

[5811] A separate kind of argument for a low cost coverage, repeated in one form or another by virtually every Periodicals mailer, concerns recent events that have affected Periodicals mailers. First, they say the rate increases of Docket No. R94-1 were larger for Periodicals mailers than for mailers on average and were larger yet for small low-volume Periodicals mailers. Second, they say Reclassification also involved rate increases for low-volume or low-density Periodicals mailers. Third, they assert that reclassification brought changes in rules and regulations that caused substantial mailer costs. Finally, witnesses Cavnar and McGarvy note that barcode discounts are not available to some publications in polybags and to tabloids. Tr. 28/15341, 15302 and 15305. Witness McGarvy believes the Service has been discriminatory and tardy in its programs to install equipment that will read barcodes on tabloid-sized flats. *Id*. at 15304.

[5812] Another factor supporting a low cost coverage, emphasized strongly by the Periodicals witnesses, is the contention that Periodicals costs are too high and have been rising at an excessive and unexplained rate for the last 11 years. The starting point for most of the cost comparisons is FY 1986, which was the base year for the rates implemented as a result of Docket No. R87-1. Witness Little points to both direct costs and piggy-back costs, and expresses “continuing frustration” over attempts to work with the Postal Service on this problem. Tr. 27/14543. Witness Crain characterizes the Service’s response to the problem as “struthious,” but then reports that the Service has agreed “to a joint study with industry to determine how flat processing costs can be reduced. …” Tr. 28/15279 and 15281. Except for general observations, these Periodicals witnesses do not provide substantive analysis of the costing issue; instead, they refer to the testimony of witnesses Cohen and Stralberg.

[5813] *Commission Analysis.* At 107 percent, the coverage the Service proposes for Periodicals is markedly lower than the 116 percent coverage recommended by the Commission in Docket No. R94-1. A wide range of arguments has been presented relating to the appropriate cost coverage for Regular Periodicals. Beyond positions that

the rates for no cells should be higher than those proposed by the Postal Service, the arguments receiving the most attention relate to the quality and reasonableness of the costs presented by the Service; to the educational, cultural, scientific, and informational value of the mail involved; to the level of service being received and to the value of that service; and to the effects of the proposed increases on mailers.

[5814] Also, several parties remind the Commission that many mailers received rate increases as a result of recent reclassification cases (Docket Nos. MC95-1 and MC96-2) and as a result of step increases specified by RFRA.[115] In addition, some parties have noted increases in mail preparation costs as a result of the reclassification cases. Thus, they express interest in keeping the average increases below the inflation level and in line with the average increase for all mail. No party has pointed to alternate delivery as an imminent threat, but witness Hehir notes that the movement toward electronic transmission has been spurred by poor and irregular service. Tr.27/14715-17.

[5815] Many of the Periodicals witnesses argue that the value of service of Periodicals has deteriorated, primarily because of the reductions in service levels. Witness Stapert says that "CRPA members have noted a distinct decline in the value of . . . service over the past few years." Tr. 22/11741. Witness McGarvy says she does "not understand the assumption that periodicals should pay more postage for worse service." Tr. 28/15302.

[5816] Most of the costing questions raised relate to mail processing costs. However, witness Hehir also notes the growth in transportation costs. He says that "most of the cubic capacity in the purchased highway transportation system is chronically unutilized, and the costs of the unutilized capacity are allocated to mail that does not necessarily cause that cost." Tr. 27/14712 (footnote omitted).

[5817] The Commission has considered the parties' positions and concludes they present a strong case that minimizing increases for Periodicals is in line with the

[115] The Commission is aware of the recent step increases required by RFRA, and notes a) that these increases were relatively small, and b) that the Commission has no control over the scheduling or the appropriateness of these increases. The Commission is also aware that the rates for Within County, Nonprofit, and Classroom are directly affected by the cost coverage selected for the Regular subclass.

requirements of the Act, including attention to relevant factors in section 3622(b). It finds that a cost coverage of 101 for the Regular Subclass is appropriate.[116] This coverage still leads to an average increase for Regular Periodicals of 4.6 percent, which is about 50 percent above the systemwide percentage increase.

[5818] This coverage barely satisfies the requirement of 39 U.S.C. § 3622 (b)(3) that rates cover costs, and allows Periodicals mailers, who have faced substantial cost increases in recent years, to make only a small contribution toward institutional costs. This approach allows recognition of the educational, cultural, scientific, and informational value of Periodicals class mail, § 3622(b)(8), and recognizes Periodicals important role in "binding the Nation together," § 101. The Commission recognizes that the low coverage it is recommending provides only a small margin for error; however, on balance, it finds this is an acceptable risk, given that expected savings from reclassification have not yet worked their way into the reporting system.

[5819] With respect to increased costs, Postal Service witness Degen contends that Periodicals costs have tracked wage costs in substantial degree since FY 1989. Tr. 36/19347. Nevertheless, it is entirely appropriate for mailers to be concerned with Postal Service efforts to restrain costs. The Commission has asked in the past that attention be given to this issue and, according to witness Cohen and others, the Service has agreed to look into the matter. The Commission supports this inquiry. Another factor in developing the recommended cost coverage is the inconsistent levels of service Periodicals apparently receive, § 3622(b)(2). The Postal Service acknowledges the limited information available to mailers on the levels of service being received by Periodicals. It appears that in some instances the published standards are not being met. This issue also should receive attention. The Commission hopes this attention will extend to small-circulation periodicals, as well as to large-circulation ones.

[5820] *Piece Rates.* The revenue to be obtained from the piece rates is 60 percent of the revenue for the subclass, after allowing for fees. In the Service's proposal,

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[116] This extremely low coverage leaves little absolute difference in markup between the Regular and Preferred subclasses.

consistent with past Commission recommendations, the calculation of these rates is relatively simple. The first step is to calculate the sum of the leakages associated with all per-piece discounts, including the cost of the editorial per-piece discount. This sum is added to the piece-revenue target and then divided by the number of pieces. The result is the basic per-piece rate, which is rounded to the nearest tenth of a cent per piece. All of the other rates are obtained by subtracting the various discounts. For example, the piece rate for 5-digit presorted pieces is equal to the basic piece rate, less the 3-digit discount, less the 5-digit discount.

[5821] Attention centers, then, on the cost avoidances and the passthroughs, for these determine the leakages. Using constant mail entry profiles, as proposed by the Service, and consistent with Commission costing decisions, the avoidances are calculated in the Commission workpapers and are somewhat higher than those proposed. For example, the savings for 5-digit mail relative to 3-digit mail is 6.5 cents, while the Service found 4.0 cents. Similarly, the savings for 5-digit barcoded flats relative to 5-digit presorted pieces without a barcoded is 2.9 cents, while the Service found 2.3 cents. The Service proposed a set of passthroughs ranging from 7.5 percent to 130 percent, primarily to smooth rate changes.

[5822] *Worksharing Discount Rationale.* Absent further justification, the Commission does not agree that such a wide range of passthroughs is in order. Providing cost-based signals is important in setting rates, as this should lead to an efficient mailstream and to efficient mailer behavior. When structural changes are made, some effects are unavoidable. The Service's proposal to create a separate rate tier for the 3-digit mailers has an opposite impact on two groups of 3-digit mail. The first group is no longer combined with higher-cost basic pieces and is therefore receiving recognition for its lower costs. The second group is no longer combined with lower-cost 5-digit mailers and its rates are no longer held down by the low costs of the 5-digit mailers. Those formerly in the basic tier should expect to receive a relative rate reduction, and those formerly in the 3/5-digit tier should expect to receive a relative rate

increase. Similarly, basic presort mail, no longer combined with some 3-digit mail, should expect to see a relative rate increase.

[5823] Another consideration, not discussed in detail by the Service, involves the proportion of mailers affected by the various rates and the size of the likely effect. For example, consider the mailers who will pay the recommended basic presort rates, as defined in the Service's proposal. According to analysis provided by the Service, only 5.0 percent of the volume will be paying the basic presort rates; however, it seems highly likely that most mailers sending pieces at the basic piece rate would also have pieces qualifying for the 3-digit rate, and perhaps some for the 5-digit rate. These latter two rates are not increasing as much as the basic rate, in percentage terms. Therefore, the actual rate situation faced by mailers cannot be assessed by looking only at specific rate cells. Furthermore, looking at the percentage increase for a rate cell like basic presort, whose definition and composition has changed, is not an apples-to-apples comparison.

[5824] For the 3-digit presort rate, the Commission recommends a passthrough of 60 percent, yielding a discount of 4.1 cents. This compares with a proposed discount of 4.6 cents. The primary reason for this reduced passthrough is to temper the increase for basic presort mail, clearly the mail most directly affected by the structural change proposed. For both the 5-digit and the carrier route discounts, the Commission recommends a passthrough of 85 percent. The respective discounts are 5.6 cents and 7.5 cents, compared to proposed discounts of 0.3 cents and 8.6 cents.[117] The passthrough of 85 percent is only slightly below the 100 percent underlying current rates and preserves fairness in worksharing discounts. The current discount for carrier route mail, relative to 3/5-digit presort, is 8.3 cents. Since the composition of the tier above carrier route is being changed to 5-digit, a reduction in the carrier route discount is to be expected.

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[117] The proposed discount of 0.3 cents is based on a passthrough of 7.5 percent of proposed costs and is unexplained on the record. The discount of 8.6 percent is based on a passthrough of 130 percent, which would seem to require some special justification. None was provided.

[5825] *High Density and Saturation Discounts.* Relative to carrier route mail, the savings for high density and saturation mail are 3.77 cents and 4.10 cents, respectively. Based on passthroughs of 34 percent and 65 percent and its costing, the Service proposes discounts of 1.2 cents and 2.6 cents respectively for these categories. Based on passthroughs of 50 percent and 90 percent, the Commission recommends discounts of 1.9 cents and 3.7 cents, respectively, substantial increases over the current discounts of 0.8 cents and 2.4 cents. The volume levels involved are about one-quarter of one percent each. The recommendation of a 50 percent passthrough for high density mail is based in part on the fact that the savings for high density mail has risen considerably since the last case and is now almost as high as that for saturation. It would seem this situation should be explained before receiving full recognition in rates. No explanation was provided.

[5826] *Barcoded Letter Discounts.* As explained earlier, the cost basis for the Service's proposed discounts for letter-sized pieces that are barcoded includes a letter/flat differential, as well as a barcode savings. For basic pieces, the savings is 24.9 cents. This goes down to 13.9 cents for 5-digit pieces. These savings seem large by any measure. Their size has not been addressed on the record. The Commission recommends a passthrough of 25 percent. At the basic, 3-digit, and 5-digit levels, the discounts are 6.2 cents, 4.7 cents, and 3.5 cents, respectively. These are larger than the current discounts, to the extent to which comparable ones exist, but are smaller than those proposed. They reflect the assumption that the value of barcoding declines somewhat as the presort level increases. In the future, specific attention needs to be given to the size of these savings and to the fairness of giving letter-size recognition to barcoded letters but not to other letters.

[5827] *Barcoded Flat Discounts.* Based on its costs, the Service has proposed discounts of 4.2 cents, 2.9 cents, and 2.8 cents, respectively. No explanation is given for why the value of a barcode on 5-digit mail should be about the same as the value on 3-digit mail. The current discounts are 3.1 cents at the basic level and 2.9 cents at the 3/5-digit level. For these categories, respectively, the Commission recommends

passthroughs of 70 percent, 90 percent, and 100 percent. The resulting discounts are 4.6 cents, 3.9 cents, and 2.9 cents. These are higher than the current discounts and, except at the 3-digit level, close to those proposed. They decline with increasing presort levels and recognize mailer worksharing in a manner that is fair.

[5828] *Per-Piece Discounts for SCF and DDU Entry.* The savings for the per-piece discounts for SCF and DDU mail are based on 50 percent of the non-transportation savings in USPS-LR-H-111, after correction,[118] consistent with Commission costing. The savings are 0.69 cents for SCF and 1.33 cents for DDU. The Commission recommends a passthrough of 100 percent on each, yielding discounts of 0.7 cents and 1.3 cents, respectively. These are lower than the current discounts of 1.1 cents and 2.1 cents. The Service proposed higher discounts, but these were based on the uncorrected version of Library Reference H-111.

[5829] *Pound Rates.* Revenue not obtained from the piece rates — approximately 40 percent of total revenue — is obtained from the pound rates. As proposed by witness Taufique and as recommended by the Commission in the past, distance-related transportation costs are distributed to the zones (excluding mail entered in the destination SCF) on the basis of pound-miles, which is a proxy for cubic-foot-miles.[119] The non-distance-related transportation costs are distributed on pounds, including destination SCF volume. Mail entered in the destination delivery unit receives no cost segment 14 transportation costs.[120] These distributions are made on transportation costs with a contingency applied but without a markup. Witness Taufique indicates that he is proposing a change in this procedure, but his workpapers show consistency with

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[118] In response to Question 1, P.O. Information Request No. 6, Tr. 14/7570-72, the Service reduced the savings for Periodicals in USPS-LR-H-111 by about 60 percent.

[119] Witness Taufique omitted Science of Agriculture pounds in his distribution of distance-related costs and did not acknowledge the revenue from these pounds in his intermediate pound-rate calculations. The Commission has corrected these errors. Tr. 10/4930, 4932.

[120] Vehicle Service Driver costs, cost segment 8, do not receive attention at this time. They are, however, not incurred by mail entered in the destination delivery unit and an analysis of them could be considered. This possibility of such consideration is not discussed on the record.

the existing procedure. *Compare* USPS-T-34 at 13-14 *and* Taufique Workpaper RR-G, pp. 1-3.

[5830] In addition to the transportation costs saved for destination SCF and DDU entry, certain non-transportation costs are avoided. Currently, these costs (estimated in USPS-LR-111) are recognized in equal parts on a pound basis and a piece basis. Witness Taufique proposes that these costs be recognized only on a piece basis and then selects a passthrough of 48 percent and 50 percent, respectively.[121] As explained above, however, the costs in USPS-LR-111 were substantially in error. Tr. 13/7130-31. Substitution of corrected figures, which have been further modified to align with Commission costing decisions, presents a significantly different situation from that faced by the Service when it filed its Request. Given the revised costs, the Commission recommends retaining the procedure of recognizing these costs in equal parts on a per-pound basis and a per-piece basis.

[5831] The per-pound cost avoidance is 1.48 cents SCF for entry pieces and 2.86 cents for DDU entry pieces. Both of these savings are relative to zones 1 and 2 mail. The Commission recommends full passthrough of the SCF savings, for a non-transportation reduction of 1.5 cents per pound. Combining this with the transportation savings yields a rate reduction of 3.7 cents per pound, which is larger than the proposed reduction of 2.3 cents. This will help provide equitable recognition for mailer worksharing efforts. For DDU mail, the Commission recommends a passthrough of 70 percent, which yields a non-transportation savings of 2 cents per pound. Combining this with the transportation savings yields a pound rate reduction of 6 cents per pound, which is also larger than the proposed difference of 4.5 cents per pound. Only a small portion of the volume (0.7 percent) is entered at this point.

[5832] The pound rates in this case are affected by two important factors. The first is that the transportation costs have increased substantially more than the average costs

[121] The Commission notes that in Docket No. R90-1, the Service proposed recognizing these costs only on a per-pound basis. In response to P.O. Information Request No. 3, Question 9, the Service indicates that its basic position on how to recognize these costs has not changed.

for the subclass. This tends to cause a large proportionate increase in all pound rates. The second is that the reduced cost coverage provides a revenue target for Regular that is increased from the last case by less than the increase in the costs of Regular and by much less than the increase in transportation costs. This tends to cause all pound rates to be held down by an absolute amount. These two factors explain why the resulting advertising pound rates are 0.5 percent higher in zones 1 and 2, and 14.6 percent higher in zone 8. At the same time, the pound rates for destination SCF mail are reduced 6.3 percent, and those for destination delivery unit mail are reduced 8.3 percent. In reviewing these percentages, the Commission has noted that only 3.5 percent of Regular volume goes to zone 8 and only 0.7 percent of the volume is entered in the destination delivery unit. Most mailers enter mail distributed among many zones, so their resulting total postage bill is a combination of percentage changes that vary widely. Also, the zoned pound rates apply only to advertising; editorial pounds in zone 8 publications pay the editorial pound rate, which is not being changed.

[5833] *Recommended Rates.* The Regular rates recommended are shown in the following table.

Table 5-19
Regular Rates

Advertising Pound Rates, cents per pound	
Destination Delivery Office	15.5
Destination SCF Entry	17.8
Zones 1 and 2	21.5
Zone 3	22.9
Zone 4	26.3
Zone 5	31.6
Zone 6	37.1
Zone 7	43.8
Zone 8	49.5
Editorial Pound Rate, cents per pound	16.1
Piece Rates, cents per piece	
Basic Presort	29.4
Barcoded Letter Discount	6.2
Barcoded Flat Discount	4.6
3-Digit Presort	25.3
Barcoded Letter Discount	4.7
Barcoded Flat Discount	3.9
5-Digit Presort	19.7
Barcoded Letter Discount	3.5
Barcoded Flat Discount	2.9
Carrier Route Presort	12.2
High Density Discount	1.9
Saturation Discount	3.7
Per-Piece Editorial Discount	5.9
Per Piece Destination SCF Entry Discount	0.7
Per Piece Destination Delivery Office Discount	1.3

b. Nonprofit Subclass

[5834] Witness Kaneer develops the proposed rates for Nonprofit Periodicals. He designs them to achieve a rate increase of 3.5 percent. *See generally* USPS-T-35. The rate structure for Nonprofit is the same as for Regular, and the Service also proposes

four presort tiers. The automation discounts for letters recognize the shape of the piece as well as the presence of a barcode.

[5835] *Pound Rates.* Witness Kaneer develops the pound rate for editorial matter in Nonprofit in accordance with the same approach used for Regular Periodicals. In Nonprofit, however, only 88.5 percent of the rate is recognized to mitigate the impact on mailers. Id. at 6. The advertising pound rates in Nonprofit are those of Regular, as required by RFRA. Under the Service's proposal, no development of zone structures or pound-rated dropship discounts is required for Nonprofit.

[5836] *Piece Rates.* The piece rate development of the Nonprofit subclass mirrors that of Regular. Witness Kaneer attempts to obtain 70 percent of the revenue requirement from the piece rates. This proportion was 71.8 percent in Docket No. R94-1 and 76 percent in Docket No. R90-1. Witness Kaneer does not discuss the reason for the proportion he selected.

[5837] The per-piece discounts proposed in Nonprofit are similar to those in Regular, but the proportions are different. As explained by Witness Kaneer, most of the passthroughs are at or near 100 percent, with a few exceptions to moderate the impact of changes. Ibid.

[5838] *Commission Analysis.* Rate design for Nonprofit is essentially the same as for Regular. The target coverage is based on a markup one-half the size of the markup for Regular, as specified by RFRA. For step 5 rates, which will apply until October 1, 1998, a markup of 5/12 the markup for Regular is used. Otherwise, the rate design for step 5 is the same as the rate design for full rates. The discounts are the same at step 5 as at full rates. Also, since RFRA specifies that Nonprofit pay the Regular advertising pound rates, the advertising pound rates are the same at step 5 as at full rates. In the Commission's workpapers, the step 5 rates are developed simultaneously with full rates and are used in the volume forecast.

[5839] One feature that exists for Nonprofit but not for Regular is the presence of "commingled" volume. This is volume sent with Nonprofit mail but not eligible for Nonprofit rates. Commingled volume pays Regular rates. Allowance is made in the

workpapers for the differences between the revenue actually paid by commingled volume and the revenue that would be obtained if Nonprofit rates applied.

[5840] *Piece Rates.* Seventy percent of the revenue is obtained from the piece rates. Using a per-piece editorial benefit of 4.4 cents, the rates are developed in the same way as Regular rates. As in Regular, 60 percent of the 3-digit savings are passed through into rates. At both the 5-digit and the carrier route level, the passthrough is 95 percent. Considering the cost savings and the resulting rates, these passthroughs are reasonable. The carrier route discount of 7 cents is equal to that proposed by the Service and is somewhat higher than the current discount of 6.7 cents.

[5841] *High Density and Saturation Discounts.* Discounts from the carrier route rate are given for mail that qualifies as high density or saturation. At 69 percent and 102 percent, respectively, the passthroughs recommended are about 10 percentage points higher than those in Regular, which allows the two discounts to be the same as those in Regular. Specifically, the discounts are 1.9 cents and 3.7 cents, which are quite close to the proposed discounts of 2.0 cents and 3.3 cents.

[5842] *Barcoded Letter Discounts.* The passthroughs recommended for the three barcoded letter discounts are 37 percent, 45 percent, and 39 percent, at the basic, 3-digit, and 5-digit levels, respectively. These are somewhat higher than those in Regular, but they allow the per-piece discounts to be the same as those in Regular. This allows a simpler rate structure. Also, the resulting discount for 5-digit letters, at 3.5 cents, is only three-tenths of a cent higher than the Service proposed. At the 3-digit and basic levels, the discounts are larger at 4.7 cents and 6.2 cents. The corresponding discounts proposed were widely disparate at 2.9 cents and 7.9 cents. Other than general effects on mailers, the Postal Service provides no justification for these passthroughs or for the rates proposed.

[5843] *Barcoded Flat Discounts.* At the basic, 3-digit, and 5-digit levels, respectively, the passthroughs recommended are 90 percent, 100 percent, and 100 percent. These are somewhat higher than those in Regular and support worksharing

and the Service's automation program. The resulting discounts are the same as Regular at the basic level and somewhat lower at the 3-digit and the 5-digit levels.

[5844] *Per-Piece Discounts for SCF and DDU Entry.* As in Regular, the passthroughs for these discounts are recommended to be 100 percent. The resulting discounts are 0.4 cents for destination SCF mail and 0.7 cents for destination delivery unit mail. These discounts are smaller than those in Regular, due primarily to the lower average weight per piece of Nonprofit.

[5845] *Pound Rates.* With the exception of the recognition of commingled volume in Nonprofit and the fact that Science of Agriculture does not exist in Nonprofit, the development of the pound rates in Nonprofit, including the development of the editorial pound rate, is the same as that in Regular. After the process is completed, the Regular advertising pound rates are applied, as specified by RFRA.

[5846] *Recommended Rates.* The full Nonprofit rates recommended, along with the step 5 rates, are shown in the following table.

Table 5-20
Nonprofit Rates

	Full	Step 5
Advertising Pound Rates, cents per pound		
Destination Delivery Office	15.5	15.5
Destination SCF Entry	17.8	17.8
Zones 1 and 2	21.5	21.5
Zone 3	22.9	22.9
Zone 4	26.3	26.3
Zone 5	31.6	31.6
Zone 6	37.1	37.1
Zone 7	43.8	43.8
Zone 8	49.5	49.5
Editorial Pound Rate, cents per pound	15.6	15.6
Piece Rates, cents per piece		
Basic Presort	25.1	25.1
Barcoded Letter Discount	6.2	6.2
Barcoded Flat Discount	4.6	4.6
3-Digit Presort	20.8	20.8
Barcoded Letter Discount	4.7	4.7
Barcoded Flat Discount	2.4	2.4
5-Digit Presort	18.3	18.3
Barcoded Letter Discount	3.5	3.5
Barcoded Flat Discount	2.1	2.1
Carrier Route Presort	11.3	11.3
High Density Discount	1.9	1.9
Saturation Discount	3.7	3.7
Per-Piece Editorial Discount	4.4	4.4
Per Piece Destination SCF Entry Discount	0.4	0.4
Per Piece Destination Delivery Office Discount	0.7	0.7

c. Within County Subclass

[5847] The Within County subclass consists of preferred rate Periodicals class mail mailed, and addressed for delivery, within the county where published and originally

entered, from either the office of original entry or additional entry. A Within County publication also must meet one of the following conditions: either the total paid circulation of the issue must be less than 10,000 copies, or the number of paid copies of the issue distributed within the county of publication must be at least one more than one-half of the total paid circulation of the issue. DMCS § 423.21.

[5848] As with the other Periodicals subclasses, the Service proposes separate recognition for 3- and 5-digit pieces. Given the existing two-tier presort structure for Within County, this results in an expansion to four categories. *See* USPS-LR-H-130.

[5849] Witness Taufique proposes to obtain 40 percent of the revenue of Within County mail from the pound rates. This subclass has only two pound rate elements: destination delivery unit (DDU) and "all other." The difference between these two elements is based on a 33 percent passthrough of the corresponding non-transportation cost difference for Nonprofit which, as explained above, was changed in response to P.O. Information Request No. 6. Witness Taufique explains that the reason for the low passthrough is to "mitigate … rate shock" because the "all other" category in Within County is different from the corresponding category in Nonprofit. USPS-T-34 at 21. The proposed per-piece discount structure for Within County is similar to that in Regular Periodicals, except that there is no SCF discount in the Within County subclass. The cost basis for the discounts are those of the Nonprofit subclass, and passthroughs range from 18 percent to 35 percent. Witness Taufique explains that these passthroughs were selected based on "rate impact mitigation" and the fact that the meaning of the rate categories is different in Within County than in Nonprofit.[122] USPS-T-34 at 21.

[5850] *Commission Analysis.* The first issue that must be addressed is NNA witness Heath's serious concerns about the quality of Within County data. Based on personal knowledge and an informal study he has conducted, Witness Heath argues that the potential volume of within-county mail has been growing, but the Service's volume

[122] For example, the preparation of 3-digit presort packages in Nonprofit requires selection and presortation, while mail for a specific county would often be only for one (or a small number of) 3-digit area(s).

figures have been declining. His conclusion is “either that weekly newspaper publishers cannot risk their franchise on spotty delivery [and have therefore switched to private delivery], or that the mail volume data are simply wrong.” Tr.27/14750. Since he views private delivery as a difficult alternative, he believes data problems are more likely. Further, he contends that if the data are wrong, rates may be too high.

[5851] Witness Heath discusses NNA’s efforts to work with the Service on this problem. His preference is for the Service to release Within-County data for small towns so that NNA can compare it with the mailing volumes of its members. The Postal Service will not release such data. In response to what he views as a difficult situation and serious data-quality questions, witness Heath suggests that the Commission either “freeze” rates until better data are available or order the Postal Service to update its methodology before the next omnibus case. Id. at 14757.

[5852] The questions raised on the record concerning the volume for Within County are not new. In Docket No. R94-1, the Postal Service made a major adjustment to Within County costs after its case had been filed. Subsequently, motion practice related to volume issues culminated in NNA’s withdrawal of a motion based on an apparent understanding that NNA and the Service would work jointly on the volume question after that case. There is no indication that this occurred.

[5853] The arguments of witness Heath, even though without a strong statistical base, suggest the need for attention. In view of the downward volume trend in recent years and the fact that data now available for FY 1997 show volume has increased, the Commission finds it appropriate to use an average of the volumes for FY 1994 through FY 1997. From this base, the growth rates used in projecting the test year are the same as those proposed by witness Tolley. This increases the volumes for Within County and lowers unit costs. As a means of achieving more permanent relief, however, mutual cooperation between NNA and the Service is essential. The Commission appreciates that concerns about confidentiality may pose difficulties in providing the data NNA requests. To the extent required, the Commission offers to assist in developing a means of assuring confidentiality.

[5854] In selecting discounts for Within County, which generally involve low passthroughs, witness Taufique refers to the nature of the cost study used and to the fact that costs from Nonprofit are used. Id. at 20-21. By this he apparently means that the entry, handling, and preparation characteristics of Within County are clearly different from those of Nonprofit, so that the Nonprofit cost study is not really applicable. One evidence of this is that the Service does not propose a destination SCF discount for Within County, but does for Nonprofit. This is apparently because nearly all of Within County mail is entered in the destination SCF, but little of it is within zones 1 and 2 and not in the destination SCF. Because of this, a discount for SCF relative to zones 1 and 2 does not make operational sense.

[5855] The Commission agrees that the entry and handling of Within County are likely different from Nonprofit. This points to the need for a study of Within County. For the piece rates in particular, this need is now more acute than in the past. Specifically, there were only two presort tiers in the past and now there are four. The Commission notes that in the past the carrier route discount relative to basic presort for Within County has been based on the carrier route costs relative to 3/5-digit costs in Nonprofit. Given the proposed presort structure, which the Commission is accepting, this kind of accommodation can no longer be made. It is now necessary to support a 3-digit discount, a 5-digit discount, and a carrier route discount, each separately. A study of the costs associated with the new structure is needed.

[5856] *Piece Rates.* The Service proposes 3-digit, 5-digit, and carrier route discounts of 1.0 cents, 0.3 cents, and 3.2 cents, respectively. The current carrier route discount, relative to basic, is 3.8 cents. The Commission recommends passthroughs of 10 percent, 30 percent, and 50 percent, respectively. These lead to discounts, in order, of 0.7 cents, 0.8 cents, and 3.7 cents. These provide reasonable signals to mailers.

[5857] At these rates, carrier route presort mailers will experience a piece-rate reduction of 0.1 cents per piece. These mailers account for about 68 percent of the overall Within County volume. The 5-digit mailers receive a piece rate decrease of 2.4 percent, and the 3-digit mailers an increase of 7.3 percent. The final category, basic

presort, receives an increase of 15.9 percent. This is larger than might be desired; however, it applies only to a small volume of residual pieces that are undoubtedly combined with pieces that qualify for either the 3-digit rate or the 5-digit rate, or both.

[5858] For the high density and saturation discounts, relative to carrier route, the Service proposes passthroughs of 25 percent, to yield proposed discounts of 0.5 cents and 0.7 cents, respectively. These discounts are the same as those currently in effect. Based on the Commission's costs, the Commission recommends passthroughs of 50 percent, yielding discounts of 1.4 cents and 1.8 cents, respectively.

[5859] As noted above, a per-piece SCF discount is not proposed for Within County. A per-piece DDU discount, however, is proposed. The Service bases this discount on the Nonprofit cost for DDU mail relative to zones 1 and 2 mail and proposes a passthrough of 30 percent. This yields a discount of 0.4 cents. Since nearly all Within County mail is naturally entered in the destination SCF, the appropriate cost base would be the Nonprofit savings for DDU mail relative to SCF mail, not relative to zones 1 and 2 mail. Accordingly, the Commission recommends using this altered base which, based on Commission costing, is 0.37 cents. The Commission recommends a passthrough of 100 percent of this cost, for a discount of 0.4 cents, which is equal to the Service's proposal.

[5860] For the three per-piece barcoded letter discounts, basic, 3-digit, and 5-digit, the Service proposes discounts, respectively, of 2.7 cents, 1.9 cents, and 1.8 cents. No explanation is provided for why the benefit of having a barcode on a 3-digit letter in Within County, for example, should be substantially less than the benefit for the same letter in Nonprofit. Based on revised costing, the Commission recommends passthroughs of 37 percent, 45 percent, and 39 percent, respectively. The resulting discounts are the same in magnitude as the corresponding ones in Nonprofit and Regular.

[5861] For barcoded flats, the Service proposes passthroughs of 82 percent, 184 percent, and 172 percent, in the same order as above. No real attention is given to the rationale for levels as high as the latter two. These yield proposed discounts of 3.7 cents, 2.6 cents, and 2.8 cents, in order. No explanation is given of why the benefit of a

barcode on a 5-digit piece should be greater than the benefit of a barcode on a 3-digit piece. It seems apparent that the 3-digit piece would receive more automated sorts, on average, than the 5-digit piece. Based on revised costing, the Commission recommends passthroughs of 90 percent, 100 percent, and 100 percent, respectively. These yield discounts equal to those in Nonprofit. They also support the Service's automation program and provide fair incentives to mailers.

[5862] *Pound Rates.* Only two pound rates exist in Within County, one for general mail and the other for mail entered in the destination delivery unit. Given the objective of obtaining 40 percent of the revenue from the pound rates, the two pound rates can be easily determined. The Service proposes to base this rate difference on passing through 30 percent of a non-transportation cost difference from Nonprofit, which gives a discount of 1.4 cents per pound for DDU entry.

[5863] There are two concerns here. First, the Service does not recognize any transportation cost differences, even though they are clearly part of the rate development in Regular. Second, the non-transportation cost used is for DDU entry relative to zones 1 and 2 entry, even though it is clear that nearly all Within County mail would be entered in a destination SCF. Accordingly, the Commission bases the non-transportation portion of the discount on the difference between the SCF and the DDU savings for Nonprofit. Also, the Commission recognizes the transportation savings. The appropriate non-transportation savings is 1.28 cents per pound, and the transportation savings is 2.43 cents per pound. The Commission passes through 70 percent of these savings, for a per-pound discount of 2.6 cents per pound. This is larger than the proposed discount of 1.4 cents and gives reasonable recognition to mailer worksharing activity.

[5864] *Recommended rates.* The following table shows the full rates recommended and the step 5 rates.

Table 5-21
Within County Rates

	Full	Step 5
Pound Rates, cents per pound		
Destination Delivery Unit Entry	10.7	10.7
General Entry	13.3	13.3
Piece Rates, cents per piece		
Basic Presort	9.5	9.5
Barcoded Letter Discount	6.2	6.2
Barcoded Flat Discount	4.6	4.6
3-Digit Presort	8.8	8.8
Barcoded Letter Discount	4.7	4.7
Barcoded Flat Discount	2.4	2.4
5-Digit Presort	8.0	8.0
Barcoded Letter Discount	3.5	3.5
Barcoded Flat Discount	2.1	2.1
Carrier Route Presort	4.3	4.3
High Density Discount	1.4	1.4
Saturation Discount	1.8	1.8
Per Piece Destination Delivery Office Discount	0.4	0.4

d. Classroom Subclass

[5865] Witness Kaneer notes that Classroom presents special problems, because the FY 1996 costs for Classroom are 21 percent greater than the corresponding costs for FY 1995. USPS-T-35 at 8. Therefore, developing Classroom rates based on Classroom costs would yield a large rate increase.

[5866] Witness Kaneer believes that “random variation” in the cost estimates may be the cause of this large increase. He also indicates that, given time, it might be possible to build a model of Classroom costs and that such a model could be used to assess existing cost estimates and, perhaps, serve as a basis for improved ones. Under these circumstances, witness Kaneer “believe[s] it most appropriate to examine

whatever information that cost models can provide …" before using the current cost information for ratesetting. Id. at 13.

[5867] Until such time as cost models can be investigated, the Postal Service proposes to apply Nonprofit rates to Classroom mail. This represents a continuation of the approach used by the Commission in Docket No. MC96-2. As a test of the reasonableness of these rates and their conformance with RFRA, witness Kaneer compares the resulting Classroom revenue to several constructed cost measures. The measures are cost averages for recent years, including and not including Base Year 1996. These costs are much closer to the Classroom revenues than are the base year Classroom costs. The resulting rate increase for Classroom Periodicals is 7.2 percent.

[5868] *Commission Analysis.* The Commission agrees that the costs available are weak and that some special arrangement is in order at this time. The Commission supports the Service's plan to inquire further into Classroom costs, perhaps with special cost models. Id. at 11-14. Applying Classroom volumes to Nonprofit rates shows a rate increase for Classroom publications of 12.1 percent (step 5 to step 5) and 9.5 percent (full to full).

e. Science of Agriculture

[5869] Science of Agriculture publications receive a reduced rate on the advertising portion of pieces qualifying for zones 1 and 2, destination SCF, or delivery unit rates. For these pieces Science of Agriculture mail only pays 75 percent of the corresponding Regular rates. Otherwise these publications pay Regular rates. No parties have addressed these rates, and the Commission recommends these rates at the level required, rounded to the nearest tenth of a cent.

7. NNA's Classification Proposals and Data Concerns

a. Destination Delivery Unit (DDU) Discounts

[5870] NNA witnesses Heath and Speights assert that under exceptional dispatch arrangements, they carry their mail to an acceptance office and then to a delivery office, but do not receive a destination delivery Unit (DDU) discount. Witness Speights says:

> I am paying the Postal Service the same rate for my newspapers delivered to New Hebron as I am for newspapers delivered to Hattiesburg, but to reach New Hebron I am buying gas, depreciating my car and spending my own time. Those contributions are significant to me and to my business. They should be recognized by the Postal Service.

Tr. 27/14898.

[5871] In addition, witness Speights indicates that establishing additional entry points, which would allow eligibility for the DDU discount under existing regulations, is not workable, because the additional-entry office is not open when the newspapers must be dropped off and because the personnel there are not familiar with postal mailing forms. Id. at 14944. Witness Speights therefore requests "that the Postal Rate Commission consider recommending a discount for these short-haul newspapers that are entered through exceptional dispatch." Id. at 14898.

[5872] Witness Heath provides further discussion of the DDU discount, relative to exceptional dispatch. He says that the need for such entry is even greater since reclassification, because service has deteriorated. He believes the volumes involved in such an arrangement would be small and that, because the mailing patterns of affected mailers are stable, periodic audits would be sufficient to assure appropriate postage payment. Id. at 14757-60.

[5873] In its brief, NNA argues that the record shows that exceptional dispatch is not a convenience to publishers, but a necessity caused by the Service's persistent inability to meet service standards. It also claims there is an absence of evidence that

exceptional dispatch creates any costs, and that there is no data to support the Service's revenue protection concerns. Finally, NNA claims the Service is introducing an opportunity for national mailers to have the verification flexibility its members have long sought on a local level, in the form of plans for a "dynamic entry process." NNA Brief at 27-28.

[5874] *The Service's Position.* The Service contends that exceptional dispatch is primarily a convenience to customers and not as advantageous as plant-verified drop shipping (PVDS) and additional entry. Therefore, the Service argues that exceptional dispatch does not merit DDU discounts. It notes, among other things, that this mail tends to be entered in the middle of the night, and thus does not undergo normal verification processes. Postal Service Reply Brief at V-119. It also says it tries to meet customer service needs in a manner that avoids the need for exceptional dispatch. Id. Moreover, the Service contends that there are alternatives, short of a classification change, that can address the needs of affected customers. Id. at V-122.

[5875] *Commission Analysis.* In Docket No. MC95-1, the Commission considered an essentially identical request from NNA. Based on a finding that exceptional dispatch and DDU deposits were not on an identical footing in terms of certain operational concerns, such as verification, the Commission did not recommend NNA's proposed change. However, among other things, it urged the Service to determine whether it could provide administrative relief or otherwise assist affected publishers in assessing the feasibility of the longstanding "additional entry" option. PRC Op. MC95-1, paras. 5319-21.

[5876] The Commission appreciates the concerns that publishers who routinely use exceptional dispatch arrangements have raised regarding the seeming inequity of ineligibility for DDU rates and the apparent lack of informed support from postal personnel at the local level. Witness Heath notes, for example, that postmasters do not seem to understand the rules for plant verified drop shipments (PVDS), and thus are not in a position to suggest them to publishers. Tr. 27/14860. Witness Speights also indicates that little information about the PVDS option is available locally. Id. at 14945.

[5877] Given two developments, the Commission believes that eligibility for the lower rates these publishers seek may be available without the need for a formal classification change. One development entails the Service' proposal to reduce the fee for additional entry authorization from $85 to $50, based on the lower costs associated with revised procedures. The Commission is recommending the fee reduction the Service has proposed. This should improve the economics of additional entry authorization for some publishers who have viewed the current fee as too high, especially when relatively low volume is involved. Postal Service Reply Brief at V-120.

[5878] The other development, addressed in detail on brief by the Postal Service, clarifies how a publisher can use PVDS procedures to obtain the DDU discount. The Service represents: "Under DMM § P750.2.0, a mailer does not need to have a detached mail unit (DMU) at their plant to qualify for PVDS. A postmaster may allow PVDS mail to be verified at the origin business mail entry unit (BMEU) when there is no DMU at the mailer's location." Ibid.

[5879] Responding to witness Speights's testimony that she does not have a commercial printing plant, has no experience with plant-verified dropshipping, and has not received any suggestions from her postmaster on this option, the Service offers the following interpretation of applicable regulations:

> Witness Speights' publication would not need a commercial plant or a detached mail unit (DMU) to use PVDS. If all the other requirements are met, which would not appear to be a problem, the origin verification can take place on Wednesdays at 2:00 p.m. when she presents her mail at the Prentiss Post Office. After the postal verification is performed, she would simply transport the PVDS pieces with Form(s) 8125 to each post office at which she wishes to obtain DDU rates. It appears that witness Speights makes this weekly trip, but is not receiving the DDU rate, because she is using exceptional dispatch. With PVDS the only additional work would be filling out Form 8125 for each destination entry post office and verification of 41 mail pieces at the Prentiss Post Office. All other mailers that find

> themselves in a similar situation could also use PVDS to obtain these work sharing discounts.

Id. at V-120-V-121 (citations omitted.)

[5880] The Service acknowledges that employees at some smaller offices may not be familiar with this mailing option, or may assume that it is only available for large publishing plants. The Service says it is considering an informational campaign through the Mailer's Companion and the Postal Bulletin to make both mailers and its own employees aware of the PVDS option as an alternative to exceptional dispatch. Id. at V-121-V-122.

[5881] The Commission finds it troubling that the PVDS option, available since 1991 according to the Service's brief, apparently is still not widely familiar to postal personnel who have day-to-day responsibility for dealing with publishers' inquiries. However, in light of the Service's representation that the DDU rate is available to NNA mailers under current regulations, and its indication that it may develop an educational campaign on this topic, the Commission does not recommend NNA's proposed classification change. The Commission urges the Service to follow through on educational efforts. Should widespread problems persist, interested publishers could refer to the quoted portions of the Postal Service's brief and this discussion in a § 3662 complaint proceeding. This provision allows mailers who believe the Service is charging rates which do not conform to the policies set out in the Postal Reorganization Act, or believe they are not receiving service in accordance with the policies of the Act, to obtain relief from the Commission.

b. Alternative Means of Satisfying Requirements for the High Density Discount

[5882] Under current regulations, Periodicals mailers with properly-prepared mail addressed to at least 125 deliveries on a carrier route are eligible for the high density discount. This discount is less than the saturation discount, which requires going to 75

percent of the stops on a route, or to 90 percent of the residential stops. Witness Heath contends that the high density requirements are illogical when applied to rural routes that often have a small number of deliveries. As an example, for a rural route with only 130 possible deliveries, the requirements for the high density discount are more demanding than those for the saturation discount. He believes that defining high density as 25 percent of the potential deliveries on a route would solve this problem and that savings would still exist for the Postal Service. Tr. 27/14761-65. He recommends the DMCS language proposed by NNA in Docket No. MC95-1.

[5883] *Commission Analysis.* The Commission agrees that the structure calling for 125 pieces is awkward in application to some of the routes carrying Within County mail. This was discussed in Docket No. MC95-1, wherein the Commission suggested that there might be a way for the Service to work with affected mailers and develop an administrative solution to the apparent anomaly. PRC Op. MC95-1, paras. 5306-07. It does not appear that this has been done.

[5884] Currently, approximately 5.2 percent of Within County volume qualifies for the high density discount. The savings, relative to carrier route presort for this mail are 2.79 cents per piece. The Commission is recommending that only 50 percent of this savings be recognized in rates. Therefore, the discount is 1.4 cents per piece. At this savings level, the revenue loss associated with the discount is $700,000, which is less than 1 percent of Within County revenue.

[5885] Pieces qualifying for the high density rates must be prepared in walk sequence order. DMM E320.6.0. The savings of 2.79 cents developed from the Service's mail processing models is designed to represent the benefit to the Service when carrier route bundles containing at least 125 pieces are placed by the mailer in walk sequence order. Basing the requirement for the discount on 25 percent of the possible deliveries on a route would allow some additional volume to qualify on those routes that have a relatively small number of possible deliveries. This additional volume is unlikely to be large. If some volume were to shift to high density, the savings might not

be as large 2.79 cents but would almost assuredly be larger than the discount of 1.4 cents, which is based on a 50 percent passthrough.

[5886] Under these conditions, the Commission recommends allowing the high density discount for Within County mail going to at least 125 deliveries or 25 percent of the possible deliveries on a route, whichever is smaller. The positive net revenue effect is likely to be small, and is not reflected in the expected coverage of Within County. The Commission believes the Service should consider whether to extend this option to other subclasses of mail.

F. Special Services

[5887] *Introduction.* The Postal Service proposes several classification changes and seeks increased fees for most services. The most significant proposed classification change is the request for a new service, delivery confirmation. This service would enable the Postal Service to match competitors that deliver parcels and expedited items. The fees for this service reflect a controversial treatment of the costs for delivery confirmation equipment. The Postal Service proposes other classification changes for registered mail (elimination of no-insurance option), stamped envelopes (creation of more categories to better reflect costs), the creation of bulk insurance service, and the option of using return receipt in conjunction with delivery confirmation.

[5888] The Postal Service submits price proposals for special services that range from small price decreases to dramatic price increases. Requested increases on average exceed those proposed for the various classes of mail. The most controversial pricing proposal is for special handling. For this low volume service, the Postal Service seeks price hikes of more than 200 percent. The Postal Service also would like to initiate a fee for stamped cards; currently it only charges customers the price of postage.

[5889] Lastly, the Postal Service proposes to reorganize the special services portion of the DMCS so that it conforms to the structure of the DMCS for classes of mail. The Postal Service groups the special services into 7 categories: addressing, delivery alternatives, payment alternatives, accountability and receipts, parcel handling, stamped paper (cards and envelopes), and money orders. These changes are organizational and are not intended to have a substantive effect on the services.

[5890] Intervenors and the OCA raise numerous issues concerning special services. The primary issues can be summarized: 1) OCA proposes a new classification schedule for post office boxes; 2) UPS and OCA question the fairness of the cost treatment of equipment used for delivery confirmation; 3) OCA argues the Postal Service

misleads customers concerning the insurance coverage of their mail; 4) witness Douglas Carlson and the OCA oppose the fee for stamped cards; 5) witness Douglas Carlson points to service deficiencies in return receipt and post office boxes; 6) ABF, OPA and OCA argue the Service's proposed increases for special handling are not adequately supported; and 7) witness David Popkin believes the Service's continuing financial success requires the Commission to reject all requests for increases for special services. Discussion of each special service follows. The fee schedules for special services are contained in Appendix One.

1. Address Correction (Schedule 911)

[5891] This service is purchased by mailers who wish to receive a forwarding address, correct address or reason why mail is undeliverable. Both manual and automated services are available. Automated correction costs a mailer 20 cents per address and manual correction is 50 cents per address. The Postal Service does not propose to change these fees. Cost coverage is 127 percent, a level at which these services are "making reasonable contributions to other costs... ." USPS-T-39 at 8. The Postal Service believes that keeping address correction fees low "encourages customers to update their address files, thereby resulting in less forwarding and return of mail." *Ibid*. The Commission recommends the Service's proposal for these fees.

2. Schedule 912

a. ZIP Coding of Mailing Lists

[5892] The ZIP Coding of mailing lists service encourages mailers to use correct ZIP Codes by sorting mailing list address cards by ZIP Code. Mailers supply individual address cards coded for single 5-digit ZIP Code post offices. For multiple 5-digit ZIP Code post offices, the Postal Service sorts the cards to 5-digit ZIP Codes and bundles

the cards for each ZIP Code. One fee is charged per mailing list, and the Postal Service would like to increase the fee from $60 to $70, or 17 percent. *Id.* at 99. The Postal Service seeks to encourage properly Zip-coded mail, so a modest cost coverage is appropriate. *Id.* at 101. The Commission recommends the fee increase as proposed, yielding a moderate cost coverage of 118 percent.

b. Correction of Mailing Lists

[5893] For a fee, the Postal Service will correct addresses on lists of addresses provided by mailers. The corrections include crossing out names to which mail can neither be delivered nor forwarded, providing new addresses when a permanent forwarding order is on file, correcting misspelled addressee names and street names, correcting ZIP Codes and post office box or rural box numbers, and providing the name of the head of the household, if known, when two or more names with the same address appear on the list. *Id.* at 39.

[5894] The Postal Service seeks to increase this fee from 17 cents to 20 cents per address because the current fee is barely covering its cost of 16.1 cents. *Id.* at 40. Also, the Commission is recommending a fee increase in the minimum charge for this service from $5.50 to $7.00 so that mailers will still have to pay for approximately the same minimum number of addresses.

[5895] The Commission recommends the increase proposed by the Service. This increases the cost coverage to 124 percent so the service can make more of a contribution to the recovery of institutional costs.

c. Address Changes for Election Boards

[5896] For a fee, the Postal Service provides change of address information to local election boards and draft registration commissions. The Postal Service proposes to increase this fee from 17 cents to 20 cents per address because it is just covering its cost of 16.1 cents. *Id.* at 6. The Commission will not require election boards to recover

institutional costs to the same extent as private mailers; election boards serve a vital function in our democracy. The Commission recommends no increase in this fee and cost coverage will remain at 106 percent.

d. Carrier Sequencing of Address Cards

[5897] This service provides mailers with addresses on a route sorted into delivery sequence. This information enables mailers to prepare mailings to receive walk sequence discounts. *Id.* at 22. The Postal Service does not charge mailers for sequencing the cards in carrier route walk sequence, or for inserting blank cards to show a missing address or range of addresses. The Postal Service charges 17 cents for each card removed due to incorrect or undeliverable address and for each card added with a new address. The Postal Service would like to increase this fee to 20 cents. The Commission recommends the Service's proposal, which yields a cost coverage of 124 percent. USPS LR-107. This remains below the system-wide average which is appropriate for a service that leads to more efficient operations for the Postal Service.

3. Post Office Boxes, Caller Service, and Reserve Call Numbers (Schedule 921)

[5898] Post office boxes provide customers with an alternative means of receiving their mail and yield a significant amount of revenue for the Postal Service, over $680 million in 1996. The Postal Service is requesting large fee increases for most boxes in order to raise the cost coverage of boxes which it calculates as 115 percent under its proposal. Tr. 32/17053.

Table 5-22
Fees for Post Office Boxes, Caller Service and Reserve Call Numbers

Description	Current Semi-annual Fee	Postal Service Proposed Fee	Commission Recommended Fees
Group A			
Size 1	$ 24.00	$ 35.00	$ 30.00
Size 2	37.00	52.50	46.00
Size 3	64.00	92.50	80.00
Size 4	121.00	162.50	151.00
Size 5	209.00	275.00	261.00
Group B			
Size 1	22.00	30.00	27.00
Size 2	33.00	45.00	41.00
Size 3	56.00	75.00	70.00
Size 4	109.00	145.00	136.00
Size 5	186.00	217.50	217.00
Group C			
Size 1	20.00	22.50	22.00
Size 2	29.00	32.50	32.00
Size 3	52.00	57.50	57.00
Size 4	86.00	97.50	97.00
Size 5	144.00	162.50	162.00
Group D			
Size 1	6.00	9.00	7.00
Size 2	10.00	15.00	12.00
Size 3	18.00	27.50	22.00
Size 4	26.50	40.00	33.00
Size 5	41.50	62.50	52.00
Group E			
Sizes1-5			0.00
Caller Service			
Group A	250.00	275.00	275.00
Group B	240.00	275.00	275.00
Groups C & D	225.00	275.00	275.00
Reserve Call Number			
Per Number (annual)	30.00	40.00	36.00

[5899] There recently have been significant classification changes made to post office boxes. In MC96-3, the Postal Service created fee groups A, B, C, D, and E. Fee Groups A through D apply to all customers who are eligible for some form of carrier delivery.

[5900] Delivery Groups A-C designate boxes in postal facilities that have city delivery carrier routes. Group A consists of ZIP Codes in Manhattan. Group B consists of high cost areas in eight large cities, including some suburban areas. Group C consists of the remaining ZIP Codes offering city carrier delivery service. Group D designates noncity delivery facilities. PRC Op. MC96-3 at 43. Now, Group E, for which there are no fees, applies to all customers who are ineligible for carrier delivery.[123]

[5901] The Postal Service's proposed fee schedule reflects a balancing of competing goals. The recovery of costs was a primary consideration. Postal Service witness Needham indicates that size 5 boxes in Groups A and B and all boxes in Group D are still below costs. USPS-T-39 at 65. Fees were designed to come closer to covering costs, yet the increases are mitigated to avoid a dramatic impact on boxholders. *Id.* at 66. Another goal in rate design was to bring Group C and Group D box fees closer together. Hence, Group C proposed increases are less than Group D's, in which proposed increases are over 50 percent. *Ibid*. Groups A's and Group B's fees also increase substantially under the Postal Service's proposal. Witness Needham believes this will more accurately reflect their costs relative to Group C. *Ibid*.

[5902] Caller Service, an adjunct service to post office boxes, would have a single semi-annual fee of $275 under the Postal Service's proposal. This is justified, witness Needham argues, because this service's costs are mostly labor and labor costs are uniform throughout the nation. *Id* at 67. Finally, the fee for a reserve call number, another adjunct service, receives a 33 percent increase, from $30 to $40 under the Service's proposal.

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[123] Late in this proceeding, as a result of a recently completed study, Postal Service witness Kaneer testified that the Postal Service has decided to drop the quarter-mile rule. The rule had been an exception to the Postal Service's policy of providing one free form of delivery to all customers. Tr. 32/16952.

[5903] Witness Douglas Carlson argues against what he describes as the Postal Service's proposed "large increase" for most box users. Tr. 24/12808. The 8.3 million Group C boxholders are 95 percent of all boxholders, and under the Service's proposal would receive increases between 10.6 and 12.5 percent. *Ibid*. He notes that the Commission rejected a 25 percent increase in MC96-3 and that Needham admits she offers no new evidence on demand for box service. *Ibid*. He then attempts to rebut Needham's claim that boxes have "extremely high value of service." *Id*. at 12809.

[5904] He points out that witness Needham claims value in receiving mail in boxes early in the day, yet the Postal Service cannot substantiate the claim that boxholders receive mail uniformly earlier or that they consistently receive mail by the cutoff time. *Id*. at 12810. He also provides ancedotal evidence of problems with his box in Berkeley, California, including long lines to pick up mail and inconsistent delivery of mail to his box. *Id*. at 12811.

[5905] Witness Needham offers rebuttal evidence to refute witness Carlson's arguments. She points out that value of service is just one consideration in ratemaking and other factors support the fee increase, most importantly the requirement that fees recover costs. Tr. 32/17052. Because cost coverage before rates is only 99.6 percent, a greater than 5 percent increase is necessary. *Id*. at 17053. She recommends smaller increases for Group C so that these fees would move closer to Group D fees.

[5906] *OCA Proposal*. As in MC96-3, the OCA proposes to group boxes by cost ascertainment group (CAG) to better reflect post office box costs in the fee structure. CAGs classify post offices by the amount of revenue generated. Witness Callow of the OCA testifies that the Postal Service's fee groups C and D do not properly reflect cost differences between small and large post offices. Tr. 23/12282. The Postal Service assigns volume variable space costs by averaging rental costs for each fee group, but witness Callow argues that rental costs vary widely within Fee Groups C and D. *Id*. at 12287. Witness Callow further suggests that the Service's averaging of all other costs is inaccurate and again does not recognize differences between large and small post offices. For example, smaller post offices may not have mailhandlers or supervisors.

Id. at 12285. His solution separates Fee Groups C and D into three fee categories that purport to produce more "rent-homogeneous" fee groups. *Id*. at 12289.

[5907] On rebuttal, Postal Service witness Kaneer criticizes witness Callow's CAG proposal on three fundamental grounds. First, he argues that there is not a strong correlation between a post office's rental costs and its CAG. Tr. 32/16952. While the average rental cost may be higher in CAGs A-D, there are tremendous variations in individual rental costs within the CAGs. *Id.* at 16953. In fact, witness Kaneer claims the within CAG group variations are much larger than the variations between witness Callow's group averages. *Ibid*. In sum, witness Kaneer claims there is insufficent correlation between CAGs and rental costs to base a fee structure. *Id.* at 32/16957.

[5908] Second, witness Kaneer claims that witness Callow's allocation of other costs based on job title is inappropriate. He claims that witness Callow erroneously allocates costs in Segments 3 by splitting box labor into clerk and mailhandler costs. *Id.* at 16961. However, witness Kaneer claims that mailhandlers do not incur labor costs related to boxes, and consequently none of these costs should be allocated according to the CAG groups. *Ibid*.

[5909] Third, witness Kaneer contends that the Service is reviewing ways to design a fee structure based on costs and demand (capacity utilization). *Id.* at 16969. This would lead to more cost-homogeneous fee groups. *Ibid*. He also tentatively identifies 80 facilities which can be moved from one fee group into another in order to better align costs and fees and to reflect capacity utilization. *Id*. at 16970. Unlike the majority of post offices, these facilites have known rental costs because they are leased. Witness Kaneer suggests it makes little sense to switch to CAGs as a basis for fees when the Service is exploring more appropriate alternatives. *Id.* at 16972.

[5910] The OCA argues on brief that its proposal better reflects costs in the pricing of boxes by reflecting important differences in average rental costs among the CAGs. OCA Brief (Second Section) at 133-40. "The significance of the relationship between CAG designation and cost is not negated by the fact that some lower CAG offices have higher average rental costs than higher level CAG offices. Any effort at averaging by

CAG would, of necessity, involve some variation." *Id*. at 137. However, the OCA does not address the overall statistically weak correlation between CAG and rental costs identified by witness Kaneer.

[5911] *Commission Analysis*. Despite arguably improving the treatment of rental costs, the OCA's costing methodology is not recommended. The Commission is hesitant to add complexity to the fee schedule without clear benefit. Witness Kaneer makes valid points about the lack of homogeneity of rental costs within CAGs. Particularly instructive is witness Kaneer's Exhibit A which shows the distribution of CAG groups A-D, E-G and H-L by average rental cost decile. Tr. 32/16977. This demonstrates that the relationship between CAGs and rental costs is not a valid basis for a fee structure. For example, almost 20 percent of the CAG group A-D have an average rental cost of $1.83 even though the group average for A-D is $9.05. The minimal benefits which might be achieved by creating more fee groups is also outweighed by the added complexity of creating four more fee groups and twenty more fees.

[5912] While the Commission is rejecting the CAG proposal, it recognizes that the Postal Service presently lacks the information to optimally align box costs and fees. Consequently, we encourage the Postal Service to actually follow through on its plan to develop the cost information described in witness Kaneer's testimony.

[5913] Witness Kaneer also revealed the Postal Service's decision to reassign post office boxes at 80 facilities from the next highest or lowest. *Id.* at 16970-72. Witness Kaneer indicates 46,607 boxes will be affected and the revenue impact will $46,080. *Ibid*. The purpose of the limited modification of fee groups was to better align costs, utilization, and fees.

> The logic of the approach was to identify facilities with high costs and low fees, or with low costs and high fees. If the former also had high capacity utilization, the facility was identified as a candidate to be moved to the next most expensive PO box fee group, *e.g.*, from Group C to Group B. Similarly, if a low cost / high fee facility also had low capacity utilization, it became a candidate for movement to the next less expensive fee group. All such facilities only became candidates, because the next step was

> verification that the values for facility cost, boxes installed, and capacity utilization were reasonable and accurate.

Id. at 16970. The OCA, on brief, expresses concern over the proposal, suggesting it is premature, discriminatory, unfair and should be reviewed by the Commission prior to implementation. OCA Brief (Second Section) at 127-33.

[5914] The Service's reassignment plan appears to be a response to the OCA's CAG proposal. The Postal Service describes its proposal as a "first step" in moving toward a better alignment of costs and fees. It does not appear to be an effort to discriminate among box users on some basis other than costs and utilization, or an effort to extract additional revenues from post office boxes. However it is no substitute for developing the cost data needed to create fee groups based on actual rental costs.

[5915] For the most part, the Commission recommends fees close to those proposed by witness Needham. As witness Needham testifies, in many cases price increases are required so the service will cover its costs. USPS-T-39 at 66. Even under the Service's proposal, fees for size 5 boxes in Groups A and B, and all boxes in Group D would not cover their costs. *Id*. at 65.

[5916] Boxholders already have absorbed several recent fee increases: an average increase of 25 percent in 1991, 14 percent in 1995, and 9 percent in 1997. *Id*. at 62. Consequently, we will mitigate the impact of this increase on boxholders (§ 3622(b)(4)), and limit any individual price increase to 25 percent. The resulting cost coverage of 110 percent is low relative to other special services, but the Commission does not wish to burden boxholders with any larger increase.

[5917] The Commission recommends the fees as proposed for caller service. It is reasonable to have a single fee for caller service as labor costs are essentially uniform throughout the nation. The Commission also recommends a 20 percent fee increase for reserve call numbers, from $30 to $36 per year. This is less than the proposed increase of 33 percent and reduces the impact of the increase on businesses that use this service (§ 3622(b)(4)).

4. Merchandise Return (Schedule 932)

[5918] Merchandise Return is similar to business reply mail in that it enables a business's customers to return parcels without paying the postage. Instead, the business pays the postage and the merchandise return fee of 30 cents. A permit fee is required to obtain merchandise return service. The Postal Service would like to retain the current fee. With per unit cost of 23.3 cents, cost coverage for merchandise return would be 128 percent. USPS-T-40 at 22. The Commission recommends the Service's proposal to leave the fee unchanged.

5. On-Site Meter Settings (Schedule 933)

[5919] A postal employee provides this service by traveling to a customer's business and resetting the postage meter. There are four fees associated with meter settings, and the Postal Service would like to increase two fees and leave two fees unchanged. The Service recognizes that the additional meter fee and fee for checking a meter in or out of service are not covering their costs and need to be increased. USPS-T-39 at 52.

Table 5-23

Service	Current	Proposed	Increase	Cost Coverage
Single Meter	$27.50	$27.50	0%	132%
Unscheduled Setting	$31.00	$31.00	0%	143%
Additional Meter	$3.25	$4.00	23%	123%
In/Out Of Serv. Check	$7.50	$8.50	13%	112%

[5920] The Commission recommends the fees proposed by the Postal Service for these services. The resulting cost coverages are closer to the system average and make more of a contribution to recovering institutional costs.

6. Certified Mail (Schedule 941)

[5921] This high volume special service provides a mailer with a receipt for mailing an item, and a record of delivery is kept on file for two years at the post office of delivery. It is often used in conjunction with return receipt service. Certified mail's current fee is $1.35.

[5922] The Postal Service seeks a 15 percent increase in the fee, up to $1.55. In support of this increase, the Postal Service notes that in past decisions "the Commission has recommended fees which it believed would produce a cost coverage for certified mail above the system average." USPS-T-39 at 31. Under the Service's proposal, cost coverage would be 137.7 percent — still below the cost coverages of First-Class and Priority Mail. The Postal Service argues this is a high value service to the sender and recipient because of the accountability of certified mail. *Id.* at 29. This service also has some prestige which contributes to the value. *Ibid.* If priced at $1.55, this service in conjunction with return receipt (if priced as the Postal Service desires at $1.45), would cost a postal customer $3.00.

[5923] The Commission recommends a 3.7 percent increase to $1.40 for this service. This more moderate increase is closer to the system-wide rate increase and lessens the increase's impact (§ 3622(b)(4)) on the mailing public which comes after a 23 percent fee increase in 1997. The recommended increase results in a cost coverage of 113 percent.

[5924] Certified mail's relatively high price reflects the costs of collecting delivery information manually. The Service should consider utilizing some of the information technology and infrastructure used for delivery confirmation which has much lower costs.

This could result in significant cost savings which could be passed on to the mailing public.

7. Registered Mail (Schedule 942)

[5925] Registered mail provides mailers with a high security method of mailing valuables. Postal employees must account for registered mail while handling it, and it is kept in more secure areas than other mail. The Postal Service is seeking large increases in the registered mail fee schedule in Docket No. R97-1.

[5926] The Postal Service also proposes to continue the simplification of the fee schedule which started in MC96-3 when uninsured mail with a value exceeding $100 was eliminated in order to better align registered mail with customer needs. *See* PRC Op. MC96-3 at 126. Now, the Service proposes to eliminate the option of not insuring registered mail valued at less than $100. Arguing for the classification changes, witness Needham refers to the § 3623(c) criteria. First, the changes would "provide a more fair and equitable classification system for registered mail." USPS-T-39 at 78. Second, she asks that the Commission consider the "logic involved in providing both an uninsured registry classification with no monetary value and providing an insured registry classification with a minimum monetary value." *Ibid*.

[5927] Registered mail fees need to be dramatically increased under the pricing method suggested by Postal Service witness Panzar. According to witness Needham, "primary consideration was given to covering the incremental costs." *Id.* at 79. The proposed fees will still yield revenues one million dollars shy of that goal, yet larger fee increases would be too burdensome on customers. "The average 51 percent proposed fee increase is substantial enough for the registered mail customers to bear." *Ibid*. Cost coverage will be 160 percent with fees in place. Exhibit USPS-30B, revised September 19, 1997.

[5928] The Commission recommends the classification change proposed by the Service. It will prevent consumers from purchasing registry without insurance when

articles have value. This is desirable because consumers may assume their registered mail is insured.

[5929] The Commission will limit the fee increase to 25 percent. As discussed in Chapter IV, the Commission does not accept witness Takis' calculation of incremental cost. The rejection of the Service's proposed 50 percent increase moderates the impact of the increase on users of registry (§ 3622(b)(4)). Cost coverage for this service will be 123 percent.

8. Insurance (Schedule 943)

a. Express Mail and Retail Insurance

[5930] This special service provides indemnity up to $5000 for lost or damaged mail and is available for Standard Mail and First-Class Mail, including Priority Mail. Insured pieces valued up to $50 are marked as such at the time of acceptance, but they are treated the same as uninsured mail. Articles valued at more than $50 are given a number at the time of acceptance; this number is placed on the article and on the customer's receipt. The signature of the addressee or the addressee's agent is required for delivery. Current fees range from $0.75 to $45.70 depending upon the declared value of the article. In Docket No. MC96-3, the indemnity limit for insurance was raised from $600 to $5,000.

[5931] The proposed fee increase for retail insurance, averaging 17.3 percent, would yield a cost coverage of 154 percent. USPS-T-40 at 3. In the Postal Service's view, the high value of the service, demonstrated by its low price elasticity of -0.1, justifies the increase. *Id*. at 6.

[5932] On brief, OCA raises some concerns over insurance coverage that it believes should be addressed before the Service's proposal for a large fee increase is recommended. OCA Brief (Second Section) at 221. First, OCA argues that consumers may not know that their mail is uninsured unless they buy insurance. *Id*. at 222. Second,

these consumers may not understand the limited extent of coverage provided by insurance. *Id.* at 224.

> In short, a consumer is at a severe disadvantage when dealing with the Postal Service. The entity with which the consumer has entrusted his parcel may lose it or damage it. Indeed, a postal employee may steal the parcel or rifle its contents. Absent insurance, a legal claim against the Postal Service for losing, stealing or damaging a parcel will be unavailing.
>
> If the consumer divines that purchase of insurance is a necessity, [s]he still may not realize that Postal Service insurance contains significant exceptions, exclusions, and limitations. The insurance receipt form given by the Postal Service to a customer, Form 3813-P[124], contains almost no information about what is covered and what is not covered by the insurance purchased.

Id. at 225 (footnotes omitted). As a remedy for this lack of consumer information, the OCA suggests the Commission require the Postal Service to distribute a brief pamphlet with insurance information. The OCA argues that this would not unduly interfere with the management of the Postal Service. *Id.* at 226.

[5933] The Postal Service argues that requiring distribution of pamphlets would interfere with its management, and there is no basis in the record for imposing such a requirement. Postal Service Reply Brief at VI-14. Further, there is simply no evidence that consumers are misled. *Id.* at VI-13. The Postal Service claims to already make detailed insurance information available to consumers in brochures. *Id.* at VI-16. The Postal Service also points out that the OCA has not demonstrated that the Service has been unfair in its handling of insurance claims. *Ibid.* Moreover, there is competition in the handling of parcels and the Service faces market pressure to satisfy its customers. *Id.* at 17.

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[124] "COVERAGE -- Postal insurance covers (1) the value of the contents at the time of mailing, if lost or totally damaged, or (2) the cost of repairs. It does not cover spoilage of perishable items. Coverage may not exceed the limit fixed for the insurance fee paid. Consult postmaster for details of insurance limits and coverage." PS Form 3813-P, February 1987.

[5934] *Commission Analysis*. The OCA has raised important issues concerning consumer information about the absence of insurance on mail. The volume of insurance transactions suggests that there are many parcels mailed without insurance. *See* Appendix G (approximately 30,000 insurance transactions versus parcel volume of over 200,000). However, there is no evidence that consumers are misled or dissatisfied. When the Service packages an item, a consumer may assume his parcel is insured. *See* PRC Op. MC97-5 at 17-18. The argument that a consumer assumes his parcel is insured is not nearly as strong as when he packages his own parcel. *Ibid*. Nor is there any incentive for the Postal Service to mislead customers; it earns income by selling insurance. The disclaimer on the back of the form might be more informative about limitations on coverage, but there is no evidence upon which to conclude that consumers are misled. Brochures explaining insurance are available. *See* "Postal Insurance & Filing Domestic Insurance Claims," Publication 122. The Postal Service might consider studying whether it should be automatically providing insurance for parcels as does UPS, its main competitor.

[5935] The Commission recommends an increase of 10 percent for retail insurance, which is more consistent with the overall rate increase in this case than the Service's proposed 17 percent increase. This moderates the impact on consumers and produces a cost coverage of 145 percent, the second highest cost coverage among the special services. With registry receiving a 25 percent increase, the smaller increase for insurance reduces the discrepancy between insurance and registry fees when items are insured for more than $1000. At these higher values, insurance costs more than registry even though registered mail receives a higher level of service.

[5936] The Postal Service proposes a fee increase for Express Mail insurance from $0.90 to $1.00 for each $100 increment of insurance and suggests that these fees maintain the existing relationship with general insurance fees. USPS-T-40 at 9. Hence, the Commission recommends a fee schedule with $0.95 increments in order to keep the Express Mail fees consistent with the retail insurance fees.

b. Bulk Insurance

[5937] The Postal Service also proposes a new insurance option for bulk mailers that would allow the purchase of insurance with electronic manifesting. This reduces the administrative costs by avoiding window service costs. *Id*. at 8. A study estimates cost savings of 79.9 cents for unnumbered insured and $1.13 for numbered insured pieces. *Ibid*. Also, indemnity costs for bulk insurance should be lower than for basic insurance. While current insurance coverage reimburses the actual value of the article at the time of mailing, bulk insurance would provide indemnity for the lesser of the actual value of the article at the time of mailing or the wholesale cost of the contents to the mailer. *Ibid*. The Service proposes to pass through half of the savings for unnumbered pieces to mailers. *Ibid*. This results in a $0.40 per item discount.

[5938] The Commission recommends the Service's proposed new classification for bulk insurance. According to the Service, the new classification will meet the demands of users, a relevant factor under § 3623(c)(5). *Id*. at 9. The Service's proposed pricing passes through 50 percent of the cost savings in the form of a discount and is fair (§§ 3622(b) (1) and (6)).

9. Collect on Delivery (Schedule 944)

[5939] This service enables a consumer to wait to pay for something ordered until its arrival through the mail. Upon delivery, the consumer pays the postal employee for the mailed article plus a fee for this special service. The Postal Service is proposing an average increase of 12 percent in this service which has a graduated fee schedule based on the value of the article.

[5940] The Postal Service recognizes that this special service tends to be used by those consumers of modest means. Hence, it only seeks a minimal markup over costs. USPS-T-39 at 37. According to the Postal Service, cost coverage under its proposal

would be 112 percent. Notice of Correction of Witness Needham's Workpaper 17, filed November 20, 1997, at 1.

[5941] The Commission recommends the increase as proposed by the Postal Service. A low cost coverage is appropriate for a service used by people who presumably do not have credit cards and may have below average incomes.

10. Return Receipt (Schedule 945)

[5942] Return receipt is designed to provide customers with proof of delivery of mail. The return receipt should provide the mailer with the signature of the addressee or the addressee's agent, the date the piece was delivered, and the address where the piece was delivered if that address is different from the address on the mail piece. The Postal Service also will be using a check-off box on the return receipt which will be checked if delivery was made to the address on the mail. The Commission recommended the Postal Service seriously consider doing this following a suggestion from intervenor Popkin. PRC Op. MC96-3 at 111.

[5943] Return receipt is available for Express, certified, COD, numbered insured and registered mail. *Ibid*. The Postal Service also proposes that return receipt be available in conjunction with the new delivery confirmation service. A delivery confirmation return receipt will be a copy of an image of the recipient's name, signature and delivery address, if different from the address on the piece of mail.

[5944] The Postal Service seeks large increases in return receipt fees requested at the time of mailing: 46 percent for merchandise and 36 percent for non-merchandise. For return receipt purchased after mailing, the proposed increase is 7 percent.

[5945] The Postal Service contends the added value of the check-off box makes return receipt a very high value service. The Postal Service estimates cost coverage would be 147 percent — still below the system-wide average. USPS-T-40 at 14. As for the large increases, "this is due in large measure to the recent overall decrease in the amount paid for return receipts after their restructuring." *Id*. at 15.

[5946] Intervenor Carlson makes several points critiquing the value of return receipt service. Tr. 24/12814-16. First, he claims that the signatures on return receipts are often illegible and that although the Postal Service has a place for the recipient to print his name on the receipt, witness Carlson claims they typically do not do so. *Id*. at 12815. He cites as evidence his own and Intervenor Popkin's experience. *Id*. at 12820.

[5947] Witness Carlson also believes that the IRS and other recipients of vast amounts of return receipt mail do not complete the return receipt when they receive the mail. *Id*. at 12818. Instead they complete return receipts themselves and return them to the Postal Service days later. *Id*. at 12817. Consequently, the date may not be correct or the receipt may have other incorrect information. *Ibid*. Witness Carlson points out that the sender and recipient are often in an adversarial relationship and the recipient may not complete the return receipt form. *Id*. at 12814. Moreover the date of receipt may be important to taxpayers. *Id*. at 12816. Witness Carlson also doubts the value of the new box on the form for indicating a change of address. First, he notes that 98 percent of current customers do not opt for the address change information when using return receipt service. *Id*. at 12818. Second, he wonders if the new feature will have any actual value for customers in light of the Postal Service's poor implementation of the requirement that recipients print their names on the form. Finally, he cites the 4,689 customer service complaints in 1996 as evidence of poor service. *Id*. at 12820.

[5948] On rebuttal, Postal Service witness Plunkett tries to refute witness Carlson's claims. He identifies an alternative to return receipt, namely a UPS product which costs $5.65. Tr. 32/17118. He also states that he is not basing the proposed fee increase on a finding of a high value of service. *Id*. at 17119. The service would still have a cost coverage below the system average. Witness Plunkett points to overall high demand for return receipt as indicative of the value of service.

[5949] Witness Plunkett next addresses witness Carlson's claims concerning the bulk processing of return receipts by the IRS. Witness Plunkett admits the procedures in place do not comply with the DMM, but he describes an automated procedure which some Postal Service facilities use to ensure that return receipts have the proper date. *Id*.

at 17122-23. Essentially, an IRS employee signs a manifest listing all the return receipts, thereby verifying that the IRS received them on a certain date. *Ibid*. Witness Plunkett suggests that the DMM should be amended to reflect this procedure. *Id.* at 17125.

[5950] Lastly, witness Plunkett believes the new check-off box will add some value to the service and claims that the Commission agreed and stated that it might justify a future fee increase. *Id.* at 17126 (citing PRC Op. MC96-3 at 112). The Commission stated that '[i]f the mailer can be sure that the mail piece has been delivered to the original address, the value of service should increase. … This might justify a future increase in the level of cost coverage for return receipt." PRC Op. MC96-3 at 112-13.

[5951] *Commission Analysis*. The Commission recognizes that the cost coverage for return receipt is below the system-wide average cost coverage. Witness Plunkett attempts to justify the increase by relying on overall demand for the service. However, the Service's testimony that available alternatives are priced considerably higher may explain the high demand for the service; overall demand may be unrelated to the quality of the service. There is no reliable evidence that this service is consistently meeting customer expectations, and the Service admits that its handling of return receipts delivered to high volume recipients does not comply with its own DMM. This, in addition to other intervenor testimony asserting service problems, indicates that there may be problems with the reliability of this service. The Commission is concerned about the quality of return receipt service, as it has been since R90-1. *See* PRC Op. R90-1, para. 6576, n.110.

[5952] The Commission recommends a fee of $1.25 for non-merchandise return receipts, $1.40 for return receipts for merchandise and $7.00 for return receipt purchased after mailing. These increases are more moderate than those proposed and lessen the impact of the increases on mailers who have few alternatives (Criteria 4 and 5). With a cost of $0.972, USPS-LR-H-107, the cost coverage for non-merchandise return receipt is 129 percent. The Commission also recommends the proposed classification change which allows customers to purchase return receipt along with delivery confirmation. The change increases consumer choice and enables return

receipt customers to obtain an electronically stored image of the name, signature and address if different from the original address. Utilization of the Postal Service's new information technology could eventually lead to lower costs for this service.

11. Certificates of Mailing (Schedule 945)

[5953] Certificates of mailing provide mailers verification of the mailing of pieces to particular addresses on a particular date, but do not provide a record of delivery. Three types of verification are available: 1) verification of individual pieces and mailings via form 3817; 2) verification of mailings of three or more pieces recorded in a firm book or customer manifest via form 3877; and 3) and verification of a bulk mailing via form 3606. The Postal Service's proposal retains the present fee structure and requests an increase in fees which averages 15 percent. The fee increases are necessary to cover increasing costs linked to postal employee wage rates. *Id.* at 4. Cost coverage would be 132 percent under the Postal Service's proposal. The Commission recommends the proposed increase which brings the cost coverage closer to the system-wide average.

12. Restricted Delivery (Schedule 946)

[5954] Restricted delivery may be used with certified, numbered insured, COD, or registered mail. Restricted delivery simply means that delivery is restricted to the addressee or an authorized agent. USPS-T-40 at 10. With cost coverage at 159 percent and the current fee at $2.75, the Postal Service is not seeking an increase. The Commission recommends that there be no fee increase for this service which is already making a sizable unit contribution to the recovery of institutional costs.

13. Delivery Confirmation (Schedule 948)

[5955] Delivery confirmation is an important new service for the Postal Service's customers, as this service has been offered by the Postal Service's competitors for years. USPS-T-40 at 17. It will provide customers with the date of delivery or attempted delivery. The Service proposes that it be available for Priority Mail, Parcel Post, Bound Printed Matter, Special and Library Mail, and would provide At this time, the Service only seeks fees for Priority Mail and Standard B. *See* USPS-T-40 at 19; Postal Service Reply Brief at VI-6.

[5956] Electronic hand-held scanners have been purchased for use in this service and 300,000 are expected to be deployed over the next 18 months. USPS-T-22 at 2. The Postal Service indicates that they will be utilized for a variety of functions other than delivery confirmation. "It is planned that the scanners ultimately will serve a variety of purposes, including delivery and collection management, service performance measurement, and mail item information acquisition." *Ibid*. Hence, capital costs associated with the scanner program are attributed to all classes of mail. *Id*. at Appendix C, Worksheet C-1.

[5957] Two types of delivery confirmation are proposed: manual and electronic. Manual delivery confirmation is intended for the individual mailer. The postal employee applies a barcode label, and the customer receives a receipt that shows an identification number. The customer then can access delivery confirmation information via telephone or the internet. Electronic delivery confirmation is designed for the volume mailer. These mailers can provide the Postal Service with an electronic manifest of all delivery confirmation pieces on the day of mailing. The manifest would include the date of the mailing, the package ID number, and the destination ZIP Code. Users of electronic delivery confirmation apply the label themselves and electronically access the delivery confirmation information.

[5958] The Postal Service's proposed fees (shown below) for this service reflect the reality of the marketplace. Electronic mailers of Priority Mail would receive the service at

no charge if they provide the barcode. Competitors of the Postal Service already offer tracking, often for no additional charge. USPS-T-40 at 18.

Table 5-24

Mail Classification	Manual	Electronic
Priority	$ 0.35	$ 0.00
Standard B	$ 0.60	$ 0.25

[5959] The Postal Service proposes an overall cost coverage of only 106 percent for this service with a cost coverage of 103 percent for Priority Mail retail customers. *Ibid*. However, the Postal Service expects Priority Mail volume to increase as a result of delivery confirmation, so it should still make a contribution to other costs. *Id*. at 20. According to the Service, delivery confirmation cost coverages for Standard B mail are 165 percent for electronic delivery confirmation and 123 percent for manual. *Id. at 18*.

[5960] UPS witness Luciani alleges the Service proposes a 15-cent subsidy for electronic users of delivery confirmation. UPS Reply Brief at 27; Tr. 26/14332. He believes these users would receive a subsidy of $9.9 million because the costs of delivery confirmation are included in the costs of Priority Mail. Tr. 26/14332. As a result, he calculates the cost coverage for Priority Mail delivery confirmation as 69 percent. *Id*. at 14331. Contending that the attributable cost for Priority Mail electronic service is approximately the same as Standard B electronic service, he argues that the fee should be similar. Hence, he proposes a $0.25 fee for Priority Mail electronic service. This argument is addressed in Chapter V, Section B.3. which discusses Priority Mail.

[5961] Witness Luciani also argues that fairness requires that those classes of mail that are eligible for delivery confirmation bear the capital costs of acquiring the scanners. Tr. 26/14331. Witness Luciani complains that only 0.5 percent of the capital cost of the

scanners is attributed to Priority Mail and Standard B. *Id*. at 14332. Finally, witness Luciani asserts that Priority Mail manual and Standard B manual delivery confirmation services should have the same fee of 60 cents. *Ibid*.

[5962] Postal Service witness Lewis presents detailed testimony countering witness Luciani's claim that only Standard B and Priority mail should bear the costs of the Mobile Data Collection Devices (scanners). Tr. 35/19015. He mentions several other uses for the scanners to rebut Luciani's contention that they are primarily for delivery confirmation. *Id.* at 19020-25. He testifies the scanners will be used to enter data in the Vehicle Management Accounting System, which records the assignment of vehicles to routes and the "linkage of employees and workloads to particular vehicles... ." *Id*. at 19020. Additionally, the scanners will be used in the Collection Box Management System which essentially monitors the collection of mail from the collection boxes to ensure that carriers are collecting the mail on time. *Id*. at 19020-21. He indicates that the scanners will be used to monitor carriers' delivery performance through the Enhanced Street Performance System to be deployed later this year. *Id*. at 19022. He also refers to a variety of service management applications. *Id*. at 19020.

[5963] Postal Service witness Rios disputes witness Luciani's contention that delivery confirmation precipitated the purchase of the scanners. She points out that the executive summary of the documents presented to the Board of Governors lists three justifications for the purchase: "delivery confirmation services, operational and service performance indicators, and increased value of accountable mail through improved access to information." *Id*. at 19038.

[5964] Witness Rios contends that there are important reasons for including some delivery confirmation costs in the cost base of Priority Mail. She argues that "[e]xtensive formal and informal market research was conducted to identify the fees and fee structure customers prefer." *Id*. at 19033. She claims that many bulk users of Priority Mail would not use delivery confirmation if there were an additional fee. *Id*. at 19035. Although these users do not have to pay a fee for delivery confirmation, they must incur the

additional costs associated with applying barcodes, manifesting, downloading and uploading information, and integrating information into their systems. *Id*. at 19036.

[5965] In contrast to the market for Priority Mail, witness Rios states that market research demonstrates that bulk and non-bulk Standard B customers want to apply delivery confirmation barcodes selectively. *Ibid*. Consequently, the Postal Service proposal is that these customers pay only when they choose to use the service. In order to meet market needs, "the Postal Service proposes two levels of delivery confirmation service for Standard B, each with an appropriate fee." *Ibid*.

[5966] OCA has concerns about the fairness of the delivery confirmation service. Their primary concern is that users of First-Class Mail, Periodicals Mail, and Standard A Mail cannot use the service. OCA Brief (Second Section) at 117. Witness Treworgy's explanation, that it was an affirmative decision to create a service for Standard B Mail and Priority Mail is insufficient. *Id*. at 118 (citing Tr. 3/1305). OCA argues that no market research was conducted to determine if First-Class Mail users would utilize the service. *Ibid.* OCA suspects that the Postal Service sought to avoid diverting volume from certified mail. *Id*. at 119.

[5967] OCA also asserts that manual users of delivery confirmation service are treated unfairly under the Postal Service's pricing plan because Standard B manual users pay 60 cents while electronic users pay 25 cents. The differential is based upon the manual users accessing delivery confirmation information via the corporate call management (interactive telephone) system while electronic users download the delivery confirmation records from a Postal Service computer. *Ibid*. OCA points out that Postal Service witness Treworgy admits that the Service will soon make the information available over the internet. *Ibid*. (citing Tr. 3/1304). Consequently, costs will be lower than the Service admits. *Ibid*.

[5968] OCA believes the Commission should offer two types of manual delivery confirmation, one allowing the user internet access of the delivery confirmation information, and the other offering the customer use of the interactive telephone system. According to OCA, witness Treworgy's arguments of customer confusion and increased

cost due to longer window time are specious. *Id*. at 121. OCA argues many households have computers and 35 percent of households will subscribe to an online service by the end of the decade. *Id*. at 123. In short, OCA concludes that delivery confirmation is a discriminatory service:

> As noted, there are two problems with the Postal Service's delivery confirmation proposal. First, it unaccountably excludes certain classes of mail. The Postal Service witness was unable to explain whether any operational difficulties would be encountered if service were extended to additional mail classes. Second, the proposal requires smaller-sized mailers to pay fees associated with the corporate call management system when those mailers could use the Internet to obtain delivery confirmation information.
>
> These are egregious examples of service and rate discrimination. As such, the Commission should not consider them as the types that are 'sufficiently fair to be included in its recommended decision . . . .' Consequently, the Commission has the legal authority 'simply [to] decline to recommend a rate or classification that it is convinced is unfair.'

Id. at 124 (quoting *Mail Order Ass'n of America v. U.S.Postal Service*, 2 F.3d 408, 424 (D.C. Cir. 1993)).

[5969] The Postal Service disputes these claims of discrimination. The Service claims to offer the service to the most logical classes of mail -- those classes of mail that ship merchandise. Postal Service Reply Brief at VI-7. "Delivery confirmation was developed in response to interest from Priority and Standard B mailers." *Ibid*. (quoting Tr. 3/873). The Service asserts that shippers of merchandise wish to be able to confirm that an item was received. *Ibid.* Mailers expect delivery confirmation to be part of expedited service. *Ibid*. (citing Tr. 3/19035). Furthermore, the Service points to operational difficulties in making the service available to all of First-Class Mail. A carrier might neglect to scan a letter because it is easier to overlook than packages and parcels and the present infrastructure might be an inefficient means of providing delivery information for letters, as letters are scanned by processing equipment. The Service

argues it may be "more efficient to leverage this existing technology base than to add an additional scan by the delivering employee." *Id.* at VI-8. In conclusion, "the Postal Service has deemed it prudent first to offer delivery confirmation where there is demonstrated need and comparatively limited volume." *Ibid*.

[5970] Next, the Service addresses OCA's criticism of its decision not to offer a two-tiered manual service that permits users to opt for either internet or telephone access. *Id*. at VI-9. The Postal Service points out that the cost differential is not that significant: only 8.47 cents. *Ibid*. This might even be offset by added window time needed for the clerk to explain the two options. Operational customer service difficulties alone outweigh any added benefit from two tiers of service. *Ibid*. The Service believes it must offer access to the information over the telephone because customers demand this option. *Id*. at VI-10 (citing Tr.35/19035). The Service claims it cannot easily distinguish between internet and telephone users in order to enforce the requirement that particular users only use the internet. *Ibid*.

[5971] *Commission Analysis*. The Commission rejects the arguments of UPS concerning attribution of the capital costs of the scanners and associated infrastructure. There may be some merit to the contention that delivery confirmation precipitated the purchase of the scanners. However, the Service has provided sufficient evidence to buttress its assertion that the scanners will be used in several other programs to monitor service performance. For example, by summer of this year, the Service claims it will be using the scanners for the Collection Box Management System. Tr. 35/19020. This use is described in the 1997 Annual Report. Postal Service Annual Report at 42. Thus, the other uses for the scanners are genuine rather than simply attempts to rationalize a particular treatment of costs.

[5972] The Commission also accepts the Service's proposed distribution of scanner volume variable costs. The Service believes they vary by the number of carrier routes, as each letter carrier will need a scanner. *See* USPS-T-22 at 18. This is a logical treatment, once one accepts that the cost of the scanners should not be attributed only to Priority Mail and Standard B Mail. Consequently, the Commission will distribute the

volume variable costs according to the overall carrier costs system as a whole. *See* USPS-T-22, Appendix C, Worksheet C-2.

[5973] OCA's arguments suggesting that the service, as proposed, improperly discriminates between classes of mail do not convince us to reject the service. It seems reasonable to offer this service on a limited basis for those classes of mail that carry merchandise or expedited mail; one would expect a greater demand for this service for those classes of mail. To expect the Service to offer delivery confirmation for First-Class letters at the outset seems unreasonable, given the uncertain demand and operational difficulties associated with what would be an even larger undertaking.

[5974] The arguments concerning the use of the internet are also unconvincing. The Postal Service's claim that it must offer a service that permits users to obtain the delivery confirmation information via the telephone seems a fair decision, as the Service would not want to exclude customers who do not have access to the internet. The Service's decision not to offer a separate internet service is reasonable in light of the small 8.47 cent cost differential. Any benefits are outweighed by potential customer service problems, increased window time and complication of the service.

[5975] The Postal Service's proposed fees for delivery confirmation are reasonable and the Commission recommends them. They balance a number of considerations such as recovery of costs, value of service and degree of mail preparation. Overall, the cost coverage for delivery confirmation is low at 107 percent, but this is not objectionable because the quality of the service is untested and its value of service is less than that of return receipt, which provides more information to the mailer. The fee structure rewards those mailers who can bypass window service with lower fees (§ 3622(b)(6)). Additionally, the fee structure is simple (§ 3622(b)(7)). Delivery confirmation's low markup also is justified by the expectation that delivery confirmation may provide system-wide benefits such as measuring attainment of service standards.

[5976] Priority Mail manual delivery confirmation has a low markup for several reasons. Priority Mail makes a large contribution and, as noted by witness Plunkett, delivery confirmation should further increase Priority Mail volumes and make an

additional contribution in this manner. Moreover, delivery confirmation may enable Priority Mail to attain higher service standards by providing a reliable indicator of areas with on-time performance problems.

[5977] Offering delivery confirmation as a part of basic Priority Mail service in response to customer requests is appropriate, given the market demand for the service as described by witness Rios. Tr. 35/19035-36. The base cost of delivery confirmation as developed by witness Treworgy, 14.86 cents, consists almost entirely of the cost of delivery. USPS-T-22 at 17. This cost has little effect on the subclass as a whole, so the Commission is including this cost in the costs attributed to Priority Mail. *See* Chapter V.B.3.c. The Commission may need to revisit this issue in future cases if delivery confirmation does become a standard feature of Priority Mail. However, for purposes of this case, the Commission recognizes the Postal Service may need some flexibility in the design and implementation of this new service until revenue and cost information are available.

[5978] The proposed fee for manual Priority Mail delivery confirmation also is reasonable given the additional costs, mostly consisting of window service time, incurred by these pieces. Priority Mail manual delivery confirmation is only responsible for an additional $0.33 beyond the base cost attributed to Priority Mail. Consequently, the Commission rejects witness Luciani's argument that Priority Mail manual delivery confirmation should receive a $0.60 fee based on a cost of $0.48.

[5979] The Commission is not treating the delivery confirmation costs for Standard B in a parallel fashion. Including the base cost of the service is not appropriate. Tr. 35/19035-36. The lower volume and muted interest expressed in delivery confirmation preclude offering the base level of service as a part of Standard B, and consequently including its cost in the costs of Standard B. Therefore, a per piece charge is appropriate.

[5980] The Commission accepts the Service's rationale for a higher markup for Standard B delivery confirmation than for Priority Mail delivery confirmation. Standard B itself makes little contribution to recovering institutional costs. USPS-T-40 at 18. This

justifies its higher cost coverage, as does the availability of competitor's alternatives (§ 3622(b)(5)). *Id.* at 21.

[5981] As delivery confirmation is a new service, the Commission must ensure that it is created pursuant to the criteria enunciated in § 3623(c). Criterion 1 of § 3623(c) is satisfied by establishing the service as an optional one with two fees for each class of mail based upon associated costs. Criterion 2 is satisfied by making customers who desire the optional service pay separately for it. As the value of the mail to the sender and the recipient increases, the sender may be more likely to choose delivery confirmation service to determine whether the item was delivered. Criterion 3 refers to the importance of providing classifications with high degrees of reliability and speed. Delivery confirmation should be useful in ensuring that Standard B and Priority Mail meet their service standards. Criterion 5 directs the Commission to consider the desirability of special classifications from the point of view of the user and the Postal Service. Delivery confirmation service is a response to customers' requests for the service. *Id.* at 17. Consequently, the Commission recommends the delivery confirmation classification and fees as proposed by the Postal Service.

14. Stamped Envelopes (Schedule 961)

[5982] Stamped envelopes, available to customers as a convenience, come with the postage pre-affixed. They may be purchased individually at windows while box lots of 50 and 500 must be ordered. Window, double window, and pre-cancelled envelopes are available and are 6 ¾, 9, and 10 inches in length. For an additional fee, stamped envelopes can be pre-printed with a return address, title, company name, telephone number or advertising slogan.

[5983] The Postal Service seeks fee increases and proposes classification changes for stamped envelopes. The number of fees declines from sixteen to twelve under this proposal, and stamped envelopes would have a cost coverage of 105 percent. A primary distinction between the current and proposed stamped envelope fee structure is

the separate grouping of hologram stamped envelopes. The Postal Service proposes to separate the higher-cost holograms from the other fee categories. The Postal Service contends this is "equitable," particularly for the users of non-hologram envelopes. USPS-T-39 at 98.

[5984] In developing fees for plain and printed box lots of 6 ¾ inch and 10 inch size envelopes, the costs for regular, window, precancelled regular, and precancelled window stamped envelopes were aggregated into four groups (6 ¾ inch plain, 6 ¾ inch printed, 10 inch plain, and 10 inch printed). Needham states that "the proposed fees represent the[se] aggregate groupings and any markups over cost are minimal." *Id.* at 95. The largest price increases are proposed for single sale envelopes; the price of single sale size-10 hologram envelopes would rise 33 percent (from 6 to 8 cents) and the prices of single sale sizes 10 and 6.75 plain envelopes would receive a 17 percent increase (from 7 to 8 cents). Witness Needham believes that "[t]hose proposed fees that are higher than the current fees (with the exception of holograms) are minimally higher." *Id.* at 97.

[5985] The Commission recommends the fees as proposed by the Postal Service. The new fee schedule represents a significant improvement. The changes reduce by one-fourth the number of fees in the schedule and more accurately reflect the higher costs of hologram envelopes. The increased simplicity (Criterion 7) will make it easier for consumers to purchase envelopes and may even reduce window time.

15. Parcel Airlift (Schedule 951)

[5986] Parcel Airlift provides air transportation for parcels going to military post offices outside of the 48 contiguous states. Fees vary by the weight of the parcel.

Table 5-25

Weight	Current Fee (dollars)	Proposed (dollars)	Percentage Change
Up to 2 pounds	$ .40	$ .45	13%
Over 2 up to 3 pounds	$ .75	$ .85	13%
Over 3 up to 4 pounds	$1.15	$1.30	13%
Over 4 pounds	$1.55	$1.75	13%

[5987] Postal Service witness Needham asserts the increases are reasonable. "The moderate proposed fee increases for parcel airlift, averaging 13 percent, were designed to maintain the five-cent rounding constraint while considering the fact that parcel airlift fees have only been increased three times since Postal Reorganization." USPS T-39 at 56. The Postal Service has not studied the costs of providing Parcel Airlift, so the cost coverage for this service cannot be calculated. USPS Exhibit-30C.

[5988] The Commission urges the Service to study the cost of this service. Given the current lack of information about costs for this service, the Commission does not recommend a change in the fees.

16. Special Handling (Schedule 952)

[5989] The Postal Service also is seeking dramatic increases in fees for special handling. Special handling provides expedited handling for Standard Mail subclasses, and is required for Standard Mail parcels containing live poultry, crickets, honey bees, and other similar items. The current fee of $5.40 for Special Handling service up to 10 pounds is proposed to increase by 219 percent to $17.25. The present fee of $7.50 for

Special Handling service over 10 pounds is proposed to increase by 220 percent to $24.00.

[5990] The Postal Service is requesting huge increases because "unit costs for special handling have more than tripled since the last omnibus rate case proceeding, Docket No. R94-1." USPS T-39 at 84. Larger increases are not sought because of § 3622(b)(4), the impact of price increase on mailers. Cost coverage will only be 102 percent with the requested fees in place. *Ibid*.

[5991] Special handling volume has declined precipitously, from 15 million pieces in 1970 to 67 thousand in 1996. However, the Postal Service does not believe the service should be eliminated. Witness Needham believes that that there are few alternatives in the marketplace, and, consequently, the Postal Service should continue to offer the service rather than eliminate it. *Id*. at 85.

[5992] Well into the rate case several poultry organizations with members that rely on special handling intervened as limited participants. These organizations, the Ohio Poultry Association, Texas Poultry Federation, Iowa Poultry Association, and Nebraska Department of Agriculture Poultry/Egg have members, hatcheries, that raise baby chickens and ship them via special handling to farmers. They testify that the "U.S. Postal Service is the only carrier that presently delivers live chicks." They cite as an example of the importance of special handling, the Mt. Healthy Hatcheries in Mt. Healthy, Ohio. This hatchery shipped 10,432 orders last year, and from January through the beginning of September, the hatchery spent $107,000 in postage.

[5993] The American Federation of Beekeepers also intervened in R97-1, voicing similar concerns about a "disastrous effect on the beekeeping industry" and other small businesses relying on special handling. Notice of Intervention of the American Beekeeping Federation Inc. at 1.

[5994] The OCA believes the IOCS data underlying the reported costs for special handling are an insufficient basis for such a huge fee increase. The OCA comments on the data:

> Witness Degen provided the estimated coefficients of variation, and the lower and upper 95 percent confidence limits for Special Handling, using both the "Old Methodology" and his "New Methodology." His Table shows that the costs of Special Handling under the "Old Methodology," at the 95 percent confidence level, could vary between $ -3,000 and $486,000, and under the "New Methodology" could vary between $ -7,000 and $370,000. These variances are very large and very speculative, so much so as to even include ZERO. Clearly, these costs are not sufficient for ratemaking—especially when they produce rate increases of the magnitude proposed here.

OCA Brief (Second Section) at 175 (citing Response to POIR No. 8, question 10). The OCA also notes that costs are based on very few tallies; this means there will be fluctuations in the reported costs. *Id.* at 175 (citing Response to POIR No. 8, question 6(a), 7). Observing that the data are flawed and citing the degree to which customers rely on the service for which there are few alternatives, the OCA concludes that it would be "unconscionable" to grant the Postal Service's request for such a large fee increase. *Id.* at 175-76. The OCA also points out that the U. S. Supreme Court has directed the Commission to "'press for better data' rather than 'construct an attribution' based on unsupported inferences of causation." National Ass'n of Greeting Card Publishers v. United States Postal Service (NAGCP), 462 U.S. 810, 827 (1983).

[5995] The Postal Service attempts to justify its reports of remarkably high costs for special handling on brief. The Service claims that now only the most costly items receive special handling. USPS Brief at VI-44 (citing Tr. 31/16432). Experience with special handling mail has declined as volume has dropped off, so processing is less efficient. *Id*. (citing Tr. 31/16433, 16437). In an effort to explain why total costs have been increasing while volume has been declining, the Service points out that from 1995 to 1996, this was not the case. *Id*. at VI-45. *See also* Response to P.O. Information Request No. 8, Table 1. Finally, the Postal Service attempts to distinguish the U. S. Supreme Court's decision in NAGCP from the analysis of special handling costs: "[t]hat holding does not apply because no issues have been raised concerning whether the tallies for special handling

have been caused by special handling service. No inferences of causation are necessary." Postal Service Reply Brief at VI-44.

[5996] *Commission Analysis*. The Commission will not recommend any change in special handling fees until the Service provides reliable data. If the Commission tripled the fees as the Postal Service proposes, the impact could be devastating for small businesses that rely heavily upon special handling, a service with few alternatives. The Postal Service's interpretation of NAGCP is far too narrow. The Court was referring to the causal analysis needed to determine what costs a subclass or service is causing. 462 U.S. at 826-27. In fact, the Commission is questioning whether the costs reported by the IOCS are caused by special handling.

[5997] There is good reason to question these reported costs. Reported total costs have generally increased as volume has precipitously decreased. This is very counterintuitive and the Service cannot explain this phenomenon. Its theory that the less costly pieces have left the system only explains why cost per piece has increased. Furthermore, the coefficient of variation for total costs is very high, suggesting unreliable cost data. Response to P.O. Information Requests No. 8, Question 10 (indicating coefficient of variation of over 50 percent). *See also* USPS T-12, Table 6 (providing coefficients of variation for other subclasses and services). This is not surprising given the limited number of tallies from which the data is derived. Response to P.O. Information Request No. 8, Question 6(a) (only nine tallies were collected in 1996). The Service has indicated it may study special handling's costs "in order to gain a better understanding of recent cost increases for special handling." Reply Brief at VI-44 n.45. Pending the completion of such a study, no increase can be justified on the record in this case.

17. Stamped Cards (Schedule 962)

[5998] Stamped cards are available at postal retail units for the price of a First-Class postcard rate, currently 20 cents. The postage is pre-affixed to the card. The

Postal Service is seeking a fee for providing the stamped card over and above the price of postage. The Postal Service requests a 2-cent fee for stamped cards and a 4-cent fee for double stamped cards, which have two stamped cards to enable the recipient to reply to the mailer.

[5999] In MC96-3, postal cards were renamed stamped cards and made a special service classification. Because the Postal Service was double counting manufacturing costs that were already considered in determining postage rates in the First-Class card subclass, the Commission declined to create a two-cent fee for stamped cards. PRC Op. MC96-3 at 136-40.

[6000] Manufacturing costs for stamped cards are 0.79 cents and the cost coverage, if priced at two cents, would be over 200 percent. USPS-T-39 at 89. Witness Needham supports the case for a two-cent fee by arguing that stamped cards are a high value service. "With the postage pre-affixed and the stationery already provided in the price of the stamped card, measurable convenience is offered to those customers valuing their time. No additional effort is necessary to purchase a postcard separately from the postage." *Ibid*. Hence, a high cost coverage is appropriate. *Ibid*.

[6001] Intervenor Carlson argues that the Postal Service's proposed fee for stamped cards would lead to a cost coverage of 303 percent, although he calculates it differently than the Postal Service by including mail processing costs and 21 cent postage in his calculation. Witness Carlson also proposes creating a separate postage rate for the Postal Service's own stamped cards because they have lower processing costs than other cards. Tr. 24/12799-800. He points to data suggesting dramatic cost differences (stamped cards incur manufacturing and processing costs of 7.6 cents as opposed to 18.7 cents for private post cards). *Id*. at 12798. Witness Carlson believes stamped cards are more automation compatible than private post cards, which are likely to be handwritten. *Ibid*. Private post cards, he claims, often have glossy pictures on them and cannot receive the RBCS ID tag or the Postnet Barcode. *Ibid*. Witness Carlson also relies on testimony by Postal Service witness Patelunas in MC96-3, who

stated that processing costs for stamped cards are lower than for private post cards because of automation compatibility. *Ibid*. (citing Tr. 19F/10090).

[6002] For these reasons, witness Carlson suggests a combined rate and fee of 20 cents for stamped cards. *Id.* at 12802. This would "reward customers for producing mail that is more compatible with automation." *Id*. at 12800. While he considered having a separate rate and fee for Stamped Cards, witness Carlson "concluded that the benefits of having a single, combined rate outweighed any benefit from a separate stamped-card fee." *Id*. at 12802. Witness Carlson contends his proposal will have less negative impact on revenue than the Service's 2-cent fee proposal, but he "cannot quantify the precise amount." *Id*. at 12806.

[6003] On brief, the Service argues that there is not sufficient data to create a separate rate for stamped cards. The Service claims to have stopped collecting data for stamped cards (then termed postal cards) because the data were unreliable due to misidentification of stamped cards as private cards. Postal Service Brief at V-74. According to the Service, there exists only a partial year of this inaccurate data upon which Carlson would have the Commission construct a separate classification. *Id*. at V-73. The Service urges the Commission to reject the classification request as inadequately based on incomplete costs from FY1996. *Id*. at V-75. In his Reply Brief, witness Carlson points out that the Service's claims of flawed data are not based on any studies and are premised more on "deductive reasoning" than any evidence that the cost data are incorrect. Carlson Reply Brief at 2.

[6004] *Commission Analysis*. The Commission agrees with witness Carlson that the evidence suggests that mail processing costs are lower for stamped cards than private cards because of physical differences between the types of cards. Nonetheless, the Commission declines to adopt witness Carlson's proposal for a separate rate as there is considerable uncertainty as to the extent of the difference in processing costs. Also, the Commission would have to forecast volumes, revenues and costs based on insufficient data. If the Service concludes that it is able and willing to collect reliable data

concerning the mail processing costs of stamped cards, the Commission will revisit the issue.

[6005] The Commission recommends fees that are half of those proposed by the Postal Service. A one-cent fee for a stamped card easily covers manufacturing costs and makes an adequate contribution with a cost coverage of 125 percent (Criterion 3). The cost coverage should be relatively low for this service, so that it will provide a low cost method by which an individual can send mail.

18. Money Orders (Schedule 971)

[6006] Money orders are used primarily by people of modest means who may not have checking accounts. There are four money order fees: Military(APO\FPO), Domestic, International and Inquiry. USPS-T-39 at 37. The Postal Service does not seek any change in the pricing of its money orders. Witness Needham indicates money orders are priced at a level that "precludes the possibility of unfair competition for commercial alternatives." *Id.* at 43.

[6007] Due to a change in costing methodology, cost attributed to money orders has declined substantially leading to a higher cost coverage. At the current fees, cost coverage for money orders is 203 percent, which includes revenue earned by "float." Exhibit USPS-30C. The Commission recommends a five cent decrease in the fee for a domestic money order to $0.80. Even with this decrease, the 147 percent cost coverage for money orders (not including float) is close to the system-wide cost coverage. A low cost coverage is appropriate for a service relied upon by consumers with modest incomes. *See* USPS T-39 at 44. The service still makes a significant unit contribution to recovering institutional costs.

19. Annual Permit Fees (Schedule 1000)

[6008] The Postal Service proposes to increase the following fees from $85 to $100: 1) First-Class Mail presort fee; 2) Standard A bulk mailing fee; 3) Standard B special presort mailing fee; 4) destination bulk mail center fee; 5) merchandise return fee; and 6) permit imprint fee. The first four fees generally enable mailers to receive discounted mail rates provided that they prepare the mail according to standards detailed in the Domestic Mail Manual. The merchandise return fee simply authorizes mailers to use merchandise return service. Permit imprint fees allow mailers to preprint mail with postage indicia and a permit number in the front upper right-hand corner, rather than use stamps or metered postage on the pieces. All classes of mail are eligible for mailing under a permit imprint. USPS-T-40 at 24.

[6009] The unit cost for administration of these permits is $87.17. *Id*. at 25. If the fee is raised to $100, cost coverage will be 115 percent.

[6010] The Commission recommends that these fees increase to $100. This increase, while substantial, produces the modest cost coverage noted above. These fees cover the costs of administering the permits and make some contribution. Although the Service did not include the bulk parcel return service fee in its Request, as its proposal for the new service was pending, the Commission recommends that the fee be raised to $100 to be consistent with the other fees.

a. Periodicals Application Fees

[6011] There are four fees associated with Periodicals applications. The original entry fee is a one-time fee paid by mailers who wish to obtain Periodical mailing privileges for their publications. *Id*. at 26. The Postal Service wishes to keep this fee at $305. *Ibid*. The additional entry fee must be paid when a mailer would like to mail from an office other than where the original entry was granted. The additional entry fee is currently $85 and the Postal Service proposes to lower this fee to $50, setting it equal to

the current reentry fee and the registration fee for news agents. The Postal Service indicates that additional entry applications are now receiving processing essentially identical to reentry applications; the Service uses Form 3510 for both applications. *Id*. at 28. Additional entry applications have unit costs of $44.65. *Ibid*. The reentry fee is required of mailers when the status of an authorized publication changes, with a change in name, number of issues or office of publication. The news agent fee covers the costs incurred processing requests by authorized news agents who handle two or more publications by different publishers. The Postal Service proposes to keep these two fees at $50.

[6012] The Commission recommends these fees as proposed. The fee structure is simplified by creating uniform fees for additional entry, re-entry and registration of news agents. The recommended fees better reflect the costs of administering additional entry applications and the cost coverage for these fees is 129 percent, below the average of all special services.

VI. DOMESTIC MAIL CLASSIFICATION SCHEDULE

A. The Postal Service's Request

[6501] The Postal Service's Request incorporates by reference the Domestic Mail Classification Schedule (DMCS) in effect as of July 10, 1997, the date the Request was filed. The Service's proposed classification changes, set out in Attachment A of the Request, include substantive changes; conforming editorial changes; reorganization and renumbering of Special Services; and minor editorial revisions. Proposed rate and fee changes appear in Attachment B of the Request.

[6502] Since the filing of the Request, substantive DMCS provisions recommended by the Commission and approved by the Governors in Docket No. MC97-3, Bound Printed Matter Weight Limitations, and Docket No. MC97-4, Bulk Parcel Return Service and Shipper Paid Forwarding Classifications and Fees, have been added to the DMCS. *See* PRC Order No. 1212 (April 20, 1998). Recommended DMCS changes in Docket No. MC97-5, Provisional Packaging Service, were transmitted to the Governors on March 31, 1998.

[6503] Provisions associated with an experimental service offering for prebarcoded parcels (DMCS § § 221.41 and 223.4), which were in effect when the Service filed its Request, expired April 28, 1998.

B. Issues Raised by Commission in Notice of Inquiry No. 2

[6504] On November 19, 1997, the Commission issued a Notice of Inquiry soliciting participants' views on several matters related to classification policy, as well as their views on various organizational and editorial improvements in the Domestic Mail Classification Schedule. The issues pertaining to organizational and editorial improvements related primarily to the Special Services but, to a limited extent, also affected the classes of mail. *See* Notice of Inquiry No. 2 (November 19, 1997) on Items of Classification Policy and DMCS Improvements. The Commission received comments in response to its Notice of Inquiry from the Postal Service and from three other participants. The matters raised in Notice of Inquiry No. 2 and the Commission's recommendations with respect to those matters are discussed below:

1. Bulk Parcel Post — Appropriate DMCS Status

[6505] The Commission solicited participants' views on the proposed DMCS treatment of Bulk Parcel Post in the Postal Service's Request. The Commission noted that the Postal Service's proposed section designation (§ 322.2) for the new provisions related to Bulk Parcel Post suggested that the Postal Service may have ascribed to Bulk Parcel Post the status of a new subclass of Standard Mail. If the establishment of a new subclass was not intended, the Commission asked participants whether "322.13" would be an appropriate section designation or, if not appropriate, what would be an appropriate designation.

[6506] In response to Notice of Inquiry No. 2, the Postal Service stated that it did not intend to make any substantive classification change in the DMCS treatment of Bulk Parcel Post. Rather, it intended only to "reflect, within the current numbering system, the *status quo* as determined by the Governors" in Docket No. MC95-1. Response of the United States Postal Service to Notice of Inquiry No. 2 (Postal Service Response) at 3. The Service interpreted the Commission's Notice of Inquiry as proposing that Bulk Parcel

Post be identified in the DMCS as a "rate category." Ibid. The Service expressed the view that such a proposal would constitute a substantive change requiring record support.

[6507] In addition to the Postal Service, the Commission received responses to Notice of Inquiry No. 2 from the Parcel Shippers Association (PSA) and from CTC Distribution Services (CTC). PSA's response states that if the Postal Service intended to create a new subclass for Bulk Parcel Post in its Request, the Service did not accomplish its purpose. PSA points out that under the Postal Service's proposal, it appears that none of the DBMC, DSC and DDU discounts would be applicable to Bulk Parcel Post but would apply only to regular parcel post. PSA has a valid point, since the definition of the parcel post subclass in section 322.1, as proposed, specifically excludes matter mailed under section 322.2 (Bulk Parcel Post). PSA states it has always believed that Bulk Parcel Post "should be" in a separate subclass. It points out that there are significant cost differences between single-piece and bulk parcels and that there is an entirely different market. It concludes: "Unfortunately, it appears that, rather than proposing a new subclass for bulk parcels, as it should have, the Postal Service merely made a mistake." Response of Parcel Shippers Association to Notice of Inquiry No. 2 (PSA Response) at 1.

[6508] CTC expresses the view that Bulk Parcel Post currently has subclass status in the DMCS and that the Postal Service's proposal is consistent with the *status quo*. CTC states that Bulk Parcel Post appears to have been treated as a separate subclass within Fourth-Class mail since the Commission's opinion in Docket No. MC73-1. CTC admits that it has not studied the Commission's opinion in MC73-1, but points out that the "important language" from that opinion was quoted in the Governors' decision in Docket No. MC95-1. CTC states that it is not apparent why the Commission sought to reclassify Bulk Parcel Post as a rate category in MC95-1.

[6509] In Docket No. MC95-1, the Postal Service proposed to identify Bulk Parcel Post as a separate subclass and designated the new subclass in the DMCS as § 322.2. The subclass provisions included two rate categories: Basic Rate and Destination BMC

Rate. The Commission rejected the Postal Service's proposal stating that it "would produce a substantive change in the status of bulk parcel post, which currently consists of two rate categories." PRC Op. MC95-1, para. 6056. In lieu of the separate subclass, the Commission proposed a new DMCS section 322.13 entitled "Bulk Parcel Post Rate Category." The Commission also recommended inclusion of the "Destination BMC Rate Category" (§ 322.14). The Commission stated that its recommended provision preserved the rate category status of bulk parcel post. Id., para. 6057. The Commission's recommended rate category for Bulk Parcel Post was rejected by the Governors. The Governors stated that "[t]he language of the current DMCS provisions cited by the Commission, however, explicitly identifies Bulk Parcel Post neither as a rate category nor as a subclass." Notice of USPS of the Decision of the Governors (March 5, 1996) at 6. The Governors noted that Bulk Parcel Post was established by the Commission in Docket No. MC73-1. The Governors cited examples from the Commission's opinion where the Commission speaks in terms of a new "subclass" or "subclassification" for bulk parcel post mailings. The Governors stated that "the Commission has never presented us with a new recommended decision that would bear on this issue, and its Opinion in Docket No. MC73-1 remains the most recent indication from the Commission of the classification status of Bulk Parcel Post." Id. at 7. The Governors stated that the DMCS language recommended by the Commission in MC95-1 was "clearly at odds" with what the Commission said in Docket No. MC73-1. Ibid. The result of the Governors' decision in MC95-1 was to leave in effect the then current Bulk Parcel Post provision — DMCS § 400.0202 — which remains in effect today.

[6510] In Docket No. MC73-1, the Commission recommended new DMCS language relating to bulk mailings of parcel post. The Postal Service had proposed amending the parcel post rate structure in order to provide simplified computation of parcel post postage for volume mailers. In its opinion, as noted by the Governors in MC95-1, the Commission's discussion of the bulk parcel post proposal falls under the heading: "New Subclassification For Parcel Post Is Appropriate." PRC Op. MC73-1 at 42. The Commission's discussion describes the settlement agreement reached by the

participants and states that the agreement achieves the goals of the original proposal — i.e., simplify computation of postage for volume mailers without threatening a significant reduction in postal revenues. The Commission explained that the existing fourth-class parcel post category was being amended to distinguish single-piece and bulk mailings. The Commission concluded its discussion of the bulk parcel post proposal with the statement: "We find, therefore, that the subclass for bulk mailings of parcel post recommended by the Commission is fair and equitable and is desirable from the point of view of both the user and the Postal Service." Id. at 44. This last statement also was cited by the Governors in MC95-1 as support for their position that the Commission had intended to create a separate subclass for Bulk Parcel Post when established in MC73-1.

[6511] Upon careful review of the Commission's opinion in MC73-1, however, it is evident that the term "subclass" was not used by the Commission with the same precision that was employed in later proceedings, particularly the proceedings in MC95-1. In Docket No. MC73-1, the Commission also recommended a new presort discount for volume mailers of Special Rate Fourth-Class mail. The Commission's explanation of the recommended discount appears under the heading: "The Commission Recommends the New *Subclassification* for Special Rate Fourth-Class." Id. at 53. (emphasis added) The Commission recommended that the present classification — Special Rate Fourth-Class — be "amended to distinguish single-piece and presorted mailings for rate purposes." Id. at 54. The Commission's concluding statement reads, in part: ". . . we find that the new *subclassification* for special rate fourth-class is fair and equitable . . .." Id. at 59 (emphasis added). Notwithstanding the Commission's use of the term "subclassification" in connection with its recommendation of presort discounts for volume mailers of special rate fourth-class mail, there has been no suggestion that the Commission intended to create a new "subclass" for presorted mailings of special rate mail. Rather, it appears that the Commission, at least in the MC73-1 proceedings, used the terms "subclass" and "subclassification" indiscriminately when discussing new mail or rate categories or discounts.

[6512] A review of Commission opinions issued after MC73-1 offers support for the view that the Commission did not intend to create a distinct subclass for Bulk Parcel Post.

[6513] In Docket No. R77-1, several intervenors questioned whether the legal status of presorted First-Class Mail was that of a rate category or an independent subclass. The intervenors argued that presorted First-Class Mail was established as a separate subclass for purposes of 39 U.S.C. § 3622(b). In support of their view that presorted First-Class Mail was intended to be a separate subclass, the intervenors pointed to the Commission's use of the term "subclass" to describe the proposal as it appeared in the Postal Service's filing in Docket No. MC73-1.

[6514] The Commission replied that there was little significance in its reference to presorted First-Class Mail as a subclass in the introductory portion of its opinion in MC73-1. The Commission pointed out that the term "subclass" ". . . is a term which is used in a descriptive manner throughout the Postal Service filing and our Opinion. *The mere use of this label is not sufficient to establish absolute legal categories....*" PRC Op. R77-1 at 244 (emphasis added).

[6515] The Commission also found that the Postal Service's agreement to include presorted First-Class Mail in its ongoing cost data systems does not necessarily imply that a separate subclass was intended. Ibid. The Commission concluded that "for purposes of § 3622(b), presorted First-Class Mail is a rate category rather than a separate subclass and, therefore, neither separately developed attributable/assignable costs, nor a separately determined cost coverage are mandatory." Id. at 242.

[6516] Finally, the Commission advised the Postal Service that if, in the future, it intended to treat presorted First-Class Mail as a separate subclass for purposes of §3622(b), it should first file a request with the Commission for a recommended decision establishing the existing presorted rate category as an independent subclass. Id. at 249.

[6517] In Docket No. R80-1, the Commission was required to determine whether one or more of the presort categories of First-Class mail should be afforded the status of a subclass, to which all the § 3622(b) factors must be applied in determining rates, or

whether they should remain rate categories for which such approach to rate determination is not mandatory. PRC Op. R80-1, para. 0673. The Commission pointed out that in Docket No. R77-1, the Commission concluded that the purpose of First-Class presort discounts was to bring about a structural reform within First Class in order to align rates with costs, rather than give recognition to unique characteristics of presorted First-Class Mail, which would warrant an independent application of all the § 3622(b) factors. Id., para. 0679.

[6518] The Commission explained that "[in] the case of postal services, the legal consequence of establishing a separate classification is not merely to allow a distinct rate to be charged, but to make applicable all of the various criteria of § 3622(b) when determining that rate." Id., para. 0684. The critical factors to be considered are "whether the cost characteristics and market demand characteristics of presorted First-Class [Mail] are sufficiently different to warrant independent evaluation under the § 3622(b) factors." Id. at 0686. The Commission concluded that "the record does not adequately demonstrate that there are unique demand characteristics for presorted First-Class Mail that would warrant treating such mail as a separate subclass for purposes of § 3622(b)." Id,. para. 0692.

[6519] In Docket No. R84-1, the Postal Service proposed rate increases for each of the fourth-class subclasses. In addition, the Postal Service proposed that mailings of 2,000 pounds or more would qualify as bulk parcel post, regardless of the number of pieces. The Commission's discussion of the fourth-class mail proposals does not identify bulk parcel post as a separate subclass. To the contrary, the Commission explains that there are "four subclasses" of fourth-class mail and goes on to describe the makeup of parcel post, special rate, library rate and bound printed matter. PRC Op. R84-1, para. 5504. In describing the Postal Service's bulk parcel post proposal, the Commission explains: "No rate difference exists for bulk parcel post; its only advantage over single-piece is simplified postage." Id., para. 5576. The term "subclass" is not used in connection with the Commission's discussion of bulk parcel post, and in the Commission's summary of statutory considerations, there is no reference to bulk parcel

post as a separate subclass. Id., para. 5592-94. The Governors accepted the Commission's classification recommendations applicable to fourth-class mail without comment. Decision of the Governors, Docket No. R84-1 at 14.

[6520] In Docket No. MC86-1, the Postal Service proposed to offer discounted rates to mailers who bring parcel post to the BMC serving the area to which the parcels are addressed. In the Commission's discussion of costs attributable to each subclass, there is no mention of a bulk parcel post subclass. PRC Op. MC86-1, paras. 214-220.

[6521] In Docket No. R87-1, the Postal Service again proposed rate increases for each of the fourth-class subclasses. The Commission again explained that there are "four subclasses" of fourth-class mail. PRC Op. R87-1, para. 5887. Throughout its lengthy discussion of parcel post, the Commission speaks in terms of a single subclass. There is no reference to a bulk parcel post subclass. Id., paras. 5891-5948.

[6522] There is little support for the Governors' position, set forth in Docket No. MC95-1, that the Commission intended to establish Bulk Parcel Post as a separate subclass in Docket No. MC73-1. There never has been developed or proposed for Bulk Parcel Post a distinct rate based on application of the criteria set forth in 39 U.S.C. § 3622(b). Moreover, as the Commission explained in its opinion in Docket No. R77-1, in reference to its earlier opinion in Docket No. MC73-1, the term "subclass" was used in a descriptive manner throughout the Postal Service's filing and the Commission's opinion in MC73-1, and "[t]he mere use of this label is not sufficient to establish absolute legal categories...." PRC Op. R77-1 at 244.

[6523] Therefore, it would be inappropriate in this case to adopt the section designation proposed by the Postal Service for Bulk Parcel Post (§ 322.2), since such designation would suggest that Bulk Parcel Post is a distinct subclass similar to Parcel Post (§ 322.1), Bound Printed Matter (§ 322.3), Special (§ 323.1) and Library (§ 323.2). The Postal Service's proposed designation reflects the "status quo," as suggested by the Service in its response to Notice of Inquiry No. 2, only if one agrees that Bulk Parcel Post currently has subclass status. (The Commission notes that the section designation recommended by the Postal Service in this case (§ 322.2) is identical to the designation

for the Bulk Parcel Post Subclass proposed by the Service in Docket No. MC95-1.) The Postal Service advises that it currently is re-examining its line of parcel services as part of the planning process for improving these services. The Service suggests that this process may lead to opportunities in the future for the Commission to resolve, in a more informative context, the issue of the appropriate DMCS treatment of Bulk Parcel Post. The Service requests, therefore, that the Commission not pursue its suggested alternative at this time.

[6524] The Commission agrees that the appropriate DMCS status of Bulk Parcel Post should be considered and resolved in a more informative context. In the interim, the Commission is recommending the Service's proposed Bulk Parcel Post provisions (with the exception of the hazardous materials surcharges). The Bulk Parcel Post provision is identified specifically neither as a rate category nor as a subclass as is the case in the current DMCS. The section designation recommended by the Commission is consistent with the current numbering system of the DMCS.

2. Bulk Insurance — Minimum Quantity

[6525] The Commission requested participants' views on one aspect of the Service's proposal to establish within the insurance service an option for bulk mailers. The new option would allow qualifying mailers to purchase insurance by using electronic manifesting. *See* proposed section 943.22 in Attachment A of the Service's Request. The Commission noted that the Service's proposal did not include language establishing a minimum quantity for utilization of the proposed bulk insurance option. The Commission questioned whether the Postal Service's apparent intent to establish such a minimum quantity by regulation is consistent with past interpretations of the scope and extent of the DMCS and suggested that such requirements or limitations be set forth in the DMCS.

[6526] In its response to Commission Notice of Inquiry No. 2, the Postal Service pointed out that the window service cost avoidance for bulk insurance mailers does not

depend on a minimum volume, since the proposed insurance would be purchased by using electronic manifesting, rather than through the window. The Service suggested that the requirement of electronic manifesting could be used in lieu of a minimum quantity requirement. The Service advised the Commission, however, that it is "seriously considering the establishment of a conservative minimum quantity to use for the initial implementation of bulk insurance service." Postal Service Response at 4. If such a minimum quantity were established, the Service assured the Commission that it would review the minimum as the bulk insurance program is implemented, with the hope of reducing or eliminating it in order to increase the utilization of the bulk insurance option. The Postal Service expressed its view that the inclusion of a minimum quantity for bulk insurance in the DMCS would make it more difficult to open up the program to additional customers as soon as possible. Id. at 5.

[6527] While the Commission believes that requirements or limitations that establish eligibility for utilization of special services or classes of mail should be set forth in clear terms in the DMCS, the Commission finds reasonable the Service's explanation for not including a minimum quantity requirement for its bulk insurance option in the DMCS. However, the Commission assumes that any such minimum quantity that is established in the future by regulation of the Postal Service will be of limited duration. Since it is clear on the record that electronic manifesting will be required for the purchase of bulk insurance, the Commission is recommending that such requirement be set forth explicitly in the DMCS.

3. Hazardous Materials Surcharges

[6528] In its Request, the Postal Service proposed to establish new surcharges for the handling of hazardous medical materials or other hazardous materials. The Commission solicited comments on whether it would be appropriate to identify the handling of hazardous materials as a special service in the DMCS, assuming the Commission were to recommend the Service's proposed surcharges.

[6529] In its response to Notice of Inquiry No. 2, the Postal Service stated that it did not propose a special service in connection with the hazardous materials surcharges because "there is no specific value-added or 'special' service being offered." The Service explained, further, that the proposed surcharges "are based on greater costs for these types of mail." Id. at 6.

[6530] For the reasons discussed in Chapter V, above, the Commission is not recommending the establishment of surcharges for hazardous materials, as proposed by the Postal Service. Therefore, it is not necessary to resolve the question of whether the handling of such materials should be identified as a special service in the DMCS.

4. Improvements in Special Services Provisions

[6531] In recently completed reclassification cases (Docket Nos. MC95-1 and MC96-2), the Postal Service proposed, and the Commission recommended, significant improvements in the organization, format and editorial presentation of the underlying provisions of the DMCS. However, in its Request in Docket No. MC96-3, Special Services Reform, the Postal Service failed to meet the standards of its earlier reclassification efforts and essentially left intact the format and text of the Special Services section of the DMCS. Believing that the Service's filing in Docket No. MC96-3 could provide an opportunity for consideration of comprehensive improvements in the Special Services section of the DMCS, the Commission issued a Notice of Inquiry No. 2 inviting all participants in the proceeding to submit comments on various improvements in the organization, format and editorial presentation of the Special Services provisions. The Commission's suggested improvements included a new numbering system more closely resembling that used for the classes of mail; new or revised internal headings based on provisions that are common to most of the Special Services; editorial revisions designed to improve the content, clarity and readability of the Special Services provisions; and minor editorial changes affecting stylistic conventions, punctuation,

grammar and basic terminology. *See* Notice of Inquiry No. 1 (November 14, 1996) in Docket No. MC96-3.

[6532] In comments filed in response to Notice of Inquiry No. 1, both the Postal Service and the Office of Consumer Advocate generally agreed that comprehensive improvements would be desirable but suggested that such improvements not be pursued in the pending proceeding (MC96-3). The Postal Service expressed its desire for an opportunity to give thorough consideration to the proposed changes without being constrained by the procedural deadlines of the pending proceeding. Comments of the United States Postal Service in Response to Commission Notice of Inquiry No. 1 at 5. The Commission acceded to the commenters' suggestions for postponement and, accordingly, recommended only limited changes in the underlying provisions of the DMCS in Docket No. MC96-3.

[6533] In this proceeding (R97-1), the Postal Service responded, in part, to the Commission's interest in considering comprehensive improvements in the Special Services section of the DMCS. In its Request, the Postal Service proposed to reorganize the Special Services into seven subject-matter categories with new organizational headings, renumber the reorganized Special Services sections into a 900 series, and make numerous non-substantive, editorial changes to promote clarity, consistency and conciseness in the DMCS.

[6534] In Notice of Inquiry No. 2, the Commission solicited participants' views on certain comprehensive organizational and editorial improvements in the Special Services section of the DMCS. The Commission presented sample versions of extensively revised DMCS provisions for selected Special Services. Participants were advised that the proposed revisions were not intended to alter the substance of the affected provisions but were intended to improve the clarity, consistency and organization of the DMCS. *See* Notice of Inquiry No. 2 (November 19, 1997) on Items of Classification Policy and DMCS Improvements at 3.

[6535] On December 19, 1997, the Postal Service filed its comments in response to the Commission's Notice of Inquiry No. 2. With respect to the Commission's proposed

improvements in the Special Services provisions of the DMCS, the Service expressed its concern that the proposed changes may have substantive effect since they involve substantial rewording. The Service expressed its view that such rewording of the DMCS provisions "would be better introduced closer to the beginning of a more limited proceeding, and with more specific explanation of the wording changes." The Service advised the Commission that it is in the process of reviewing many of its Special Services and that it expects to decide about proposing DMCS changes in the near future. Postal Service Response at 7 (footnote omitted). The Service, therefore, urged the Commission to defer consideration of its proposed changes until after the Service has had an opportunity to consider the need to propose substantive changes to selected Special Services. Id. at 8.

[6536] The Commission continues to believe that the Special Services section of the DMCS warrants extensive revision along the lines suggested by the Commission in Attachment Four to Notice of Inquiry No. 2. The input and cooperation of the Postal Service is important to the successful completion of such an undertaking. The Commission appreciates the Service's desire to complete its review of the Special Services before being required to consider any additional substantive changes in those provisions. However, as evidenced by its issuance of Notice of Inquiry No. 2, the Commission is resolved to improving the clarity, consistency and organization of the Special Services section of the DMCS. The Commission, therefore, requests that the Postal Service submit to the Commission, within six months following the date of the Governors' decision in this proceeding, a report on the status of its review of the Special Services and an estimate of the date by which the Service will be prepared to consider or propose appropriate changes that will substantially improve the Special Services section of the DMCS.

[6537] With respect to the Special Services improvements proposed by the Service in this docket, the Commission is accepting the Service's proposed subject-matter categories, its proposed renumbering of the Special Services sections into a new 900 series, and the majority of its proposed non-substantive editorial changes. Other Special

Services changes proposed by the Service in this proceeding are discussed under part C, below.

5. Forwarding and Return Provision

[6538] Attachment Three of the Commission's Notice of Inquiry No. 2 contained a working draft, prepared by Commission staff, of the Forwarding and Return provisions of section 353.1 of the DMCS. The draft incorporated changes to section 353.1, which had been approved by the Governors of the Postal Service in their October 5, 1997 decision in Docket No. MC97-4 (Bulk Parcel Return Service and Shipper-Paid Forwarding). The draft also reflected the elimination of Single-Piece Standard Mail, as proposed by the Postal Service in that docket. The Commission expressed the view that the addition of the new forwarding and return options established in Docket No. MC97-4 have added complexity to section 353.1. The Commission solicited participants' views as to whether more extensive editorial revisions would improve the clarity of section 353.1.

[6539] In its response to the Commission's Notice of Inquiry, the Postal Service expressed its view that further editorial changes in section 353.1 are unnecessary at this time. The Service stated its belief that "the provision as currently worded is both accurate, and understood by users of the services." Response of the United States Postal Service to Notice of Inquiry No. 2 at 10. The Service advised the Commission that the forwarding and return services and the effect of the proposed elimination of Single-Piece Standard Mail are matters that the Service is actively studying for additional refinement and improvement. Therefore, according to the Service, there may be opportunities in the future to reconsider the language of section 353.1 in a fuller context.

[6540] While the Commission continues to believe that additional editorial changes in section 353.1 may be warranted to improve the clarity of that section, the Commission accepts the Service's view that there will be an opportunity to consider such further changes in a future proceeding. Accordingly, the Commission is not recommending any additional changes in the forwarding and return provisions of section 353.1.

6. Editorial Corrections in Special Services Section

[6541] In Notice of Inquiry No. 2, the Commission solicited comments on several matters related to the Service's proposed changes in the Special Services section of the DMCS. Several of the matters involved apparent erroneous section references or designations.

[6542] In its response to the Commission's Notice of Inquiry, the Postal Service confirmed that certain section references and designations appearing in Attachment A of its Request were erroneous, and it provided corrections for the items in question. Postal Service Response at 10-12.

[6543] The Commission noted that the Postal Service has proposed to eliminate the words "Classification Schedule" which appear in the title of each Special Service. The Commission pointed out, however, that within the text of several of the Special Services sections set forth in Attachment A of the Service's Request, the term "classification schedule" is used in reference to a particular Special Service. The Commission questioned whether the continued use of the term "classification schedule" is appropriate when referring to individual Special Services, given the Postal Service's proposed change in the title of each of the Special Services.

[6544] In its response to the Commission, the Postal Service advised that its continued use of the term "classification schedule" when referring to individual Special Services was inadvertent, and it stated that the references could be eliminated. Id. at 10. The Commission is recommending the elimination of such references.

[6545] The Commission questioned whether the section designation "921" and accompanying title, "POST OFFICE BOX AND CALLER SERVICE," should be deleted, since Caller Service and Post Office Box Service appear to be identified in Attachment A of the Service's Request as two separate services. The Postal Service replied that Post Office Box Service and Caller Service should be treated as a single Special Service, because the Postal Service's data systems produce a single revenue figure and a single cost figure for post office box and caller service for purposes of determining a cost

coverage figure. The Service recommended that Caller Service be designated as section 921.1 and Post Office Box Service as section 921.2. Id. at 10 and 11. The Commission is recommending the changes to section to 921 proposed by the Postal Service.

[6546] Finally, the Commission questioned whether the references to "Insured Mail," appearing in numerous sections of the Service's Attachment A, should be changed to "Insurance" in view of the Service's proposed change in the title of section 943. The Postal Service responded that the references to "Insured Mail" in the Special Services section of its Attachment A should be changed to "General Insurance" to be consistent with the Service's proposed title for section 943.2. Id. at 12. The Commission agrees with the corrections proposed by the Service and is recommending those changes.

7. Standard Mail References

[6547] The Commission solicited participants' views on the appropriateness of amending the DMCS to incorporate the labels "Standard A," "Standard B" and "Standard C" as general references for the various subclasses of Standard Mail. The Commission noted the prevailing practice of using the labels "Standard A" and "Standard B" when referring to Standard Mail subclasses formerly known as third-class or fourth-class mail.

[6548] In its response to the Commission's Notice of Inquiry, the Postal Service expressed its view that none of the proposed changes should be made. The Service explained that the "label 'Standard Mail (A)' evolved in order to facilitate the writing of DMM regulations, since the subclasses formerly known as third-class mail have distinct preparation rules which needed to be described separately from those for other Standard Mail classifications." Postal Service Response at 12. The Service pointed out that while the label "Standard Mail (B)" generally refers to the subclasses of mail formerly known as fourth-class mail, those subclasses more commonly are referred to by their subclass names. The Service stated that the Commission's suggestions, if recommended, "would

unnecessarily complicate the already complicated process of implementing the changes ultimately approved as a result of this Docket." Id. at 13.

[6549] The Parcel Shippers Association (PSA), in response to the Commission's Notice of Inquiry, expressed its view that using the label "Standard C" as a general reference for the Special and Library subclasses of Standard Mail would not be helpful. PSA believes that the "Standard C" label would compound "the confusion already attendant upon the use of the word 'standard' to embrace so many different kinds of mail." *See* PSA Response at 1-2.

[6550] In view of the comments received, the Commission is not recommending amending the DMCS in the manner discussed above.

8. Changes in Terminology

[6551] In Attachment A of the Service's Request, the Postal Service proposed numerous editorial changes in the language of the DMCS. Of most significance is the Service's proposal to substitute the word "specified" for the word "prescribed" throughout the DMCS. In several instances, the phrase "as specified by the Postal Service" is substituted for the phrase "as prescribed by regulation."

[6552] In Notice of Inquiry No. 2, the Commission asked participants to express their views on whether the Service's proposed editorial changes are appropriate in every instance. In its response to the Notice of Inquiry, the Postal Service, which was the sole respondent on this issue, expressed its view that its proposed editorial changes are appropriate and generally consistent with the terminology used in the Domestic Mail Manual. Postal Service Response at 13.

[6553] The Commission is recommending the majority of the Service's proposed editorial changes in the DMCS.

C. Summary of Selected DMCS Changes

[6554] With respect to First-Class Mail, the Commission recommends amending the DMCS to include provisions establishing rate categories for QBRM, PRM and CEM. The Commission recommends amendments reflecting an increase from 11 ounces to 13 ounces in the transitional weight between the Letters and Sealed Parcels subclass and the Priority Mail subclass. The Commission also recommends conforming changes to reflect that keys and identification devices, formerly within the single-piece Standard Mail subclass, are subject to applicable First-Class Mail rates and fees.

[6555] In the subclass of First-Class Mail currently referred to as “Stamped Cards and Post Cards,” the Commission recommends editorial changes revising the name of the subclass to “Cards.”

[6556] With respect to Standard Mail, the Commission recommends deleting DMCS provisions related to the Single-Piece subclass. It also recommends deleting DMCS provisions related to keys and identification devices. As indicated above, these provisions are relocated in the First-Class Mail section.

[6557] With respect to Periodicals, the Commission recommends amending the DMCS to include new and revised provisions reflecting establishment of four presort tiers in each subclass. The Commission also recommends a provision allowing Within County mail to qualify for the High Density discount on an alternative basis.

[6558] In the Special Services section, the Commission recommends substantive changes in the DMCS recognizing the introduction of Delivery Confirmation Service and Bulk Insurance. These provisions include explicit references to electronic confirmation and to electronic manifesting, as the Service’s sponsoring witnesses have indicated these features materially distinguish the offerings. The Commission also recommends a provision recognizing the establishment of the Prepaid Reply Mail service, a companion service to the new Prepaid Reply Mail rate category of First-Class Mail.

[6559] As discussed under Part B, above, the Commission recommends amending the DMCS to reflect numerous editorial and organizational changes in the Special

Services, including extensive renumbering and regrouping. A table in Appendix Two provides cross-references. The Commission has also assigned numbers to Shipper-Paid Forwarding and Bulk Parcel Return Service that conform to the new designation format.

[6560] As proposed by the Service, the Commission recommends that Caller Service and Post Office Box Service be treated as a single Special Service. Therefore, the provisions relating to the two items are combined in the same Special Services section of the DMCS.

[6561] In the Shipper-Paid Forwarding section, the Commission recommends conforming amendments to reflect the recommended elimination of the Standard Mail Single Piece rate.

[6562] The Commission recommends amending the Registered Mail provisions to delete the language providing optional insurance for items valued at $100 or less and to insert language providing that insurance is not available for articles having no value.

[6563] In the Retail Insurance provisions of the Insurance section, the Commission recommends new language providing that indemnity is provided for the actual value of the article at the time of mailing.

[6564] The Commission's recommended decision in Docket No. MC97-5, which would establish a new packaging service, is pending before the Governors. Therefore, this service is not included in the table or in the accompanying DMCS.

[6565] Throughout the DMCS, the Commission recommends minor editorial changes. Many of these were requested by the Postal Service; others are included to improve clarity or to conform to stylistic conventions. Expired provisions have not been deleted, but have been revised to indicate their status.

UNITED STATES OF AMERICA
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners: Edward J. Gleiman, Chairman;
George W. Haley, Vice Chairman;
W.H. "Trey" LeBlanc III, and George A. Omas*

Postal Rate and Fee Changes, 1997 Docket No. R97-1

RECOMMENDED DECISION

(Issued May 11, 1998)

A full public hearing having been held in the above-entitled proceeding, and the Commission, upon consideration of the record, having issued its Opinion, which is attached hereto and made a part hereof,

IT IS ORDERED:

1. That the Commission's Opinion be transmitted to the Governors of the Postal Service and that the Governors thereby be advised that:
   a. The rates of postage and fees for postal services set forth in Appendix One hereof are in accordance with the policies of title 39, United States Code and the factors set forth in § 3622(b) thereof; and they are hereby recommended to the Governors for approval.
   b. The proposed amendments to the Domestic Mail Classification Schedule set forth in Appendix Two are in accordance with the policies of title 39 of the United States Code and the factors set forth in § 3623(c) thereof; and they are hereby recommended to the Governors for approval.

* Commissioner Ruth Y. Goldway was sworn in on April 15, 1998 and did not participate in this decision.

2. Except to the extent granted or otherwise disposed of herein, all motions, exceptions, and other outstanding requests filed in Docket No. R97-1 hereby are denied.

By the Commission.
(S E A L)

Margaret P. Crenshaw
Secretary

EXPRESS MAIL
SCHEDULES 121, 122 AND 123

(Dollars)

Weight not Exceeding (Pounds)	**Schedule 121** Same Day Airport Service	**Schedule 122** Custom Designed	**Schedule 123** Next Day and Second Day PO to PO	**Schedule 123** Next Day and Second Day PO to Addressee
1/2	9.25	9.55	9.70	11.75
1	10.75	13.55	13.70	15.75
2	10.75	13.55	13.70	15.75
3	13.75	16.30	16.45	18.50
4	15.00	19.05	19.20	21.25
5	16.25	21.80	21.95	24.00
6	17.60	24.55	24.70	26.75
7	18.85	27.20	27.35	29.40
8	20.20	28.40	28.55	30.60
9	21.50	29.60	29.75	31.80
10	22.70	30.80	30.95	33.00
11	24.05	32.25	32.40	34.45
12	25.35	34.60	34.75	36.80
13	26.60	35.85	36.00	38.05
14	27.95	37.20	37.35	39.40
15	29.20	38.40	38.55	40.60
16	30.50	39.70	39.85	41.90
17	31.80	41.05	41.20	43.25
18	33.10	42.25	42.40	44.45
19	34.40	43.55	43.70	45.75
20	35.65	44.85	45.00	47.05
21	36.95	46.10	46.25	48.30
22	38.25	47.35	47.50	49.55
23	39.55	48.70	48.85	50.90
24	40.90	49.90	50.05	52.10
25	42.10	51.20	51.35	53.40
26	43.40	52.45	52.60	54.65
27	44.55	53.75	53.90	55.95
28	45.65	55.00	55.15	57.20
29	46.75	56.30	56.45	58.50
30	47.85	57.60	57.75	59.80
31	48.90	58.85	59.00	61.05
32	49.95	60.15	60.30	62.35
33	51.05	61.40	61.55	63.60
34	52.10	62.70	62.85	64.90
35	53.25	63.95	64.10	66.15
36	54.30	65.25	65.40	67.45
37	55.30	66.45	66.60	68.65
38	56.45	67.80	67.95	70.00
39	57.50	69.05	69.20	71.25
40	58.55	70.30	70.45	72.50
41	59.70	71.55	71.70	73.75
42	60.70	72.90	73.05	75.10
43	61.80	74.15	74.30	76.35
44	62.90	75.45	75.60	77.65
45	63.95	76.75	76.90	78.95
46	65.05	77.95	78.10	80.15
47	66.15	79.30	79.45	81.50
48	67.20	80.55	80.70	82.75
49	68.25	81.80	81.95	84.00
50	69.35	83.05	83.20	85.25

EXPRESS MAIL
SCHEDULES 121, 122 AND 123 (continued)

(Dollars)

Weight not Exceeding (Pounds)	**Schedule 121** Same Day Airport Service	**Schedule 122** Custom Designed	**Schedule 123** Next Day and Second Day PO to PO	**Schedule 123** Next Day and Second Day PO to Addressee
51	70.45	84.40	84.55	86.60
52	71.45	85.60	85.75	87.80
53	72.60	86.95	87.10	89.15
54	73.65	88.20	88.35	90.40
55	74.75	89.45	89.60	91.65
56	75.85	90.80	90.95	93.00
57	76.90	92.00	92.15	94.20
58	77.95	93.30	93.45	95.50
59	79.05	94.70	94.85	96.90
60	80.10	96.20	96.35	98.40
61	81.25	97.80	97.95	100.00
62	82.30	99.30	99.45	101.50
63	83.30	100.80	100.95	103.00
64	84.45	102.40	102.55	104.60
65	85.50	103.90	104.05	106.10
66	86.60	105.50	105.65	107.70
67	87.70	107.00	107.15	109.20
68	88.70	108.60	108.75	110.80
69	89.80	110.10	110.25	112.30
70	90.90	111.60	111.75	113.80

SCHEDULES 121, 122 AND 123 NOTES

[1] The applicable 2-pound rate is charged for matter sent in a ‘flat rate’ envelope provided by the Postal Service.

[2] Add $8.25 for each pickup stop.

[3] Add $8.25 for each Custom Designed delivery stop.

FIRST-CLASS MAIL
RATE SCHEDULE 221

LETTERS AND SEALED PARCELS

	Rate (cents)
Regular	
Single Piece: First Ounce	33.0
Presort[1]	30.5
Prepaid Reply Mail	30.0
Qualified Business Reply Mail	30.0
Additional Ounce[2]	22.0
Nonstandard Surcharge	
Single Piece	11.0
Presort	5.0
Automation - Presort[1]	
Letters[3]	
Basic Presort[4]	27.0
3-Digit Presort[5]	26.1
5-Digit Presort[6]	24.3
Carrier Route Presort[7]	23.8
Flats[8]	
Basic Presort[9]	30.0
3/5-Digit Presort[10]	27.0
Additional Ounce[2]	22.0
Nonstandard Surcharge	5.0

SCHEDULE 221 NOTES

[1] A mailing fee of $100.00 must be paid once each year at each office of mailing by any person who mails other than Single Piece First-Class Mail. Payment of the fee allows the mailer to mail at any First-Class rate. For presorted mailings weighing more than 2 ounces, subtract 4.6 cents per piece.

[2] Rate applies through 13 ounces. Heavier pieces are subject to Priority Mail rates.

[3] Rates apply to bulk-entered mailings of at least 500 letter-size pieces, which must be delivery point barcoded and meet other preparation requirements specified by the Postal Service.

[4] Rate applies to letter-size Automation-Presort category mail not mailed at 3-Digit, 5-Digit, or Carrier Route rates.

[5] Rate applies to letter-size Automation-Presort category mail presorted to single or multiple three-digit ZIP Code destinations specified by the Postal Service.

[6] Rate applies to letter-size Automation-Presort category mail presorted to single or multiple five-digit ZIP Code destinations specified by the Postal Service.

[7] Rate applies to letter-size Automation-Presort category mail presorted to carrier routes specified by the Postal Service.

[8] Rates apply to bulk-entered mailings of at least 500 flat-size pieces, each of which must be delivery-point barcoded or bear a ZIP+4 barcode, and must meet other preparation requirements specified by the Postal Service.

[9] Rate applies to flat-size Automation-Presort category mail not mailed at the 3/5-Digit rate.

[10] Rate applies to flat-size Automation-Presort category mail presorted to single or multiple three- and five-digit ZIP Code destinations as specified by the Postal Service.

FIRST-CLASS MAIL
RATE SCHEDULE 222

CARDS

	Rate (cents)
Regular	
Single Piece	20.0
Presort[1]	18.0
Prepaid Reply Mail	18.0
Qualified Business Reply Mail	18.0
Automation-Presort[1, 2]	
Basic Presort[3]	16.6
3-Digit Presort[4]	15.9
5-Digit Presort[5]	14.6
Carrier Route Presort[6]	14.1

SCHEDULE 222 NOTES

1 A mailing fee of $100.00 must be paid once each year at each office of mailing by any person who mails other than Single Piece First-Class Mail. Payment of the fee allows the mailer to mail at any First-Class rate.

2 Rates apply to bulk-entered mailings of at least 500 pieces, which must be barcoded and meet other preparation requirements specified by the Postal Service.

3 Rate applies to Automation-Presort category mail not mailed at 3-Digit, 5-Digit, or Carrier Route rates.

4 Rate applies to Automation-Presort category mail presorted to single or multiple three-digit ZIP Code destinations as specified by the Postal Service.

5 Rate applies to Automation-Presort category mail presorted to single or multiple five-digit ZIP Code destinations as specified by the Postal Service.

6 Rate applies to Automation-Presort category mail presorted to carrier routes specified by the Postal Service.

FIRST-CLASS MAIL
SCHEDULE 223

PRIORITY MAIL SUBCLASS

(dollars)

Weight not Exceeding (Pounds)	L,1,2,3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
1	3.20	3.20	3.20	3.20	3.20	3.20
2	3.20	3.20	3.20	3.20	3.20	3.20
3	4.30	4.30	4.30	4.30	4.30	4.30
4	5.40	5.40	5.40	5.40	5.40	5.40
5	6.50	6.50	6.50	6.50	6.50	6.50
6	6.60	6.90	7.10	7.45	7.70	8.25
7	6.70	7.30	7.70	8.40	8.90	10.00
8	6.80	7.70	8.30	9.35	10.10	11.75
9	6.90	8.10	8.90	10.30	11.30	13.50
10	7.00	8.50	9.50	11.25	12.50	15.25
11	7.20	9.15	10.30	12.20	13.45	16.50
12	7.40	9.80	11.05	13.10	14.45	17.80
13	7.75	10.40	11.80	14.05	15.50	19.10
14	8.10	11.05	12.55	14.95	16.50	20.40
15	8.50	11.70	13.30	15.85	17.50	21.70
16	8.85	12.30	14.00	16.75	18.55	23.00
17	9.20	12.95	14.75	17.70	19.55	24.30
18	9.60	13.60	15.50	18.60	20.60	25.60
19	9.95	14.20	16.25	19.50	21.60	26.95
20	10.35	14.85	17.00	20.40	22.65	28.20
21	10.70	15.50	17.70	21.35	23.65	29.45
22	11.05	16.15	18.45	22.25	24.70	30.65
23	11.45	16.75	19.20	23.15	25.70	31.85
24	11.75	17.40	19.95	24.05	26.70	33.05
25	12.15	18.05	20.70	25.00	27.75	34.35
26	12.55	18.65	21.40	25.90	28.75	35.55
27	12.90	19.30	22.15	26.80	29.80	36.75
28	13.25	19.95	22.90	27.70	30.80	37.95
29	13.65	20.55	23.65	28.60	31.85	39.15
30	14.00	21.20	24.40	29.55	32.85	40.35
31	14.35	21.85	25.10	30.45	33.90	41.55
32	14.75	22.45	25.85	31.35	34.90	42.80
33	15.10	23.10	26.60	32.25	35.95	44.00
34	15.45	23.70	27.35	33.15	36.95	45.20
35	15.80	24.35	28.10	34.10	37.95	46.40
36	16.20	25.00	28.80	35.00	39.00	47.60
37	16.60	25.65	29.55	35.90	40.00	48.80
38	16.90	26.25	30.30	36.85	41.05	50.05
39	17.30	26.90	31.05	37.75	42.05	51.25
40	17.70	27.55	31.80	38.65	43.10	52.45

PRIORITY MAIL SUBCLASS (continued)

(dollars)

Weight not Exceeding (Pounds)	L,1,2,3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
41	18.00	28.15	32.50	39.55	44.10	53.65
42	18.40	28.80	33.25	40.45	45.15	54.85
43	18.80	29.45	34.00	41.40	46.15	56.10
44	19.15	30.05	34.75	42.30	47.20	57.35
45	19.50	30.70	35.50	43.20	48.20	58.55
46	19.85	31.35	36.20	44.10	49.20	59.75
47	20.25	31.95	36.95	45.05	50.25	60.95
48	20.60	32.60	37.70	45.95	51.25	62.15
49	20.95	33.25	38.45	46.85	52.30	63.35
50	21.35	33.85	39.20	47.75	53.30	64.55
51	21.70	34.50	39.90	48.65	54.25	65.80
52	22.05	35.15	40.65	49.60	55.30	67.00
53	22.45	35.75	41.40	50.50	56.25	68.20
54	22.80	36.40	42.15	51.40	57.25	69.40
55	23.15	37.05	42.90	52.30	58.20	70.60
56	23.55	37.65	43.60	53.25	59.20	71.80
57	23.90	38.30	44.35	54.15	60.20	73.05
58	24.25	38.95	45.10	55.05	61.15	74.25
59	24.65	39.55	45.85	55.95	62.20	75.45
60	25.00	40.20	46.60	56.90	63.15	76.65
61	25.35	40.85	47.30	57.80	64.15	77.90
62	25.75	41.45	48.05	58.70	65.10	79.10
63	26.10	42.10	48.80	59.60	66.10	80.35
64	26.50	42.75	49.55	60.55	67.10	81.55
65	26.85	43.35	50.25	61.45	68.05	82.75
66	27.20	44.00	51.00	62.35	69.10	83.95
67	27.60	44.65	51.75	63.25	70.05	85.15
68	27.95	45.25	52.50	64.15	71.00	86.35
69	28.30	45.90	53.25	65.10	72.05	87.55
70	28.70	46.55	53.95	66.00	73.00	88.80

SCHEDULE 223 NOTES

[1] The 2-pound rate is charged for matter sent in a ‘flat rate’ envelope provided by the Postal Service.

[2] Add $8.25 for each pickup stop.

[3] EXCEPTION: Parcels weighing less than 15 pounds, measuring over 84 inches in length and girth combined, are chargeable with a minimum rate equal to that for a 15-pound parcel for the zone to which addressed.

STANDARD MAIL
RATE SCHEDULE 321.2A

REGULAR SUBCLASS
PRESORT CATEGORY[1]

	Rate (cents)
Letter Size	
Piece Rate	
Basic	23.5
3/5-Digit	20.7
Destination Entry Discount per Piece	
BMC	1.6
SCF	2.1
Non-Letter Size[2]	
Piece Rate	
Minimum per Piece[3]	
Basic	30.4
3/5 Digit	24.0
Destination Entry Discount per Piece	
BMC	1.6
SCF	2.1
Pound Rate[3]	67.7
Plus per Piece Rate	
Basic	16.4
3/5-Digit	10.0
Destination Entry Discount per Pound	
BMC	7.9
SCF	10.0

SCHEDULE 321.2A NOTES

[1] A fee of $100 must be paid each 12-month period for each bulk mailing permit.

[2] Residual shape pieces are subject to a surcharge of $0.10 per piece.

[3] Mailer pays either the minimum piece rate or the pound rate, whichever is higher.

STANDARD MAIL
RATE SCHEDULE 321.2B

REGULAR SUBCLASS
AUTOMATION CATEGORY[1]

	Rate (cents)
Letter Size[2]	
Piece Rate	
Basic Letter[3]	18.3
3-Digit Letter[4]	17.6
5-Digit Letter[5]	16.0
Destination Entry Discount per Piece	
BMC	1.6
SCF	2.1
Flat Size[6]	
Piece Rate	
Minimum per Piece[7]	
Basic Flat[8]	24.5
3/5-Digit Flat[9]	20.3
Destination Entry Discount per Piece	
BMC	1.6
SCF	2.1
Pound Rate[7]	67.7
Plus per piece Rate	
Basic Flat[8]	10.5
3/5-Digit Flat[9]	6.3
Destination Entry Discount per Pound	
BMC	7.9
SCF	10.0

SCHEDULE 321.2B NOTES

[1] A fee of $100 must be paid once each 12-month period for each bulk mailing permit.

[2] For letter-size automation pieces meeting applicable Postal Service regulations.

[3] Rate applies to letter-size automation mail not mailed at 3-digit, 5-digit or carrier route rates.

[4] Rate applies to letter-size automation mail presorted to single or multiple three-digit ZIP Code destinations as specified by the Postal Service.

[5] Rate applies to letter-size automation mail presorted to single or multiple five-digit ZIP Code destinations as specified by the Postal Service.

[6] For flat-size automation mail meeting applicable Postal Service regulations.

[7] Mailer pays either the minimum piece rate or the pound rate, whichever is higher.

[8] Rate applies to flat-size automation mail not mailed at 3/5-digit rate.

[9] Rate applies to flat-size automation mail presorted to single or multiple three- and five-digit ZIP Code destinations as specified by the Postal Service.

STANDARD MAIL
RATE SCHEDULE 321.3

ENHANCED CARRIER ROUTE SUBCLASS[1]

	Rate (cents)
Letter Size	
Piece Rate	
Basic	16.2
Basic Automated Letter[2]	15.6
High Density	13.9
Saturation	13.0
Destination Entry Discount per Piece	
BMC	1.6
SCF	2.1
DDU	2.6
Non-Letter Size[3]	
Piece Rate	
Minimum per Piece[4]	
Basic	16.2
High Density	15.1
Saturation	14.0
Destination Entry Discount per Piece	
BMC	1.6
SCF	2.1
DDU	2.6
Pound Rate[4]	66.3
Plus per Piece Rate	
Basic	2.5
High Density	1.4
Saturation	0.3
Destination Entry Discount per Pound	
BMC	7.9
SCF	10.0
DDU	12.6

SCHEDULE 321.3 NOTES

[1] A fee of $100 must be paid each 12-month period for each bulk mailing permit.

[2] Rate applies to letter-size automation mail presorted to routes specified by the Postal Service.

[3] Residual shape pieces are subject to a surcharge of $0.10 per piece.

[4] Mailer pays either the minimum piece rate or the pound rate, whichever is higher.

STANDARD MAIL
RATE SCHEDULE 321.4A

NONPROFIT SUBCLASS
PRESORT CATEGORIES[1]
(Full Rates)

	Rates (cents)
Letter Size	
Piece Rate	
Basic	16.9
3/5-Digit	14.2
Destination Entry Discount per Piece	
BMC	1.6
SCF	2.1
Non-Letter Size[2]	
Piece Rate	
Minimum per Piece[3]	
Basic	23.3
3/5-Digit	16.5
Destination Entry Discount per Piece	
BMC	1.6
SCF	2.1
Pound Rate[3]	55.0
Plus per Piece Rate	
Basic	12.0
3/5-Digit	5.2
Destination Entry Discount per Pound	
BMC	7.9
SCF	10.0

SCHEDULE 321.4A NOTES

[1] A fee of $100.00 must be paid once each 12-month period for each bulk mailing permit.

[2] Residual shape pieces are subject to a surcharge of $0.10 per piece.

[3] Mailer pays either the minimum piece rate or the pound rate, whichever is higher.

STANDARD MAIL
RATE SCHEDULE 321.4B

NONPROFIT SUBCLASS
AUTOMATION CATEGORIES[1]
(Full Rates)

	Rate (cents)
Letter Size[2]	
Piece Rate	
Basic Letter[3]	11.9
3-Digit Letter[4]	11.4
5-Digit Letter[5]	9.3
Destination Entry Discount per Piece	
BMC	1.6
SCF	2.1
Flat Size[6]	
Piece Rate	
Minimum per Piece[7]	
Basic Flat[8]	18.2
3/5-Digit Flat[9]	14.4
Destination Entry Discount per Piece	
BMC	1.6
SCF	2.1
Pound Rate[7]	55.0
Plus per Piece Rate	
Basic Flat[8]	6.9
3/5-Digit Flat[9]	3.1
Destination Entry Discount per Pound	
BMC	7.9
SCF	10.0

SCHEDULE 321.4B NOTES

[1] A fee of $100 must be paid once each 12-month period for each bulk mailing permit.

[2] For letter-size automation pieces meeting applicable Postal Service regulations.

[3] Rate applies to letter-size automation mail not mailed at 3-digit, 5-digit or carrier route rates.

[4] Rate applies to letter-size automation mail presorted to single or multiple three-digit ZIP Code destinations as specified by the Postal Service.

[5] Rate applies to letter-size automation mail presorted to single or multiple five-digit ZIP Code destinations as specified by the Postal Service.

[6] For flat-size automation mail meeting applicable Postal Service regulations.

[7] Mailer pays either the minimum piece rate or the pound rate, whichever is higher.

[8] Rate applies to flat-size automation mail not mailed at 3/5-digit rate.

[9] Rate applies to flat-size automation mail presorted to single or multiple three- and five-digit ZIP Code destinations as specified by the Postal Service.

STANDARD MAIL
RATE SCHEDULE 321.5

NONPROFIT ENHANCED CARRIER ROUTE SUBCLASS[1]
(Full Rates)

	Rate (cents)
Letter Size	
Piece Rate	
Basic	9.9
Basic Automated Letter[2]	9.2
High Density	7.8
Saturation	7.2
Destination Entry Discount per Piece	
BMC	1.6
SCF	2.1
DDU	2.6
Non-Letter Size[3]	
Piece Rate	
Minimum per Piece[4]	
Basic	9.9
High Density	9.2
Saturation	8.4
Destination Entry Discount per Piece	
BMC	1.6
SCF	2.1
DDU	2.6
Pound Rate[4]	29.0
Plus per Piece Rate	
Basic	3.9
High Density	3.2
Saturation	2.4
Destination Entry Discount per Pound	
BMC	7.9
SCF	10.0
DDU	12.6

SCHEDULE 321.5 NOTES

[1] A fee of $100 must be paid each 12-month period for each bulk mailing permit.

[2] Rate applies to letter-size automation mail presorted to routes specified by the Postal Service.

[3] Residual shape pieces are subject to a surcharge of $0.10 per piece.

[4] Mailer pays either the minimum piece rate or the pound rate, whichever is higher.

STANDARD MAIL
RATE SCHEDULE 322.1A

PARCEL POST SUBCLASS
INTER-BMC RATES

(dollars)

Weight not Exceeding (Pounds)	Zone1/2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
2	$3.15	$3.15	$3.15	$3.15	$3.15	$3.15	$3.15
3	3.59	3.90	4.25	4.25	4.25	4.25	4.25
4	3.73	4.16	4.91	5.35	5.35	5.35	5.35
5	3.86	4.39	5.33	6.45	6.45	6.45	6.45
6	3.99	4.62	5.71	7.10	7.40	7.60	8.15
7	4.11	4.82	6.07	7.72	8.35	8.75	9.85
8	4.24	5.01	6.38	8.26	9.30	9.90	11.55
9	4.33	5.19	6.71	8.76	10.25	11.05	13.25
10	4.45	5.36	6.99	9.23	10.92	12.20	14.95
11	4.54	5.53	7.27	9.66	11.47	13.30	16.10
12	4.64	5.68	7.53	10.06	11.97	14.30	17.35
13	4.73	5.81	7.77	10.44	12.44	15.17	18.65
14	4.82	5.97	8.01	10.80	12.89	15.74	19.90
15	4.90	6.10	8.24	11.13	13.31	16.28	21.15
16	4.98	6.23	8.45	11.45	13.70	16.77	21.85
17	5.07	6.34	8.66	11.74	14.08	17.25	22.49
18	5.14	6.46	8.85	12.02	14.42	17.69	23.10
19	5.23	6.58	9.04	12.29	14.76	18.12	23.67
20	5.29	6.68	9.20	12.54	15.07	18.52	24.21
21	5.36	6.80	9.37	12.79	15.38	18.90	24.72
22	5.43	6.89	9.54	13.02	15.66	19.26	25.21
23	5.50	7.01	9.71	13.23	15.93	19.60	25.67
24	5.55	7.10	9.85	13.45	16.19	19.94	26.12
25	5.62	7.19	10.01	13.64	16.44	20.24	26.54
26	5.68	7.28	10.15	13.84	16.68	20.54	26.93
27	5.75	7.37	10.28	14.02	16.90	20.82	27.32
28	5.80	7.46	10.43	14.20	17.12	21.09	27.68
29	5.86	7.55	10.56	14.36	17.33	21.35	28.04
30	5.92	7.63	10.67	14.52	17.52	21.60	28.36
31	5.98	7.70	10.80	14.67	17.72	21.85	28.68
32	6.03	7.79	10.92	14.82	17.90	22.08	28.99
33	6.08	7.87	11.04	14.97	18.07	22.30	29.28
34	6.14	7.93	11.14	15.11	18.24	22.51	29.56
35	6.19	8.01	11.26	15.24	18.40	22.71	29.83
36	6.24	8.07	11.38	15.37	18.56	22.90	30.09
37	6.29	8.14	11.47	15.50	18.71	23.10	30.34
38	6.34	8.22	11.58	15.61	18.85	23.27	30.58
39	6.40	8.28	11.67	15.72	18.99	23.44	30.81
40	6.44	8.35	11.77	15.84	19.13	23.62	31.02

PARCEL POST SUBCLASS
INTER-BMC RATES (continued)

(dollars)

Weight not Exceeding (Pounds)	Zone1/2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
41	6.50	8.42	11.86	15.95	19.26	23.78	31.24
42	6.54	8.48	11.95	16.05	19.38	23.93	31.45
43	6.58	8.54	12.05	16.15	19.51	24.08	31.64
44	6.63	8.59	12.13	16.24	19.62	24.22	31.84
45	6.67	8.66	12.22	16.34	19.74	24.36	32.02
46	6.72	8.72	12.30	16.44	19.85	24.50	32.19
47	6.77	8.78	12.38	16.52	19.96	24.63	32.37
48	6.81	8.84	12.47	16.61	20.05	24.75	32.53
49	6.85	8.89	12.55	16.69	20.16	24.88	32.68
50	6.89	8.94	12.61	16.77	20.26	25.00	32.84
51	6.94	9.00	12.70	16.85	20.35	25.11	32.98
52	6.98	9.06	12.77	16.93	20.44	25.22	33.12
53	7.02	9.11	12.83	17.00	20.53	25.33	33.27
54	7.06	9.17	12.91	17.08	20.62	25.44	33.40
55	7.10	9.20	12.99	17.14	20.69	25.53	33.53
56	7.15	9.27	13.05	17.22	20.78	25.63	33.66
57	7.19	9.32	13.12	17.28	20.86	25.73	33.77
58	7.23	9.36	13.18	17.35	20.93	25.82	33.89
59	7.27	9.41	13.25	17.41	21.01	25.90	34.00
60	7.31	9.46	13.33	17.47	21.07	25.99	34.12
61	7.36	9.52	13.38	17.53	21.15	26.08	34.27
62	7.40	9.56	13.44	17.59	21.21	26.15	34.41
63	7.42	9.61	13.51	17.64	21.28	26.23	34.55
64	7.46	9.65	13.57	17.69	21.34	26.30	34.68
65	7.50	9.70	13.62	17.75	21.41	26.38	34.81
66	7.55	9.75	13.68	17.80	21.46	26.45	34.93
67	7.59	9.79	13.74	17.86	21.53	26.52	35.06
68	7.62	9.83	13.81	17.91	21.58	26.59	35.19
69	7.66	9.87	13.86	17.95	21.64	26.66	35.29
70	7.70	9.93	13.92	18.01	21.69	26.72	35.42
Oversize parcels[6]	45.88	49.98	56.02	65.60	76.92	92.33	117.82

SCHEDULE 322.1A NOTES

[1] For nonmachinable Inter-BMC parcels, add: $1.65 per piece.

[2] For each pickup stop, add: $8.25.

[3] For Origin Bulk Mail Center Discount, deduct $0.57 per piece.

[4] For BMC Presort, deduct $0.22 per piece.

[5] For Barcoded Discount, deduct $0.03 per piece.

[6] *See* DMCS section 322.16 for oversize Parcel Post.

STANDARD MAIL
RATE SCHEDULE 322.1B

PARCEL POST SUBCLASS
INTRA-BMC RATES

(dollars)

Weight not Exceeding (Pounds)	Local	Zone 1/2	Zone 3	Zone 4	Zone 5
2	$2.80	$2.80	$2.80	$2.80	$2.80
3	2.87	3.17	3.26	3.27	3.29
4	3.04	3.32	3.57	3.58	4.14
5	3.19	3.45	3.85	3.88	4.63
6	3.28	3.58	4.13	4.15	5.08
7	3.35	3.69	4.37	4.40	5.50
8	3.43	3.82	4.59	4.63	5.90
9	3.50	3.91	4.77	4.86	6.27
10	3.58	4.03	5.01	5.08	6.62
11	3.64	4.12	5.18	5.27	6.94
12	3.71	4.23	5.33	5.47	7.26
13	3.78	4.32	5.46	5.65	7.54
14	3.84	4.41	5.55	5.83	7.82
15	3.90	4.49	5.68	5.99	8.08
16	3.97	4.56	5.81	6.15	8.33
17	4.02	4.65	5.93	6.31	8.56
18	4.07	4.72	6.05	6.45	8.80
19	4.12	4.81	6.16	6.59	9.01
20	4.19	4.88	6.27	6.74	9.21
21	4.23	4.94	6.38	6.87	9.41
22	4.28	5.02	6.47	7.00	9.60
23	4.33	5.08	6.59	7.13	9.79
24	4.38	5.14	6.68	7.24	9.96
25	4.43	5.20	6.77	7.36	10.13
26	4.47	5.27	6.86	7.47	10.29
27	4.52	5.33	6.96	7.58	10.44
28	4.56	5.38	7.05	7.69	10.59
29	4.62	5.45	7.14	7.80	10.74
30	4.67	5.50	7.22	7.89	10.89
31	4.71	5.56	7.28	7.99	11.02
32	4.75	5.62	7.37	8.09	11.15
33	4.80	5.67	7.45	8.19	11.29
34	4.84	5.72	7.51	8.27	11.40
35	4.88	5.77	7.59	8.37	11.52
36	4.91	5.82	7.66	8.46	11.65
37	4.95	5.88	7.72	8.54	11.76
38	4.99	5.93	7.80	8.62	11.87
39	5.04	5.98	7.87	8.71	11.97
40	5.08	6.02	7.93	8.78	12.08

PARCEL POST SUBCLASS
INTRA-BMC RATES (continued)

(dollars)

Weight not Exceeding (Pounds)	Local	Zone 1/2	Zone 3	Zone 4	Zone 5
41	5.12	6.08	8.01	8.87	12.18
42	5.16	6.12	8.06	8.94	12.27
43	5.20	6.16	8.13	9.02	12.38
44	5.25	6.21	8.18	9.10	12.46
45	5.28	6.25	8.24	9.16	12.56
46	5.32	6.31	8.31	9.24	12.64
47	5.36	6.36	8.36	9.30	12.73
48	5.40	6.40	8.42	9.38	12.83
49	5.43	6.44	8.48	9.44	12.90
50	5.47	6.47	8.53	9.51	12.99
51	5.51	6.53	8.58	9.57	13.06
52	5.54	6.57	8.65	9.64	13.14
53	5.58	6.60	8.70	9.70	13.21
54	5.62	6.64	8.75	9.76	13.29
55	5.66	6.68	8.79	9.82	13.36
56	5.69	6.73	8.85	9.89	13.42
57	5.72	6.77	8.91	9.94	13.50
58	5.76	6.81	8.94	9.99	13.57
59	5.80	6.85	9.00	10.06	13.63
60	5.82	6.89	9.05	10.11	13.70
61	5.88	6.94	9.10	10.17	13.77
62	5.90	6.98	9.14	10.22	13.82
63	5.94	7.01	9.19	10.28	13.88
64	5.97	7.05	9.23	10.33	13.95
65	6.01	7.09	9.28	10.38	14.00
66	6.03	7.14	9.33	10.44	14.07
67	6.08	7.18	9.37	10.49	14.12
68	6.11	7.20	9.41	10.54	14.17
69	6.15	7.24	9.45	10.59	14.23
70	6.18	7.28	9.52	10.64	14.28
Oversize parcels[3]	28.72	37.71	37.71	37.71	37.71

SCHEDULE 322.1B NOTES

[1] For each pickup stop, add $8.25.

[2] For Barcoded Discount, deduct $0.03 per piece.

[3] *See* DMCS section 322.16 for oversize Parcel Post.

STANDARD MAIL
RATE SCHEDULE 322.1C

PARCEL POST SUBCLASS
DESTINATION BMC RATES

(dollars)

Weight not Exceeding (Pounds)	Zone 1/2	Zone 3	Zone 4	Zone 5	Weight not Exceeding (Pounds)	Zone 1/2	Zone 3	Zone 4	Zone 5
					36	$5.36	$7.05	$8.06	$11.08
2	$2.23	$2.40	$2.40	$2.40	37	5.40	7.11	8.14	11.19
3	2.40	2.86	2.87	2.89	38	5.46	7.19	8.22	11.29
4	2.58	3.17	3.18	3.94	39	5.51	7.24	8.31	11.39
5	2.74	3.45	3.48	4.40	40	5.56	7.31	8.38	11.50
6	2.88	3.73	3.75	4.83	41	5.61	7.38	8.47	11.59
7	3.02	3.97	4.00	5.22	42	5.65	7.44	8.54	11.68
8	3.15	4.19	4.23	5.60	43	5.71	7.49	8.62	11.79
9	3.28	4.37	4.46	5.95	44	5.75	7.54	8.70	11.87
10	3.40	4.51	4.68	6.29	45	5.79	7.61	8.76	11.96
11	3.51	4.67	4.87	6.59	46	5.85	7.67	8.84	12.04
12	3.62	4.81	5.07	6.89	47	5.89	7.72	8.90	12.13
13	3.73	4.93	5.25	7.16	48	5.93	7.77	8.98	12.22
14	3.82	5.08	5.43	7.42	49	5.98	7.83	9.04	12.29
15	3.91	5.20	5.59	7.67	50	6.02	7.88	9.11	12.38
16	4.01	5.32	5.75	7.91	51	6.06	7.93	9.17	12.45
17	4.09	5.43	5.91	8.13	52	6.11	8.00	9.24	12.52
18	4.18	5.54	6.05	8.35	53	6.14	8.05	9.30	12.60
19	4.26	5.64	6.19	8.55	54	6.18	8.09	9.36	12.67
20	4.34	5.75	6.34	8.74	55	6.23	8.13	9.42	12.74
21	4.42	5.85	6.47	8.94	56	6.27	8.19	9.49	12.80
22	4.49	5.94	6.60	9.12	57	6.30	8.24	9.54	12.88
23	4.56	6.05	6.73	9.30	58	6.35	8.28	9.59	12.94
24	4.63	6.14	6.84	9.46	59	6.38	8.33	9.66	13.01
25	4.70	6.21	6.96	9.62	60	6.42	8.39	9.71	13.07
26	4.76	6.31	7.07	9.78	61	6.46	8.42	9.77	13.14
27	4.83	6.38	7.18	9.92	62	6.50	8.46	9.82	13.19
28	4.89	6.47	7.29	10.07	63	6.53	8.52	9.88	13.25
29	4.96	6.57	7.40	10.21	64	6.57	8.55	9.93	13.31
30	5.01	6.63	7.49	10.35	65	6.61	8.61	9.98	13.37
31	5.08	6.70	7.59	10.48	66	6.65	8.66	10.04	13.43
32	5.13	6.79	7.69	10.61	67	6.68	8.70	10.09	13.48
33	5.19	6.85	7.79	10.73	68	6.71	8.74	10.14	13.54
34	5.25	6.92	7.87	10.84	69	6.75	8.76	10.19	13.59
35	5.31	6.99	7.97	10.96	70	6.79	8.83	10.24	13.64
					Oversize parcels[2]	24.29	22.73	28.00	28.00

SCHEDULE 322.1C NOTES

[1] For Barcoded Discount, deduct $0.03 per piece

[2] *See* DMCS section 322.16 for oversize Parcel Post.

[3] A fee of $100 must be paid each year for DBMC, DSCF, and DDU.

STANDARD MAIL
RATE SCHEDULE 322.1D

PARCEL POST SUBCLASS
DESTINATION SCF RATES

(dollars)

Weight (Pounds)		Weight (Pounds)	
		36	3.94
2	1.67	37	3.97
3	1.78	38	4.02
4	1.91	39	4.06
5	2.02	40	4.10
6	2.12	41	4.14
7	2.21	42	4.17
8	2.30	43	4.22
9	2.40	44	4.26
10	2.48	45	4.29
11	2.56	46	4.34
12	2.64	47	4.37
13	2.72	48	4.40
14	2.78	49	4.45
15	2.84	50	4.48
16	2.92	51	4.51
17	2.98	52	4.55
18	3.04	53	4.58
19	3.10	54	4.61
20	3.16	55	4.65
21	3.22	56	4.69
22	3.27	57	4.71
23	3.32	58	4.76
24	3.38	59	4.78
25	3.43	60	4.82
26	3.47	61	4.85
27	3.53	62	4.88
28	3.57	63	4.91
29	3.63	64	4.94
30	3.67	65	4.98
31	3.72	66	5.01
32	3.76	67	5.04
33	3.81	68	5.07
34	3.86	69	5.10
35	3.90	70	5.14
		Oversize parcels[1]	11.99

SCHEDULE 322.1D NOTES

[1] *See* DMCS section 322.16 for oversize Parcel Post.

[2] A fee of $100.00 must be paid each year for DBMC, DSCF, and DDU.

STANDARD MAIL
RATE SCHEDULE 322.1E

PARCEL POST SUBCLASS
DESTINATION DELIVERY UNIT RATES

(dollars)

Weight (Pounds)		Weight (Pounds)	
		36	2.69
2	1.10	37	2.71
3	1.35	38	2.75
4	1.42	39	2.78
5	1.48	40	2.81
6	1.53	41	2.84
7	1.58	42	2.86
8	1.63	43	2.90
9	1.69	44	2.92
10	1.74	45	2.95
11	1.78	46	2.99
12	1.83	47	3.02
13	1.88	48	3.04
14	1.91	49	3.07
15	1.95	50	3.10
16	2.00	51	3.13
17	2.03	52	3.16
18	2.08	53	3.18
19	2.11	54	3.20
20	2.15	55	3.24
21	2.19	56	3.27
22	2.22	57	3.29
23	2.26	58	3.33
24	2.29	59	3.34
25	2.33	60	3.37
26	2.36	61	3.40
27	2.40	62	3.43
28	2.43	63	3.45
29	2.47	64	3.48
30	2.49	65	3.51
31	2.53	66	3.54
32	2.56	67	3.56
33	2.59	68	3.58
34	2.63	69	3.61
35	2.66	70	3.65
		Oversize parcels[1]	8.69

SCHEDULE 322.1E NOTES

[1] *See* DMCS section 322.16 for oversize Parcel Post.

[2] A fee of $100.00 must be paid each year for DBMC, DSCF, and DDU.

STANDARD MAIL
RATE SCHEDULE 322.3A

BOUND PRINTED MATTER SUBCLASS
SINGLE PIECE RATES[1]

(dollars)

Weight not Exceeding (Pounds)	Zones							
	Local	1 & 2	3	4	5	6	7	8
1.5	1.14	1.54	1.57	1.63	1.72	1.81	1.92	2.02
2	1.16	1.57	1.61	1.69	1.81	1.93	2.08	2.21
2.5	1.18	1.60	1.66	1.76	1.90	2.06	2.24	2.40
3	1.20	1.63	1.70	1.82	1.99	2.18	2.40	2.60
3.5	1.22	1.66	1.74	1.88	2.08	2.30	2.56	2.79
4	1.24	1.70	1.79	1.94	2.18	2.42	2.72	2.98
4.5	1.26	1.73	1.83	2.01	2.27	2.55	2.88	3.17
5	1.28	1.76	1.88	2.07	2.36	2.67	3.05	3.37
6	1.31	1.82	1.96	2.20	2.54	2.92	3.37	3.75
7	1.35	1.89	2.05	2.32	2.73	3.16	3.69	4.14
8	1.39	1.95	2.14	2.45	2.91	3.41	4.01	4.52
9	1.43	2.02	2.22	2.57	3.10	3.65	4.33	4.91
10	1.47	2.08	2.31	2.70	3.28	3.90	4.65	5.29
11	1.51	2.14	2.40	2.83	3.46	4.15	4.97	5.68
12	1.55	2.21	2.48	2.95	3.65	4.39	5.29	6.06
13	1.59	2.27	2.57	3.08	3.83	4.64	5.61	6.45
14	1.63	2.34	2.66	3.20	4.02	4.88	5.93	6.83
15	1.67	2.40	2.75	3.33	4.20	5.13	6.26	7.22
Per Piece Rate	1.08	1.44	1.44	1.44	1.44	1.44	1.44	1.44
Per Pound Rate	0.039	0.064	0.087	0.126	0.184	0.246	0.321	0.385

SCHEDULE 322.3A NOTES

[1] Includes both catalogs and similar bound printed matter.

[2] For barcoded discount, deduct $0.03 per piece.

STANDARD MAIL
RATE SCHEDULE 322.3B

BOUND PRINTED MATTER SUBCLASS
BULK AND CARRIER ROUTE PRESORT RATES[1]

(dollars)

Zone	Per Piece[3]	Carrier Route[2]	Per Pound
Local	0.54	0.463	0.028
1&2	0.72	0.643	0.051
3	0.72	0.643	0.073
4	0.72	0.643	0.112
5	0.72	0.643	0.171
6	0.72	0.643	0.233
7	0.72	0.643	0.307
8	0.72	0.643	0.371

SCHEDULE 322.3B NOTES

1 Includes both catalogs and similar bound printed matter.

2 Applies to mailings of at least 300 pieces presorted to carrier route as specified by the Postal Service.

3 For Barcoded Discount, deduct $0.03 per piece

STANDARD MAIL
RATE SCHEDULES 323.1 AND 323.2
SPECIAL AND LIBRARY RATE SUBCLASSES

Schedule 323.1: Special

		Rates (cents)
First Pound	Not presorted[4]	113
	LEVEL A Presort (5-digits)[1, 2]	64
	LEVEL B Presort (BMC)[1, 3, 4]	95
Each additional pound through 7 pounds		45
Each additional pound over 7 pounds		28

Schedule 323.2: Library

[Rates for Special Subclass in Schedule 323.1 apply.]

SCHEDULE 323.1 AND 323.3 NOTES

[1] A fee of $100.00 must be paid once each 12-month period for each permit.

[2] For mailings of 500 or more pieces properly prepared and presorted to five-digit destination ZIP Codes.

[3] For mailings of 500 or more pieces properly prepared and presorted to Bulk Mail Centers.

[4] For Barcoded Discount, deduct $0.03 per-piece

PERIODICALS
RATE SCHEDULE 421

REGULAR SUBCLASS[1, 2]

	Postage Rate Unit	Rate[3] (cents)
Per Pound		
Nonadvertising Portion:	Pound	16.1
Advertising Portion:		
Delivery Office[4]	Pound	15.5
SCF[5]	Pound	17.8
1&2	Pound	21.5
3	Pound	22.9
4	Pound	26.3
5	Pound	31.6
6	Pound	37.1
7	Pound	43.8
8	Pound	49.5
Science of Agriculture		
Delivery Office	Pound	11.6
SCF	Pound	13.3
Zones 1&2	Pound	16.1
Per Piece		
Less Nonadvertising Factor[6]		5.9
Required Preparation[7]	Piece	29.4
Presorted to 3-digit	Piece	25.3
Presorted to 5-digit	Piece	19.7
Presorted to Carrier Route	Piece	12.2
Discounts:		
Prepared to Delivery Office[4]	Piece	1.3
Prepared to SCF[5]	Piece	0.7
High Density[8]	Piece	1.9
Saturation[9]	Piece	3.7
Automation Discounts for Automation Compatible Mail[10]		
From Required:		
Prebarcoded letter size	Piece	6.2
Prebarcoded flats	Piece	4.6
From 3-Digit:		
Prebarcoded letter size	Piece	4.7
Prebarcoded flats	Piece	3.9
From 5-Digit:		
Prebarcoded letter size	Piece	3.5
Prebarcoded flats	Piece	2.9

SCHEDULE 421 NOTES

[1] The rates in this schedule also apply to commingled nonsubscriber, non-requester, complimentary, and sample copies in excess of 10 percent allowance in regular-rate, non-profit, and classroom periodicals.

[2] Rates do not apply to otherwise regular rate mail that qualifies for the Within County rates in Schedule 423.2.

[3] Charges are computed by adding the appropriate per-piece charge to the sum of the nonadvertising portion and the advertising portion, as applicable.

[4] Applies to carrier route (including high density and saturation) mail delivered within the delivery area of the originating post office.

[5] Applies to mail delivered within the SCF area of the originating SCF office.

[6] For postage calculations, multiply the proportion of nonadvertising content by this factor and subtract from the applicable piece rate.

[7] Mail not eligible for carrier-route, 5-digit or 3-digit rates.

[8] Applicable to high density mail, deducted from carrier route presort rate.

[9] Applicable to saturation mail, deducted from carrier route presort rate.

[10] For automation compatible mail meeting applicable Postal Service regulations.

PERIODICALS
RATE SCHEDULE 423.2

WITHIN COUNTY
(Full Rates)

	Rate (cents)
Per Pound	
General	13.3
Delivery Office[1]	10.7
Per Piece	
Required Presort	9.5
Presorted to 3-digit	8.8
Presorted to 5-digit	8.0
Carrier Route Presort	4.3
Per Piece Discount	
Delivery Office[2]	0.4
High Density (formerly 125 piece)[3]	1.4
Saturation	1.8
Automation Discounts for Automation Compatible Mail[4]	
From Required:	
Prebarcoded Letter size	6.2
Prebarcoded Flat size	4.6
From 3-digit:	
Prebarcoded Letter size	4.7
Prebarcoded Flat size	2.4
From 5-digit:	
Prebarcoded Letter size	3.5
Prebarcoded Flat size	2.1

SCHEDULE 432.2 NOTES

1 Applicable only to carrier route (including high density and saturation) presorted pieces to be delivered within the delivery area of the originating post office.

2 Applicable only to carrier presorted pieces to be delivered within the delivery area of the originating post office.

3 Applicable to high density mail, deducted from carrier route presort rate. Mailers also may qualify for this discount on an alternative basis as provided in DMCS section 423.83.

4 For automation compatible pieces meeting applicable Postal Service regulations.

PERIODICALS
RATE SCHEDULE 423.3

PUBLICATIONS OF AUTHORIZED NONPROFIT ORGANIZATIONS[10]
(Full Rates)

	Postage Rate Unit	Rate[1] (cents)
Per Pound		
Nonadvertising portion:	Pound	15.6
Advertising portion:[9]		
Delivery Office[2]	Pound	15.5
SCF[3]	Pound	17.8
1&2	Pound	21.5
3	Pound	22.9
4	Pound	26.3
5	Pound	31.6
6	Pound	37.1
7	Pound	43.8
8	Pound	49.5
Per Piece		
Less Nonadvertising Factor[4]		4.4
Required Preparation[5]	Piece	25.1
Presorted to 3-digit	Piece	20.8
Presorted to 5-digit	Piece	18.3
Presorted to Carrier Route	Piece	11.3
Discounts:		
Prepared to Delivery Office[2]	Piece	0.7
Prepared to SCF[3]	Piece	0.4
High Density (formerly 125-Piece)[6]	Piece	1.9
Saturation[7]	Piece	3.7
Automation Discounts for Automation Compatible Mail[8]		
From Required:		
Prebarcoded letter size	Piece	6.2
Prebarcoded flats	Piece	4.6
From 3-Digit:		
Prebarcoded letter size	Piece	4.7
Prebarcoded flats	Piece	2.4
From 5-Digit:		
Prebarcoded letter size	Piece	3.5
Prebarcoded flats	Piece	2.1

SCHEDULE 423.3 NOTES

[1] Charges are computed by adding the appropriate per-piece charge to the sum of the nonadvertising portion and the advertising portion, as applicable.

[2] Applies to carrier route (including high density and saturation) mail delivered within the delivery area of the originating post office.

[3] Applies to mail delivered within the SCF area of the originating SCF office.

[4] For postage calculation, multiply the proportion of nonadvertising content by this factor and subtract from the applicable piece rate.

[5] Mail not eligible for carrier route, 5-digit or 3-digit rates.

[6] Applicable to high density mail, deducted from carrier route presort rate.

[7] Applicable to saturation mail, deducted from carrier route presort rate.

[8] For automation compatible mail meeting applicable Postal Service regulations.

[9] Not applicable to publications containing 10 percent or less advertising content.

[10] If qualified, nonprofit publications may use Within County rates for applicable portions of a mailing.

PERIODICALS
RATE SCHEDULE 423.4

CLASSROOM PUBLICATIONS[10]
(Full Rates)

	Postage Rate Unit	Rate[1] (cents)
Per Pound		
Nonadvertising Portion:	Pound	15.6
Advertising Portion:[9]		
Delivery Office[2]	Pound	15.5
SCF[3]	Pound	17.8
1&2	Pound	21.5
3	Pound	22.9
4	Pound	26.3
5	Pound	31.6
6	Pound	37.1
7	Pound	43.8
8	Pound	49.5
Per Piece		
Less Nonadvertising Factor[4]		4.4
Required Preparation[5]	Piece	25.1
Presorted to 3-digit	Piece	20.8
Presorted to 5-digit	Piece	18.3
Presorted to Carrier Route	Piece	11.3
Discounts:		
Prepared to Delivery Office[2]	Piece	0.7
Prepared to SCF	Piece	0.4
High Density (formerly 125-Piece)[6]	Piece	1.9
Saturation[7]	Piece	3.7
Automation Discounts for Automation Compatible Mail[8]		
From Required:		
Prebarcoded Letter size	Piece	6.2
Prebarcoded Flats	Piece	4.6
From 3-Digit:		
Prebarcoded Letter size	Piece	4.7
Prebarcoded Flats	Piece	2.4
From 5-Digit:		
Prebarcoded Letter size	Piece	3.5
Prebarcoded Flats	Piece	2.1

SCHEDULE 423.4 NOTES

[1] Charges are computed by adding the appropriate per-piece charge to the sum of the nonadvertising portion and the advertising portion, as applicable.

[2] Applies to carrier route (including 125-piece walk sequence and saturation) mail delivered within the delivery area of the originating post office.

[3] Applies to mail delivered within the SCF area of the originating SCF office.

[4] For postage calculation, multiply the proportion of nonadvertising content by this factor and subtract from the applicable piece rate.

[5] Mail not eligible for carrier route, 5-digit, or 3-digit rates.

[6] For walk sequenced mail in batches of 125 pieces or more from carrier route presorted mail.

[7] Applicable to saturation mail; deducted from carrier route presort rate.

[8] For automation compatible mail meeting applicable Postal Service regulations.

[9] Not applicable to publications containing 10 percent or less of advertising content.

[10] If qualified, classroom publications may use Within County rates for applicable portions of a mailing.

FEE SCHEDULE 911

ADDRESS CORRECTIONS

Description	Fee
Per manual correction	$0.50
Per automated correction	$0.20

FEE SCHEDULE 912

ZIP CODING OF MAILING LISTS

	Fee
Per thousand addresses	$70.00

CORRECTION OF MAILING LISTS

	Fee
Per submitted address	$0.20
Minimum charge per list corrected	$7.00

ADDRESS CHANGES FOR ELECTION BOARDS AND REGISTRATION COMMISSIONS

	Fee
Per change of address	$0.17

CORRECTIONS ASSOCIATED WITH ARRANGEMENT OF ADDRESS CARDS IN CARRIER DELIVERY SEQUENCE

	Fee
Per Correction	$0.20

NOTE

When rural routes have been consolidated or changed to another post office, no charge will be made for correction if the list contains only names of persons residing on the route or routes involved.

FEE SCHEDULE 921

POST OFFICE BOXES AND CALLER SERVICE

I. Semi-annual Box Fees[1]

	Fee Group				
Box Size[2]	**A**	**B**	**C**	**D**	**E**
1	$ 30.00	$ 27.00	$ 22.00	$ 7.00	$ 0.00
2	46.00	41.00	32.00	12.00	0.00
3	80.00	70.00	57.00	22.00	0.00
4	151.00	136.00	97.00	33.00	0.00
5	261.00	217.00	162.00	52.00	0.00

[1] A customer ineligible for carrier delivery may obtain a post office box at Group E fees, subject to administrative decisions regarding customer's proximity to post office.

[2] Box Size 1 = under 296 cubic inches; 2 = 296-499 cubic inches; 3 = 500-999 cubic inches; 4 = 1000-1999 cubic inches; 5 = 2000 cubic inches and over.

II. Semi-annual Caller Service Fees

Fee Group	Fee
A	$275
B	$275
C	$275
D	$275

III. Annual Call Number Reservation Fee

(all applicable Fee Groups) $36

FEE SCHEDULE 931

BUSINESS REPLY MAIL

	Fee
Active business reply advance deposit account:	
Per piece	
Qualified	$0.05
Nonletter-size, using reverse manifest (experimental)	$0.02
Nonletter-size, using weight averaging (experimental)	$0.03
Other	$0.08
Payment of postage due charges if active business reply mail advance deposit account not used:	
Per piece	$0.30
Annual License and Accounting Fees:	
Accounting Fee for Advance Deposit Account	$300
Permit fee (with or without Advance Deposit Account)	$100
Monthly Fees for customers using a reverse manifest or weight averaging for nonletter-size business reply	
Nonletter-size, using reverse manifest (experimental)	$1,000
Nonletter-size, using weight averaging (experimental)	$3,000
Set-up/Qualification fee for customers using a reverse manifest or weight averaging for nonletter-size business reply	
Nonletter-size, using reverse manifest (experimental)	$1,000
Nonletter-size, using weight averaging (experimental)	$3,000

[1] Experimental per piece, monthly, and set-up/qualification fees are applicable only to participants selected by the Postal Service for the nonletter-size business reply mail experiment. The experimental fees expire June 7, 1999.

FEE SCHEDULE 932

MERCHANDISE RETURN

	Fee
Per Transaction	
Shipper must have an advance deposit account (see DMCS Schedule 1000)	$0.30

FEE SCHEDULE 933

ON-SITE METER SETTING

		Fee
First Meter	By appointment	$27.50
	Unscheduled request	31.00
Additional meters		4.00
Checking meter in or out of service (per meter)		8.50

FEE SCHEDULE 934

PREPAID REPLY MAIL

	Fee
Annual Permit Fee	$100
Monthly Accounting Fee	$1,000

FEE SCHEDULE 935

BULK PARCEL RETURN SERVICE

	Fee
Per Returned Piece	$1.75

FEE SCHEDULE 941

CERTIFIED MAIL

Description	Fee (in addition to postage)
Service (per mailpiece)	$1.40

FEE SCHEDULE 942

REGISTERED MAIL

Declared Value of Article[1]			Fee (in addition to postage)	Handling Charge
$ 0			$6.00	None
0.01	to	100	6.20	
100.01	to	500	6.75	
500.01	to	1,000	7.30	
1,000.01	to	2,000	7.85	
2,000.01	to	3,000	8.40	
3,000.01	to	4,000	8.95	
4,000.01	to	5,000	9.50	
5,000.01	to	6,000	10.05	
6,000.01	to	7,000	10.60	
7,000.01	to	8,000	11.15	
8,000.01	to	9,000	11.70	
9,000.01	to	10,000	12.25	
10,000.01	to	11,000	12.80	
11,000.01	to	12,000	13.35	
12,000.01	to	13,000	13.90	
13,000.01	to	14,000	14.45	
14,000.01	to	15,000	15.00	
15,000.01	to	16,000	15.55	
16,000.01	to	17,000	16.10	
17,000.01	to	18,000	16.65	
18,000.01	to	19,000	17.20	
19,000.01	to	20,000	17.75	
20,000.01	to	21,000	18.30	
21,000.01	to	22,000	18.85	
22,000.01	to	23,000	19.40	
23,000.01	to	24,000	19.95	
24,000.01	to	25,000	20.50	

Declared Value of Article[1]	Fee (in addition to postage)	
25,000.01 to 1 million	$20.50	plus 55 cents for each $1,000 (or fraction thereof) over $25,000
Over $1 million to 15 million	$556.75	plus 55 cents for each $1,000 (or fraction thereof) over $1 million
Over 15 million	$8,256.75	plus amount determined by the Postal Serice based on weight, space and value

[1] Articles with a declared value of more than $25,000 can be registered, but compensation for loss or damage is limited to $25,000.

FEE SCHEDULE 943

INSURANCE

Express Mail Insurance

Document Reconstruction

Coverage			Fee (in addition to postage)
$ 0.01	to	$ 500	no charge

Merchandise

Coverage			Fee (in addition to postage)
$ 0.01	to	$ 500	no charge
500.01	to	5000	$0.95 for each $100 (or fraction thereof) over $500 in value

General Insurance

Coverage			Fee[1] (in addition to postage)
$ 0.01	to	$ 50	$0.85
50.01	to	100	$1.80
100.01	to	5000	$1.80 plus $0.95 for each $100 (or fraction thereof) over $100 in coverage

[1] For bulk insurance, deduct $0.40 per piece.

FEE SCHEDULE 944

COLLECT ON DELIVERY

Amount to be collected, or Insurance Coverage Desired			**Fee** (in addition to postage)
$ 0.01	to	$ 50	$4.00
50.01	to	100	$5.00
100.01	to	200	$6.00
200.01	to	300	$7.00
300.01	to	400	$8.00
400.01	to	500	$9.00
500.01	to	600	$10.00
Notice of nondelivery of COD			$3.00
Alteration of COD charges or designation of new addressee			$3.00
Registered COD			$4.00

FEE SCHEDULE 945

RETURN RECEIPTS

Description	Fee (in addition to postage)
Receipt Issued at Time of Mailing[1]	
Items other than Merchandise	$1.25
Merchandise (without another special service)	$1.40
Receipt Issued after Mailing[2]	$7.00

[1] This receipt shows the signature of the person to whom the mailpiece was delivered, the date of delivery and the delivery address, if such address is different from the address on the mailpiece.

[2] This receipt shows to whom the mailpiece was delivered and the date of delivery.

FEE SCHEDULE 946

RESTRICTED DELIVERY

	Fee (in addition to postage)
Per Piece	$2.75

FEE SCHEDULE 947

CERTIFICATE OF MAILING

	Fee (in addition to postage)
Individual Pieces	
Original certificate of mailing for listed pieces of all classes of ordinary mail (per piece)	$0.60
Three or more pieces individually listed in a firm mailing book or an approved customer provided manifest (per piece)	0.25
Each additional copy of original certificate of mailing or original mailing receipt for registered, insured, certified, and COD mail (each copy)	0.60

Bulk Pieces

Identical pieces of First-Class and Regular, Enhanced Carrier Route, Nonprofit, and Nonprofit Enhanced Carrier Route Standard Mail paid with ordinary stamps, precanceled stamps, or meter stamps are subject to the following fees:

Up to 1,000 pieces (one certificate for total number)	3.00
Each additional 1,000 pieces or fraction	0.40
Duplicate copy	0.60

FEE SCHEDULE 948

DELIVERY CONFIRMATION

Service	**Fee** (in addition to postage)
Used in Conjunction with Priority Mail	
Electronic	$0.00
Manual	$0.35
Used in Conjunction with Parcel Post, Bound Printed Matter, Library, and Special Standard Mail	
Electronic	$0.25
Manual	$0.60

FEE SCHEDULE 951

PARCEL AIR LIFT

	Fee (in addition to Parcel Post postage)
Up to 2 pounds	$0.40
Over 2 up to 3 pounds	$0.75
Over 3 up to 4 pounds	$1.15
Over 4 pounds	$1.55

FEE SCHEDULE 952

SPECIAL HANDLING

	Fee (in addition to postage)
Not more than 10 pounds	$5.40
More than 10 pounds	$7.50

FEE SCHEDULE 961

STAMPED ENVELOPES

Description		Fee (in addition to postage)
Single Sale		$ 0.07
Single Sale Hologram		$ 0.08
PLAIN BULK (500) #6-3/4 size:	Regular	$ 8.50
	Window	$ 8.50
PRINTED BULK (500) #6-3/4 size	Regular	$ 14.00
	Window	$ 14.00
BANDED (500) #6-3/4 size	Regular	$ 9.50
PLAIN BULK (500) size > #6-3/4 through #10[1]	Regular	$ 11.50
	Window	$ 11.50
PRINTED BULK (500) size > #6-3/4 through #10	Regular	$ 15.00
	Window	$ 15.00
	Savings Bond	$ 15.00
	Hologram	$ 19.00
BANDED (500) size > #6-3/4 size through #10		$ 12.00
Multi-Color Printing (500) #6-3/4 size		$ 14.00
#10 size[1]		$ 15.00
Printing Charge per 500 Envelopes (for each type of printed envelope)		
Minimum Order (500 envelopes)		NA
Order for 1,000 or more envelopes		NA
Double Window (500) size > #6-3/4 through #10[1]		$ 11.50
Household (50): size # 6-3/4	Regular	$ 3.00
	Window	$ 3.00
size > # 6-3/4 through #10	Regular	$ 3.25
	Window	$ 3.25
	Hologram	$ 3.50

NOTES

[1] Fee for precancelled envelopes is the same.

FEE SCHEDULE 962

STAMPED CARDS

Description	Fee (in addition to postage)
Stamped Card	$0.01
Double Stamped Card	$0.02

FEE SCHEDULE 971

MONEY ORDERS

		Fee
Domestic		
	$0.01 to $700	$0.80
APO-FPO		
	$0.01 to $700	0.30
Inquiry Fee, which includes the issuance of copy of a paid money order		2.75

SCHEDULE 1000

	Fee
First-Class Presorted Mailing	$100.00
Periodicals	
A. Original Entry	$305.00
B. Additional Entry	$50.00
C. Re-entry	$50.00
D. Registration for News Agents	$50.00
Regular, Enhanced Carrier Route, Nonprofit, and Nonprofit Enhanced Carrier Route Standard Mail Bulk Mailing	$100.00
Parcel Post: Destination BMC, SCF, and DDU	$100.00
Special Standard Mail Presorted Mailing	$100.00
Authorization to Use Permit Imprint	$100.00
Merchandise Return (per facility receiving merchandise return labels)	$100.00
Prepaid Reply Mail Permit (*see* Fee Schedule 934)	
Business Reply Mail Permit (*see* Fee Schedule 931)	
Authorization to Use Bulk Parcel Return Service	$100.00

RECOMMENDED CHANGES IN THE DOMESTIC MAIL CLASSIFICATION SCHEDULE

In its Request, the Postal Service asked that the Commission recommend certain changes in the Domestic Mail Classification Schedule (DMCS). The changes recommended herein alter the DMCS as amended from time to time.

Proposed additions to text of the classification schedules are underlined and proposed deletions are in brackets. The Special Services, which currently are numbered as schedules SS-1 through SS-6, SS-8 through SS-16 and SS-18 through SS-22, are renumbered as indicated in the table on the next page. Existing numbers for the special service sections do not appear in brackets; only the proposed numbers are shown.

SPECIAL SERVICES
DMCS CROSS-REFERENCE TABLE
EXISTING TO RECOMMENDED

SERVICE	EXISTING DMCS SECTION	RECOMMENDEDD MCS SECTION
Address Correction Service	SS-1	911
Business Reply Mail	SS-2	931
Caller Service	SS-3	921
Certificate of Mailing	SS-4	947
Certified Mail	SS-5	941
Collect on Delivery Service	SS-6	944
Domestic Postal Money Orders	SS-8	971
Insured Mail	SS-9	943
Post Office Box Service	SS-10	921
Mailing List Services	SS-11	912
On-Site Meter Setting	SS-12	933
Parcel Airlift (PAL)	SS-13	951
Registered Mail	SS-14	942
Restricted Delivery	SS-15	946
Return Receipts	SS-16	945
Special Handling	SS-18	952
Stamped Envelopes	SS-19	961
Stamped Cards	SS-19A	962
Merchandise Return	SS-20	932
Bulk Parcel Return Service	SS-21	935
Shipper-Paid Forwarding	SS-22	936
Prepaid Reply Mail	NA	934
Delivery Confirmation	NA	948

The changes in the DMCS recommended by the Postal Rate Commission are as follows:

AMEND THE DOMESTIC MAIL CLASSIFICATION SCHEDULE AS FOLLOWS:

EXPEDITED MAIL CLASSIFICATION SCHEDULE

110 **DEFINITION**

Expedited Mail is mail matter entered as Express Mail **[**in accordance with**]** under the provisions of this Schedule. Any matter eligible for mailing may, at the option of the mailer, be mailed as Express Mail. Insurance is either included in Express Mail postage or is available for an additional charge, depending on the value and nature of the item sent by Express Mail.

120 **DESCRIPTION OF SERVICES**

121 **Same Day Airport Service**

Same Day Airport service is available between designated airport mail facilities.

122 **Custom Designed Service**

122.1 **General**. Custom Designed service is available between designated postal facilities or other designated locations for mailable matter tendered **[**in accordance with**]** under a service agreement between the Postal Service and the mailer. Service under a service agreement shall be offered in a manner consistent with 39 U.S.C. 403(c).

122.2 **Service Agreement**. A service agreement shall set forth the following:

a. The scheduled place for each shipment tendered for service to each specific destination;

b. Scheduled place for claim, or delivery, at destination for each scheduled shipment;

c. Scheduled time of day for tender at origin and for claim or delivery at destination.

122.3 **Pickup and Delivery**. Pickup at the mailer's premises, and/or delivery at an address other than the destination postal facility is provided under terms and conditions as **[**prescribed**]** specified by the Postal Service.

122.4 **Commencement of Service Agreement**. Service provided pursuant to a service agreement shall commence not more than 10 days after the signed service agreement is tendered to the Postal Service.

122.5 **Termination of Service Agreement**

122.51 **Termination by Postal Service.** Express Mail service provided pursuant to a service agreement may be terminated by the Postal Service upon 10 days prior written notice to the mailer if:

a. Service cannot be provided for reasons beyond the control of the Postal Service or because of changes in Postal Service facilities or operations, or

b. The mailer fails to adhere to the terms of the service agreement or this schedule.

122.52 **Termination by Mailers**. The mailer may terminate a service agreement, for any reason, by notice to the Postal Service.

123 **Next Day Service and Second Day Service**

123.1 **Availability of Services**. Next Day and Second Day Services are available at designated retail postal facilities to designated destination facilities or locations for items tendered by the time or times**[** prescribed**]** specified by the Postal Service. Next Day Service is available for overnight delivery. Second Day Service is available for second day delivery.

123.2 **Pickup Service**. Pickup service is available for Next Day and Second Day Services under terms and conditions as **[**prescribed**]** specified by the Postal Service. Service shall be offered in a manner consistent with 39 U.S.C. 403(c).

130 PHYSICAL LIMITATIONS

Express Mail may not exceed 70 pounds or 108 inches in length and girth combined.

140 POSTAGE AND PREPARATION

Except as provided in Rate Schedules 121, 122 and 123, postage on Express Mail is charged on each piece. For shipments tendered in Express Mail pouches under a service agreement, each pouch is a piece.

150 DEPOSIT AND DELIVERY

151 Deposit

Express Mail must be deposited at places designated by the Postal Service.

152 Receipt

A receipt showing the time and date of mailing will be provided to the mailer upon acceptance of Express Mail by the Postal Service. This receipt serves as evidence of mailing.

153 Service

Express Mail service provides a high speed, high reliability service. Same Day Airport Express Mail will be dispatched on the next available transportation to the destination airport mail facility. Custom Designed Express Mail will be available for claim or delivery as specified in the service agreement.

154 Forwarding and Return

When Express Mail is returned, or forwarded, as **[**prescribed**]** <u>specified</u> by the Postal Service, there will be no additional charge.

160 **ANCILLARY SERVICES**

The following services may be obtained in conjunction with mail sent under this classification schedule upon payment of applicable fees:

	Service	Schedule
a.	Address correction	911 **[**SS-1**]**
b.	Return receipts	945 **[**SS-16**]**
c.	COD	944 **[**SS-6**]**
d.	Express Mail Insurance	943 **[**SS-9**]**

170 **RATES AND FEES**

The rates for Express Mail are set forth in the following rate schedules:

		Schedule
a.	Same Day Airport	121
b.	Custom Designed	122
c.	Next Day Post Office-to-Post Office	123
d.	Second Day Post Office-to-Post Office	123
e.	Next Day Post Office-to-Addressee	123
f.	Second Day Post Office-to-Addressee	123

180 **REFUNDS**

181 **Procedure**

Claims for refunds of postage must be filed within the period of time and under terms and conditions **[**prescribed**]** specified by the Postal Service.

182 **Availability**

182.1 **Same Day Airport.** The Postal Service will refund the postage for Same Day Airport Express Mail not available for claim by the time specified, unless the delay is caused by:

a. Strikes or work stoppage;

b. Delay or cancellation of flights; or

c. Governmental action beyond the control of Postal Service or air carriers.

182.2 **Custom Designed**. Except where a service agreement provides for claim, or delivery, of Custom Designed Express Mail more than 24 hours after scheduled tender at point of origin, the Postal Service will refund postage for such mail not available for claim, or not delivered, within 24 hours of mailing, unless the item was delayed by strike or work stoppage.

182.3 **Next Day.** Unless the item was delayed by strike or work stoppage, the Postal Service will refund postage for Next Day Express Mail not available for claim or not delivered:

a. By 10:00 a.m., or earlier time(s) **[**prescribed**]** <u>specified</u> by the Postal Service, of the next delivery day in the case of Post Office-to-Post Office service;

b. By 3:00 p.m., or earlier time(s) **[**prescribed**]** <u>specified</u> by the Postal Service, of the next delivery day in the case of Post Office-to-Addressee service.

182.4 **Second Day.** Unless the item was delayed by strike or work stoppage, the Postal Service will refund postage for Second Day Express Mail not available for claim or not delivered:

a. By 10:00 a.m., or earlier time(s) **[**prescribed**]** <u>specified</u> by the Postal Service, of the second delivery day in the case of Post Office-to-Post Office service;

b. By 3:00 p.m., or earlier time(s) **[**prescribed**]** <u>specified</u> by the Postal Service, of the second delivery day in the case of Post Office-to-Addressee service.

FIRST-CLASS MAIL
CLASSIFICATION SCHEDULE

210 DEFINITION

Any matter eligible for mailing may, at the option of the mailer, be mailed as First-Class Mail. The following must be mailed as First-Class Mail, unless mailed as Express Mail or exempt under title 39, United States Code, or except as authorized under sections 344.12, 344.23 and 443:

a. Mail sealed against postal inspection as set forth in section 5000;

b. Matter wholly or partially in handwriting or typewriting except as specifically permitted by sections 312, 313, 323, 344.22, and 446;

c. Matter having the character of actual and personal correspondence except as specifically permitted by sections 312, 313, 323, 344.22, and 446; and

d. Bills and statements of account.

220 DESCRIPTION OF SUBCLASSES

221 Letters and Sealed Parcels Subclass

221.1 **General.** The Letters and Sealed Parcels subclass consists of First-Class Mail weighing **[**11**]**13 ounces or less that is not mailed under section 222 or 223.

221.2 **Regular Rate Categories.** The regular rate categories consist of Letters and Sealed Parcels subclass mail not mailed under section 221.3.

221.21 **[Single Piece] Single-Piece Rate Category.** The single-piece rate category applies to regular rate Letters and Sealed Parcels subclass mail not mailed under section 221.22**[.]**, 221.23, 221.24, or 221.25.

221.22 **Presort Rate Category.** The **[**P**]**presort rate category applies to Letters and Sealed Parcels subclass mail that:

a. Is prepared in a mailing of at least 500 pieces;

b. Is presorted, marked, and presented as **[**prescribed**]** specified by the Postal Service; and

c. Meets the addressing and other preparation requirements **[**prescribed**]** specified by the Postal Service.

221.23 **Prepaid Reply Mail Rate Category.** The prepaid reply mail rate category applies to Letters and Sealed Parcels subclass mail that:

a. Is provided to senders with postage prepaid by the recipient, a prepaid reply mail permit holder, for return by mail to the recipient;

b. Bears the recipient's preprinted machine-readable return address, a barcode representing not more than 11 digits (not including "correction" digits), a Facing Identification Mark, and other markings specified and approved by the Postal Service; and

c. Meets the letter machinability and other preparation requirements specified by the Postal Service.

221.24 **Qualified Business Reply Mail Rate Category.** The qualified business reply mail rate category applies to Letters and Sealed Parcels subclass mail that:

a. Is provided to senders by the recipient, an advance deposit account business reply mail permit holder, for return by mail to the recipient;

b. Bears the recipient's preprinted machine-readable return address, a barcode representing not more than 11 digits (not including "correction" digits), a Facing Identification Mark, and other markings specified and approved by the Postal Service; and

c. Meets the letter machinability and other preparation requirements specified by the Postal Service.

221.25 **Courtesy Envelope Mail Rate Category.** The courtesy envelope mail rate category applies to Letters and Sealed Parcels subclass mail in envelopes that:

a. Are preaddressed and preprinted reply envelopes, of a design approved by the Postal Service;

b. Bear a facing identification mark as specified by the Postal Service;

c. Bear a proper barcode corresponding to the correct ZIP Code, as specified by the Postal Service;

d. Bear an indication that the envelope is eligible for the discount, as specified by the Postal Service; and

e. Meet automation compatibility criteria as specified by the Postal Service.

221.26 **Nonstandard Size Surcharge.** Regular rate category Letters and Sealed Parcels subclass mail is subject to a surcharge if it is nonstandard size mail, as defined in section 232.

221.27 **Presort Discount for Pieces Weighing More Than Two Ounces.** Presort rate category Letters and Sealed Parcels subclass mail is eligible for an additional presort discount on each piece weighing more than two ounces.

221.3 **Automation Rate Categories — Letters and Flats**

221.31 **General.** The automation rate categories consist of Letters and Sealed Parcels subclass mail weighing **[**11**]**13 ounces or less that:

a. Is prepared in a mailing of at least 500 pieces;

b. Is presorted, marked, and presented as specified by the Postal Service;

c. Bears a barcode representing not more than 11 digits (not including "correction" digits) as **[**prescribed**]** specified by the Postal Service; and

d. Meets the machinability, addressing, barcoding, and other preparation requirements **[**prescribed**]** specified by the Postal Service.

221.32 **Basic Rate Category.** The basic rate category applies to letter-size automation rate category mail not mailed under section 221.33, 221.34, or 221.35.

221.33 **Three-Digit Rate Category.** The three-digit rate category applies to letter-size automation rate category mail presorted to single or multiple three-digit ZIP Code destinations as **[**prescribed**]** specified by the Postal Service.

221.34 **Five-Digit Rate Category.** The five-digit rate category applies to letter-size automation rate category mail presorted to single or multiple five-digit ZIP Code destinations as **[**prescribed**]** specified by the Postal Service.

221.35 **Carrier Route Rate Category.** The carrier route rate category applies to letter-size automation rate category mail presorted to carrier routes. It is available only for those carrier routes **[**prescribed**]** specified by the Postal Service.

221.36 **Basic Flats Rate Category.** The basic flats rate category applies to flat-size automation rate category mail not mailed under section 221.37.

221.37 **Three- and Five-Digit Flats Rate Category.** The three- and five-digit flats rate category applies to flat-size automation rate category mail presorted to single or multiple three- and five-digit ZIP Code destinations as specified by the Postal Service.

221.38 **Nonstandard Size Surcharge.** Flat-size automation rate category pieces are subject to a surcharge if they are nonstandard size mail, as defined in section 232.

221.39 **Presort Discount for Pieces Weighing More Than Two Ounces.** Presorted automation rate category mail is eligible for an additional presort discount on each piece weighing more than two ounces.

221.4 **Automation Rate Category — Parcels**

221.41 **Prebarcoded Parcel Rate Category.** The prebarcoded parcel rate category applies to Letters and Sealed Parcels subclass nonpresorted mail that:

a. Is prepared in a mailing of at least 50 pieces;

b. Bears a barcode as prescribed by the Postal Service;

c. Is marked and presented as prescribed by the Postal Service; and

d. Meets the machinability, addressing, barcoding, and other preparation requirements prescribed by the Postal Service.

This provision was applicable only to mailings entered for processing at no more than six facilities designated by the Postal Service. This provision expired April 28, 1998.

222 **[Stamped Cards and Post Cards] Cards Subclass**

222.1 **Definition**

[222.11 **Stamped Card.** A Stamped Card is a card with postage imprinted or impressed on it and supplied by the Postal Service for the transmission of messages.**]**

222.1**[**2**]**1 **[Post Card] Cards.** The Cards subclass consists of Stamped Cards, defined in section 962.11, and postcards. A **[**post card**]** postcard is a privately printed mailing card for the transmission of messages. To be eligible to be mailed as a First-Class **[**post card**]** postcard, a card must be of uniform thickness and must not exceed any of the following dimensions:

a. 6 inches in length;

b. 4¼ inches in width;

c. 0.016 inch in thickness.

222.1**[**3**]**2 **Double Cards.** Double Stamped Cards or **[**post cards**]** double postcards may be mailed as Stamped Cards or **[**post cards**]**postcards. **[**A d**]**Double Stamped Cards are defined in section 962.12. **[**or post card**]** A double postcard consists of two attached cards, one of which may be detached by the receiver and returned by mail as a single **[**Stamped Card or**]** postcard **[**post card**]**.

222.2 **Restriction.** A mailpiece with any of the following characteristics is not mailable as a Stamped Card or **[**post card**]** postcard unless it is prepared as **[**prescribed**]** specified by the Postal Service:

a. Numbers or letters unrelated to postal purposes appearing in the address portion of the card;

b. Punched holes;

c. Vertical tearing guide;

d. An address portion which is smaller than the remainder of the card.

222.3 **Regular Rate Categories**

222.31 **Single-Piece Rate Category.** The single-piece rate category applies to regular rate **[**Stamped Cards and Post**]** Cards subclass mail not mailed under section 222.32**[.]**, 222.33, or 222.34.

222.32 **Presort Rate Category.** The presort rate category applies to **[**Stamped Cards and Post**]** Cards subclass mail that:

a. Is prepared in a mailing of at least 500 pieces;

b. Is presorted, marked, and presented as **[**prescribed**]** specified by the Postal Service; and

c. Meets the addressing and other preparation requirements **[**prescribed**]** specified by the Postal Service.

222.33 **Prepaid Reply Mail Rate Category.** The prepaid reply mail rate category applies to Cards subclass mail that:

a. Is provided to senders with postage prepaid by the recipient, a prepaid reply mail permit holder, for return by mail to the recipient;

b. Bears the recipient's preprinted machine-readable return address, a barcode representing not more than 11 digits (not including "correction" digits), a Facing Identification Mark, and other markings specified and approved by the Postal Service; and

c. Meets the card machinability and other preparation requirements specified by the Postal Service.

222.34 **Qualified Business Reply Mail Rate Category.** The qualified business reply mail rate category applies to Cards subclass mail that:

a. Is provided to senders by the recipient, an advance deposit account business reply mail permit holder, for return by mail to the recipient;

b. Bears the recipient's preprinted machine-readable return address, a barcode representing not more than 11 digits (not including "correction" digits), a Facing Identification Mark, and other markings specified and approved by the Postal Service; and

c. Meets the card machinability and other preparation requirements specified by the Postal Service.

222.4 **Automation Rate Categories**

222.41 **General.** The automation rate categories consist of **[**Stamped Cards and Post**]** Cards subclass mail that:

a. Is prepared in a mailing of at least 500 pieces;

b. Is presorted, marked, and presented as specified by the Postal Service;

c. Bears a barcode representing not more than 11 digits (not including "correction" digits) as **[**prescribed**]** specified by the Postal Service; and

d. Meets the machinability, addressing, barcoding, and other preparation requirements **[**prescribed**]** specified by the Postal Service.

222.42 **Basic Rate Category.** The basic rate category applies to automation rate category cards not mailed under section 222.43, 222.44, or 222.45.

222.43 **Three-Digit Rate Category.** The three-digit rate category applies to automation rate category cards presorted to single or multiple three-digit ZIP Code destinations as **[**prescribed**]** specified by the Postal Service.

222.44 **Five-Digit Rate Category.** The five-digit rate category applies to automation rate category cards presorted to single or multiple five-digit ZIP Code destinations as **[**prescribed**]** specified by the Postal Service.

222.45 **Carrier Route Rate Category.** The carrier route rate category applies to automation rate category cards presorted to carrier routes. It is available only for those carrier routes **[**prescribed**]** specified by the Postal Service.

223 **Priority Mail Subclass**

223.1 **General.** The Priority Mail subclass consists of:

a. First-Class Mail weighing more than **[**11**]**13 ounces; and

b. Any mailable matter which, at the option of the mailer, is mailed for expeditious mailing and transportation.

223.2 **Single-Piece Priority Mail Rate Category.** The single-piece Priority Mail **[**priority mail**]** rate category applies to Priority Mail subclass mail not mailed under section 223.**[**3**]**4.

223.3 **[Presorted Priority Mail Rate Category.** The presorted priority mail rate category applies to Priority Mail subclass mail that:

a. Is prepared in a mailing of at least 300 pieces;

b. Is presorted, marked, and presented as prescribed by the Postal Service; and

c. Meets the machinability, addressing, and other preparation requirements prescribed by the Postal Service.**]** **[Reserved]**

223.4 **Prebarcoded Priority Mail Parcel Rate Category**. The prebarcoded Priority Mail Parcel rate category applies to Priority Mail subclass nonpresorted mail that:

a. Is prepared in a mailing of at least 50 pieces;

b. Bears a barcode as prescribed by the Postal Service;

c. Is marked and presented as prescribed by the Postal Service; and

d. Meets the machinability, addressing, barcoding, and other preparation requirements prescribed by the Postal Service.

This provision was applicable only to mailings entered for processing at no more than six facilities designated by the Postal Service. This provision expired April 28, 1998.

223.5 **Flat Rate Envelope.** Priority Mail subclass mail sent in a "flat rate" envelope provided by the Postal Service is charged the two-pound rate.

223.6 **Pickup Service.** Pickup service is available for Priority Mail subclass mail under terms and conditions **[**prescribed**]** specified by the Postal Service.

223.7 **Bulky Parcels.** Priority Mail subclass mail weighing less than 15 pounds, and measuring over 84 inches in length and girth combined, is charged a minimum rate equal to that for a 15-pound parcel for the zone to which the piece is addressed.

230 PHYSICAL LIMITATIONS

231 Size and Weight

First-Class Mail may not exceed 70 pounds or 108 inches in length and girth combined. Additional size and weight limitations apply to individual First-Class Mail subclasses.

232 Nonstandard Size Mail

Letters and Sealed Parcels subclass mail weighing one ounce or less is nonstandard size if:

a. Its aspect ratio does not fall between 1 to 1.3 and 1 to 2.5 inclusive; or

b. It exceeds any of the following dimensions:

   i. 11.5 inches in length;

   ii. 6.125 inches in width; or

   iii. 0.25 inch in thickness.

240 POSTAGE AND PREPARATION

Postage on First-Class Mail must be paid as set forth in section 3000. Postage is computed separately on each piece of mail. Pieces not within the same postage rate increment may be mailed at other than a single-piece rate as part of the

same mailing only when specific methods approved by the Postal Service for **[**ascertaining**]** determining and verifying postage are followed. All mail mailed at other than a single-piece rate must have postage paid in a manner not requiring cancellation.

250 DEPOSIT AND DELIVERY

251 Deposit

First-Class Mail must be deposited at places and times designated by the Postal Service.

252 Service

First-Class Mail receives expeditious handling and transportation, except that when First-Class Mail is attached to or enclosed with mail of another class, the service of that class applies.

253 Forwarding and Return

First-Class Mail that is undeliverable-as-addressed is forwarded or returned to the sender without additional charge.

260 **ANCILLARY SERVICES**

First-Class Mail, except as otherwise noted, will receive the following additional services upon payment of the fees prescribed in the corresponding schedule:

	Service	Schedule
a.	Address correction	911 **[**SS-1**]**
b.	Business reply mail	931 **[**SS-2**]**
c.	Certificates of mailing	947 **[**SS-4**]**
d.	Certified mail	941 **[**SS-5**]**
e.	COD	944 **[**SS-6**]**
f.	[Insured mail] Insurance	943 **[**SS-9**]**
g.	Registered mail	942 **[**SS-14**]**
h.	Return receipt (limited to merchandise sent by Priority Mail)	945 **[**SS-16**]**
i.	Merchandise return	932 **[**SS-20**]**
	Delivery Confirmation (limited to Priority Mail)	948
k.	Prepaid Reply Mail	934

270 **RATES AND FEES**

271 The rates **[**and fees**]** for First-Class Mail are set forth in the following schedules:

		Schedule
a.	Letters and Sealed Parcels	221
b.	**[**Stamped Cards and Post**]** Cards	222
c.	Priority Mail	223
[d.	Fees	SS-19A and 1000**]**

272 **Keys and Identification Devices.** Keys, identification cards, identification tags, or similar identification devices that:

a. weigh no more than 2 pounds;
b. are mailed without cover; and
c. bear, contain, or have securely attached the name and address information, as specified by the Postal Service, of a person, organization, or concern, with instructions to return to the address and a statement guaranteeing the payment of postage due on delivery; are subject to the following rates and fees:

i. the applicable single-piece rates in schedules 221 or 223;
ii. the fee set forth in fee schedule 931 for payment of postage due charges if an active business reply mail advance deposit account is not used, and
iii. if applicable, the surcharge for nonstandard size mail, as defined in section 232.

280 **AUTHORIZATIONS AND LICENSES**

The fee set forth in **[**Rate**]** Schedule 1000 must be paid once each year at each office of mailing by any person who mails other than single-piece First-Class Mail or courtesy envelope mail. Payment of the fee allows the mailer to mail at any First-Class rate.

STANDARD MAIL
CLASSIFICATION SCHEDULE

310 DEFINITION

311 General

Any mailable matter may be mailed as Standard Mail except:

a. Matter required to be mailed as First-Class Mail;

b. Copies of a publication that is entered as Periodicals class mail, except copies sent by a printer to a publisher, and except copies that would have traveled at the former second-class transient rate. (The transient rate applied to individual copies of second-class mail (currently Periodicals class mail) forwarded and mailed by the public, as well as to certain sample copies mailed by publishers.)

312 Printed Matter

Printed matter, including printed letters which according to internal evidence are being sent in identical terms to several persons, but which do not have the character of actual or personal correspondence, may be mailed as Standard Mail. Printed matter does not lose its character as Standard Mail when the date and name of the addressee and of the sender are written thereon. For the purposes of the Standard Mail Classification Schedule, "printed" does not include reproduction by handwriting or typewriting.

313 Written Additions

Standard Mail may have the following written additions placed on the wrapper, on a tag or label attached to the outside of the parcel, or inside the parcel, either loose or attached to the article:

a. Marks, numbers, name, or letters descriptive of contents;

b. "Please Do Not Open Until Christmas," or words of similar import;

c. Instructions and directions for the use of an article in the package;

d. Manuscript dedication or inscription not in the nature of personal correspondence;

e. Marks to call attention to any word or passage in text;

f. Corrections of typographical errors in printed matter;

g. Manuscripts accompanying related proof sheets, and corrections in proof sheets to include: corrections of typographical and other errors, alterations of text, insertion of new text, marginal instructions to the printer, and rewrites of parts if necessary for correction;

h. Handstamped imprints, except when the added matter is itself personal or converts the original matter to a personal communication;

i. An invoice.

320 **DESCRIPTION OF SUBCLASSES**

321 **Subclasses Limited to Mail Weighing Less than 16 Ounces**

321.1 **[Single Piece Subclass] <u>[Reserved]</u>**

[321.11 **Definition.** The Single Piece subclass consists of Standard Mail weighing less than 16 ounces that is not mailed under sections 321.2, 321.3, 321.4, 321.5 or 323.**]**

[321.12 **Basic Rate Category.** The basic rate category applies to Single Piece subclass mail not mailed under section 321.13.**]**

[321.13 **Keys and Identification Devices Rate Category.** The keys and identification devices rate category applies to keys, identification cards, identification tags, or similar identification devices mailed without cover, and which bear, contain, or have securely attached the name and complete address of a person, organization, or concern, with instructions to return to such address and a statement guaranteeing the payment of postage due on delivery.**]**

[321.14 **Nonstandard Size Surcharge.** Single Piece subclass mail, other than that mailed under section 321.13, is subject to a surcharge if it is nonstandard size mail, as defined in section 333.**]**

321.2 **Regular Subclass**

321.21 **General.** The Regular subclass consists of Standard Mail weighing less than 16 ounces that is not mailed under sections **[**321.1,**]** 321.3, 321.4, 321.5 or 323.

321.22 **Presort Rate Categories**

321.221 **General.** The presort rate categories apply to Regular subclass mail that:

a. Is prepared in a mailing of at least 200 addressed pieces or 50 pounds of addressed pieces;

b. Is presorted, marked, and presented as **[**prescribed**]** <u>specified</u> by the Postal Service; and

c. Meets the machinability, addressing, and other preparation requirements **[**prescribed**]** <u>specified</u> by the Postal Service.

321.222 **Basic Rate Categories.** The basic rate categories apply to presort rate category mail not mailed under section 321.223.

321.223 **Three- and Five-Digit Rate Categories.** The three- and five-digit rate categories apply to presort rate category mail presorted to single or multiple three- and five-digit ZIP Code destinations as **[**prescribed**]** <u>specified</u> by the Postal Service.

321.23 **Automation Rate Categories**

321.231 **General.** The automation rate categories apply to Regular subclass mail that:

a. Is prepared in a mailing of at least 200 addressed pieces or 50 pounds of addressed pieces;

b. Is presorted, marked, and presented as **[**prescribed**]** <u>specified</u> by the Postal Service;

c. Bears a barcode representing not more than 11 digits (not including "correction" digits) as **[**prescribed**]** specified by the Postal Service;

d. Meets the machinability, addressing, barcoding, and other preparation requirements **[**prescribed**]** specified by the Postal Service.

321.232 **Basic Barcoded Rate Category.** The basic barcoded rate category applies to letter-size automation rate category mail not mailed under section 321.233 or 321.234.

321.233 **Three-Digit Barcoded Rate Category.** The three-digit barcoded rate category applies to letter-size automation rate category mail presorted to single or multiple three-digit ZIP Code destinations as **[**prescribed**]** specified by the Postal Service.

321.234 **Five-Digit Barcoded Rate Category.** The five-digit barcoded rate category applies to letter-size automation rate category mail presorted to single or multiple five-digit ZIP Code destinations as **[**prescribed**]** specified by the Postal Service.

321.235 **Basic Barcoded Flats Rate Category.** The basic barcoded flats rate category applies to flat-size automation rate category mail not mailed under section 321.236.

321.236 **Three- and Five-Digit Barcoded Flats Rate Category.** The three- and five-digit barcoded flats rate category applies to flat-size automation rate category mail presorted to single or multiple three- and five-digit ZIP Code destinations as **[**prescribed**]** specified by the Postal Service.

321.24 **Destination Entry Discounts**. The destination entry discounts apply to Regular subclass mail prepared as **[**prescribed**]** specified by the Postal Service and addressed for delivery within the service area of the BMC (or auxiliary service facility), or sectional center facility (SCF), at which it is entered, as defined by the Postal Service.

321.25 **Residual Shape Surcharge**. Regular subclass mail is subject to a surcharge if it is prepared as a parcel or if it is not letter or flat shaped.

321.3 Enhanced Carrier Route Subclass

321.31 **Definition.** The Enhanced Carrier Route subclass consists of Standard Mail weighing less than 16 ounces that is not mailed under section **[**321.1,**]** 321.2, 321.4, 321.5 or 323, and that:

a. Is prepared in a mailing of at least 200 addressed pieces or 50 pounds of addressed pieces;

b. Is prepared, marked, and presented as **[**prescribed**]** specified by the Postal Service;

c. Is presorted to carrier routes as **[**prescribed**]** specified by the Postal Service;

d. Is sequenced as **[**prescribed**]** specified by the Postal Service; and

e. Meets the machinability, addressing, and other preparation requirements **[**prescribed**]** specified by the Postal Service.

321.32 **Basic Rate Category.** The basic rate category applies to Enhanced Carrier Route subclass mail not mailed under section 321.33, 321.34 or 321.35.

321.33 **Basic Pre-Barcoded Rate Category.** The basic pre-barcoded rate category applies to letter-size Enhanced Carrier Route subclass mail which bears a barcode representing not more than 11 digits (not including "correction" digits), as specified **[**prescribed**]** by the Postal Service, and which meets the machinability, addressing, and barcoding specifications and other preparation requirements **[**prescribed**]** specified by the Postal Service.

321.34 **High Density Rate Category.** The high density rate category applies to Enhanced Carrier Route subclass mail presented in walk-sequence order and meeting the high density requirements **[**prescribed**]** specified by the Postal Service.

321.35 **Saturation Rate Category.** The saturation rate category applies to Enhanced Carrier Route subclass mail presented in walk-sequence order and meeting the saturation requirements **[**prescribed**]** specified by the Postal Service.

321.36 **Destination Entry Discounts.** Destination entry discounts apply to Enhanced Carrier Route subclass mail prepared as **[**prescribed**]** specified by the Postal Service and addressed for delivery within the service area of the BMC (or auxiliary service facility), sectional center facility (SCF), or destination delivery unit (DDU) at which it is entered, as defined by the Postal Service.

321.37 **Residual Shape Surcharge**. Enhanced Carrier Route subclass mail is subject to a surcharge if it is prepared as a parcel or if it is not letter or flat shaped.

321.4 **Nonprofit Subclass**

321.41 **General**. The Nonprofit subclass consists of Standard Mail weighing less than 16 ounces that is not mailed under section **[**321.1,**]** 321.2, 321.3, 321.5 or 323, and that is mailed by authorized nonprofit organizations or associations of the following types:

a. Religious, as defined in section 1009,

b. Educational, as defined in section 1009,

c. Scientific, as defined in section 1009,

d. Philanthropic, as defined in section 1009,

e. Agricultural, as defined in section 1009,

f. Labor, as defined in section 1009,

g. Veterans', as defined in section 1009,

h. Fraternal, as defined in section 1009,

i. Qualified political committees,

j. State or local voting registration officials when making a mailing required or authorized by the National Voter Registration Act of 1993.

321.411 **Qualified Political Committees**. The term "qualified political committee" means a national or State committee of a political party, the Republican and Democratic Senatorial Campaign Committees, the Democratic National Congressional Committee, and the National Republican Congressional Committee:

a. The term "national committee" means the organization which, by virtue of the bylaws of a political party, is responsible for the day-to-day operation of such political party at the national level; and

b. The term "State committee" means the organization which, by virtue of the bylaws of a political party, is responsible for the day-to-day operation of such political party at the State level.

321.412 *Limitation on Authorization.* An organization authorized to mail at the nonprofit Standard rates for qualified nonprofit organizations may mail only its own matter at these rates. An organization may not delegate or lend the use of its permit to mail at **[**special**]** nonprofit Standard rates to any other person, organization or association.

321.42 **Presort Rate Categories**

321.421 **General.** The presort rate categories apply to Nonprofit subclass mail that:

a. Is prepared in a mailing of at least 200 addressed pieces or 50 pounds of addressed pieces;

b. Is presorted, marked, and presented as **[**prescribed**]** specified by the Postal Service; and

c. Meets the machinability, addressing, and other preparation requirements **[**prescribed**]** specified by the Postal Service.

321.422 **Basic Rate Categories.** The basic rate categories apply to presort rate category mail not mailed under section 321.423.

321.423 **Three- and Five-Digit Rate Categories.** The three- and five-digit rate categories apply to presort rate category mail presorted to single or multiple three- and five-digit ZIP Code destinations as **[**prescribed**]** specified by the Postal Service.

321.43 **Automation Rate Categories**

321.431 **General.** The automation rate categories apply to Nonprofit subclass mail that:

a. Is prepared in a mailing of at least 200 addressed pieces or 50 pounds of addressed pieces;

b. Is presorted, marked, and presented as **[**prescribed**]** specified by the Postal Service;

c. Bears a barcode representing not more than 11 digits (not including "correction" digits) as **[**prescribed**]** specified by the Postal Service; and

d. Meets the machinability, addressing, barcoding, and other preparation requirements **[**prescribed**]** specified by the Postal Service.

321.432 **Basic Barcoded Rate Category.** The basic barcoded rate category applies to letter-size automation rate category mail not mailed under section 321.433 or 321.434.

321.433 **Three-Digit Barcoded Rate Category.** The three-digit barcoded rate category applies to letter-size automation rate category mail presorted to single or multiple three-digit ZIP Code destinations as **[**prescribed**]** specified by the Postal Service.

321.434 **Five-Digit Barcoded Rate Category.** The five-digit barcoded rate category applies to letter-size automation rate category mail presorted to single or multiple five-digit ZIP Code destinations as **[**prescribed**]** specified by the Postal Service.

321.435 **Basic Barcoded Flats Rate Category.** The basic barcoded flats rate category applies to flat-size automation rate category mail not mailed under section 321.436.

321.436 **Three- and Five-Digit Barcoded Flats Rate Category.** The three- and five-digit barcoded flats rate category applies to flat-size automation rate category mail presorted to single or multiple three- and five-digit ZIP Code destinations as **[**prescribed**]** specified by the Postal Service.

321.44 **Destination Entry Discounts.** Destination entry discounts apply to Nonprofit subclass mail prepared as **[**prescribed**]** specified by the Postal Service and addressed for delivery within the service area of the BMC (or auxiliary service facility) or sectional center facility (SCF) at which it is entered, as defined by the Postal Service.

321.45 **Residual Shape Surcharge**. Nonprofit subclass mail is subject to a surcharge if it is prepared as a parcel or if it is not letter or flat shaped.

321.5 **Nonprofit Enhanced Carrier Route Subclass**

321.51 **Definition.** The Nonprofit Enhanced Carrier Route subclass consists of Standard Mail weighing less than 16 ounces that is not mailed under section **[**321.1,**]** 321.2, 321.3, 321.4 or 323, that is mailed by authorized nonprofit organizations or associations (as defined in section 321.41) under the terms and limitations stated in section 321.412, and that:

a. Is prepared in a mailing of at least 200 addressed pieces or 50 pounds of addressed pieces;

b. Is prepared, marked, and presented as **[**prescribed**]** specified by the Postal Service;

c. Is presorted to carrier routes as **[**prescribed**]** specified by the Postal Service;

d. Is sequenced as **[**prescribed**]** specified by the Postal Service; and

e. Meets the machinability, addressing, and other preparation requirements **[**prescribed**]** specified by the Postal Service.

321.52 **Basic Rate Category.** The basic rate category applies to Nonprofit Enhanced Carrier Route subclass mail not mailed under section 321.53, 321.54 or 321.55.

321.53 **Basic Pre-Barcoded Rate Category.** The basic pre-barcoded rate category applies to letter-size Nonprofit Enhanced Carrier Route subclass mail which bears a barcode representing not more than 11 digits (not including "correction" digits), as **[**prescribed**]** specified by the Postal Service, and which meets the machinability, addressing, and barcoding specifications and other preparation requirements **[**prescribed**]** specified by the Postal Service.

321.54 **High Density Rate Category.** The high density rate category applies to Nonprofit Enhanced Carrier Route subclass mail presented in walk-sequence order and meeting the high density requirements **[**prescribed**]** specified by the Postal Service.

321.55 **Saturation Rate Category.** The saturation rate category applies to Nonprofit Enhanced Carrier Route subclass mail presented in walk-sequence order and meeting the saturation requirements **[**prescribed**]** specified by the Postal Service.

321.56 **Destination Entry Discounts.** Destination entry discounts apply to Nonprofit Enhanced Carrier Route subclass mail prepared as **[**prescribed**]** specified by the Postal Service and addressed for delivery within the service area of the BMC (or auxiliary service facility), sectional center facility (SCF), or destination delivery unit (DDU) at which it is entered, as defined by the Postal Service.

321.57 **Residual Shape Surcharge.** Nonprofit Enhanced Carrier Route subclass mail is subject to a surcharge if it is prepared as a parcel or if it is not letter or flat shaped.

322 **Subclasses Limited to Mail Weighing 16 Ounces or More**

322.1 **Parcel Post Subclass**

322.11 **Definition.** The Parcel Post subclass consists of Standard Mail weighing 16 ounces or more that is not mailed under sections 322.3, 323.1, or 323.2.

[322.12 **Basic Rate Category.** The basic rate category applies to all Parcel Post subclass mail not mailed under sections 322.13 or 322.14.**]**

322.12 **Description of Rate Categories**

322.121 **Inter-BMC Rate Category.** The Inter-BMC rate category applies to all Parcel Post subclass mail not mailed under sections 322.122, 322.123, 322.124, or 322.125.

322.122 **Intra-BMC Rate Category.** The Intra-BMC rate category applies to Parcel Post subclass mail originating and destinating within a designated BMC or auxiliary service facility service area, Alaska, Hawaii or Puerto Rico.

322.123 **Destination Bulk Mail Center (DBMC) Rate Category.** The destination bulk mail center rate category applies to Parcel Post subclass mail prepared as specified by the Postal Service in a mailing of at least 50 pieces entered at a designated destination BMC, auxiliary service facility, or other equivalent facility, as specified by the Postal Service.

322.124 **Destination Sectional Center Facility (DSCF) Rate Category.** The destination sectional center facility rate category applies to Parcel Post subclass mail prepared as specified by the Postal Service in a mailing of at least 50 pieces sorted to five-digit destination ZIP Codes as specified by the Postal Service and entered at a designated destination processing and distribution center or facility, or other equivalent facility, as specified by the Postal Service.

322.125 **Destination Delivery Unit (DDU) Rate Category.** The destination delivery unit rate category applies to Parcel Post subclass mail prepared as specified by the Postal Service in a mailing of at least 50 pieces, and entered at a designated destination delivery unit, or other equivalent facility, as specified by the Postal Service.

322.13 **Bulk Parcel Post.** Bulk Parcel Post mail is Parcel Post mail consisting of properly prepared and separated single mailings of at least 300 pieces or 2000 pounds. Pieces weighing less than 15 pounds and measuring over 84 inches in length and girth combined or pieces measuring over 108 inches in length and girth combined are not mailable as Bulk Parcel Post mail.

322.131 **Barcoded Discount.** The barcoded discount applies to Bulk Parcel Post mail that is entered at designated facilities, bears a barcode specified by the Postal Service, is prepared as specified by the Postal Service, and meets all other preparation and machinability requirements of the Postal Service.

[400.0202 **Bulk**

Bulk parcel post mail is fourth-class parcel post mail consisting of properly prepared and separated single mailings of at least 300 pieces or 2000 pounds. Pieces weighing less than 15 pounds and measuring over 84 inches in length and girth combined are not mailable as bulk parcel post. Provision for mailing nonidentical pieces is set forth in section 400.046.

322.14 **Destination BMC Rate Category.** Parcel Post subclass mail is eligible for destination BMC rates if it is included in a mailing of at least 50 pieces deposited at the destination BMC, auxiliary service facility, or other equivalent facility, as prescribed by the Postal Service.**]**

322.14 **Bulk Mail Center (BMC) Presort Discounts**

322.141 **BMC Presort Discount.** The BMC presort discount applies to Inter-BMC Parcel Post subclass mail that is prepared as specified by the Postal Service in a mailing of 50 or more pieces, entered at a facility authorized by the Postal Service, and sorted to destination BMCs, as specified by the Postal Service.

322.142 **Origin Bulk Mail Center (OBMC) Discount.** The origin bulk mail center discount applies to Inter-BMC Parcel Post subclass mail that is prepared as specified by the Postal Service in a mailing of at least 50 pieces, entered at the origin BMC, and sorted to destination BMCs, as specified by the Postal Service.

[322.15 **Intra-BMC Discount.** Basic rate category Parcel Post subclass mail is eligible for the intra-BMC discount if it originates and destinates within the same BMC or auxiliary service facility service area, Alaska, Hawaii or Puerto Rico.**]**

322.15 **Barcoded Discount.** The barcoded discount applies to Inter-BMC, Intra-BMC, and DBMC Parcel Post subclass mail that is entered at designated facilities, bears a barcode specified by the Postal Service, is prepared as specified by the Postal Service in a mailing of at least 50 pieces, and meets all other preparation and machinability requirements of the Postal Service.

322.16 **Oversize Parcel Post**

322.161 **Excessive Length and Girth.** Parcel Post subclass mail pieces exceeding 108 inches in length and girth combined, but not greater than 130 inches in length and girth combined, are mailable.

322.162 **Balloon Rate.** Parcel Post subclass mail pieces exceeding 84 inches in length and girth combined and weighing less than 15 pounds are subject to a rate equal to that for a 15 pound parcel for the zone to which the parcel is addressed.

322.1**[**6**]**7 **Nonmachinable Surcharge. [**Basic rate category Parcel Post subclass mail**]** Inter-BMC Parcel Post subclass mail that does not meet machinability criteria **[**prescribed**]** specified by the Postal Service is subject to a nonmachinable surcharge.

322.1**[**7**]**8 **Pickup Service.** Pickup service is available for Parcel Post subclass mail under terms and conditions **[**prescribed**]** specified by the Postal Service.

322.2 **[Reserved]**

322.3 **Bound Printed Matter Subclass**

322.31 **Definition.** The Bound Printed Matter subclass consists of Standard Mail weighing at least 16 ounces, but not more than 15 pounds, which:

a. Consists of advertising, promotional, directory, or editorial material, or any combination thereof;

b. Is securely bound by permanent fastenings including, but not limited to, staples, spiral bindings, glue, and stitching; loose leaf binders and similar fastenings are not considered permanent;

c. Consists of sheets of which at least 90 percent are imprinted with letters, characters, figures or images or any combination of these, by any process other than handwriting or typewriting;

d. Does not have the nature of personal correspondence; and

e. Is not stationery, such as pads of blank printed forms.

322.32 **Single-Piece Rate Category**. The single-piece rate category applies to Bound Printed Matter subclass mail which is not mailed under section 322.33 or 322.34.

322.33 **Bulk Rate Category**. The bulk rate category applies to Bound Printed Matter subclass mail prepared in a mailing of at least 300 pieces, prepared and presorted as **[**prescribed**]** specified by the Postal Service.

322.34 **Carrier Route Presort Rate Category.** The carrier route presort rate category applies to Bound Printed Matter subclass mail prepared in a mailing of at least

300 pieces of carrier route presorted mail, prepared and presorted as specified **[**prescribed**]** by the Postal Service.

322.35 **Barcoded Discount.** The barcoded discount applies to single-piece rate and bulk rate Bound Printed Matter subclass mail that is entered at designated facilities, bears a barcode specified by the Postal Service, is prepared as specified by the Postal Service in a mailing of at least 50 pieces, and meets all other preparation and machinability requirements of the Postal Service.

323 **Subclasses With No 16-Ounce Limitation**

323.1 **Special Subclass**

323.11 **Definition.** The Special subclass consists of Standard Mail of the following types:

a. Books, including books issued to supplement other books, of at least eight printed pages, consisting wholly of reading matter or scholarly bibliography or reading matter with incidental blank spaces for notations, and containing no advertising matter other than incidental announcements of books. Not more than three of the announcements may contain as part of their format a single order form, which may also serve as a postcard **[**post card.**]** **[**The**]** These order forms **[**permitted in this subsection**]** are in addition to and not in lieu of order forms which may be enclosed by virtue of any other provision;

b. 16 millimeter or narrower width films which must be positive prints in final form for viewing, and catalogs of such films, of 24 pages or more, at least 22 of which are printed, except when sent to or from commercial theaters;

c. Printed music, whether in bound form or in sheet form;

d. Printed objective test materials and accessories thereto used by or in behalf of educational institutions in the testing of ability, aptitude, achievement, interests and other mental and personal qualities with or without answers, test scores or identifying information recorded thereon in writing or by mark;

e. Sound recordings, including incidental announcements of recordings and guides or scripts prepared solely for use with such recordings. Not more than three of the announcements **[**permitted in this subsection**]** may contain

as part of their format a single order form, which may also serve as a postcard **[**post card.**]** **[**The**]** These order forms **[**permitted in this subsection**]** are in addition to and not in lieu of order forms which may be enclosed by virtue of any other provision;

f. Playscripts and manuscripts for books, periodicals and music;

g. Printed educational reference charts, permanently processed for preservation;

h. Printed educational reference charts, including but not limited to

i. Mathematical tables,

ii. Botanical tables,

iii. Zoological tables, and

iv. Maps produced primarily for educational reference purposes;

i. Looseleaf pages and binders therefor, consisting of medical information for distribution to doctors, hospitals, medical schools, and medical students;

j. Computer-readable media containing prerecorded information and guides or scripts prepared solely for use with such media; and

k. Any mailing eligible to be entered as Library subclass mail.

323.12 **Single-Piece Rate Category.** The single-piece rate category applies to Special subclass mail not mailed under section 323.13 or 323.14.

323.13 **Level A Presort Rate Category.** The Level A presort rate category applies to mailings of at least 500 pieces of Special subclass mail, prepared and presorted to five-digit destination ZIP Codes as **[**prescribed**]** specified by the Postal Service.

323.14 **Level B Presort Rate Category.** The Level B presort rate category applies to mailings of at least 500 pieces of Special subclass mail, prepared and presorted to destination Bulk Mail Centers as **[**prescribed**]** specified by the Postal Service.

323.15 **Barcoded Discount.** The barcoded discount applies to single-piece rate and Level B presort rate Special subclass mail that is entered at designated facilities, bears a barcode specified by the Postal Service, is prepared as specified by the Postal Service in a mailing of at least 50 pieces, and meets all other preparation and machinability requirements of the Postal Service.

323.2 **Library Subclass**

323.21 **Definition.**

323.211 **General**. The Library subclass consists of Standard Mail of the following types, separated or presorted as **[**prescribed**]** specified by the Postal Service:

a. Matter designated in **[**sub**]**section 323.213, loaned or exchanged (including cooperative processing by libraries) between:

   i. Schools or colleges, or universities;

   ii. Public libraries, museums and herbaria, nonprofit religious, educational, scientific, philanthropic, agricultural, labor, veterans' or fraternal organizations or associations, or between such organizations and their members, readers or borrowers.

b. Matter designated in **[**sub**]**section 323.214, mailed to or from schools, colleges, universities, public libraries, museums and herbaria and to or from nonprofit religious, educational, scientific, philanthropic, agricultural, labor, veterans' or fraternal organizations or associations; or

c. Matter designated in **[**sub**]**section 323.215, mailed from a publisher or a distributor to a school, college, university or public library.

323.212 *Definition of Nonprofit Organizations and Associations.* Nonprofit organizations or associations are defined in section 1009.

323.213 *Library subclass mail under section 323.211.a.* Matter eligible for mailing as Library subclass mail under subsection a of section 323.211**[**a**]** consists of:

a. Books consisting wholly of reading matter or scholarly bibliography or reading matter with incidental blank spaces for notations and containing no advertising other than incidental announcements of books;

b. Printed music, whether in bound form or in sheet form;

c. Bound volumes of academic theses in typewritten or other duplicated form;

d. Periodicals, whether bound or unbound;

e. Sound recordings;

f. Other library materials in printed, duplicated or photographic form or in the form of unpublished manuscripts; and

g. Museum materials, specimens, collections, teaching aids, printed matter and interpretative materials intended to inform and to further the educational work and interest of museums and herbaria.

323.214 *Library subclass mail under section 323.211.b.* Matter eligible for mailing as Library subclass mail under subsection b of section 323.211**[**b**]** consists of:

a. 16-millimeter or narrower width films; filmstrips; transparencies; slides; microfilms; all of which must be positive prints in final form for viewing;

b. Sound recordings;

c. Museum materials, specimens, collections, teaching aids, printed matter, and interpretative materials intended to inform and to further the educational work and interests of museums and herbaria;

d. Scientific or mathematical kits, instruments or other devices; and

e. Catalogs of the materials in subsections a through d of section 323.214 **[**a through d**]** and guides or scripts prepared solely for use with such materials.

323.215 *Library subclass mail under section 323.211.c.* Matter eligible for mailing as Library subclass mail under subsection c of section 323.211**[**c**]** consists of books, including books to supplement other books, consisting wholly of reading matter or scholarly bibliography or reading matter with incidental blank spaces for notations, and containing no advertising matter other than incidental announcements of books.

323.22 **Basic Rate Category.** The basic rate category applies to all Library subclass mail.

323.23 **Barcoded Discount.** The barcoded discount applies to Library subclass mail that is entered at designated facilities, bears a barcode specified by the Postal Service, is prepared as specified by the Postal Service in a mailing of at least 50 pieces, and meets all other preparation and machinability requirements of the Postal Service.

330 **PHYSICAL LIMITATIONS**

331 **Size**

Except as provided in section 322.161, Standard Mail may not exceed 108 inches in length and girth combined. Additional size limitations apply to individual Standard Mail subclasses. The maximum size for mail presorted to carrier route in the Enhanced Carrier Route and Nonprofit Enhanced Carrier Route subclasses is 14 inches in length, 11.75 inches in width, and 0.75 inch in thickness. For merchandise samples mailed with detached address cards, the carrier route maximum dimensions apply to the detached address cards and not to the samples.

332 **Weight**

Standard Mail may not weigh more than 70 pounds. Additional weight limitations apply to individual Standard Mail subclasses.

[333 **Nonstandard Size Mail**

Single Piece subclass mail weighing one ounce or less is nonstandard size if:

a. Its aspect ratio does not fall between 1 to 1.3 and 1 to 2.5 inclusive; or

b. It exceeds any of the following dimensions:

   i. 11.5 inches in length;

   ii. 6.125 inches in width; or

   iii. 0.25 inch in thickness.**]**

340 POSTAGE AND PREPARATION

341 Postage

Postage must be paid as set forth in section 3000. When the postage computed at a **[**Single Piece,**]** Regular, Enhanced Carrier Route, Nonprofit or Nonprofit Enhanced Carrier Route Standard rate is higher than the rate prescribed in any of the Standard subclasses listed in 322 or 323 for which the piece also qualifies (or would qualify, except for weight), the piece is eligible for the applicable lower rate. All mail mailed at a bulk or presort rate must have postage paid in a manner not requiring cancellation.

342 Preparation

All pieces in a Standard mailing must be separately addressed. All pieces in a Standard mailing must be identified as **[**prescribed**]** specified by the Postal Service, and must contain the ZIP Code of the addressee when **[**prescribed**]** specified by the Postal Service. All Standard mailings must be prepared and presented as specified **[**prescribed**]** by the Postal Service. Two or more Standard mailings may be commingled and mailed only when specific methods approved by the Postal Service for **[**ascertaining**]** determining and verifying postage are followed.

343 Non-Identical Pieces

Pieces not identical in size and weight may be mailed at a bulk or presort rate as part of the same mailing only when specific methods approved by the Postal Service for **[**ascertaining**]** determining and verifying postage are followed.

344 Attachments and Enclosures

344.1 [Single Piece,] Regular, Enhanced Carrier Route, Nonprofit and Nonprofit Enhanced Carrier Route Subclasses (section 321)

344.11 **General.** First-Class Mail may be attached to or enclosed in Standard books, catalogs, and merchandise entered under section 321. The piece must be marked as **[**prescribed**]** specified by the Postal Service. Except as provided in section 344.12, additional postage must be paid for the attachment or enclosure as if it had been mailed separately. Otherwise, the entire combined piece is subject to the First-Class rate for which it qualifies.

344.12 **Incidental First-Class Attachments and Enclosures.** First-Class Mail, as defined in subsections b through d of section 210 **[**b through d**]**, may be attached to or enclosed with Standard merchandise entered under section 321, including books but excluding merchandise samples, with postage paid on the combined piece at the applicable Standard rate, if the attachment or enclosure is incidental to the piece to which it is attached or with which it is enclosed.

344.2 Parcel Post, Bound Printed Matter, Special, and Library Subclasses (sections 322 and 323)

344.21 **General.** First-Class Mail or Standard Mail from any of the subclasses listed in section 321 (**[**Single Piece,**]** Regular, Enhanced Carrier Route, Nonprofit or Nonprofit Enhanced Carrier Route) may be attached to or enclosed in Standard Mail mailed under sections 322 and 323. The piece must be marked as **[**prescribed**]** specified by the Postal Service. Except as provided in sections 344.22 and 344.23, additional postage must be paid for the attachment or enclosure as if it had been mailed separately. Otherwise, the entire combined piece is subject to the First-Class or section 321 Standard rate for which it qualifies (unless the rate applicable to the host piece is higher), or, if a combined piece with a section 321 Standard Mail attachment or enclosure weighs 16 ounces or more, the piece is subject to the Parcel Post rate for which it qualifies.

344.22 **Specifically Authorized Attachments and Enclosures.** Standard Mail mailed under sections 322 and 323 may contain enclosures and attachments as **[**prescribed**]** specified by the Postal Service and as described in subsections a and e of section 323.11 **[**a and e,**]** with postage paid on the combined piece at the Standard rate applicable to the host piece.

344.23 **Incidental First-Class Attachments and Enclosures.** First-Class Mail that meets one or more of the definitions in subsections b through d of section 210, **[**b through d,**]** may be attached to or enclosed with Standard Mail mailed under section 322 or 323, with postage paid on the combined piece at the Standard rate applicable to the host piece, if the attachment or enclosure is incidental to the piece to which it is attached or with which it is enclosed.

350 **DEPOSIT AND DELIVERY**

351 **Deposit**

Standard Mail must be deposited at places and times designated by the Postal Service.

352 **Service**

Standard Mail may receive deferred service.

353 **Forwarding and Return**

353.1 **[Single Piece,] Regular, Enhanced Carrier Route, Nonprofit and Nonprofit Enhanced Carrier Route Subclasses (section 321)**

Undeliverable-as-addressed Standard Mail mailed under section 321 will be returned on request of the mailer, or forwarded and returned on request of the mailer. Undeliverable-as-addressed combined First-Class and Standard pieces will be returned as **[**prescribed**]** specified by the Postal Service. Except as provided in **[**Schedule SS-21,**]**section 935, the **[**Single Piece Standard**]** applicable First-Class Mail rate is charged for each piece receiving return only service. Except as provided in **[**Schedule SS-22,**]** section 936, charges for forwarding-and-return service are assessed only on those pieces which cannot be forwarded and are returned. Except as provided in **[**Schedules SS-21 and SS-22,**]** sections 935 and 936, the charge for those returned pieces is the appropriate **[**Single Piece Standard**]** First-Class Mail rate for the piece plus that rate multiplied by a factor equal to the number of section 321 Standard pieces nationwide that are successfully forwarded for every one piece that cannot be forwarded and must be returned.

353.2 **Parcel Post, Bound Printed Matter, Special, and Library Subclasses (sections 322 and 323)**

Undeliverable-as-addressed Standard Mail mailed under sections 322 and 323 will be forwarded on request of the addressee, returned on request of the mailer, or forwarded and returned on request of the mailer. Pieces which combine Standard Mail from one of the subclasses described in 322 and 323 with First-Class Mail or Standard Mail from one of the subclasses described in 321 will be forwarded if undeliverable-as-addressed, and returned if undeliverable, as specified **[**prescribed**]** by the Postal Service. When Standard Mail mailed under sections 322 and 323 is forwarded or returned from one post office to another, additional charges will be based on the applicable **[**appropriate**]** **[**S**]**single **[**P**]**piece Standard Mail rate under 322 or 323.

360 **ANCILLARY SERVICES**

361 **All Subclasses**

All Standard Mail will receive the following services upon payment of the appropriate fees:

	Service	**Schedule**
a.	Address correction	911**[**SS-1**]**
b.	Certificates of mailing indicating that a specified number of pieces have been mailed	947**[**SS-4**]**

Certificates of mailing are not available for Regular, Enhanced Carrier Route, Nonprofit and Nonprofit Enhanced Carrier Route subclass mail when postage is paid with **[**by**]** permit imprint.

362 **[Single Piece,] Parcel Post, Bound Printed Matter, Special, and Library Subclasses**

[Single Piece,**]** Parcel Post, Bound Printed Matter, Special, and Library subclass mail will receive the following additional services upon payment of the appropriate fees:

	Service	**Schedule**
a.	Certificates of mailing	947 **[**SS-4**]**
b.	COD	944 **[**SS-6**]**
c.	**[**Insured mail**]** Insurance	943 **[**SS-9**]**
d.	Special handling	952 **[**SS-18**]**
e.	Return receipt (merchandise only)	945 **[**SS-16**]**
f.	Merchandise return	932 **[**SS-20**]**
g.	Delivery Confirmation	948

Insurance, special handling, and COD services may not be used selectively for individual pieces in a multi-piece **[**Parcel Post subclass**]** Standard Mail mailing unless specific methods approved by the Postal Service for **[**ascertaining**]** determining and verifying postage are followed.

363 **Regular and Nonprofit**

Regular and Nonprofit subclass mail will receive the following additional services upon payment of the appropriate fees.

	Service	**Schedule**
a.	Bulk Parcel Return Service	**[**SS-21**]** 935
b.	Shipper-Paid Forwarding	**[**SS-22**]** 936

370 **RATES AND FEES**

The rates and fees for Standard Mail are set forth as follows:

		Schedule
[a.	Single Piece subclass	321.1**]**
[b.**]**a.	Regular subclass	321.2
[c.**]**b.	Enhanced Carrier Route subclass	321.3
[d.**]**c.	Nonprofit subclass	321.4
[e.**]**d.	Nonprofit Enhanced Carrier Route subclass	321.5
[f.**]**e.	Parcel Post subclass	
	[Basic**]**Inter-BMC	322.1A
	Intra-BMC	322.1B
	Destination BMC	322.1**[**B**]**C
	Destination SCF	322.1D
	Destination Delivery Unit	322.1E
[g.**]**f.	Bound Printed Matter subclass	
	Single-Piece	322.3A
	Bulk and Carrier Route	322.3B
[h.**]**g.	Special subclass	323.1
[i.**]**h.	Library subclass	323.2
[j.**]**i.	Fees	1000

380 **AUTHORIZATIONS AND LICENSES**

381 **Regular, Enhanced Carrier Route, Nonprofit and Nonprofit Enhanced Carrier Route Subclasses**

A mailing fee as set forth in **[**Rate**]** Schedule 1000 must be paid once each year by mailers of Regular, Enhanced Carrier Route, Nonprofit and Nonprofit Enhanced Carrier Route subclass mail.

382 **Special Subclass**

A presort mailing fee as set forth in **[**Rate**]** Schedule 1000 must be paid once each year at each office of mailing by or for any person who mails presorted Special subclass mail. Any person who engages a business concern or other individuals to mail presorted Special subclass mail must pay the fee.

383 **Parcel Post Subclass**

A mailing fee as set forth in **[**Rate**]** Schedule 1000 must be paid once each year by mailers of Destination BMC, Destination SCF or Destination Delivery Unit rate category mail in the Parcel Post subclass.

PERIODICALS
CLASSIFICATION SCHEDULE

410 DEFINITION

411 General Requirements

411.1 **Definition.** A publication may qualify for mailing under the Periodicals Classification Schedule if it meets all **[**of**]** the requirements in sections 411.2 through 411.5 and the requirements for one of the qualification categories in sections 412 through 415. Eligibility for specific Periodicals rates is prescribed in section 420.

411.2 **Periodicals.** Periodicals class mail is mailable matter consisting of newspapers and other periodical publications. The term "periodical publications" includes, but is not limited to:

a. Any catalog or other course listing including mail announcements of legal texts which are part of post-bar admission education issued by any institution of higher education or by a nonprofit organization engaged in continuing legal education.

b. Any looseleaf page or report (including any index, instruction for filing, table, or sectional identifier which is an integral part of such report) which is designed as part of a looseleaf reporting service concerning developments in the law or public policy.

411.3 Issuance

411.31 **Regular Issuance.** Periodicals class mail must be regularly issued at stated intervals at least four times a year, bear a date of issue, and be numbered consecutively.

411.32 **Separate Publication.** For purposes of determining Periodicals rate eligibility, an "issue" of a newspaper or other periodical shall be deemed to be a separate publication when the following conditions exist:

a. The issue is published at a regular frequency more often than once a month either on (1) the same day as another regular issue of the same publication; or (2) on a day different from regular issues of the same publication, and

b. More than 10 percent of the total number of copies of the issue is distributed on a regular basis to recipients who do not subscribe to it or request it, and

c. The number of copies of the issue distributed to nonsubscribers or nonrequesters is more than twice the number of copies of any other issue distributed to nonsubscribers or nonrequesters on that same day, or, if no other issue that day, any other issue distributed during the same period. "During the same period" shall be defined as the periods of time ensuing between the distribution of each of the issues whose eligibility is being examined. Such separate publications must independently meet the qualifications for Periodicals eligibility.

411.4 **Office of Publication.** Periodicals class mail must have a known office of publication. A known office of publication is a public office where business of the publication is transacted during the usual business hours. The office must be maintained where the publication is authorized original entry.

411.5 **Printed Sheets.** Periodicals class mail must be formed of printed sheets. It may not be reproduced by stencil, mimeograph, or hectograph processes, or reproduced in imitation of typewriting. Reproduction by any other printing process is permissible. Any style of type may be used.

412 **General Publications**

412.1 **Definition.** To qualify as a General Publication, Periodicals class mail must meet the requirements in section 411 and in sections 412.2 through 412.4.

412.2 **Dissemination of Information.** A General Publication must be originated and published for the purpose of disseminating information of a public character, or devoted to literature, the sciences, art, or some special industry.

412.3 **Paid Circulation**

412.31 **Total Distribution.** A General Publication must be designed primarily for paid circulation. At least 50 percent or more of the copies of the publication must be distributed to persons who have paid above a nominal rate.

412.32 **List of Subscribers.** A General Publication must be distributed to a legitimate list of persons who have subscribed by paying or promising to pay at a rate

above nominal for copies to be received during a stated time. Copies mailed to persons who are not on a legitimate list of subscribers are nonsubscriber copies.

412.33 **Nominal Rates.** As used in section 412.31, nominal rate means:

a. A token subscription price that is so low that it cannot be considered a material consideration;

b. A reduction to the subscriber, under a premium offer or any other arrangements, of more than 50 percent of the amount charged at the basic annual rate for a subscriber to receive one copy of each issue published during the subscription period. The value of a premium is considered to be its actual cost to the publishers, the recognized retail value, or the represented value, whichever is highest.

412.34 **Nonsubscriber Copies**

412.341 *Up to Ten Percent.* Nonsubscriber copies, including sample and complimentary copies, mailed at any time during the calendar year up to and including 10 percent of the total number of copies mailed to subscribers during the calendar year are mailable at the rates that apply to subscriber copies provided that the nonsubscriber copies would have been eligible for those rates if mailed to subscribers.

412.342 *Over Ten Percent.* Nonsubscriber copies, including sample and complimentary copies, mailed at any time during the calendar year, in excess of 10 percent of the total number of copies mailed to subscribers during the calendar year which are presorted and commingled with subscriber copies are charged the applicable rates for Regular Periodicals. The 10 percent limitation for a publication is based on the total number of all copies of that publication mailed to subscribers during the calendar year.

412.35 **Advertiser's Proof Copies.** One complete copy of each issue of a General Publication may be mailed to each advertiser in that issue as an advertiser's proof copy at the rates that apply to subscriber copies, whether the advertiser's proof copy is mailed to the advertiser directly or, instead, to an advertising representative or agent of the publication. These copies count as subscriber copies.

412.36 **Expired Subscriptions.** For six months after a subscription has expired, copies of a General Publication may be mailed to a former subscriber at the rates that apply to copies mailed to subscribers, if the publisher has attempted during that six months to obtain payment, or a promise to pay, for renewal. These copies do not count as subscriber copies.

412.4 **Advertising Purposes**

A General Publication may not be designed primarily for advertising purposes. A publication is "designed primarily for advertising purposes" if it:

a. Has advertising in excess of 75 percent in more than one-half of its issues during any 12-month period;

b. Is owned or controlled by individuals or business concerns and conducted as an auxiliary to and essentially for the advancement of the main business or calling of those who own or control it;

c. Consists principally of advertising and editorial write-ups of the advertisers;

d. Consists principally of advertising and has only a token list of subscribers, the circulation being mainly free;

e. Has only a token list of subscribers and prints advertisements free for advertisers who pay for copies to be sent to a list of persons furnished by the advertisers; or

f. Is published under a license from individuals or institutions and features other businesses of the licensor.

413 **Requester Publications**

413.1 **Definition.** A publication which is circulated free or mainly free may qualify for Periodicals class as a Requester Publication if it meets the requirements in sections 411, and 413.2 through 413.4.

413.2 **Minimum Pages.** It must contain at least 24 pages.

413.3 **Advertising Purposes**

413.31 **Advertising Percentage.** It must devote at least 25 percent of its pages to nonadvertising and not more than 75 percent to advertisements.

413.32 **Ownership and Control.** It must not be owned or controlled by one or more individuals or business concerns and conducted as an auxiliary to and essentially for the advancement of the main business or calling of those who own or control it.

413.4 **Circulated to Requesters**

413.41 **List of Requesters.** It must have a legitimate list of persons who request the publication, and 50 percent or more of the copies of the publication must be distributed to persons making such requests. Subscription copies paid for or promised to be paid for, including those at or below a nominal rate may be included in the determination of whether the 50 percent request requirement is met. Persons will not be deemed to have requested the publication if their request is induced by a premium offer or by receipt of material consideration, provided that mere receipt of the publication is not material consideration.

413.42 **Nonrequester Copies**

413.421 *Up to Ten Percent.* Nonrequester copies, including sample and complimentary copies, mailed at any time during the calendar year up to and including 10 percent of the total number of copies mailed to requesters during the calendar year are mailable at the rates that apply to requester copies provided that the nonrequester copies would have been eligible for those rates if mailed to requesters.

413.422 *Over Ten Percent.* Nonrequester copies, including sample and complimentary copies, mailed at any time during the calendar year, in excess of 10 percent of the total number of copies mailed to requesters during the calendar year which are presorted and commingled with requester copies are charged the applicable rates for Regular Periodicals. The 10 percent limitation for a publication is based on the total number of all copies of that publication mailed to requesters during the calendar year.

413.43 **Advertiser's Proof Copies.** One complete copy of each issue of a Requester Publication may be mailed to each advertiser in that issue as an advertiser's

proof copy at the rates that apply to requester copies, whether the advertiser's proof copy is mailed to the advertiser directly or, instead, to an advertising representative or agent of the publication. These copies count as requester copies.

414 **Publications of Institutions and Societies**

414.1 **Publisher's Own Advertising.** Except as provided in section 414.2, a publication which meets the requirements of sections 411 and 412.4, and which contains no advertising other than that of the publisher, qualifies for Periodicals class as a publication of an institution or society if it is:

a. Published by a regularly incorporated institution of learning;

b. Published by a regularly established state institution of learning supported in whole or in part by public taxation;

c. A bulletin issued by a state board of health or a state industrial development agency;

d. A bulletin issued by a state conservation or fish and game agency or department;

e. A bulletin issued by a state board or department of public charities and corrections;

f. Published by a public or nonprofit private elementary or secondary institution of learning or its administrative or governing body;

g. Program announcements or guides published by an educational radio or television agency of a state or political subdivision thereof, or by a nonprofit educational radio or television station;

h. Published by or under the auspices of a benevolent or fraternal society or order organized under the lodge system and having a bona fide membership of not less than 1,000 persons;

i. Published by or under the auspices of a trade(s) union;

j. Published by a strictly professional, literary, historical, or scientific society; or,

k. Published by a church or church organization.

414.2 **General Advertising.** A publication published by an institution or society identified in sections 414.1 h through k, may contain advertising of other persons, institutions, or concerns, if the following additional conditions are met:

a. The publication is originated and published to further the objectives and purposes of the society;

b. Circulation is limited to:

i. Copies mailed to members who pay either as a part of their dues or assessment or otherwise, not less than 50 percent of the regular subscription price;

ii Other actual subscribers; and

iii. Exchange copies.

c. The circulation of nonsubscriber copies, including sample and complimentary copies, does not exceed 10 percent of the total number of copies referred to in 414.2b.

415 **Publications of State Departments of Agriculture**

A publication which is issued by a state department of agriculture and which meets the requirements of sections 411 qualifies for Periodicals class as a publication of a state department of agriculture if it contains no advertising and is published for the purpose of furthering the objects of the department.

416 **Foreign Publications**

Foreign newspapers and other periodicals of the same general character as domestic publications entered as Periodicals class mail may be accepted on application of the publishers thereof or their agents, for transmission through the mail at the same rates as if published in the United States. This section does not authorize the transmission through the mail of a publication which violates a copyright granted by the United States.

420 **DESCRIPTION OF SUBCLASSES**

421 **Regular Subclass**

421.1 **Definition.** The Regular subclass consists of Periodicals class mail that is not mailed under section 423 and that:

a. Is presorted, marked, and presented as specified **[**prescribed**]** by the Postal Service; and

b. Meets machinability, addressing, and other preparation requirements **[**prescribed**]** specified by the Postal Service.

421.2 **Regular Pound Rates**

An unzoned pound rate applies to the nonadvertising portion of Regular subclass mail. A zoned pound rate applies to the advertising portion and may be reduced by applicable destination entry discounts. The pound rate postage is the sum of the nonadvertising portion charge and the advertising portion charge.

421.3 **Regular Piece Rates**

421.31 **Basic Rate Category.** The basic rate category applies to all Regular subclass mail not mailed under section 421.32, **[**or**]** 421.33, or 421.34**.**

421.32 **Three[-Digit City and Five]-Digit Rate Category.** The three-digit rate category applies **[**rates for this category apply**]** to Regular subclass mail presorted to **[**three-digit cities and five-digit**]** single or multiple three-digit ZIP Code destinations as **[**prescribed**]** specified by the Postal Service.

421.33 **Five-Digit Rate Category.** The five-digit rate category applies to Regular subclass mail presorted to single or multiple five-digit ZIP Code destinations as specified by the Postal Service.

421.34 **Carrier Route Rate Category.** The carrier route rate category applies to Regular subclass mail presorted to carrier routes as **[**prescribed**]** specified by the Postal Service.

421.4 **Regular Subclass Discounts**

421.41 **Barcoded Letter Discounts.** Barcoded letter discounts apply to letter size Regular subclass mail mailed under sections 421.31, **[**and**]** 421.32, and 421.33 which bears a barcode representing not more than 11 digits (not including "correction" digits) as **[**prescribed**]** specified by the Postal Service, and which meets the machinability, addressing, and barcoding specifications and other preparation requirements **[**prescribed**]** specified by the Postal Service.

421.42 **Barcoded Flats Discounts.** Barcoded flats discounts apply to flat size Regular subclass mail mailed under sections 421.31, **[**and**]** 421.32, and 421.33 which bear a barcode representing not more than 11 digits (not including "correction" digits) as **[**prescribed**]** specified by the Postal Service, and meet the flats machinability, addressing, and barcoding specifications and other preparation requirements specified **[**prescribed**]** by the Postal Service.

421.43 **High Density Discount.** The high density discount applies to Regular subclass mail mailed under section **[**421.33**]** 421.34, presented in walk-sequence order, and meeting the high density and preparation requirements specified **[**prescribed**]** by the Postal Service.

421.44 **Saturation Discount.** The saturation discount applies to Regular subclass mail mailed under section **[**421.33**]** 421.34, presented in walk-sequence order, and meeting the saturation and preparation requirements specified **[**prescribed**]** by the Postal Service.

421.45 **Destination Entry Discounts.** Destination entry discounts apply to Regular subclass mail which is destined for delivery within the service area of the destination sectional center facility (SCF) or the destination delivery unit (DDU) in which it is entered, as defined by the Postal Service. The DDU discount only applies to Carrier Route rate category mail.

421.46 **Nonadvertising Discount.** The nonadvertising discount applies to all Regular subclass mail and is determined by multiplying the proportion of nonadvertising content by the discount factor set forth in Rate Schedule 421 and subtracting that amount from the applicable piece rate.

422 **[Reserved]**

423 **Preferred Rate Periodicals**

423.1 **Definition.** Periodicals class mail, other than publications qualifying as Requester Publications, may qualify for Preferred Rate Periodicals rates if it meets the applicable requirements for those rates in sections 423.2 through 423.5.

423.2 **Within County Subclass**

423.21 **Definition.** Within County mail consists of Preferred Rate Periodicals class mail mailed in, and addressed for delivery within, the county where published and originally entered, from either the office of original entry or additional entry. In addition, a Within County publication must meet one of the following conditions:

a. The total paid circulation of the issue is less than 10,000 copies; or

b. The number of paid copies of the issue distributed within the county of publication is at least one more than one-half **[**of**]** the total paid circulation of such issue.

423.22 **Entry in an Incorporated City.** For the purpose of determining eligibility for Within County mail, when a publication has original entry at an independent incorporated city which is situated entirely within a county or which is contiguous to one or more counties in the same state, such incorporated city shall be considered to be within the county with which it is principally contiguous. Where more than one county is involved, the publisher will select the principal county.

423.3 Nonprofit Subclass

Nonprofit mail is Preferred Rate Periodicals class mail entered by authorized nonprofit organizations or associations of the following types:

a. Religious, as defined in section 1009,

b. Educational, as defined in section 1009,

c. Scientific, as defined in section 1009,

d. Philanthropic, as defined in section 1009,

e. Agricultural, as defined in section 1009,

f. Labor, as defined in section 1009,

g. Veterans', as defined in section 1009,

h. Fraternal, as defined in section 1009, and

i. Associations of rural electric cooperatives,

j. One publication, which contains no advertising (except advertising of the publisher) published by the official highway or development agency of a state,

k. Program announcements or guides published by an educational radio or television agency of a state or political subdivision thereof or by a nonprofit educational radio or television station.

l. One conservation publication published by an agency of a state which is responsible for management and conservation of the fish or wildlife resources of such state.

423.4 Classroom Subclass

Classroom mail is Preferred Rate Periodicals class mail which consists of religious, educational, or scientific publications designed specifically for use in school classrooms or religious instruction classes.

423.5 **Science of Agriculture**

Science of Agriculture mail consists of Preferred Rate Periodicals class mail devoted to the science of agriculture if the total number of copies of the publication furnished during any 12-month period to subscribers residing in rural areas amounts to at least 70 percent of the total number of copies distributed by any means for any purpose.

423.6 **Preferred Rate Pound Rates**

For Preferred Rate Periodicals entered under sections 423.3, 423.4 and 423.5, an unzoned pound rate applies to the nonadvertising portion. A zoned pound rate applies to the advertising portion and may be reduced by applicable destination entry discounts. The pound rate postage is the sum of the nonadvertising portion charge and the advertising portion charge. For Preferred Rate Periodicals entered under section 423.2, one pound rate applies to the pieces presorted to carrier route to be delivered within the delivery area of the originating post office, and another pound rate applies to all other pieces.

423.7 **Preferred Rate Piece Rates**

423.71 **Basic Rate Category.** The basic rate category applies to all Preferred Rate Periodicals not mailed under section 423.72, **[**or**]** 423.73, or 423.74.

423.72 **Three[-digit City and Five]-Digit Rate Category.** The three-digit rate category applies **[**rates for this category apply**]** to Preferred Rate Periodicals entered under sections 423.2, 423.3, 423,4, or 423.5 that are presorted to single or multiple three-digit **[**cities and five-digit**]** ZIP **[**c**]**Code destinations as **[**prescribed**]** specified by the Postal Service.

423.73 **Five-Digit Rate Category.** The five-digit rate category applies to Preferred Rate Periodicals entered under sections 423.2, 423.3, 423,4, or 423.5 that are presorted to single or multiple five-digit ZIP Code destinations as specified by the Postal Service.

423.74 **Carrier Route Rate Category.** The carrier route rate category applies to Preferred Rate Periodicals presorted to carrier routes as **[**prescribed**]** specified by the Postal Service.

423.8 **Preferred Rate Discounts**

423.81 **Barcoded Letter Discounts.** Barcoded letter discounts apply to letter size Preferred Rate Periodicals mailed under sections 423.71, **[**and**]** 423.72, and 423.73 which bear a barcode representing not more than 11 digits (not including "correction" digits) as specified **[**prescribed**]** by the Postal Service, and which meet the machinability, addressing, and barcoding specifications and other preparation requirements **[**prescribed**]** specified by the Postal Service.

423.82 **Barcoded Flats Discounts.** Barcoded flats discounts apply to flat size Preferred Rate Periodicals mailed under sections 423.71, **[**and**]** 423.72, and 423.73 which bear a barcode representing not more than 11 digits (not including "correction" digits) as **[**prescribed**]** specified by the Postal Service, and meet the flats machinability, addressing, and barcoding specifications and other preparation requirements **[**prescribed**]** specified by the Postal Service.

423.83 **High Density Discount.** The high density discount applies to Preferred Rate Periodicals mailed under section **[**423.73**]** 423.74, presented in walk-sequence order, and meeting the high density and preparation requirements **[**prescribed**]** specified by the Postal Service**[.]**, except that mailers of Within County mail may qualify for such discount also by presenting otherwise eligible mailings containing pieces addressed to a minimum of 25 percent of the addresses per carrier route.

423.84 **Saturation Discount.** The saturation discount applies to Preferred Rate Periodicals mailed under section **[**423.73**]** 423.74, presented in walk-sequence order, and meeting the saturation and preparation requirements **[**prescribed**]** specified by the Postal Service.

423.85 **Destination Entry Discounts.** Destination entry discounts apply to Preferred Rate Periodicals which are destined for delivery within the service area of the destination sectional center facility (SCF) or the destination delivery unit (DDU) in which they are entered, as defined by the Postal Service. the DDU discount only applies to Carrier Route rate category mail; the SCF discount is not available for mail entered under section 423.2.

423.86 **Nonadvertising Discount.** The nonadvertising discount applies to Preferred Rate Periodicals entered under sections 423.3, 423.4, 423.5 and is determined by multiplying the proportion of nonadvertising content by the discount factor set forth in Rate Schedules 421, 423.3 or 423.4 and subtracting that amount from the applicable piece rate.

430 PHYSICAL LIMITATIONS

There are no maximum size or weight limits for Periodicals class mail.

440 POSTAGE AND PREPARATION

441 **Postage.** Postage must be paid on Periodicals class mail as set forth in section 3000.

442 **Presortation.** Periodicals class mail must be presorted **[**in accordance with regulations prescribed**]** as specified by the Postal Service.

443 Attachments and Enclosures

443.1 **General.** First-Class Mail or Standard Mail from any of the subclasses listed in section 321 (**[**Single Piece,**]** Regular, Enhanced Carrier Route, **[**or**]** Nonprofit or Nonprofit Enhanced Carrier Route) may be attached to or enclosed with Periodicals class mail. The piece must be marked as **[**prescribed**]** specified by the Postal Service. Except as provided in section 443.2, additional postage must be paid for the attachment or enclosure as if it had been mailed separately. Otherwise, the entire combined piece is subject to the appropriate First-Class or section 321 Standard Mail rate for which it qualifies (unless the rate applicable to the host piece is higher), or, if a combined piece with a section 321 Standard Mail attachment or enclosure weighs 16 ounces or more, the piece is subject to the Parcel Post rate for which it qualifies.

443.2 **Incidental First-Class Mail Attachments and Enclosures.** First-Class Mail that meets one or more of the definitions in sections 210 b through d may be attached to or enclosed with Periodicals class mail, with postage paid on the combined piece at the applicable Periodicals rate, if the attachment or enclosure is incidental to the piece to which it is attached or with which it is enclosed.

444 **Identification**

Periodicals class mail must be identified as required by the Postal Service. Nonsubscriber and nonrequester copies, including sample and complimentary copies, must be identified as required by the Postal Service.

445 **Filing of Information**

Information relating to Periodicals class mail must be filed with the Postal Service **[**in accordance with**]** under 39 U.S.C. 3685.

446 **Enclosures and Supplements**

Periodicals class mail may contain enclosures and supplements as **[**prescribed**]** specified by the Postal Service. An enclosure or supplement may not contain writing, printing or sign thereof or therein, in addition to the original print, except as authorized by the Postal Service, or as authorized under section 443.2.

450 **DEPOSIT AND DELIVERY**

451 **Deposit**

Periodicals class mail must be deposited at places and times designated by the Postal Service.

452 **Service**

Periodicals class mail is given expeditious handling insofar as is practicable.

453 **Forwarding and Return**

Undeliverable-as-addressed Periodicals class mail will be forwarded or returned to the mailer, as **[**prescribed**]** specified by the Postal Service. Undeliverable-as-addressed combined First-Class and Periodicals class mail pieces will be forwarded or returned, as **[**prescribed**]** specified by the Postal Service. Additional charges when Periodicals class mail is returned will be based on the applicable **[**Standard**]** First-Class Mail rate.

470 RATES AND FEES

The rates and fees for Periodicals class mail are set forth as follows:

		Schedule
a.	Regular	421
b.	Within County	423.2
c.	Nonprofit	423.3
d.	Classroom	423.4
e.	Science of Agriculture	421
f.	Fees	1000

480 AUTHORIZATIONS AND LICENSES

481 Entry Authorizations

Prior to mailing at Periodicals rates, a publication must be authorized for entry as Periodicals class mail by the Postal Service. Each authorized publication will be granted one original entry authorization at the post office where the office of publication is maintained. An authorization for the establishment of an account to enter a publication at an additional entry office may be granted by the Postal Service upon application by the publisher. An application for re-entry must be made whenever the publisher proposes to change the publication's title, frequency of issue or office of original entry.

482 Preferred Rate Authorization

Prior to mailing at Nonprofit, Classroom, and Science of Agriculture rates, a publication must obtain an additional Postal Service entry authorization to mail at those rates.

483 Mailing by Publishers and News Agents

Periodicals class mail may be mailed only by publishers or registered news agents. A news agent is a person or concern engaged in selling two or more Periodicals publications published by more than one publisher. News agents must register at all post offices at which they mail Periodicals class mail.

484 **Fees**

Fees for original entry, additional entry, re-entry, and registration of a news agent are set forth in **[**Rate**]** Schedule 1000.

RENUMBER AND AMEND SPECIAL SERVICE CLASSIFICATION SCHEDULES SS—1-6, SS—8-16, AND SS—18-22 AS FOLLOWS:

SPECIAL SERVICES

910 **ADDRESSING**

911 **ADDRESS CORRECTION SERVICE**

911.1 **Definition**

911.11 Address correction service is a service which provides the mailer with a method of obtaining the correct address, if available to the Postal Service, of the addressee or the reason for nondelivery.

911.2 **Description of Service**

911.21 Address correction service is available to mailers of postage prepaid mail of all classes. Periodicals class mail will receive address correction service.

911.22 Address correction service is not available for items addressed for delivery by military personnel at any military installation.

911.23 Address correction provides the following service to the mailer:

a. If the correct address is known to the Postal Service, the mailer is notified of both the old and the correct address.

b. If the item mailed cannot be delivered, the mailer will be notified of the reason for nondelivery.

911.3 **Requirements of the Mailer**

911.31 Mail, other than Periodicals class mail, sent under this **[**classification schedule**]** section must bear a request for address correction service.

911.4 **Fees**

911.41 There is no charge for address correction service when the correction is provided incidental to the return of the **[**mail piece**]** mailpiece to the sender.

911.42 A fee, as set forth in **[**Rate**]** Fee Schedule **[**SS-1**]** 911, is charged for all other forms of address correction service.

912 **MAILING LIST SERVICES**

912.1 **Definition**

912.11 Mailing list services include:

a. Correction of mailing lists;
b. **[**Change of address**]** Change-of-address information for election boards and registration commissions;
c. ZIP coding of mailing lists; and
d. Arrangement of address cards in the sequence of delivery.

912.12 Correction of mailing list service provides current information concerning name and address mailing lists or correct information concerning occupant mailing lists.

912.13 ZIP coding of mailing lists service is a service identifying ZIP **[**c**]**Code addresses in areas served by multi-ZIP coded postal facilities.

912.2 **Description of Service**

912.21 Correction of mailing list service is available only to the following owners of name and address or occupant mailing lists:

a. Members of Congress
b. Federal agencies
c. State government departments
d. Municipalities
e. Religious organizations
f. Fraternal organizations
g. Recognized charitable organizations
h. Concerns or persons who solicit business by mail

912.22 The following corrections will be made to name and address lists:

a. Names to which mail cannot be delivered or forwarded will be deleted;
b. Incorrect house, rural, or post office box numbers will be corrected;
c. When permanent forwarding orders are on file for customers who have moved, new addresses including ZIP **[**c**]** Codes will be furnished;
d. New names will not be added to the list.

912.23 The following corrections will be made to occupant lists:

a. Numbers representing incorrect or non-existent street addresses will be deleted;
b. Business or rural route addresses will be distinguished if known;
c. Corrected cards or sheets will be grouped by route;
d. Street address numbers will not be added or changed.

912.24 Corrected lists will be returned to customers at no additional charge.

912.25 Residential change-of-address information is available only to election boards or registration commissions for obtaining, if known to the Postal Service, the current address of an addressee.

912.26 ZIP coding or mailing list service provides that addresses will be sorted to the finest possible ZIP **[**c**]** Code sortation.

912.27 Gummed labels, wrappers, envelopes, **[**or**]** Stamped Cards, or **[**post cards**]** postcards indicative of one-time use will not be accepted as mailing lists.

912.28 Sequencing of address cards service provides for the removal of incorrect addresses, notation of missing addresses and addition of missing addresses.

912.3 **Requirements of Customer**

912.31 A customer desiring correction of a mailing list or arrangement of address cards in sequence of carrier delivery must submit the list or cards as **[**prescribed**]** specified by **[**regulation**]** the Postal Service.

912.4 **Fees**

912.41 The fees for mailing list services are set forth in **[**Rate**]** Fee Schedule**[**s**]** 912 **[**SS-11a, SS-11b, SS-11c and SS-11d**]**.

920 **DELIVERY ALTERNATIVES**

921 **POST OFFICE BOX AND CALLER SERVICE**

921.1 **Caller Service**

921.11 **Definition**

921.111 Caller service is a service which permits a customer to obtain mail addressed to the customer's box number through a call window or loading dock.

921.12 **Description of Service**

921.121 Caller service uses post office box numbers as the address medium but does not actually use a post office box.

921.122 Caller service is not available at certain postal facilities.

921.123 Caller service is provided to customers on the basis of mail volume received and number of post office boxes used at any one facility.

921.124 A customer may reserve a caller number.

921.125 Caller service cannot be used when the sole purpose is, by subsequently filing **[**change of address**]** change-of-address orders, to have mail forwarded or transferred to another address by the Postal Service free of charge.

921.13 **Fees**

921.131 Fees for caller service are set forth in **[**Rate**]** Fee Schedule 921. **[**SS-10.**]**

921.2 **Post Office Box Service**

921.21 **Definition**

921.211 Post office box service is a service which provides the customer with a private, locked receptacle for the receipt of mail during the hours when the lobby of a postal facility is open.

921.22 **Description of Service**

921.221 The Postal Service may limit the number of post office boxes occupied by any one customer.

921.222 A post office **[**box holder**]** boxholder may ask the Postal Service to deliver to the post office box all mail properly addressed to the holder. If the post office box is located at the post office indicated on the piece, it will be transferred without additional charge, **[**in accordance with**]** under existing regulations.

921.223 Post office box service cannot be used when the sole purpose is, by subsequently filing **[**change of address**]** change-of-address orders, to have mail forwarded or transferred to another address by the Postal Service free of charge.

921.23 **Fees**

921.231 Fees for post office box service are set forth in **[**Rate**]** Fee Schedule 921. **[**SS-10.**]**

921.232 In postal facilities primarily serving academic institutions or the students of such institutions, fees for post office boxes are:

Period of box use	Fee
95 days or less	½ semi-annual fee
96 to 140 days	¾ semi-annual fee
141 to 190 days	Full semi-annual fee
191 to 230 days	1¼ semi-annual fee
231 to 270 days	1½ semi-annual fee
271 days to full year	Full annual fee

921.233 No refunds will be made for post office box fees paid under section 921.232. **[**10.031.**]** For purposes of this **[**classification schedule SS-10**]** section, the full annual fee is twice the amount of the semi-annual fee.

930 PAYMENT ALTERNATIVES

931 BUSINESS REPLY MAIL

931.1 Definitions

931.11 Business reply mail is a service whereby business reply cards, envelopes, cartons and labels may be distributed by or for a business reply distributor for use by mailers for sending First-Class Mail without prepayment of postage to an address chosen by the distributor. A distributor is the holder of a business reply license.

931.12 A business reply mail piece is nonletter-size for purposes of **[**Classification Schedule SS–2**]** this section if it meets addressing and other preparation requirements, but does not meet the machinability requirements **[**prescribed**]** specified by the Postal Service for mechanized or automated letter sortation.

This provision expires June 7, 1999.

931.2 Description of Service

931.21 The distributor guarantees payment on delivery of postage and fees for all returned business reply mail. Any distributor of business reply cards, envelopes, cartons and labels under any one license for return to several addresses guarantees to pay postage and fees on any returns refused by any such addressee.

931.3 Requirements of the Mailer

931.31 Business reply cards, envelopes, cartons and labels must be preaddressed and bear business reply markings.

931.32 Handwriting, typewriting or handstamping are not acceptable methods of preaddressing or marking business reply cards, envelopes, cartons, or labels.

931.4 **Fees**

931.41 The fees for business reply mail are set forth in **[**Rate**]** Fee Schedule 931 **[**SS–2**]**.

931.42 To qualify as an active business reply mail advance deposit trust account, the account must be used solely for business reply mail and contain sufficient postage and fees due for returned business reply mail.

931.43 An accounting fee as set forth in **[**Rate**]** Fee Schedule 931 **[**SS–2**]** must be paid each year for each advance deposit business reply account at each facility where the mail is to be returned.

931.5 **Experimental Reverse Manifest Fees**

931.51 A set-up/qualification fee as set forth in **[**Rate**]** Fee Schedule 931 **[**SS–2**]** must be paid by each business reply mail advance deposit trust account holder at each destination postal facility at which it applies to receive nonletter-size business reply mail for which the postage and fees will be accounted for through a reverse manifest method approved by the Postal Service for **[**ascertaining**]** determining and verifying postage.

A distributor must pay this fee for each business reply mail advance deposit trust account for which participation in the nonletter-size business reply mail experiment is requested.

This provision expires June 7, 1999.

931.52 A nonletter-size reverse manifest monthly fee as set forth in **[**Rate**]** Fee Schedule 931 **[**SS–2**]** must be paid each month during which the distributor's reverse manifest account is active.

This fee applies to the (no more than) 10 advance deposit account holders which are selected by the Postal Service to participate in the reverse manifest nonletter-size business reply mail experiment and which utilize reverse manifest accounting methods approved by the Postal Service for **[**ascertaining**]** determining and verifying postage and fees.

This provision expires June 7, 1999.

931.6 **Experimental Weight Averaging Fees**

931.61 A set-up/qualification fee as set forth in **[**Rate**]** Fee Schedule 931 **[**SS–2**]** must be paid by each business reply mail advance deposit trust account holder at each destination postal facility at which it applies to receive nonletter-size business reply mail for which the postage and fees will be accounted for through a weight averaging method approved by the Postal Service for **[**ascertaining**]** determining and verifying postage.

A distributor must pay this fee for each business reply mail advance deposit trust account for which participation in the nonletter-size business reply mail experiment is requested.

This provision expires June 7, 1999.

931.62 A nonletter-size weight averaging monthly fee as set forth in **[**Rate**]** Fee Schedule 931 **[**SS–2**]** must be paid each month during which the distributor's weight averaging account is active.

This fee applies to the (no more than) 10 advance deposit account holders which are selected by the Postal Service to participate in the weight averaging nonletter-size business reply mail experiment.

This provision expires June 7, 1999.

931.7 **Authorizations and Licenses**

931.71 In order to distribute business reply cards, envelopes, cartons or labels, the distributor must obtain a license or licenses from the Postal Service and pay the appropriate fee as set forth in **[**Rate**]** Fee Schedule 931 **[**SS–2**]**.

931.72 Except as provided in section 931.73 **[**2.0502**]**, the license to distribute business reply cards, envelopes, cartons, or labels must be obtained at each office from which the mail is offered for delivery.

931.73 If the business reply mail is to be distributed from a central office to be returned to branches or dealers in other cities, one license obtained from the post office where the central office is located may be used to cover all business reply mail.

931.74 The license to mail business reply mail may be canceled for failure to pay business reply postage and fees when due, and for distributing business reply cards or envelopes **[**which**]** that do not conform to prescribed form, style or size.

931.75 Authorization to pay experimental nonletter-size business reply mail fees as set forth in **[**Rate**]** Fee Schedule 931 **[**SS–2**]** may be canceled for failure of a business reply mail advance deposit trust account holder to meet the standards **[**prescribed**]** specified by the Postal Service for the applicable reverse manifest or weight averaging accounting method.

This provision expires June 7, 1999.

932 MERCHANDISE RETURN SERVICE

932.1 Definition

932.11 Merchandise return service provides a method whereby a shipper may authorize its customers to return a parcel with the postage paid by the shipper. A shipper is the holder of a merchandise return permit.

932.2 Description of Service

932.21 Merchandise return service is available to all shippers who obtain the necessary permit and who guarantee payment of postage and fees for all returned parcels.

932.22 Merchandise return service is available for the return of any parcel under the following classification schedules:

a. First-Class Mail
b. Standard Mail

932.3 Requirements of the Mailer

932.31 Merchandise return labels must be prepared at the shipper's expense to specifications set forth by the Postal Service.

932.32 The shipper must furnish its customer with an appropriate merchandise return label.

932.4 **Other Services**

932.41 The following services may be purchased in conjunction with Merchandise Return Service:

	[Classification Schedule] Service	**Fee Schedule**
a.	Certificate of mailing	947 **[**SS-4**]**
b.	**[**Insured mail**]** Insurance	943 **[**SS-9**]**
c.	Registered mail	942 **[**SS-14**]**
d.	Special handling	952 **[**SS-18**]**

932.42 Only the shipper may purchase insurance service for the merchandise return parcel by indicating the amount of insurance on the merchandise return label before providing it to the customer. The customer who returns a parcel to the shipper under merchandise return service may not purchase insurance.

932.5 **Fees**

932.51 The fee for the merchandise return service is set forth in **[**Rate**]** Fee Schedule 932. **[**SS-20.**]** This fee is paid by the shipper.

932.6 **Authorizations and Licenses**

932.61 A permit fee as set forth in **[**Rate**]** Schedule 1000 must be paid once each calendar year by shippers utilizing merchandise return service.

932.62 The merchandise return permit may be canceled for failure to maintain sufficient funds in a trust account to cover postage and fees on returned parcels or for distributing merchandise return labels that do not conform to Postal Service specifications.

933 **ON-SITE METER SETTING**

933.1 **Definition**

933.11 On-site meter setting or examination service is a service whereby the Postal Service will service a postage meter at the mailer's or meter manufacturer's premises.

933.2 **Description of Service**

933.21 On-site meter setting or examination service is available on a scheduled basis, and meter setting may be **[**done**]** performed on an emergency basis for those customers enrolled in the scheduled on-site meter setting or examination program.

933.3 **Fees**

933.31 The fees for on-site meter setting or examination service are set forth in **[**Rate**]** Fee Schedule 933 **[**SS-12**]**.

934 **PREPAID REPLY MAIL**

934.1 **Definition**

934.11 Prepaid reply mail is a service whereby letter-size reply cards and envelopes may be distributed by or for a prepaid reply mail distributor for use by mailers for sending First-Class Mail reply letters or cards on which postage is prepaid by the distributor. A distributor is the holder of a prepaid reply mail license.

934.2 **Description of Service**

When paying postage on outgoing mail pieces which contain reply cards and letters to be returned by mail under the terms of this section, the distributor simultaneously pays postage on reply cards and letters anticipated in response to those outgoing pieces.

934.3 **Requirements of the Mailer**

934.31 Prepaid reply cards and envelopes must be preaddressed and bear prepaid reply mail markings.

934.32 Handwriting, typewriting, or other handstamping are not acceptable methods of preaddressing or marking prepaid reply cards and envelopes.

934.4 **Fees**

934.41 To qualify as an active prepaid reply mail account, the account must be used solely for prepaid reply mail and contain a balance sufficient to cover postage for returned prepaid reply mail.

934.42 A monthly accounting fee as set forth in Fee Schedule 934 must be paid for each prepaid reply mail account at each facility where the mail is returned.

934.5 **Authorizations and Licenses**

934.51 In order to distribute prepaid reply mail cards and envelopes, the distributor must obtain a license or licenses from the Postal Service and pay an annual permit fee as set forth in Fee Schedule 934.

934.52 Except as provided in section 934.53, the license to distribute prepaid reply mail cards and envelopes must be obtained at each office from which the mail is offered for delivery.

934.53 If the prepaid reply mail is to be distributed from a central office to be returned to branches or dealers in other cities, one license obtained from the post office where the central office is located may be used to cover all prepaid reply mail.

934.54 The license to mail prepaid reply mail may be canceled for failure to pay prepaid reply mail postage and monthly fees when due, and for distributing business reply cards and envelopes that do not conform to prescribed form, style, size, or thickness.

935 **BULK PARCEL RETURN SERVICE**

935.1 **Definition**

935.11 Bulk Parcel Return Service provides a method whereby high-volume parcel mailers may have undeliverable-as-addressed machinable parcels returned to designated postal facilities for pickup by the mailer at a predetermined frequency **[**prescribed**]** specified by the Postal Service or delivered by the Postal Service in bulk in a manner and frequency **[**prescribed**]** specified by the Postal Service.

935.2 **Description of Service**

935.21 Bulk Parcel Return Service is available only for the return of machinable parcels, as defined by the Postal Service, initially mailed under the following Standard Mail subclasses: Regular and Nonprofit.

935.3 **Requirements of the Mailer**

935.31 Mailers must receive authorization from the Postal Service to use Bulk Parcel Return Service.

935.32 To claim eligibility for Bulk Parcel Return Service at each facility through which the mailer requests Bulk Parcel Return Service, the mailer must demonstrate receipt of 10,000 returned machinable parcels at a given delivery point in the previous postal fiscal year or must demonstrate a high likelihood of receiving 10,000 returned parcels in the postal fiscal year for which the service is requested.

935.33 Payment for Bulk Parcel Return Service is made through advance deposit account, or as otherwise specified by the Postal Service.

935.34 Mail for which Bulk Parcel Return Service is requested must bear endorsements **[**prescribed**]** specified by the Postal Service.

935.35 Bulk Parcel Return Service mailers must meet the documentation and audit requirements of the Postal Service.

935.4 **Other Services**

935.41 The following services may be purchased in conjunction with Bulk Parcel Return Service:

	Service	**[Classification] Fee Schedule**
a.	Address Correction Service	911 **[**SS-1**]**
b.	Certificate of Mailing	947 **[**SS-4**]**
c.	Shipper-Paid Forwarding	936 **[**SS-22**]**

935.5 **Fee**

935.51 The fee for Bulk Parcel Return Service is set forth in Fee Schedule **[**SS-21**]** 935.

935.6 **Authorizations and Licenses**

935.61 A permit fee as set forth in **[**Fee**]** Schedule 1000 must be paid once each calendar year by mailers utilizing Bulk Parcel Return Service.

935.62 The Bulk Parcel Return Service permit may be canceled for failure to maintain sufficient funds in an advance deposit account to cover postage and fees on returned parcels or for failure to meet the specifications of the Postal Service.

936 **SHIPPER-PAID FORWARDING**

936.1 **Definition**

936.11 Shipper-Paid Forwarding provides a method whereby mailers may have undeliverable-as-addressed machinable parcels forwarded at **[**Standard Mail Single Piece**]** applicable First-Class Mail rates for up to one year from the date that the addressee filed a change-of-address order. If the parcel, for which Shipper-Paid Forwarding is elected, is returned, the mailer will pay the **[**appropriate Standard Mail Single Piece**]** applicable First-Class Mail rate, or the Bulk Parcel Return Service fee, if that service was elected.

936.2 **Description of Service**

936.21 Shipper-Paid Forwarding is available only for the forwarding of machinable parcels, as defined by the Postal Service, initially mailed under the following Standard Mail subclasses: Regular and Nonprofit.

936.3 **Requirements of the Mailer**

936.31 Shipper-Paid Forwarding is available only in conjunction with automated Address Correction Service in **[**Schedule SS-1**]** section 911.

936.32 Mail for which Shipper-Paid Forwarding is purchased must meet the preparation requirements of the Postal Service.

936.33 Payment for Shipper-Paid Forwarding is made through advance deposit account, or as otherwise specified by the Postal Service.

936.34 Mail for which Shipper-Paid Forwarding is requested must bear endorsements **[**prescribed**]** specified by the Postal Service.

936.4 **Other Services**

936.41 The following services may be purchased in conjunction with Shipper-Paid Forwarding:

	Service	**[Classification] Fee Schedule**
a.	Certificate of Mailing	947 **[**SS-4**]**
b.	Bulk Parcel Return Service	935 **[**SS-21**]**

936.5 **Applicable Rates**

936.51 Except as provided in **[**Schedule SS-21, Standard Mail Single Piece Rates, set forth in Rate Schedule 321.1**]** section 935, single-piece rates under the Letters and Sealed Parcels subclass or the Priority Mail subclass of First-Class Mail, as set forth in Rate Schedules 221 and 223, apply to pieces forwarded or returned **[**in connection with Shipper-Paid Forwarding**]** under this section.

940 **ACCOUNTABILITY & RECEIPTS**

941 **CERTIFIED MAIL**

941.1 **Definition**

941.11 Certified mail service is a service that provides a mailing receipt to the sender and a record of delivery at the office of delivery**[**address**]**.

941.2 **Description of Service**

941.21 Certified mail service is provided for matter mailed as First-Class Mail.

941.22 If requested by the mailer, the time of acceptance**[**s**]** by the Postal Service will be indicated on the receipt.

941.23 A record of delivery is retained at the office of delivery for a specified period of time.

941.24 If the initial attempt to **[**delivery**]** deliver the mail is not successful, a notice of **[**arrival**]** attempted delivery is left at the mailing address.

941.25 A receipt of mailing may be obtained only if the article is mailed at a post office, branch or station, or given to a rural carrier.

941.26 Additional copies of the original mailing receipt may be obtained by the mailer.

941.3 **Deposit of Mail**

941.31 Certified mail must be deposited in a manner specified by the Postal Service.

941.4 **Other Services**

941.41 The following services may be obtained in conjunction with mail sent under this **[**classification schedule**]** section upon payment of the applicable fees:

	Service	**[Classification] Fee Schedule**
a.	Restricted Delivery	946 **[**SS-15**]**
b.	Return Receipt	945 **[**SS-16**]**

941.5 **Fees**

941.51 The fees for certified mail service are set forth in **[**Rate**]** Fee Schedule 941. **[**SS-5.**]**

942 **REGISTERED MAIL**

942.1 **Definition**

942.11 Registered mail is a service that **[**which**]** provides added protection to mail sent under this **[**Domestic Mail Classification Schedule**]** section and **[**optional**]** indemnity in case of loss or damage.

942.2 **Description of Service**

942.21 Registered mail service is available to mailers of prepaid mail sent as First-Class Mail except that registered mail must meet the minimum requirements for length and width regardless of thickness.

942.22 Registered mail service provides insurance up to a maximum of $25,000, depending upon the actual value at the time of mailing, except that insurance is **[**optional for articles valued $100 or less.**]** not available for articles of no value.

942.23 There is no limit on the value of articles sent under this **[**classification schedule**]** section.

942.24 Registered mail service is not available for:

a. All delivery points because of the high security required for registered mail; in addition, not all delivery points will be available for registry and liability is limited in some geographic areas**[.]**;

b. Mail of any class sent in combination with First-Class Mail;

c. Two or more articles tied or fastened together, unless the envelopes are enclosed in the same envelope or container.

942.25 The following services are provided as part of registered mail service at no additional cost to the mailer:

a. A receipt;

b. A record of delivery, retained by the Postal Service for a specified period of time;

c. A notice of **[**arrival**]** attempted delivery will be left at the mailing address if the initial delivery attempt is unsuccessful;

d. When registered mail is undeliverable-as-addressed and cannot be forwarded, a notice of nondelivery is provided.

942.26 A claim for complete loss of insured articles may be filed by the mailer only. A claim for damage or for partial loss of insured articles may be filed by either the mailer or addressee.

942.27 Indemnity claims for registered mail **[**on which insurance is provided, or for articles valued $100 or less on which optional insurance has been elected,**]** must be filed within a **[**specified**]** period of time, specified by the Postal Service, from the date the article was mailed.

[942.28 No indemnity is paid on any matter registered free.**]**

942.3 **Deposit of Mail**

942.31 Registered mail must be deposited in a manner specified by the Postal Service.

942.4 **Service**

942.41 Registered mail is provided maximum security.

942.5 **Forwarding and Return**

942.51 Registered mail is forwarded and returned without additional registry charge.

942.6 **Other Services**

942.61 The following services may be obtained in conjunction with mail sent under this **[**classification schedule**]** section upon payment of applicable fees:

	Service	**[Classification] Fee Schedule**
a.	Collect on delivery	944 **[**SS-6**]**
b.	Restricted delivery	946 **[**SS-15**]**
c.	Return receipt	945 **[**SS-16**]**
d.	Merchandise return (shippers only)	932 **[**SS-20**]**

942.7 **Fees**

942.71 The fees for registered mail are set forth in **[**Rate**]** Fee Schedule 942. **[**SS-14.**]**

943 **INSURANCE**

943.1 **Express Mail Insurance**

943.11 **Definition**

943.111 Express Mail Insurance is a service that provides the mailer with indemnity for loss of, rifling of, or damage to items sent by Express Mail.

943.12 **Description of Service**

943.121 Express Mail Insurance is available only for Express Mail.

943.122 Insurance coverage is provided, for no additional charge, up to $500 per piece for document reconstruction, up to $5,000 per occurrence regardless of the number of claimants. Insurance coverage is also provided, for no additional charge, up to $500 per piece for merchandise. Insurance coverage for merchandise valued at more than $500 is available for an additional fee, as set forth in **[**Rate**]** Fee Schedule 943 **[**SS-9**]**. The maximum liability for merchandise is $5,000 per piece. For negotiable items, currency, or bullion, the maximum liability is $15.

943.123 Indemnity claims for Express Mail must be filed within a specified period of time from the date the article was mailed.

943.124 Indemnity will be paid under terms and conditions **[**prescribed**]** specified by the Postal Service.

943.125 Among other limitations **[**prescribed**]** specified by the Postal Service, indemnity will not be paid by the Postal Service for loss, damage or rifling:

a. Of nonmailable matter;

b. Due to improper packaging;

c. Due to seizure by any agency of government; or[,]

d. Due to war, insurrection or civil disturbances.

943.13 **Fees**

943.131 The fees for Express Mail Insurance service are set forth in **[**Rate**]** Fee Schedule 943.**[**SS-9.**]**

943.2 **General Insurance**

943.21 **Retail Insurance**

943.211 **[**General**]** Retail Insurance is a service that provides the mailer with indemnity for loss of, rifling of, or damage to mailed items.

943.212 The maximum liability of the Postal Service **[**under this part**]** for Retail Insurance is $5000.

943.213 **[**General**]** Retail Insurance is available for mail sent under the following classification schedules:

a. First-Class Mail, if containing matter **[**which**]** that may be mailed as Standard Mail;

b. **[**Single Piece,**]** Parcel Post, Bound Printed Matter, Special, and Library subclasses of Standard Mail.

943.214 **[**This service**]** Retail Insurance is not available for matter offered for sale, addressed to prospective purchasers who have not ordered or authorized their sending. If such matter is received in the mail, payment will not be made for loss, rifling, or damage.

943.215 For Retail Insurance, the **[**The**]** mailer is issued a receipt for each item mailed. For items insured for more than $50, a receipt of delivery is obtained by the Postal Service.

943.216 For items insured for more than $50, a notice of **[**arrival**]** attempted delivery is left at the mailing address when the first attempt at delivery is unsuccessful.

943.217 Retail insurance provides indemnity for the actual value of the article at the time of mailing.

943.22 **Bulk Insurance**

943.221 Bulk Insurance service is available for mail entered in bulk at designated facilities and in a manner specified by the Postal Service, including the use of electronic manifesting, and sent under the following classification schedules:

a. First-Class Mail, if containing matter that may be mailed as Standard Mail;

b. Parcel Post, Bound Printed Matter, Special, and Library subclasses of Standard Mail.

943.222 Bulk Insurance bears endorsements and identifiers specified by the Postal Service. Bulk Insurance mailers must meet the documentation requirements of the Postal Service.

943.223 Bulk Insurance provides indemnity for the lesser of (1) the actual value of the article at the time of mailing, or (2) the wholesale cost of the contents to the sender.

943.23 **Claims**

943.231 For Retail Insurance, a **[**A**]** claim for complete loss may be filed by the mailer only,**[**.**]** and a **[**A**]** claim for damage or for partial loss may be filed by either the mailer or addressee. For Bulk Insurance, all claims must be filed by the mailer.

943.232 A claim for damage or loss on a parcel sent merchandise return under section 932 **[**(SS-20)**]** may **[**only**]** be filed only by the purchaser of the insurance.

943.233 Indemnity claims must be filed within a specified period of time from the date the article was mailed.

[943.234 Additional copies of the original mailing receipt may be obtained by the mailer, upon payment of the applicable fee set forth in Rate Schedule SS-9.**]**

943.24 **Deposit of Mail**

943.241 Mail insured under **[**this part**]** section 943.2 must be deposited **[**in a manner**]** as specified by the Postal Service.

943.25 **Forwarding and Return**

943.251 By insuring an item, the mailer guarantees forwarding and return postage unless instructions on the piece mailed indicate that it not be forwarded or returned.

943.252 Mail undeliverable as addressed **[**sent under this part**]** will be returned to the sender as specified by the sender or by the Postal Service.

943.26 **Other Services**

943.261 The following services, if applicable to the subclass of mail, may be obtained in conjunction with mail sent under this **[**part**]** section upon payment of the applicable fees:

	Service	**[Classification] Fee Schedule**
a.	Parcel Airlift	951 **[**SS-13**]**
b.	Restricted delivery (for items insured for more than $50)	946 **[**SS-15**]**
c.	Return receipt (for items insured for more than $50)	945 **[**SS-16**]**
d.	Special handling	952 **[**SS-18**]**
e.	Merchandise return (shippers only)	932 **[** SS-20**]**

943.27 **Fees**

943.271 The fees for **[**General**]** Insurance are set forth in **[**Rate**]** Fee Schedule 943. **[**SS-9**]**.

944 COLLECT ON DELIVERY

944.1 Definition

944.11 Collect on Delivery (COD) service is a service **[**which**]** that allows a mailer to mail an article for which **[**he has not been paid**]** full or partial payment has not yet been received and have the price, the cost of postage and fees, and anticipated or past due charges collected by the Postal Service from the addressee when the article is delivered.

944.2 Description of Service

944.21 COD service is available for collection of $600 or less upon the delivery of postage prepaid mail sent under the following classification schedules:

a. Express Mail
b. First-Class Mail
c. **[**Single Piece,**]** Parcel Post,
Bound Printed Matter, Special, and
Library subclasses of Standard Mail

944.22 Service under this **[**schedule**]** section is not available for:

a. Collection agency purposes;

b. Return of merchandise about which some dissatisfaction has arisen, unless the new addressee has consented in advance to such return;

c. Sending only bills or statements of indebtedness, even though the sender may establish that the addressee has agreed to collection in this manner; however, when the legitimate COD shipment consisting of merchandise or bill of lading, is being mailed, the balance due on a past or anticipated transaction may be included in the charges on a COD article, provided the addressee has consented in advance to such action;

d. Parcels containing moving-picture films mailed by exhibitors to moving-picture manufacturers, distributors, or exchanges;

e. Goods that **[**which**]** have not been ordered by the addressee.

944.23 COD service provides the mailer with insurance against loss, rifling and damage to the article as well as failure to receive the amount collected from the addressee. This provision insures only the receipt of the instrument issued to the mailer after payment of COD charges, and is not to be construed to make the Postal Service liable upon any such instrument other than a Postal Service money order.

944.24 A receipt is issued to the mailer for each piece of COD mail. Additional copies of the original mailing receipt may be obtained by the mailer.

944.25 Delivery of COD mail will be made in a manner specified by the Postal Service. If a delivery to the mailing address is not attempted or if a delivery attempt is unsuccessful, a notice of **[**arrival**]** attempted delivery will be left at the mailing address.

944.26 The mailer may receive a notice of nondelivery if the piece mailed is endorsed appropriately.

944.27 The mailer may designate a new addressee or alter the COD charges by submitting the appropriate form and by paying the appropriate fee as set forth in **[**Rate**]** Fee Schedule 944. **[**SS-6.**]**

944.28 A claim for complete loss may be filed by the mailer only. A claim for damage or for partial loss may be filed by either the mailer or addressee.

944.29 COD indemnity claims must be filed within a specified period of time from the date the article was mailed.

944.3 **Requirements of the Mailer**

944.31 COD mail must be identified as COD mail.

944.4 **Deposit of Mail**

944.41 COD mail must be deposited in a manner specified by the Postal Service.

944.5 **Forwarding and Return**

944.51 A mailer of COD mail guarantees to pay any return postage, unless otherwise specified on the piece mailed.

944.52 For COD mail sent as Standard Mail, postage at the applicable rate will be charged to the addressee:

a. When an addressee, entitled to delivery to the mailing address under Postal Service regulations, requests delivery of COD mail**[**which**]** that was refused when first offered for delivery;

b. For each delivery attempt, to an addressee entitled to delivery to the mailing address under Postal Service regulations, after the second such attempt.

944.6 **Other Services**

944.61 The following services, if applicable to the subclass of mail, may be obtained in conjunction with mail sent under this **[**classification schedule**]** section upon payment of the applicable fee:

	Service	**[Classification] Fee Schedule**
a.	Registered mail, if sent as First-Class	942 **[**SS-14**]**
b.	Restricted delivery	946 **[** SS-15**]**
c.	Special handling	952 **[**SS-18**]**

944.7 **Fees**

944.71 Fees for COD service are set forth in **[**Rate**]** Fee Schedule 944 **[**SS-6**]**.

945 **RETURN RECEIPT**

945.1 **Definition**

945.11 Return receipt service is a service that **[**which**]** provides evidence to the mailer that an article has been received at the delivery address.

945.2 **Description of Service**

945.21 Return receipt service is available for mail sent under the following sections or classification schedules:

		[Classification Schedule]
a.	Certified mail	941 **[**SS-5**]**
b.	COD mail	944 **[**SS-6**]**
c.	Insurance **[**Insured mail**]** (if insured for more than $50)	943 **[**SS-9**]**
d.	Registered mail	942 **[**SS-14**]**
e.	Delivery Confirmation	948
[e.**]** f.	Express Mail	
[f.**]** g.	Priority Mail (merchandise only)	
[g.**]** h.	Standard Mail (limited to merchandise sent by **[**Single Piece,**]** Parcel Post, Bound Printed Matter, Special, and Library subclasses)	

945.22 Return receipt service is available at the time of mailing or, when purchased in conjunction with certified mail, COD, **[**insured**]** Insurance (if for more than $50), registered mail, or Express Mail, after mailing.

945.23 Mailers requesting return receipt service at the time of mailing will be provided, as appropriate, the signature of the addressee or addressee's agent, the date delivered, and the address of delivery, if different from the address on the mailpiece.

945.24 Mailers requesting return receipt service after mailing will be provided the date of delivery and the name of the person who signed for the article.

945.25 If the mailer does not receive a return receipt within a specified period of time from the date of mailing, the mailer may request a duplicate return receipt. No fee is charged for a duplicate return receipt.

945.3 **Fees**

945.31 The fees for return receipt service are set forth in **[**Rate**]** Fee Schedule 945 **[**SS-16**]**.

946 **RESTRICTED DELIVERY**

946.1 **Definition**

946.11 Restricted delivery service is a service that provides a means by which a mailer may direct that delivery will be made only to the addressee or to someone authorized by the addressee to receive such mail.

946.2 **Description of Service**

946.21 This service is available for mail sent under the following **[**classification schedules**]** sections:

		[Classification Schedule]
a.	Certified Mail	941**[**SS-5**]**
b.	COD Mail	944**[**SS-6**]**
c.	**[**Insured Mail**]** Insurance (if insured for more than $50)	943**[** SS-9**]**
d.	Registered Mail	942**[** SS-14**]**

946.22 Restricted delivery is available to the mailer at the time of mailing or after mailing.

946.23 Restricted delivery service is available only to natural persons specified by name.

946.24 A record of delivery will be retained by the Postal Service for a specified period of time.

946.25 Failure to provide restricted delivery service when requested after mailing, due to prior delivery, is not grounds for refund of the fee or communications charges.

946.3 **Fees**

946.31 The fees for restricted delivery service are set forth in**[** Rate**]** Fee Schedule 946 **[**SS-15**]**.

947 **CERTIFICATE OF MAILING**

947.1 **Definition**

947.11 Certificate of mailing service is a service **[**which**]** that furnishes evidence of mailing.

947.2 **Description of Service**

947.21 Certificate of mailing service is available to mailers of matter sent under the classification schedule to any class of mail.

947.22 A receipt is not obtained upon delivery of the mail to the addressee. No record of mailing is maintained at the post office.

947.23 Additional copies of certificates of mailing may be obtained by the mailer.

947.3 **Other Services**

947.31 The following services, if applicable to the subclass of mail, may be obtained in conjunction with mail sent under this classification schedule upon payment of the applicable fees:

Service	**[Classification] Fee Schedule**
a. Parcel airlift	951 **[**SS-13**]**
b. Special handling	952 **[** SS-18**]**

947.4 **Fees**

947.41 The fees for certificate of mailing service are set forth in **[**Rate**]** Fee Schedule 947 **[**SS-4**]**.

948 **DELIVERY CONFIRMATION**

948.1 **Definition**

948.11 Delivery confirmation service provides electronic confirmation to the mailer that an article was delivered or that a delivery attempt was made.

948.2 **Description of Service**

948.21 Delivery confirmation service is available for Priority Mail and the Parcel Post, Bound Printed Matter, Special and Library subclasses of Standard Mail.

948.22 Delivery confirmation service may be requested only at the time of mailing.

948.23 Mail for which delivery confirmation service is requested must meet preparation requirements established by the Postal Service, and bear a barcode specified by the Postal Service.

948.24 Matter for which delivery confirmation service is requested must be deposited in a manner specified by the Postal Service.

948.3 **Fees**

948.31 Delivery confirmation service is subject to the fees set forth in Fee Schedule 948.

950 **PARCEL HANDLING**

951 **PARCEL AIRLIFT (PAL)**

951.1 **Definition**

951.11 Parcel airlift service is a service that provides for air transportation of parcels on a space available basis to or from military post offices outside the contiguous 48 states.

951.2 **Description of Service**

951.21 Parcel airlift service is available for mail sent under the **[**following classification schedule:**]** Standard Mail Classification Schedule.

[Standard Mail**]**

951.3 **Physical Limitations**

951.31 The minimum physical limitations established for the mail sent under the classification schedule for which postage is paid apply to parcel airlift mail. In no instance may the parcel exceed 30 pounds in weight, or 60 inches in length and girth combined.

951.4 **Requirements of the Mailer**

951.41 Mail sent under this **[**schedule**]** section must be endorsed as **[**prescribed**]** specified by **[**regulation**]** the Postal Service.

951.5 **Deposit of Mail**

951.51 PAL mail must be deposited in a manner specified by the Postal Service

951.6 **Forwarding and Return**

951.61 PAL mail sent for delivery outside the contiguous 48 states is forwarded as set forth in section 2030 of the General Definitions, Terms and Conditions. PAL mail sent for delivery within the contiguous 48 states is forwarded or returned as set forth in section 353 as appropriate.

951.7 **Other Services**

951.71 The following services, if applicable to the subclass of mail, may be obtained in conjunction with mail sent under this **[**classification schedule**]** section upon payment of the applicable fees:

	Service	**[Classification] Fee Schedule**
a.	Certificate of mailing	947 **[**SS-4 **]**
b.	**[**Insured mail**]** Insurance	943 **[**SS-9 **]**
c.	Restricted delivery (if insured for more than $50)	946 **[**SS-15**]**
d.	Return receipt (if insured for more than $50)	945 **[**SS-16**]**
e.	Special handling	952**[** SS-18**]**

951.8 **Fees**

951.81 The fees for parcel airlift service are set forth in **[**Rate**]** Fee Schedule 951 **[**SS-13**]**.

952 **SPECIAL HANDLING**

952.1 **Definition**

952.11 Special handling service is a service that provides preferential handling to the extent practicable during dispatch and transportation.

952.2 **Description of Service**

952.21 Special handling service is available for mail sent under the following classification schedules:

a. First-Class Mail
b. **[**Single Piece,**]** Parcel Post,
Bound Printed Matter,
Special, and Library subclasses of Standard Mail

952.22 Special handling service is mandatory for matter **[**which**]** that requires special attention in handling, transportation and delivery.

952.3 **Requirements of the Mailer**

952.31 Mail sent under this **[**schedule**]** section must be identified as **[**prescribed**]** specified by the Postal Service**[**regulation.**]**

952.4 **Deposit of Mail**

952.41 Mail sent under this **[**schedule**]** section must be deposited in a manner **[**prescribed**]** specified by the Postal Service.

952.5 **Forwarding and Return**

952.51 If undeliverable as addressed, special handling mail that is forwarded to the addressee is given special handling without requiring payment of an additional handling fee. However, additional postage at the applicable Standard Mail rate is collected on delivery.

952.6 **Other Services**

952.61 The following services, if applicable to the subclass of mail, may be obtained in conjunction with mail sent under this **[**classification schedule**]** section upon payment of the applicable fees:

	Service	**[Classification] Fee Schedule**
a.	COD mail	944 **[**SS-6**]**
b.	**[**Insured mail**]** Insurance	943**[** SS-9**]**
c.	Parcel airlift	951 **[**SS-13**]**
d.	Merchandise return (shippers only)	932**[** SS-20**]**

952.7 **Fees**

952.71 The fees for special handling service are set forth in **[**Rate**]** Fee Schedule 952 **[**SS-18**]**.

960 **STAMPED PAPER**

961 **STAMPED ENVELOPES**

961.1 **Definition**

961.11 Plain stamped envelopes and printed stamped envelopes are envelopes with postage thereon offered for sale by the Postal Service.

961.2 **Description of Service**

961.21 Stamped envelopes are available for:

a. First-Class Mail within the first rate increment.

b. Standard Mail mailed at a minimum **[**per piece**]** per piece rate as **[**prescribed**]** specified by the Postal Service.

961.22 Printed stamped envelopes may be obtained by special request.

961.3 **Fees**

961.31 The fees for stamped envelopes are set forth in **[**Rate**]** Fee Schedule 961 **[**SS-19**]**.

962 **STAMPED CARDS**

962.1 **Definition**

962.11 **Stamped Cards.** Stamped Cards are cards with postage imprinted or impressed on them and supplied by the Postal Service for the transmission of messages.

962.12 **Double Stamped Cards.** Double Stamped Cards consist of two attached cards, one of which may be detached by the receiver and returned by mail as a single Stamped Card.

962.2 **Description of Service.** Stamped Cards are available for First-Class Mail.

962.3 **Fees.** The fees for Stamped Cards are set forth in **[**Rate**]** Fee Schedule 962 **[**SS-19A**]**.

970 **POSTAL MONEY ORDERS**

971 **DOMESTIC POSTAL MONEY ORDERS**

971.1 **Definition**

971.11 Money order service is a service that provides the customer with an instrument for payment of a specified sum of money.

971.2 **Description of Service**

971.21 The maximum value for which a domestic postal money order may be purchased is $700. Other restrictions on the number or dollar value of postal money order sales, or both, may be imposed **[**in accordance with**]** by law or under regulations prescribed by the Postal Service.

971.22 A receipt of purchase is provided at no additional cost.

971.23 The Postal Service will replace money orders that are spoiled or incorrectly prepared, regardless of who caused the error, without charge if replaced on the date originally issued**.**

971.24 If a replacement money order is issued after the date of original issue because the original was spoiled or incorrectly prepared, the applicable money order fee may be collected from the customer.

971.25 Inquiries **[**and**]** or claims may be filed by the purchaser, payee, or endorsee.

971.3 **Fees**

971.31 The fees for domestic postal money orders are set forth in **[**Rate**]** Fee Schedule 971 **[**SS-8**]**.

AMEND THE DOMESTIC MAIL CLASSIFICATION SCHEDULE AS FOLLOWS:

GENERAL DEFINITIONS, TERMS AND CONDITIONS

1000 **GENERAL DEFINITIONS**

As used in this Domestic Mail Classification Schedule, the following terms have the meanings set forth below.

1001 **Advertising**

Advertising includes all material for the publication of which a valuable consideration is paid, accepted, or promised, that calls attention to something for the purpose of getting people to buy it, sell it, seek it, or support it. If an advertising rate is charged for the publication of reading matter or other material, such material shall be deemed to be advertising. Articles, items, and notices in the form of reading matter inserted in accordance with a custom or understanding that textual matter is to be inserted for the advertiser or his products in the publication in which a display advertisement appears are deemed to be advertising. If a publisher advertises his own services or publications, or any other business of the publisher, whether in the form of display advertising or editorial or reading matter, this is deemed to be advertising.

1002 **Aspect Ratio**

Aspect ratio is the ratio of width to length.

1003 **Bills and Statements of Account**

1003.1 A bill is a request for payment of a definite sum of money claimed to be owing by the addressee either to the sender or to a third party. The mere assertion of an indebtedness in a definite sum combined with a demand for payment is sufficient to make the message a bill.

1003.2 A statement of account is the assertion of the existence of a debt in a definite amount but which does not necessarily contain a request or a demand for payment. The amount may be immediately due or may become due after a certain time or upon demand or billing at a later date.

1003.3 A bill or statement of account must present the particulars of an indebtedness with sufficient definiteness to inform the debtor of the amount **[**he is**]** required **[**to pay to acquit himself**]** for acquittal of the debt. However, neither a bill nor a statement of account need state the precise amount if it contains sufficient information to enable the debtor to determine the exact amount of the claim asserted.

1003.4 A bill or statement of account is not the less a bill or statement of account merely because the amount claimed is not in fact owing or may not be legally collectible.

1004 **Girth**

Girth is the measurement around a piece of mail at its thickest part.

1005 **Invoice**

An invoice is a writing showing the nature, quantity, and cost or price of items shipped or sent to a purchaser or consignor.

1006 **Permit Imprints**

Permit imprints are printed indicia indicating postage has been paid by the sender under the permit number shown.

1007 **Preferred Rates**

Preferred rates are the reduced rates established pursuant to 39 U.S.C. 3626.

1008 **ZIP Code**

The ZIP Code is a numeric code that facilitates the sortation, routing, and delivery of mail.

1009 Nonprofit Organizations and Associations

Nonprofit organizations or associations are organizations or associations not organized for profit, none of the net income of which benefits any private stockholder or individual, and which meet the qualifications set forth below for each type of organization or association. The standard of primary purpose applies to each type of organization or association, except veterans' and fraternal. The standard of primary purpose requires that each type of organization or association be both organized and operated for the primary purpose. The following are the types of organizations or associations **[**which**]** that may qualify as authorized nonprofit organizations or associations.

a. Religious. A nonprofit organization whose primary purpose is one of the following:

   i. To conduct religious worship;

   ii. To support the religious activities of nonprofit organizations whose primary purpose is to conduct religious worship;

   iii. To perform instruction in, to disseminate information about, or otherwise to further the teaching of particular religious faiths or tenets.

b. Educational. A nonprofit organization whose primary purpose is one of the following:

   i. The instruction or training of the individual for the purpose of improving or developing his capabilities;

   ii. The instruction of the public on subjects beneficial to the community.

An organization may be educational even though it advocates a particular position or viewpoint so long as it presents a sufficiently full and fair exposition of the pertinent facts to permit an individual or the public to form an independent opinion or conclusion. On the other hand, an organization is not educational if its principal function is the mere presentation of unsupported opinion.

c. Scientific. A nonprofit organization whose primary purpose is one of the following:

i. To conduct research in the applied, pure or natural sciences;

ii. To disseminate systematized technical information dealing with applied, pure or natural sciences.

d. Philanthropic. A nonprofit organization primarily organized and operated for purposes beneficial to the public. Philanthropic organizations include, but are not limited to, organizations that **[**which**]** are organized for:

i. Relief of the poor and distressed or of the underprivileged;

ii. Advancement of religion;

iii. Advancement of education or science;

iv. Erection or maintenance of public buildings, monuments, or works;

v. Lessening of the burdens of government;

vi. Promotion of social welfare by organizations designed to accomplish any of the above purposes or:

(A) To lessen neighborhood tensions;
(B) To eliminate prejudice and discrimination;
(C) To defend human and civil rights secured by law; or
(D) To combat community deterioration and juvenile delinquency.

e. Agricultural. A nonprofit organization whose primary purpose is the betterment of the conditions of those engaged in agriculture pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in agriculture. The organization may advance agricultural interests through educational activities; the holding of agricultural fairs; the collection and dissemination of information concerning cultivation of the soil and its fruits or the harvesting of marine resources; the rearing, feeding, and management of livestock, poultry, and bees, or other activities relating to agricultural interests. The term agricultural nonprofit organization also includes any nonprofit

organization whose primary purpose is the collection and dissemination of information or materials relating to agricultural pursuits.

f. Labor. A nonprofit organization whose primary purpose is the betterment of the conditions of workers. Labor organizations include, but are not limited to, organizations in which employees or workmen participate, whose primary purpose is to deal with employers concerning grievances, labor disputes, wages, hours of employment and working conditions.

g. Veterans'. A nonprofit organization of veterans of the armed services of the United States, or an auxiliary unit or society of, or a trust or foundation for, any such post or organization.

h. Fraternal. A nonprofit organization **[**which**]** that meets all **[**of**]** the following criteria:

i. Has as its primary purpose the fostering of brotherhood and mutual benefits among its members;

ii. Is organized under a lodge or chapter system with a representative form of government;

iii. Follows a ritualistic format; and

iv. Is comprised of members who are elected to membership by vote of the members.

2000 DELIVERY OF MAIL

2010 Delivery Services

The Postal Service provides the following modes of delivery:

a. Caller service. The fees for caller service are set forth in **[**Rate**]** Fee Schedule 921 **[**SS-10.**]**

b. Carrier delivery service.

c. General delivery.

d. Post office box service. The fees for post office box service are set forth in **[**Rate**]** Fee Schedule 921**[**SS-10.**]**

2020 **Conditions of Delivery**

2021 **General.** Except as provided in section 2022, mail will be delivered as addressed unless the Postal Service is instructed otherwise by the addressee in writing.

2022 **Refusal of Delivery.** The addressee may control delivery of his mail. The addressee may refuse to accept a piece of mail that does not require a delivery receipt at the time it is offered for delivery or after delivery by returning it unopened to the Postal Service. For mail that requires a delivery receipt, the addressee or his representative may read and copy the name of the sender of registered, insured, certified, COD, return receipt, and Express Mail prior to accepting delivery. Upon signing the delivery receipt the piece may not be returned to the Postal Service without the applicable postage and fees affixed.

2023 **Receipt.** If a signed receipt is required, mail will be delivered to the addressee (or competent member of his family), to persons who customarily receive his mail or to one authorized in writing to receive the addressee's mail.

2024 **Jointly Addressed Mail.** Mail addressed to several persons may be delivered to any one of them. When two or more persons make conflicting orders for delivery for the same mail, the mail shall be delivered as determined by the Postal Service.

2025 **Commercial Mail Receiving Agents.** Mail may be delivered to a commercial mail receiving agency on behalf of another person. In consideration of delivery of mail to the commercial agent, the addressee and the agent are considered to agree that:

a. No **[**change of address**]** change-of-address order will be filed with the post office when the agency relationship is terminated;

b. When remailed by the commercial agency, the mail is subject to payment of new postage.

2026 **Mail Addressed To Organizations.** Mail addressed to governmental units, private organizations, corporations, unincorporated firms or partnerships,

persons at institutions (including but not limited to hospitals and prisons), or persons in the military is delivered as addressed or to an authorized agent.

2027 **Held Mail.** Mail will be held for a specified period of time at the office of delivery **[**address**]** upon request of the addressee, unless the mail:

a. Has contrary retention instructions;

b. Is perishable; or

c. Is registered, COD, insured, return receipt, certified, or Express Mail for which the normal retention period expires before the end of the specified holding period.

2030 **Forwarding and Return**

2031 **Forwarding.** Forwarding is the transfer of undeliverable-as-addressed mail to an address other than the one originally placed on the **[**mail piece**]**mailpiece. All post offices will honor **[**change of address**]** change-of-address orders for a period of time specified by the Postal Service.

2032 **Return.** Return is the delivery of undeliverable-as-addressed mail to the sender.

2033 **Applicable Provisions.** The provisions of sections 150, 250, 350, **[**and**]** 450, **[**and schedules SS-21 and SS-22**]** 935 and 936 apply to forwarding and return.

2034 **Forwarding for Postal Service Adjustments.** When mail is forwarded due to Postal Service adjustments (such as, but not limited to, the discontinuance of the post office of original address, establishment of rural carrier service, conversion to city delivery service from rural, readjustment of delivery districts, or renumbering of houses and renaming of streets), it is forwarded without charge for a period of time specified by the Postal Service.

3000 **POSTAGE AND PREPARATION**

3010 **Packaging**

Mail must be packaged so that:

a. The contents will be protected against deterioration or degradation;

b. The contents will not be likely to damage other mail, Postal Service employees or property, or to become loose in transit;

c. The package surface must be able to retain postage indicia and address markings;

d. It is marked by the mailer with a material **[**which**]** that is **[**not**]** neither readily water soluble nor **[**which can be**]** easily rubbed off or smeared, and the marking will be sharp and clear.

3020 **Envelopes**

Paper used in the preparation of envelopes may not be of a brilliant color. Envelopes must be prepared with paper strong enough to withstand normal handling.

3030 **Payment of Postage and Fees**

Postage must be fully prepaid on all mail at the time of mailing, except as authorized by law or this Schedule. Except as authorized by law or this Schedule, mail deposited without prepayment of sufficient postage shall be delivered to the addressee subject to payment of deficient postage, returned to the sender, or otherwise disposed of as **[**prescribed**]** specified by the Postal Service. Mail deposited without any postage affixed will be returned to the sender without any attempt at delivery.

3040 **Methods for Paying Postage and Fees**

Postage for all mail may be prepaid **[**by**]** with postage meter indicia, adhesive stamps, or permit imprint, unless otherwise limited or **[**prescribed**]** specified by the Postal Service. The following methods of paying postage and fees require prior authorization from the Postal Service:

a. Permit imprint,

b. Postage meter,

c. Precanceled stamps, precanceled envelopes, and mailer's precanceled postmarks.

3050 **Authorization Fees**

Fees for authorization to use a permit imprint are set forth in **[**Rate**]** Schedule 1000. No fee is charged for authorization to use a postage meter. Fees for setting postage meters are set forth in **[**Rate**]** Fee Schedule 933**[**SS-12.**]** No fee is charged for authorization to use precanceled stamps, precanceled envelopes or mailer's precanceled postmark.

3060 **Special Service Fees**

Fees for special services may be prepaid in any manner appropriate for the class of mail indicated or as otherwise **[**prescribed**]** specified by the Postal Service.

3070 **Marking of Unpaid Mail**

Matter authorized for mailing without prepayment of postage must bear markings identifying the class of mail service. Matter so marked will be billed at the applicable rate of postage set forth in this Schedule. Matter not so marked will be billed at the applicable First-Class rate of postage.

3080 **Refund of Postage**

When postage and special service fees have been paid on mail for which no service is rendered for the postage or fees paid, or collected in excess of the lawful rate, a refund may be made. There shall be no refund for registered, COD, general insurance, and Express Mail Insurance fees when the article is **[**later**]** withdrawn by the mailer after acceptance. In cases involving returned articles improperly accepted because of excess size or weight, a refund may be made.

3090 **Calculation of Postage**

When a rate schedule contains per piece and per pound rates, the postage shall be the sum of the charges produced by those rates. When a rate schedule contains a minimum**[**-per-piece**]** per piece rate and a pound rate, the postage shall be the greater of the two. When the computation of postage yields a fraction of a cent in the charge, the next higher whole cent must be paid.

4000 POSTAL ZONES

4010 Geographic Units of Area

In the determination of postal zones, the earth is considered to be divided into units of area thirty minutes square, identical with a quarter of the area formed by the intersecting parallels of latitude and meridians of longitude. The distance between these units of area is the basis of the postal zones.

4020 Measurement of Zone Distances

The distance upon which zones are based shall be measured from the center of the unit of area containing the dispatching sectional center facility or multi-ZIP coded post office not serviced by a sectional center facility. A post office of mailing and a post office of delivery shall have the same zone relationship as their respective sectional center facilities or multi-ZIP coded post offices, but this shall not cause two post offices to be regarded as within the same local zone.

4030 Definition of Zones

4031 **Local Zone.** The local zone applies to mail mailed at any post office for delivery at that office; at any city letter carrier office or at any point within its delivery limits for delivery by carriers from that office; at any office from which a rural route starts for delivery on the same route; and on a rural route for delivery at the office from which the route starts or on any rural route starting from that office.

4032 **First Zone.** The first zone includes all territory within the quadrangle of entry in conjunction with every contiguous quadrangle, representing an area having a mean radial distance of approximately 50 miles from the center of a given unit of area. The first zone also applies to mail between two post offices in the same sectional center.

4033 **Second Zone.** The second zone includes all units of area outside the first zone lying in whole or in part within a radius of approximately 150 miles from the center of a given unit of area.

4034 **Third Zone.** The third zone includes all units of area outside the second zone lying in whole or in part within a radius of approximately 300 miles from the center of a given unit of area.

4035 **Fourth Zone.** The fourth zone includes all units of area outside the third zone lying in whole or in part within a radius approximately 600 miles from the center of a given unit of area.

4036 **Fifth Zone.** The fifth zone includes all units of area outside the fourth zone lying in whole or in part within a radius of approximately 1,000 miles from the center of a given unit of area.

4037 **Sixth Zone.** The sixth zone includes all units of area outside the fifth zone lying in whole or in part within a radius of approximately 1,400 miles from the center of a given unit of area.

4038 **Seventh Zone.** The seventh zone includes all units of area outside the sixth zone lying in whole or in part within a radius of approximately 1,800 miles from the center of a given unit of area.

4039 **Eighth Zone.** The eighth zone includes all units of area outside the seventh zone.

4040 **Zoned Rates**

Except as provided in section 4050, rates according to zone apply for zone-rated mail sent between Postal Service facilities including **[**a**]**Armed **[**f**]**Forces post offices, wherever located.

4050 **APO/FPO Mail**

4051 **General.** Except as provided in section 4052, the rates of postage for zone-rated mail transported between the United States, or the possessions or territories of the United States, on the one hand, and Army, Air Force and Fleet Post Offices on the other, or among the latter, shall be the applicable zone rates for mail between the place of mailing or delivery and the city of the postmaster serving the Army, Air Force or Fleet Post Office concerned.

4052 **Transit Mail.** The rates of postage for zone-rated mail **[**which**]** that is mailed at or addressed to an Armed Forces**[**armed forces**]** post office and **[**which**]** is transported directly to or from Armed Forces **[**armed forces**]** post offices at the expense of the Department of Defense, without transiting any of the 48 contiguous states (including the District of Columbia), shall be the applicable local zone rate; provided, however, that if the distance from the place of mailing to the embarkation point or the distance from the point of debarkation to the place of delivery is greater than the local zone for such mail, postage shall be assessed on the basis of the distance from the place of mailing to the embarkation point or the distance from the point of debarkation to the place of delivery of such mail, as the case may be. The word "transiting" does not include enroute transfers at coastal gateway cities which are necessary to transport military mail directly between military post offices.

5000 PRIVACY OF MAIL

5010 First-Class and Express Mail

Matter mailed as First-Class Mail or Express Mail shall be treated as mail which is sealed against postal inspection and shall not be opened except as authorized by law.

5020 All Other Mail

Matter not paid at First-Class Mail or Express Mail rates must be wrapped or secured in the manner **[**prescribed**]** specified by the Postal Service so that the contents may be examined. Mailing of sealed items as other than First-Class Mail or Express Mail is considered consent by the sender to the postal inspection of the contents.

6000 MAILABLE MATTER

6010 General

Mailable matter is any matter which:

a. Is not mailed in contravention of 39 U.S.C. Chapter 30, or of 17 U.S.C. 109;

b. While in the custody of the Postal Service is not likely to become damaged itself, to damage other pieces of mail, to cause injury to Postal Service employees or to damage Postal Service property; and

c. Is not mailed contrary to any special conditions or limitations placed on transportation or movement of certain articles, when imposed under law by the U.S. Department of the Treasury; U.S. Department of Agriculture; U.S. Department of Commerce; U.S. Department of Health and Human Services, U.S. Department of Transportation; and any other Federal department or agency having legal jurisdiction.

6020 **Minimum Size Standards**

The following minimum size standards apply to all mailable matter:

a. All items must be at least 0.007 inches thick, and

b. all items, other than keys and identification devices, which are 0.25 inch thick or less must be

   i. rectangular in shape,

   ii. at least 3.5 inches in width, and

   iii. at least 5 inches in length.

6030 **Maximum Size and Weight Standards**

Where applicable, the maximum size and weight standards for each class or subclass of mail are set forth in sections 130, 230, 322.16, 330 and 430**.** Additional limitations may be applicable to specific subclasses, and rate and discount categories as provided in the eligibility provisions for each subclass or category.

ABBREVIATIONS AND ACRONYMS

AAP	Association of American Publishers
AAPS	Association of Alternate Postal Systems
ABA	American Bankers Association
ABP	American Business Press
ACSS	Air Contract Support System
Advo	Advo, Inc.
AFSA	American Financial Services Association
AISOP	Alliance of Independent Store Owners and Professionals
ALA	American Library Association
AMC	Airport Mail Center
AMMA	Advertising Mail Marketing Association
ANM	Alliance of Nonprofit Mailers
AO	Associate Offices
APA	Agricultural Publishers Association
APCP	Association of Paid Circulation Publications, Inc.
APMU	Association of Priority Mail Users, Inc.
APPA	American Public Power Association
APWU	American Postal Workers Union, AFL-CIO
ASF	Auxiliary Service Facility

BAM	Business and Mixed
BARM	Bulk Automated Reply Mail
BCR	Barcode Reader
BCS	Barcode Sorters
Beekeepers	American Beekeepers Federation, Inc.
BMC	Bulk Mail Center
BMEU	Business Mail Entry Unit
BMM	Bulk Metered Mail
BRMAS	Business Reply Mail Accounting System
Brooklyn Union	Brooklyn Union Gas Company
CAG	Cost Ascertainment Group
Carlson	Douglas F. Carlson
Carol Wright	Carol Wright Promotions, Inc.
CAT/FAT	Curbline and Foot Access Test
CCS	Carrier Cost System
CEM	Courtesy Envelop Mail
CFS	Computerized Forwarding System
Coalition	Saturation Mailers Coalition
COLA	Cost of Living Adjustment
Condé Nast	Condé Nast Publications Inc.
Consumers Union	Consumers Union of United States, Inc.
CPA	Classroom Publishers Association

CPI-W	Consumer Price Index-Urban Wage Earners and Clerical Workers
CPP	Centralized Postage Payment
CRA	Cost and Revenue Analysis
CRM	Courtesy Reply Mail
CRPA	Coalition of Religious Press Associations
CTC	CTC Distribution Services, L.L.C.
DBMC	Destination Bulk Mail Center
DDU	Destination Delivery Unit
District	District Photo Inc.
DMA	Direct Marketing Association, Inc.
DMCS	Domestic Mail Classification Schedule
DMM	Domestic Mail Manual
Donnelley	R.R. Donnelley & Sons Company
Dow Jones	Dow Jones & Company, Inc.
Dowden	Dowden Publishing Company
DPS	Delivery Point Sequencing
DSCF	Destination Sectional Center Facility
ECP	Efficient Component Pricing
ECR	Enhanced Carrier Route
ECSI	Educational, Cultural, Scientific and Informational
EEI	Edison Electric Institute

E-Stamp	E-Stamp Corporation
EXFC	External First-Class Measurement System
FASB	Financial Accounting Standards Board
FedEx	Federal Express Corporation
FERS	Federal Employees Retirement System
FHP	First Handling Pieces
FIM	Facing Identification Mark
First Image	First Image Management Company
FSM	Flat Sorting Machine
FY	Fiscal Year
G+J Publishing	Gruner + Jahr USA Publishing
GAAP	Generally Accepted Accounting Principles
GCA	Greeting Card Association
Gift Fruit Shippers	Florida Gift Fruit Shippers Association
Hallmark	Hallmark Cards, Incorporated
HCSS	Highway Contract Support System
HDS	Household Diary Study
Hearst	The Hearst Corporation
HMM	Hazardous Medical Materials
ICC	Inland Capital Corporation
ILCA	International Labor Communications Association
IMHS	Integrated Mail Handling System

OCS	In-Office Cost System
Joint Parties	Advertising Mail Marketing Association, Direct Marketing Association, Mail Order Association of America, Parcel Shippers Association, and Advo, Inc.
Knight-Ridder	Knight-Ridder, Inc.
Lab*One* et al.	Lab*One*, Inc., Osborn Laboratories, Inc. and Clinical Reference Laboratory, Inc.
LDC	Labor Distribution Code
League	National League of Postmasters of the United States
LIOCATT	In-Office Cost Attributable (computer program written by the Postal Service)
LSM	Letter Sorting Machine
LTV	Load Time Variability
MASA	Mail Advertising Service Association International
McGraw-Hill	McGraw-Hill Companies, Inc.
MDCD	Mobile Data Collection Device
MDR	Multiple Delivery Residential
Merck-Medco	Merck-Medco Managed Care, L.L.C.
Meredith	Meredith Corporation
MMA	Major Mailers Association
MOAA	Mail Order Association of America
MODS	Management Operating Data System
Moore & Associates	Peter J. Moore & Associates
MPA	Magazine Publishers of America

MPLSM	Multi-Position Letter Sorting Machine
MTEC	Mail Transportation Equipment Centers
Mystic	Mystic Color Lab
NAA	Newspaper Association of America
NALC	National Association of Letter Carriers, AFL-CIO
NAPM	National Association of Presort Mailers
NAPUS	National Association of Postmasters of the United States
Nashua	Nashua Photo Inc.
NASS	National Air and Surface System
NCOA	National Change of Address
NECR	Nonprofit Enhanced Carrier Route
NFN	National Federation of Nonprofits
Niagara	Niagara Telephone Company
NMC	National Mail Count
NMO	Nonmachinable outside
NNA	National Newspaper Association
NPMHU	National Postal Mail Handlers Union
NPPC	National Postal Policy Council, Inc.
NRF	National Retail Federation
OBMC	Origin BMC
OBRA	Omnibus Budget Reconciliation Act
OCA	Office of the Consumer Advocate

OCR	Optical Character Reader
ODIS	Origin-Destination Information System
OHM	Other Hazardous Materials
OHMM	Other Hazardous Medical Materials
OPM	Office of Personnel Management
OTR	Over-the-road
Penney	J.C. Penney Company, Inc.
PERMIT	Permit Imprint
PFY	Postal Fiscal Year
PIRS	Productivity Information Reporting System
PMBDC	Priority Mail Base Delivery Confirmation
PMPC	Priority Mail Processing Center
PMRSDC	Priority Mail Retail Surcharge Delivery Confirmation
Popkin	David B. Popkin
Poultry Associations	Ohio Poultry Association, Texas Poultry Federation, Iowa Poultry Association, and Nebraska Department of Agriculture/Egg
PRA	Postal Reorganization Act
PRM	Prepaid Reply Mail
PSA	Parcel Shippers Association
PVDS	Plant-verified Drop Shipment
PYL	Prior Years' Losses
QBRM	Qualified Business Reply Mail

RBCS	Remote Bar Coding System
RCCS	Rural Carrier Cost System
RDA	Reader’s Digest Association, Inc.
RFRA	Revenue Foregone Reform Act
RIAA	Recording Industry Association of America, Inc.
RPW	Revenue, Pieces and Weight
RPYL	Recovery of Prior Years’ Losses
RTS	Return-to-Sender
Rusmar	Rusmar Inc.
SCF	Sectional Center Facility
SDR	Single Delivery Residential
Seattle	Seattle Filmworks, Inc.
SJ Consulting	SJ Consulting Group
SmartMail	SmartMail, Inc.
SPBS	Small Parcel and Bundle Sorter
SPLY	Same Period Last Year
SS	Sector Segment
STS	Street Time Sampling
Time Warner	Time Warner, Inc.
TMR	TMR Services
TPH	Total Piece Handlings
TRACS	Transportation Cost System

TY	Test Year
TYBR	Test Year Before Rates
UAA	Undeliverable-as-addressed
U.S. News	U.S. News & World Report, L.P.
UNITE	Union of Needletrades, Industrial and Textile Employees
UPS	United Parcel Service
VBL	Computer program filename used by the U. S. Postal Service
VPDA	Val-Pak Dealers' Association, Inc.
VPDMS	Val-Pak Direct Marketing Systems, Inc.
VSD	Vehicle Service Driver