

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

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POSTAL RATE COMMISSION  
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

NOTICE OF THE UNITED STATES POSTAL SERVICE CONCERNING ERRATA  
TO TESTIMONY OF WITNESS FRONK (USPS-T-33) (ERRATUM)

The United States Postal Service hereby provides notice of the filing of errata to the testimony of witness Fronk (USPS-T-33). These errata flow from three sources, and result in changes to the following portions of USPS-T-33:

- ◆ the April 17, 2000, response of the Postal Service to OCA/USPS-106 – affects USPS-T-33, at pages 2, 44 and 46;
- ◆ the April 11 and March 31, 2000, errata of witness Miller (USPS-T-24) – affect USPS-T-33, at pages 28, 33, 34 and 35; and
- ◆ the March 1, 2000, errata of witness Daniel (USPS-T-28) – affect USPS-T-33, at pages 24 and 25.

The summary impact of these changes is reflected in USPS-T-33, Attachment B.

The attached revised pages of USPS-T-33 filed today replace the original USPS-T-33 pages filed on January 12, 2000. On each revised page, the changes are highlighted by shading.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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1 (USPS-T-32) provides the overall revenue requirement and subclass cost  
 2 coverage targets for First-Class Mail. Second, I rely on the cost work of witness  
 3 Miller (USPS-T-24) for updated information on worksharing cost savings, witness  
 4 Daniel (USPS-T-28) for a new weight study relevant for the additional ounce  
 5 rate, and witness Campbell (USPS-T-29) for updated information on Qualified  
 6 Business Reply Mail (QBRM) costs. For the nonstandard surcharge, I cite  
 7 updated cost data developed by witness Miller (USPS-T-24).

8 My testimony concludes in Section VIII with an overall discussion of the  
 9 financial impact of the proposed First-Class Mail rates. Section VIII relies on my  
 10 Workpaper (USPS-T-33 Fronk Workpaper, filed electronically as USPS LR-I-  
 11 169), which details the revenue and volume results of the rate proposal at the  
 12 billing determinant level. The Workpaper itself contains references to sources  
 13 and data relied upon.

14

15 **III. PROPOSAL**

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

18	Letters Subclass	3.5%
19	Cards Subclass	5.0%
20	Total Class	3.6%

21 These changes result in revenues that are **197.1** percent of volume  
 22 variable cost for letters and 148.5 percent of volume variable cost for cards. For  
 23 the class as a whole, the resulting cost coverage is **195.3** percent.

1           Several considerations went into developing the proposed 23-cent rate,  
 2 including achievement of the revenue requirement and the First-Class Mail cost  
 3 coverage provided by witness Mayes. The Postal Service also considers it  
 4 important to develop an additional ounce rate that reflects the underlying costs  
 5 the rate is designed to recover. The testimony of witness Daniel (USPS-T-28)  
 6 presents the results of the First-Class Mail weight study prepared for this docket.

7           As noted by witness Daniel (USPS-T-28), there is difficulty in measuring  
 8 additional ounce costs with the highest degree of precision on a weight-step-by-  
 9 weight-step basis. Nevertheless, the weight study does provide a basis for  
 10 evaluating, in the aggregate, the alignment between the additional ounce rate  
 11 and the overall costs it is designed to recover. Also, the weight study provides a  
 12 basis for addressing potential concerns that there may be a large disparity  
 13 between the additional ounce rate and its underlying costs.

14           As discussed in USPS-T-28, the weight study develops costs for both  
 15 single-piece and presort. On average, across all weight steps, each additional  
 16 ounce for single-piece mail adds **12.4** cents to cost (USPS-T-28, Table 1), while  
 17 each additional ounce for a presort mail piece adds 14.8 cents to cost (Id. at  
 18 Table 2). Taking single-piece and presort mail together, each additional ounce  
 19 on average adds 12.7 cents to First-Class Mail costs.<sup>4</sup>

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<sup>4</sup> Calculated by using the data in USPS-T-28 as follows: **12.4** cents for single-piece calculated in Table 1 by taking **\$2,231,018,245** in costs / 17,967,736,454 additional ounces, and 14.8 cents presort calculated in Table 2 by taking **\$389,997,819** in costs / 2,639,970,578 additional ounces. The weighted average of the two is **12.719**, or **\$2,621,016,064** in costs (**\$2,231,018,245 + \$389,997,819**) divided by 20,607,707,032 additional ounces (17,967,736,454 + 2,639,970,578).

1           While the concept of mark-up applies most directly at the subclass level,  
2 examining the mark-up for an individual rate can give an indication of how the  
3 rate compares with the rate/cost relationship for the subclass as a whole. As  
4 shown in the First-Class Mail Test Year Summary (below in Attachment USPS-  
5 33B), the mark-up for the letters subclass at proposed rates is approximately 96  
6 percent. The mark-up for the additional ounce rate is approximately 81 percent  
7 (23 cents in revenue per ounce/12.7 cents in cost per ounce), which is somewhat  
8 below, but generally consistent with the subclass as a whole. Because the  
9 additional ounce mark-up is below the subclass average, the additional ounce  
10 rate is serving to reduce the overall mark-up for the letters subclass.

11           The cost data compiled by witness Daniel also show that the first  
12 additional ounce of single-piece mail adds 22.3 cents to unit costs (USPS-T-28  
13 at Table 1), while the first additional ounce of presort mail adds 17.7 cents to  
14 cost (Id. at Table 2). In general, subsequent additional ounces add less to costs  
15 than the first additional ounce for both single-piece and presort mail.

16           In addition, while the first additional-ounce costs less for presort mail than  
17 for single-piece mail, these costs catch up for heavier pieces. This cost behavior  
18 argues against a lower additional-ounce rate for presort, since the lower rate  
19 would steadily increase the presort discount as the weight of the piece  
20 increased, even though the weight study data indicate that the cost difference  
21 does not continue to increase for heavier pieces.

22           It might be argued that the rates for additional ounces of First-Class Mail  
23 should be strictly cost based. Under such a scheme, the rates for additional

1 and the supporting cost study drew criticism and considerable attention from  
2 intervening parties. The Docket No. R2000-1 testimony of witness Miller (USPS-  
3 T-24 at Attachment USPS-24B) addresses several mail processing and cost  
4 issues which surfaced in the earlier docket, demonstrating that the Postal  
5 Service has made substantial progress in addressing that criticism.

6 The nonstandard surcharge performs an important role in signaling  
7 mailers that the cost of processing nonstandard pieces is higher. Mailers may  
8 find that a nonstandard piece will best meet their needs and that they are willing  
9 to pay the corresponding surcharge. However, if the price mailers pay for  
10 nonstandard pieces is not sufficiently high, the Postal Service may not properly  
11 signal the impact of nonstandard pieces on its mail processing operations.  
12 Generally, it is the Postal Service's policy to provide mailers with a low-cost  
13 method of processing differently shaped and sized one-ounce First-Class Mail  
14 pieces. Some standardization of basic mail pieces is necessary to achieve this  
15 objective, and the nonstandard surcharge encourages such standardization.  
16 Without an appropriate surcharge, Postal Service mail processing operations  
17 could be adversely affected by large numbers of nonstandard pieces.

18 In his study, witness Miller obtains nonstandard surcharge costs of **23.3**  
19 cents for nonpresort nonstandard pieces and **9.2** cents for presort nonstandard  
20 pieces. These costs are clearly above the present levels of the surcharge for  
21 both nonpresort and presort mail.

22 While witness Miller's study makes significant progress in addressing  
23 issues identified in Docket No. R97-1, even his improved nonstandard cost

**Table 7**  
**Unit Cost Savings and Discounts for Automation Letters**

	<b>Unit Cost Savings*</b> (Cents)	<b>Current Discount</b> (Cents)	<b>Proposed Discount</b> (Cents)
Basic Automation	5.2	6.0	6.0
3-Digit	1.0	0.9	0.9
5-Digit	1.3	1.8	1.8
Carrier Route	0.3	0.5	0.5

\* Unit costs include mail processing and delivery costs. Source USPS-T-24 at Table 1.

Table 7 also presents the current and proposed discounts for automation letters, where discounts, like unit cost savings, are expressed in terms of the previous tier. As shown in the table, the newly measured cost avoidances are now below the current discounts in key instances. For example, the rate for basic automation letters is currently 6.0 cents below the single-piece rate. The latest cost data show that the mail processing and delivery costs avoided by a basic automation letter are now 5.2 cents, which, by itself, would suggest that the discount should be reduced by 0.8 cents, to 5.2 cents below the single-piece rate.

Instead, the passthroughs and the discounts that underlie the proposed rates were selected to balance several goals, including: (1) achieving the cost coverage target provided by witness Mayes, (2) recognizing the value of mailer worksharing, (3) avoiding changes in discount levels which result in disruptive rate impacts, and (4) acknowledging the importance of mailer barcoding in overall postal operations. Mailers have invested significantly in automation equipment and changed their mail processes as a result of the recent expansion

1 in worksharing incentives, and it would be unfair to sharply reverse these  
2 incentives. At the same time, the Postal Service could experience operational  
3 difficulties if a large portion of the nearly 45 billion workshared First-Class Mail  
4 pieces reverted to the Postal Service for sorting and barcoding.

5 **a. Basic Automation Letters**

6 The Table 7 difference in unit costs between a basic automation letter and  
7 the bulk metered benchmark is **5.2** cents. The current basic automation rate is  
8 6.0 cents below the single-piece rate. Thus, the latest cost data, taken by itself,  
9 would suggest that this discount should be reduced by **0.8** cents, to **5.2** cents  
10 below the single-piece rate. Since the discounts for the subsequent automation  
11 tiers are keyed to the basic automation starting point, any decision to reduce the  
12 basic automation discount would also work to reduce the discounts from the  
13 single-piece rate for 3-digit, 5-digit, and carrier route mail.

14 Instead, the Postal Service is proposing to pass through **15%** of the  
15 measured cost avoidance and maintain this discount at its present level of 6.0  
16 cents. This results in a one-cent increase in this rate from its present 27.0 cents  
17 to a proposed 28.0 cents. This is consistent with the ratemaking goals described  
18 above, including the avoidance of disruptive rate increases and the maintenance  
19 of incentives to automate. The fact that this represents a shift from the trend  
20 toward expanding discounts serves to signal the mailing community about the  
21 smaller cost avoidances that are currently being measured.

22

23

1 **b. 3-Digit Letters**

2 This rate applies to the largest volume of barcoded letters. In the test  
3 year, more than one-half of the automation letters are in this rate category. The  
4 Postal Service proposes a one-cent increase in the current 26.1 cent rate to 27.1  
5 cents.

6 This proposed rate maintains the discount at its present 0.9 cents below  
7 the basic automation rate and 6.9 cents below the single-piece rate. While this  
8 proposal passes through somewhat less than the amount of avoided costs  
9 between basic automation and 3-digit letters (90 percent), it also results in a  
10 passthrough of **11** percent of the measured cost avoidance between the bulk  
11 metered benchmark and 3-digit letters (6.9 cents / **6.2** cents). As such, the  
12 discussion regarding the basic automation rate design is also applicable here.

13 **c. 5-Digit Letters**

14 Consistent with its rate proposals for basic automation and 3-digit letters,  
15 the Postal Service proposes maintaining the current 1.8 cent discount from the  
16 3-digit rate (compared with the **13**-cent measured cost avoidance between the  
17 3-digit and 5-digit automation tiers). The proposed rate is 25.3 cents, a 4.1  
18 percent increase over the current rate. Use of this rate category, which contains  
19 the second largest volume among automated rate categories, is optional.  
20 Mailers can be expected to use this rate only when their cost of making the 5-  
21 digit separation is less than the rate difference between the 3-digit and 5-digit  
22 rates, and when their mailings have sufficient geographic density. Again, the



1 (USPS-T-33 Fronk Workpaper). The key financial results are summarized below  
2 in Table 8. Revenues include fees.

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**Table 8**  
**Estimated Total Revenue, Cost, and Contribution**  
**Test Year 2001 After Rates**  
**(\$ thousands)**

	<b>Revenue</b>	<b>Cost</b>	<b>Contribution</b>	<b>Percentage Rate Increase</b>
Letters	\$36,165,944	\$18,345,506	\$17,820,437	3.5%
Cards	\$1,052,689	\$708,877	\$343,812	5.0%
Total Class	\$37,218,633	\$19,054,383	\$18,164,249	3.6%

## Attachment USPS-33B

**FIRST-CLASS MAIL TEST YEAR SUMMARY**

	<u>BEFORE RATES</u>	<u>AFTER RATES</u>	<u>% CHANGE</u>
<b><u>LETTERS SUBCLASS:</u></b>			
Volumes	100,261,726	99,857,394	-0.40%
Revenues:			
Postage Revenue	\$34,933,727	\$35,976,352	2.98%
Fee Revenue	\$156,588	\$189,592	21.08%
Total Revenue	\$35,090,315	\$36,165,944	3.07%
Revenue Per Piece	\$0.349987	\$0.362176	3.48%
Costs:			
Total Costs (incl. contg.)	\$18,459,138	\$18,345,506	-0.62%
Cost Coverage	190.10%	197.14%	
Contribution	\$16,631,177	\$17,820,437	7.15%
<b><u>CARDS SUBCLASS:</u></b>			
Volumes	5,584,931	5,440,951	-2.58%
Revenues:			
Postage Revenue	\$1,021,746	\$1,043,775	2.16%
Fee Revenue	\$7,500	\$8,914	18.85%
Total Revenue	\$1,029,246	\$1,052,689	2.28%
Revenue Per Piece	\$0.184290	\$0.193475	4.98%
Costs:			
Total Costs (incl. contg.)	\$727,672	\$708,877	-2.58%
Cost Coverage	141.44%	148.50%	
Contribution	\$301,574	\$343,812	14.01%
<b><u>TOTAL FIRST-CLASS MAIL:</u></b>			
Volumes	105,846,657	105,298,345	-0.52%
Revenues:			
Postage Revenue	\$35,955,473	\$37,020,127	2.96%
Fee Revenue	\$164,088	\$198,506	20.98%
Total Revenue	\$36,119,561	\$37,218,633	3.04%
Revenue Per Piece	\$0.341244	\$0.353459	3.58%
Costs:			
Total Costs (incl. contg.)	\$19,186,810	\$19,054,383	-0.69%
Cost Coverage	188.25%	195.33%	
Contribution	\$16,932,751	\$18,164,249	7.27%

Source: USPS-T-33 Fronk Workpaper at page 1.

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

A handwritten signature in black ink, appearing to read "M T Tidwell", written over a horizontal line.

Michael T. Tidwell

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April 17, 2000