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DOCKET NO. R2000-1

DIRECT TESTIMONY

OF

WIN ZIMMERMANN

ON BEHALF OF

PARCEL SHIPPERS ASSOCIATION

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AUTOBIOGRAPHICAL SKETCH

My name is Winfried (Win) Zimmermann and I'm employed with the Swiss Colony, Inc. of Monroe, Wisconsin as Executive Director of Operations. The Swiss Colony is the oldest specialty mail order food company in the country. But in recent years our product line has diversified to include a variety of other consumer goods as well.

For thirty-eight years, since college and the military, I have been employed by businesses that require a residential delivery. Most of this time has been with Encyclopedia Britannica and the Swiss Colony managing their distribution, mailing, and production operations. During this time I've seen common carrier deregulation, the demise of REA, the inception of FedEx, the tremendous growth of UPS and the commensurate decline of parcel post volume.

Since 1975 I have been affiliated with the Parcel Shippers Association (PSA) and am currently serving as Chair. The Swiss Colony is also a founding member of the National Association of Perishable Shippers (NAPS) and I'm privileged to serve on its board as well. I have represented PSA on MATC and am currently serving as a representative for NAPS.

In addition to service to national trade groups, I'm past secretary/treasurer of the Wisconsin Gift Cheese Association.

PARCEL SHIPPERS ASSOCIATION

The Parcel Shippers Association was founded in 1953 with its primary mission to foster competition in the parcel delivery market by promoting the most efficient service at the lowest possible cost. It has more than 80 members, most of whom advertise their products through the U.S. mails, as well as other media, and who ship their products using the Standard (A), Standard (B), Priority Mail and Express Mail Package Services of the Postal Service, as well as the services of UPS and Fed Ex/RPS. Our members are also greatly dependent on the Postal Service to deliver to them mail orders for the merchandise they advertise and to send bills and receive payment for that merchandise.

INTRODUCTION.

The common need our members share, from the origins of the Association, has been the need for cost efficient carriage of their small parcels both to business and residential customers. We have worked consistently with the carriers, urging technological advance, innovation, arguing for rate structures that encourage us to do work sharing where we can more efficiently perform functions than can our carriers.

We have found there is more effective innovation and competition in the expedited delivery market, where there are more than a few providers of service. And, recently, there has been some competition in the business-to-business market. However, for almost half a century the small parcel residential delivery market has been dominated by two carriers, USPS and United Parcel Service, with UPS being the dominant, de facto, monopoly supplier of service for most of the last twenty-five years. For the last decade our Association has done everything it can to encourage the Postal Service, and those that regulate that service and its rates, to become a meaningful competitor to UPS for residential delivery. Frankly, we would like to see more than two carriers in this market but, it is clear to us, in the short run only USPS is in a position to provide the competition to UPS that is essential to ensure fair prices and good service.

My testimony will explain why our membership believes that the Postal Service's rates and classifications are crucial to their interests, not only in the ground parcel delivery market, but also in the expedited delivery market.

As my testimony will develop, while it may appear that the overall Standard (B) Parcel Post increase of 1.3% is moderate, when added to the excessively large increase that went into effect just a year and a half ago, Parcel Post rates are right now, and will be even more so, excessive and anticompetitive. As my testimony will further develop, our members are also users of Priority Mail, Bound Printed Matter, and Standard (A) Parcel Service. The rates proposed in this case for those services are excessive and inconsistent with the rate criteria of the Act.

The innovative change in Docket No. R97-1 to allow the Postal Service to carry parcels between 108" and 130" in length and girth combined had great promise to meet a serious service problem. However, the oversized rates recommended then and proposed in this proceeding have, for all practical purposes, killed the usage of this service. These oversized rates should be substantially moderated from those proposed.

Another innovation introduced in Docket No. R97-1, which held much promise, is delivery confirmation for Standard (B) Parcels. However, the price imposed on that service is such as to inhibit its usage and, as our testimony will develop, is neither in the interests of the Postal Service or the users.

We very much support the Postal Service's increased emphasis on destination discounts for Standard (B) Parcels. We also applaud the Postal Service proposal to extend the bar code discount to Standard (A) Parcels, as it did to Standard (B) Parcels in the last proceeding. That, coupled with the lower pound rate for Standard (A), does have the effect of mitigating the otherwise ridiculously large increase in the Standard (A) Parcel Surcharge, an 80% increase in that rate element.

And finally, as we are sure most other parties to this proceeding will agree, the Postal Service's revenue requirement is grossly exaggerated and cannot be justified on any basis other than the Postal Service's desire to have a large cushion in case they fail to implement the programmed productivity improvements, and fail to achieve the savings from automation, savings that will only come from very hard-headed implementation and management of those changes to ensure that the postal labor force is efficiently deployed and not engaged in manual activities which automation has made obsolete. Because the revenue requirement is such a central element to every aspect of the Postal Service's proposals, my testimony will begin its specific treatment with that issue.

I. THE REVENUE REQUIREMENT

The Postal Service has requested an overall 6.4% increase to cover an anticipated $3.68 billion deficit, a deficit which includes a 2-1/2% contingency and a prior loss recovery of $268 million. In fact, subtracting the contingency and prior loss recovery reveals that the actual anticipated deficit is only $1.7 billion, $2 billion less than requested. (Exhibit USPS-32B) Perhaps coincidentally, the actual projected deficit of $1.7 billion is about the same amount of revenue increase that the Commission allowed the Postal Service in Docket R97-1. It is also noteworthy that the Postal Service, using the reduced $1.6 billion increase from Docket R97-1, has been able to operate in the black to date, even though that increase was not placed into effect until some three months after the close of the Test Year, FY 1998.

What is very significant is that the last two rate proceedings, Docket R94-1 and Docket R97-1, were cases in which the Postal Service requested and the Commission recommended overall rate increases that were less than the rate of inflation in the general economy. It is undeniable that the Postal Service has prospered under a regime of moderate to small rate increases, producing a string of "profits" that is unprecedented since Postal Reform. One must ask why would the Postal Service jeopardize this very successful formula of small to moderate increases, and why would they think the Commission would want to risk a return to the era in which very large postal rate increases had the predictable effect of killing volume, thereby spreading non-variable institutional costs over a smaller base, with resultant adverse revenue effects and an almost unbroken string of deficits?

The Postal Service agrees that its estimated increased costs of 3.6% for FY 2000 and 3.8% for FY 2001 (Exhibit USPS-9M) are greater than the estimated changes in the CPI-W of 2.7% for FY 2000 and 2.0% for FY 2001 (Table 14 of USPS-T-9.) The Service's explanation of why they are estimating cost increases for 2000 and 2001 that exceed cumulatively the CPI by 2.7% is that the increases over the previous two rate cycles were 5% below inflation. Such an explanation of course is nonsense. Rather than explaining why the Postal Service is entitled to assume an excess inflation in its own costs, its ability to operate profitably in the previous two rate cycles with rate increases 5% below inflation is proof that they do not need to assume costs in excess of the inflation rate. The Postal Service's proven ability to operate at a less than inflation rate over the previous six years argues against a departure from a pattern of rate increases less than inflation.

If the overall 6.4% increase were reduced by 2.7%, the amount by which their assumed inflation cumulatively exceeds the CPI-W estimated inflation rate, it would have the effect of reducing the overall increase by $1.5 billion. Quite apart from any other specific overstatements that the Commission may find, the contingency should be reduced by at least $1 billion; that would be much more in alignment with the expected rate of inflation, an inflation rate which the Postal Service has bested for six years running.

II. COMPETITION IN THE PARCEL SHIPMENT MARKET.

While the Postal Service is often characterized as a monopoly, it must be remembered that everything the Postal Service does, except for the "letter mail" monopoly, is open to competition. Moreover, in those competitive markets only one competitor, the USPS, is tightly regulated. On the other hand, all users of services in this market, even those who only use non-regulated carriers other than the Postal Service, are nevertheless affected by the regulation of USPS.

The package market is an increasingly important market, and significantly important to the United States where this country is the fastest growing participant in the fastest growing freight transportation market.

Dr. Tolley has provided the 1998 shares of the package/parcel market by segregating it into the overnight, the two to three day, and the ground shipment market. (Tr. Vol. 9, pp. 3651-2) The data for overnight shows that UPS has 21% of that market, Fed Ex and RPS 43.4%, and USPS 11%. The Postal Service is not doing well despite the fact that it invented overnight service with Express Mail.

In the two to three day market, the Postal Service has the dominant share of the market, with its Priority Mail Service capturing 68-1/2% of the market, the remainder being roughly divided between UPS and Fed Ex.

In these two markets, the product is not the conventional parcel; rather, these markets consist in substantial part of letters and flats.

The more conventional package, or parcel, is in the ground transportation category. Dr. Tolley divides this market primarily among UPS, Fed Ex/RPS, and the Postal Service. Dr. Tolley estimates the size of this market at 4,138,000,000 parcels. The market share of Standard (B) Parcel Post in 1998 Dr. Tolley estimates to have been around 322 million, or roughly 7.8% of the market.[1] The Postal Service also had 868 million Standard (A) Parcels, or roughly 21% of the market; and it had another 706 million pieces of Bound Printed Matter and Books, which equates to 17% of the market.

Neither United Parcel Service nor Fed Ex/RPS makes any distinction between Standard (A) and B Parcels, nor Bound Printed Matter, nor Books and Records. So far as UPS is concerned they are simply parcels. However, because of the very distinct classifications between Standard (B) Parcel Post and other kinds of packages, those very rigid classifications with separate rate and service structures do define a separate market, and, in that market, the Postal Service's 322 million parcels in 1998 were an insignificant portion. If one excludes the other separate subclasses of Bound Printed Matter Books, and under 1 pound parcels, the remaining market consists of 3,108,000,000 parcels, with UPS' share 78.4%, Fed Ex/RPS' share 11.2%, and Parcel Post's share 10.4%.

All domestic ground parcel rates will be affected by the Commission's recommendation in this proceeding, including UPS' 78% share of that market as well as Roadway's 11% share.

If there is to be competition in the growing ground parcel delivery market the Postal Service must grow its 10% share. However, given its costs and labor structure

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[1] Dr. Tolley elsewhere estimates the 1998 volume to have been around 320 million . (USPS-T-6, chart 4, p. 154)

the only way it can do this is by utilizing competitive drop ship rates and improving the level and consistency of its service.

As the Commission we are sure is well aware, it is not possible simply to compare the published tariff of United Parcel Service and that of the Postal Service to determine whether Parcel Post rates are higher or lower than UPS rates. A very substantial number of major parcel shippers who utilize UPS have secret contract rates that are unrelated to whatever published tariff UPS may have at any given moment. A number of our members have those secret arrangements.

The reality is that the Postal Service may not approach a major shipper of packages and parcels of varying content descriptions and weights, both under and over 1 pound, and negotiate a blended rate against certain guaranteed volumes and somewhat exclusive patronage. That is exactly what the major shipper does with both Fed Ex and UPS. So, for Fed Ex and UPS there are three markets, all determined by level of service: Overnight, Two to Three day service, and Deferred or Ground transportation service. Moreover, UPS will make deals that combine all three services under one umbrella. Because of the statutorily imposed artificial constraints under which the Postal Service must operate, it is not possible to view the package market as one large market; rather both postal competitors and customers have to view these as very distinct and separate markets so far as Parcel Post competition is concerned, and for that reason the Commission should treat them as distinct markets.

Even where the Postal Service does have a rate advantage in their Parcel Post rates compared to UPS residential delivery rates, because the customer does not have a separate contractual deal with UPS, there are a number of other disadvantages to using the Parcel Post Service that often erase whatever actual rate advantage there may have been. Many of these real costs are imposed by inferior service. Thus, merely maintaining equality in the rate levels will not in any way guarantee that there will be effective competition in the residential delivery market.

We hope the Commission, when applying Criterion 4, the effect of its recommended rates on competition, will continue to apply that criterion in a manner that encourages competition in the several markets, and not view that criterion as a shield to a single competitor to continue its dominant position. The parcel competition that the Postal Service has been able to provide to United Parcel Service due to the competitive rates that the Postal Rate Commission has recommended in the last ten years is good for consumer and competition alike. The fact is that UPS has just posted record quarterly profits.

The Reuters News Service has reported that UPS beat analysts' forecasts. Reuters quotes the Company as saying it would use up to $1.2 billion in proceeds from last year's IPO to buy back Class A and B common stock; that UPS is aiming for revenue growth of about 10% and earnings growth of about 15% in 2000. Reuters quoted Robert Clanin, UPS Chief Financial Officer, as saying that UPS recorded solid growth with improving yields in its core U.S. market where total average daily domestic package volumes grew 5.3% over the previous quarter in 1999. Reuters said that Mr. Clanin attributed these strong results to its aggressive bid to carve out new markets in e-commerce and business-to-business services.

In fact, the last twenty-five years have been a demonstration of how UPS has benefited from regulation – not regulation of UPS, but regulation of the United States Postal Service in its rates and services.

III. PRIORITY MAIL AND BOUND PRINTED MATTER MAIL.

A number of our members are significant users of Priority Mail, and, it would appear, this will be an increasingly used service by our membership. The Postal Service is proposing an overall 15% increase for Priority Mail. This is an astoundingly large increase, given the high cost coverage of this subclass, in a rate proceeding where the overall increase is only 6.4%, which, as I have elsewhere pointed out, we believe is excessive. It seems to us that there is absolutely no justification for such a high increase other than the Postal Service's naïve belief that this is what the traffic will bear. We think the Postal Service underestimates its competition and their willingness to slash prices in order to gain market share. The Postal Service can ill afford to lose its strong position as a leader in this particular service. These overall increases should be cut in half. We feel no need to suggest where the lost revenue would come from because, as we have already testified, the Postal Service overall rate increase is excessive and should be cut by at least $1 billion, and this is one of the specific cuts that should be applied.

In fact the 15% increase may be understated ; it would appear to be larger for much of the Priority Mail Service that our membership might use. For example, the Postal-Provided Envelope Priority Mail increases from $3.20 to $3.85, a 20% increase. And increases for Priority Mail up to 5 pounds appear to be more on the order of 18% than 15%.

Bound Printed Matter is proposed to rise 18.15%. While the Postal Service forecasts substantially increased costs for this rate category, this increase should be tempered in view of Criterion 4 of the Act, which requires consideration of the impact of an increase on the users of that service. We support the first time introduction of SCF and DDU rates for Bound Printed Matter, but, at the same time, note that many BPM users will not have sufficient volumes and therefore will be left to pay an extremely high 18.15% rate increase. Likewise, the ECSI value under Criterion 8 of the Act also argues against a percentage increase of these dimensions, particularly when increases in so many other rate categories were constrained so that they would not exceed 10%.

IV. MISCELLANEOUS PROPOSALS.

We also endorse several minor proposals of the Postal Service which we think would be helpful to postal customers. The proposal to allow parcels under 1 pound to be commingled with and rated as Parcel Post is good business for the Postal Service and should be helpful to our members since it will help them to meet make up requirements for some of the discounted Parcel Post categories.

Also, the Service has proposed to eliminate the Merchandise Return Service Fee which, of course, is long overdue and makes a great deal of sense.

We also note with approval the proposed reduction in the Bulk Parcel Return Service rate, although we hope that the Governors will, at their June Board Meeting, approve the Commission's recommended rate reduction without awaiting a further action by the Commission in this proceeding.

We are also pleased that Standard (A) Parcels will be eligible for the Service's delivery confirmation service that is presently offered to Standard (B) Parcels.

However, as our testimony elsewhere points out we believe there is a fundamental problem with charging for a service which should be an automatic feature of all package handling by the Postal Service.

V. PROPOSALS FOR STANDARD (A) PARCELS.

Our members are very substantial users of the Standard (A) Parcel service. Of course, the Postal Service has not segregated Standard (A) Parcels into a subclass; nor have they even segregated those parcels into a rate category. Standard (A) Parcels are simply one component of four different rate categories of non-letter size Standard (A) Mail. Notwithstanding the fact that this kind of mail is neither a subclass nor a rate category, the Postal Service has once again singled it out for exceptional treatment by increasing the surcharge on it by 80% over the initial surcharge imposed in Docket R97-1.

The Service, however, proposes several things that do make some sense with respect to Standard (A) Parcels: they propose that they be eligible for the same 3¢ discount Standard (B) Parcels get if a bar code is applied; they propose that, for a fee that will greatly increase the cost of the service, delivery confirmation will be available; and they propose that these parcels can be commingled with Standard (B) Parcels, and pay the Standard (B) rate.

Having said that, however, we object once again to the fact that the Postal Service has blended into one category, both for surcharge purposes and for cost purposes, four separate subclasses of mail: Bulk Regular Standard (A) Irregular Shapes; Bulk Non-Profit Irregular Shapes; ECR Standard (A) Irregular Shapes; and Non-Profit ECR Standard (A) Irregular Shapes. What we find particularly troubling is that the Postal Service has taken a tiny piece of four different subclasses of mail, put them together, and proposes to affix a rate affect upon them as if they were one singular, recognized category of mail. Taken separately, none of these are either a separately recognized rate subclass or rate category, being merely a part of a rate category of a subclass. Why has the Postal Service done this? Have the users of the four various subclasses to which these pieces of mail belong complained that within their subclass there are irregular shaped pieces that cause disproportionate incurrence of costs? Absolutely not. The USPS has produced no evidence in this proceeding nor in any prior proceeding of complaints by postal customers who felt they were adversely impacted by the failure to separately rate this kind of mail.

Presumably the revenues collected from the surcharge on this type of mail mean that mailers in the various four Standard (A) subclasses who send flat shape mail will benefit by having a lower rate for their Standard (A) pieces. The members of our Association are those mailers. We are both the mailers of Standard (A) Regular flat pieces as well as the Irregular Shape pieces. Our members do not believe that this surcharge has helped them. Nor have they ever complained about the supposedly higher parcel costs either to the Postal Service or in a rate proceeding. We strongly disapprove of what we regard as a subversion of the Postal Reorganization Act and its classification structure. The Act did not contemplate that the Postal Service would skim through a very elaborate structure of classes, subclasses and rate categories to pick out isolated pieces of these variegated categories and put them together for purposes of a rate action, without ever having gone through the statutory steps of creating a separate rate category, let alone a separate subclass.

Another aspect of the obfuscation practiced by the Postal Service with respect to these parcels, parcels that belong to four different subclasses, and four different rate categories within those subclasses, is the deliberate avoidance of comparing the amount of revenue per piece contributed by these pieces versus flat shaped pieces, but constantly emphasizing the cost differences between parcel shaped pieces and non-parcel shaped pieces.

USPS witness Crum (page 10) combined all four subclasses of Standard Mail A to find that parcels cost 78¢ per piece versus 12.2¢ per piece for flats, or a 65.8¢ difference. To extrapolate to the Test Year he multiplied the wage adjustment factor of 1.124, producing a Test Year parcel cost of 87.67¢. Allowing for the deeper drop-shipment of Standard (A) flats and their finer presortation, he then reduced the cost by 8.5¢, to a cost of 79.17¢ for parcels versus a cost of 13.712¢ for flats, yielding a cost difference for the two categories of 65.5¢ in the Test Year. The revenue for a regular parcel-shaped piece in FY 1998 was 47.8¢. (Tr. Vol. 8, p. 3425) The Postal Service was unable to produce parcel revenues and costs for the regular subclass in the Test Year After Rates because they stated that the data were not available. (Tr. Vol. 10, p. 3936) If one applies the Standard (A) regular proposed increase of 9.4%, that would produce an additional revenue per piece of 4.5¢ for a total revenue per piece in the Test Year of 52.3¢. If the 18¢ proposed surcharge is added to the 52.3¢, it will be seen that the Standard (A) Regular Parcel revenue per piece would be 70.8¢.

The regular flat revenue in 1998 was 23.4¢ per piece. If we apply the same 9.4% increase to flats, that averages an additional 2.12¢ per piece for a total of 25.6¢ per piece. Thus, while the Postal Service may wish to emphasize the fact that, as they say, a parcel will cost 65¢ more than a flat to process in the Test Year, a reasonable estimate (since the Postal Service says they do not have the data to produce a real one) of revenue per piece in the Test Year for a parcel will be 70.8¢, 45.2¢ more than a Standard (A) flat. Thus, while there is a 65.46¢ cost difference, there is also in the opposite direction a 45.2¢ (est.) revenue difference. While this does not put parcels and flats in Standard (A) on an exactly even keel, it certainly dispels the impression the Service's testimony seeks to create that there is this huge difference between parcels and flats; the difference is small and the remedy, an 80% increase in the surcharge, is large.

We point out the fragility of the Postal Service's cost estimates. The Postal Service cannot reconcile the absurd finding that a non-profit ECR parcel costs three times as much as a regular parcel to process. (Tr. Vol. 8, p. 3425) Manifestly, the smaller the sample size the less reliable and credible the data. The Postal Service counters by claiming that the data on parcels and flats has been consistent from year to year, and yet the Table that the Postal Service supplied to support that contention shows the exact opposite to be the case. That data shows that Standard (A) parcels cost 52¢ per piece in FY 1993, 57¢ in 1994, 54¢ in 1995 and back to 52¢ in 1996. While there is some suspicion to numbers which go up and then go down as inflation increases, there is some relative constancy of these parcel costs. However, in the Base Year 1998, the parcel costs go from 51.6¢ in Base Year 1996 to 78¢ in Base Year 1998, a 26.4¢ increase, an increase of over 51% in two years. USPS witness Crum was unable to reconcile why the Standard (A) parcel regular costs had jumped 50%. (Tr.

Vol. 8, pp. 3501-4) That is hardly calculated to instill confidence in the Postal Service's cost numbers for Standard (A) parcels.

USPS witness Moeller pointed out that, for FY 1998, since the cost of a parcel is 77¢, and the revenue without a surcharge is 48¢, the parcel fails to cover its costs by 29¢, and even with an 18¢ surcharge still fails to cover its costs by 9¢. Stated differently, if it were a subclass it would have, with the 18¢ surcharge, cost coverage of 83% [64¢ ÷ 77¢ = .83]. Of course, that means that it is still not covering its costs; however, Standard (A) parcels is not a subclass; it is not even a rate category. There is no requirement that it covers its costs, even if the Postal Service's cost numbers had greater credibility. It puts the matter much more in perspective to point out that Standard (A) parcels would have 83% cost coverage as opposed to the false image created by the Postal Service when it insists on emphasizing that it is passing through only 27.5% of the cost differences between flats and parcels, implying that there is a failure to cover costs by that margin. (Tr. Vol. 10, p. 3935)

VI. DELIVERY CONFIRMATION.

The Postal Service proposes to continue the delivery confirmation charge of 25¢ per transaction for an electronic manifest mailer using Parcel Select, and also to extend that service, at 25¢ per transaction, to Standard (A) parcels. This is a greatly underutilized service by our members and, based on the numbers, by all Standard (B) parcel mailers.

For Priority Mail users with electronic manifest, the cost of delivery confirmation is free, implying that the costs, such as they are, are baked into the Priority Mail costs. Since this is a standard service for Priority Mail, presumably the equipment costs have already been incurred and we are simply talking about a question of utilization of that equipment plus whatever added variable labor costs that may be involved in order to scan and transmit.

As reported in the Federal Times, USPS Manager of Information Systems and Expedited Package Services, Julie Rios, briefed the Postal Board of Governors on the delivery confirmation service. According to her it generated $170 million in new revenue in its first year of use. However, only $30 million of that was generated by the fees that were charged. The other $140 million was generated because the Service estimates that it attracted that much new Priority Mail business by offering the service, a service which is free for Priority Mail users. (Federal Times, May 15, 2000) Perhaps it might occur to the Postal Service that, if they offered this confirmation service free to Standard (B) parcel shippers, it might also attract additional volume and revenue from that source.

There should be no charge to an electronic manifest Parcel Select mailer. That mailer's reduced rates are predicated on the work sharing performed by that mailer. It is very short-sighted for the Postal Service to selectively decide what kind of parcels they will maintain information about. Moreover, there is a real question whether this should be standard operating procedure for the Postal Service internally to know what is going on, as well as a service to its customers. The competition, specifically UPS, tracks every parcel; knows where it is at every stage of its processing; and is able and to so inform its customers upon inquiry. The Postal Service, by failing to match this level of service, is simply further handicapping itself in its losing battle with its competitors.

VII. DROP SHIP DISCOUNTS – DBMC, DSCF AND DDU.

The Postal Service effectively proposes no increases for the Parcel Select, DSCF and DDU rate categories. Because these new rates were not introduced until the second quarter of Fiscal Year 1999, there is too little data to make a judgment as to whether the discounts, which are not proposed to be increased, are adequate to create the necessary incentives for mailers to do the considerable work and/or consolidating necessary to meet the volume and preparation requirements to be eligible for these discounts.

For most of the DBMC rate cells there are increases of some dimension, ranging from pennies up to 8%. Generally, heavier parcels, those over 20 pounds, or parcels going to the further zones are proposed to have 8% increases.

As my testimony will later develop, it is our position that the Postal Service proposed coverage for the Parcel Post subclass is excessive, and, because the increases in Docket R97-1 were premised upon incorrect data, resulting in much higher increases than would have occurred were the true data available, the base from which rate adjustments in this case are made is much higher than would have been the case otherwise. Consequently, we urge the Commission to reject all increases for DBMC, and recommend larger increases in the DSCF and DDU discounts. It is in these drop ship categories that the Postal Service has experienced growth and for which there is the greatest promise to make the Postal Service a competitive factor in the parcel delivery business.

The Postal Service hourly wage rates for clerks and mail handlers for Fiscal Years 1998 through the Test Year Before and After Rates show an increase of 4.09% in

FY 1999, 4.07% in FY 2000, and an estimate of about 3.8% Before and After Rates in the Test Year. (LR-127, Chapter VIIIe, pp. 440-1) These wage increases, well in excess of the rate of inflation in the general economy, demonstrate the importance of avoiding labor intensive postal operations through drop ship rate categories such as DBMC, DSCF, and DDU.

It is also our position that the Postal Service has understated the amount of cost avoidance in DSCF and DDU because USPS witness Eggleston failed to apply the normal CRA adjustment factor for Parcel Post, even though as she elsewhere testified: "Not using some sort of CRA adjustment factors in the estimated mail processing costs would severely underestimate costs." (Tr. Vol. 13, pp. 5109-10) It seems obvious to us that, just as failing to make the CRA adjustment would understate parcel costs, it will also have the effect of understating the amount of costs that are avoided through drop shipping. The Postal Service's position is that the CRA adjustment should not be made to modeled costs for a new subclass of mail but only be applied to well-established subclasses. Apparently the justification is that, with a new subclass, the data is sufficiently sparse so that it creates the possibility of error or rather the possibility of overstating the amount of cost avoidance. While that may be true it seems to us that to fail to make the adjustment far more likely guarantees that the amount of cost avoidance will be underestimated.

USPS witness Daniel, who used Ms. Eggleston's cost models for DDU and DSCF realized that she did have to make a CRA adjustment to witness Eggleston's cost model in order to get the correct total of Parcel Post costs. (LR-I-98, p. 15) Had not witness Daniel applied the CRA adjustment to Ms. Eggleston's modeled costs for DSCF and DDU, the costs for those rate categories would have been overstated due to an understatement of the cost avoidance, and that, in turn, would have led to an overstatement of Parcel Post costs.

The same reasons that led witness Daniel to apply the CRA adjustment to Ms. Eggleston's modeled cost avoidances for DSCF and DDU should have also led Ms. Eggleston herself to make that adjustment. While USPS witness Daniel effectively did incorporate the CRA adjustment factors in her analysis of Parcel Post costs, including DSCF and DDU costs, witness Eggleston did not make the adjustments to her cost models for the purpose of rate design. Consequently, when witness Plunkett designed the rates for DSCF and DDU he was using a pass through of cost avoidance that had not been adjusted by the CRA adjustment factor, potentially resulting in an understatement of the cost avoidance. To compound the matter, witness Plunkett testified that he, presumably in an exercise of conservatism, constrained the DSCF and DDU rates so that the effective pass through of witness Eggleston's modeled cost avoidances was 80%. The correct method to employ conservatism for a new rate category is to do exactly what witness Plunkett did, that is, exercise conservatism in the rate design. However, witness Plunkett's conservatism was improperly employed because he was making a conservative calculation on numbers that had already been understated because of witness Eggleston's conservatism. The net result of this doubling is that the Postal Service is proposing DSCF and DDU rates that fail by as much as 25% to fully reflect the amount of costs avoided by those two rate categories. (Tr. Vol. 13, p. 5009)

VIII. PARCEL POST COST COVERAGE.

As the Commission is well aware, the Postal Service revised its data collection methodology for Parcel Post subsequent to Docket R97-1. It is important to review just how staggering the Postal Service's data errors were. In Docket R97-1 the FY 1997 CRA reported there were 236 million parcels; whereas, the restated FY 1997, using the RPW methodology, is shown to be 291.65 million pieces. (USPST-6, Chart H, p. 153)

More importantly, the FY 1998 Test Year in Docket R97-1 projected total parcels of 266.5 million and revenues of $823.6 million. In fact, using the new RPW system the pieces were 316,148,000, almost 50 million pieces more than were projected in the case; and revenues were $947.9 million, $124.3 million more than projected. The costs as reported were correct, $862,300,000. (WitnessTolley revised the number in his testimony to show that 1998 pieces were actually 319.99 million (USPS-T-6, Chart 4, p. 154).)

Using the Postal Service's data the Postal Rate Commission found that Parcel Post, Before Rates, utilizing Postal Service costing methodology had a 96.8% coverage, whereas utilizing its own costing methodology, which excluded Alaska costs, parcel coverage was 98%. In fact, using the corrected data from the RPW system, the Before Rates coverage for Parcel Post in the Test Year 1998 was 122%, using Postal Service methodology excluding Alaska costs, and 112.4% coverage utilizing Postal Rate Commission costing methodology. Thus, with no rate increase whatsoever Parcel Post had 3.4% higher coverage than the Postal Rate Commission, utilizing its costing methodology, recommended for Parcel Post. Thus, the Postal Rate Commission could have recommended zero increases for Parcel Post in Docket R97-1 and still have exceeded their recommended coverage by 3.4%. (Tr. Vol. 11, pp. 4380-81) Moreover, had the Postal Rate Commission's 12.3% rate increase been implemented during the Test Year, the cost coverage for Parcel Post would have been 126.2%. (Tr. Vol. 11, p. 4380)

The Postal Service proposal for a 115.1% cost coverage, produced by a 1.3% overall price increase, is a coverage the Postal Service would never have proposed had they not erred so colossaly in Docket R97-1 in underestimating both revenues and volume for Parcel Post, producing a rate increase that was five times the system-wide average increase. The math is quite simple: had the Postal Service provided the correct data for Parcel Post in the last rate case, the cost coverages sought by both the Postal Service and the Postal Rate Commission would have been met with no rate increase whatsoever. Assuming, however, that the Commission would have recommended at least the system-wide average increase for Parcel Post, 2.5%, which would have still produced higher cost coverage than in fact the Commission recommended, then in this proceeding, a system-wide average price increase of 6.4% for Parcel Post (the second most price sensitive of all categories of mail according to the Postal Service) would produce cumulative increases from Docket R97-1 and the current Docket of 2-1/2% plus 6.4%, which would be an 8.9% increase. Because Parcel Post was increased on the basis of false estimates in Docket R97-1, thereby incurring a 12.5% increase, it would require a 4% reduction in Parcel Post rates across-the-board in order to produce the rate levels that would obtain if Parcel Post, the second most price sensitive class of mail, were to have received the average system-wide rate increase in Docket R97-1 and as proposed by the Postal Service in the current Docket.

(As we have elsewhere noted, the Postal Rate Commission should not recommend increases that will total 6.4% because that is at least $1 billion more than the Postal Service can justify.)

Had the true facts been known it is most certainly the case that the Postal Service would not have proposed increases larger than the system-wide average for a subclass of mail that USPS witness Mayes categorizes as; "low intrinsic value of service; lower delivery priority; not good security and delivery; lack of free service such as insurance, tracking, etc.; and an-own-price elasticity above 1.0, indicating a low economic value of service." (T32 pp. 40-41)

It is a historical fact, although not necessarily a cause and effect relationship, that the highest cost coverages for Parcel Post, since the first rate case, Docket R71-1, coincided with the very steep decline in Parcel Post volume, a decline of over two-thirds of its volume. It is also historically the fact that the rejuvenation of Parcel Post and the increase in its volumes, by almost 100%, occurred since the Docket R90-1 rate case when the cost coverages in Dockets R94-1 and R97-1 were the lowest.

Library Reference H-117 describes the history of Parcel Post volume declines, and it shows that volume declined steadily between 1970 and 1990, and at its low point Parcel Post volume in 1989 was only 21% of the 1970 volume.

It should not be surprising that volume decreases and increases very much track high and low cost coverages for Parcel Post since Parcel Post is the second most price elastic category of mail. (USPS T-32, p. 40)

It is painfully evident that the Postal Service's recommended coverage of 115.1% is a mere accident of how the rates came out. USPS witness Mayes' initial recommendation was for 114% cost coverage, because she thought that was what witness Plunkett's rates produced. When informed that she was mistaken about that, and that in fact witness Plunkett's rates produced a 115.1% cost coverage, witness Mayes promptly changed her testimony to say that she was recommending 115.1%, rather than 114%. In other words, her coverage recommendation was whatever the rates happened to be.

IX. CONCLUSION.

The Postal Service has not in any way justified or explained why it is recommending 115.1% coverage. It is perfectly obvious that the coverage is a function of two things: it happens to fit the rates that witness Plunkett designed; and, more importantly, a more appropriate cost coverage would have required the Postal Service to request a reduction in Parcel Post rates. That is exactly what the Postal Service should have proposed in this case. The fact is that the Test Year Before Rates cost coverage for Parcel Post is estimated to be greater than the Postal Rate Commission proposed in Docket R97-1, using the PRC cost methodology. The PRC should recommend what USPS should have proposed: no increases across-the-board, and increased discounts for Drop Ship rate categories.

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.

Timothy J. May

Dated: May 22, 2000