UNITED STATES OF AMERICA
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners: Edward J. Gleiman, Chairman;
George A. Omas, Vice Chairman;
Dana B. Covington; Ruth Y. Goldway;
and W.H. "Trey" LeBlanc III

Postal Rate and Fee Changes Docket No. R2000-1

NOTICE OF INQUIRY NO. 3
FIRST-CLASS REVENUE ADJUSTMENT FACTOR (RAF) ERROR AND ADDITIONAL OUNCE METHOD CHANGE

(Issued June 30, 2000)

Participants are requested to consider the test year forecast of additional ounces for First-Class letters. On April 17, 2000, the Postal Service filed errata to the testimony and workpapers of witness Fronk (USPS-T-33) to incorporate changes described in the response to interrogatory OCA/USPS-106(d), filed on the same date. Interrogatory OCA/USPS-106(d) asked the Postal Service to identify how net overpayment of First-Class postage was included in the Postal Service's test year revenue calculations.

In its response, the Postal Service acknowledged that, because the base year additional ounce revenue no longer includes the net overpayment of postage, witness Fronk had erred by not applying revenue adjustment factors (RAFs) to First-Class Mail revenue calculated using the billing determinants. As explained in the first part of the response, the application of revenue adjustment factors is necessary to reconcile the billing determinant calculated revenue with the postage revenue in the Revenue, Pieces, and Weight (RPW) report.[1]

[1] During cross-examination, OCA requested and received a brief explanation from witness Fronk of why the RAF is now necessary (Transcript at 4901-2).

The response goes on to state that witness Fronk is also making a second change to his revenue calculations. He is changing the method used to calculate the volume of single-piece additional ounces in the test year. Where the initial forecast allowed the ratio of single-piece additional ounces per piece to rise between the base year and the test year, his revised method holds that ratio constant from year to year.

The net effect of the two changes is the addition of $47 million in net revenue in the test year. However, further analysis reveals that each of the changes has a more significant, but mutually offsetting impact on test year net revenue. Test year net revenue is increased $219 million by the application of revenue adjustment factors, and reduced $172 million by the change in the forecast of additional ounces. Table 1 presents the effects of each of the two changes.

Table 1. Impact on First-Class Revenue and Cost of Witness Fronk Revisions ($ Millions)

	Application of RAFs	Change in Add'l Oz. Forecast	Net Effect of Fronk Revisions 1/
	(1)	(2)	(3)=(1)+(2)
TYAR Revenue Change:			
Single-Piece Letters	192.3	(283.5)	(91.2)
Presort Letters	(1.1)		(1.1)
Automation Letters	27.0		27.0
Single-Piece Cards	1.2		1.2
Total Revenue Change	219.4	(283.5)	(64.1)
TYAR Cost Change:			
Single-Piece Letters		(111.3)	(111.3)
Net Surplus (Loss)	**219.4**	**(172.2)**	**47.2**

1/ Except for the $1.2 million change in cards revenue, the numbers in column (3) are also presented at the end of USPS Response to OCA/USPS-106(d). Witness Fronk did not calculate the $1.2 million change in cards revenue because the RAFs for "cards subclass have *de minimis* impact" on First-Class revenue (see response to OCA/USPS-106(d).)

Because the billing determinants for the base year reflect a physical measure of additional ounces, there remains a portion of RPW revenue (primarily net overpaid postage) that is unaccounted for in witness Fronk's workpapers as initially filed.

Therefore, the addition of the previously omitted revenue adjustment factors by witness Fronk appears to be a necessary correction.

However, the revised calculation of the number of single-piece additional ounces in the test year reflects a change from the initial or "as-filed" forecasting method, as opposed to a simple error correction. Initially, witness Fronk's forecast employs a method developed by witness Thress, whereby the ratio of single-piece additional ounces per piece increases between the base year and the test year. This is accomplished by first calculating a base year ratio of additional ounces per piece for both presort letters and the letter subclass as a whole. Next, the base year ratios are applied to the test year volumes of presort and total letters. Finally, single-piece additional ounces are calculated for the test year as the difference between total additional ounces and presort additional ounces.[2] In contrast, the revised forecasting method estimates test year single-piece additional ounces by applying the ratio of single-piece additional ounces per piece from the base year to test year single-piece volume.[3]

The Postal Service explains in the response that the initial forecasting method was designed to reflect the migration of single-piece mail to the workshare category in response to rate incentives. "If the pieces migrating from single-piece to workshare were typical of existing workshare mail pieces, the migrating pieces would be lighter than the average piece of single piece mail. The average weight of the remaining single-piece mail would increase." (response at 3rd unnumbered page).

Attachment 1 is a chart of the historical average weight per piece for First-Class single-piece, presort, and all letters going back to FY 1972.[4] It shows that while the average weight of presort mail has basically remained constant, the average weight of single-piece mail has seen continuous growth, increasing from 0.543 ounces in FY 1972 to 0.786 ounces in FY 1999. It also shows that the average weight of total First-Class letters has been steadily increasing since 1972. Both of these trends are also visible in

[2] For a presentation of the initial USPS method, see USPS-T-7, Workpaper 4, and LR-I-122.
[3] As explained in the response, there are two classification changes between the base year and test year which complicate the calculations: the change in the maximum weight for First-Class Mail, and the elimination of Standard (A) single piece. The treatment of these changes is the same in both the initial and the revised forecasts. The revisions affect only the 0-11 ounce weight range.

Attachment 2, which breaks down the weight data by quarter for the past 10 years, including the first three quarters of FY 2000.

Attachment 3 is a table of the 10-year history of additional ounces per piece for First-Class single-piece letters, workshared letters, and total First-Class letters.[5] For each category, the initial and revised forecasts for FY 2000 and 2001 are provided for comparison. Although this measure contained net overpayment of postage until FY 1997, it still provides insight into the growth of additional ounces per piece. Attachments 4 and 5 are graphical representations of the single-piece and total letters data, respectively.

The long-term upward trend in both the weight and additional ounces per piece of single-piece lend support to the reasoning behind the Postal Service's initial forecasting method. Also, the initial method assumes that additional ounces per piece for the subclass as a whole remain constant from the base year to the test year. In light of the historical upward trend in average weight for the subclass, this assumption makes the initial forecast conservative.

The Postal Service states that it revised the forecasting method because "newly available 1999 data...indicate that the additional ounces per piece in th(e) 0-11 ounce weight range have remained almost constant between 1998 and 1999." (response at 3rd - 4th unnumbered pages). The Postal Service suggests that this may be because of new mail entering both the single-piece and presort mail streams. However, the Postal Service's response does not offer an explanation supporting its premise that the long-term upward trend in weight per piece has ended.

The central issue for evaluating the forecasting methods is the significance of the newly available data. If there has been a fundamental change and the average weight of 0-11 ounce single-piece letters has ceased its upward climb, then the revised forecasting method better reflects this new reality. On the other hand, if the recent data is anomalous, reflecting either unexplained variation around the long-term trend or the one-time effects of increasing the maximum weight allowance, then the initial forecasting method more accurately projects a continuation of the trend.

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[4] The charts are imbedded in the electronic version of this document, which is available on the commission's website at www.prc.gov. This has been done to allow access to the underlying data.
[5] Attachments 3, 4 and 5 reflect 0-11 ounce pieces only.

Participants are requested to consider the relative merit of the initial and revised methods of forecasting additional ounces in the test year, and provide comments or testimony on this issue by July 17, 2000. Any testimony submitted on this topic will be received at a hearing on July 21, 2000.

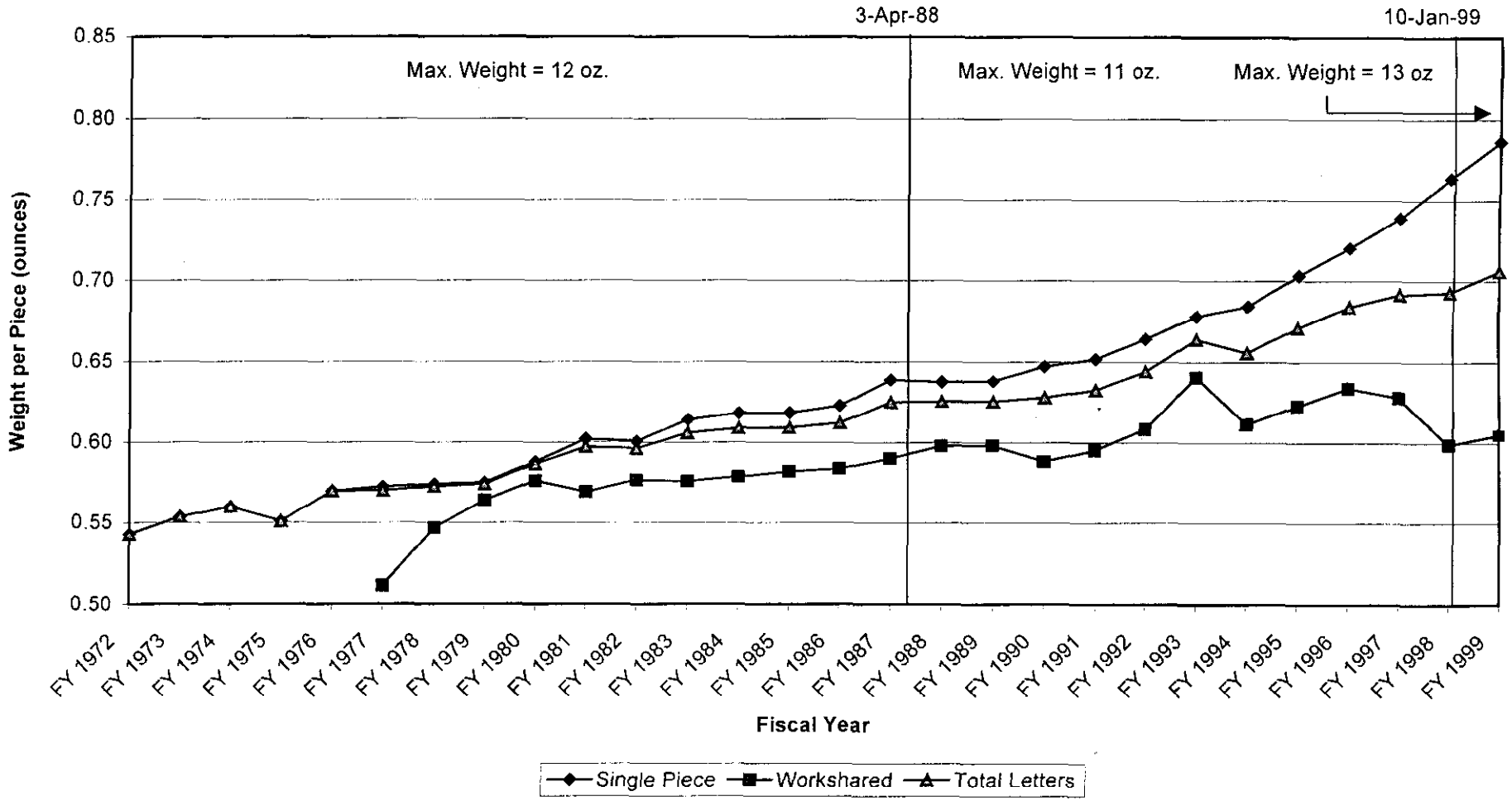
By the Commission.

(SEAL)

Margaret P. Crenshaw

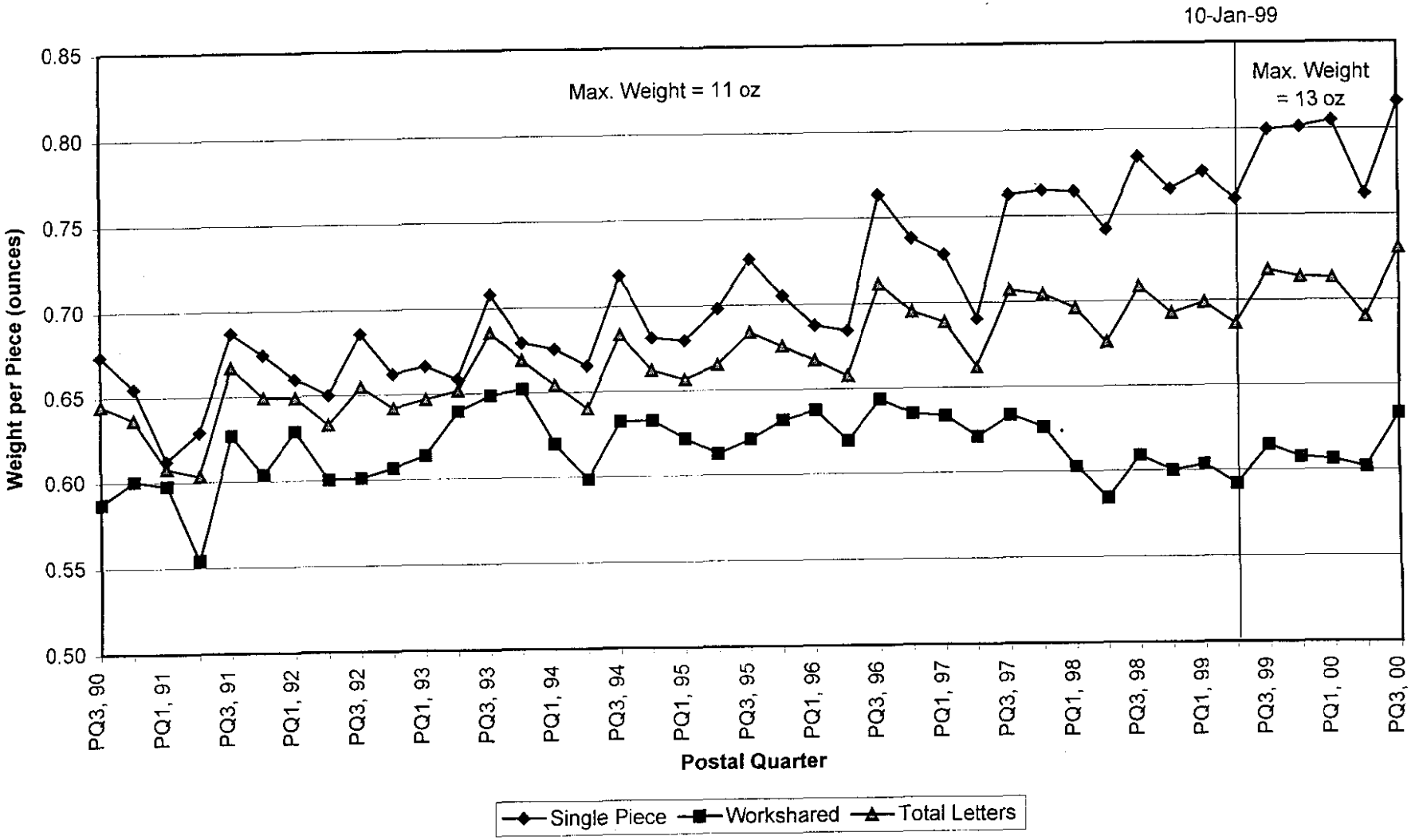
Margaret P. Crenshaw
Secretary

Annual Weight per Piece
First-Class Letters
(Source: USPS Revenue, Pieces, and Weight Report)



Attachment 2

Quarterly Weight per Piece
First-Class Letters
(Source: USPS Revenue, Pieces, and Weight Report)



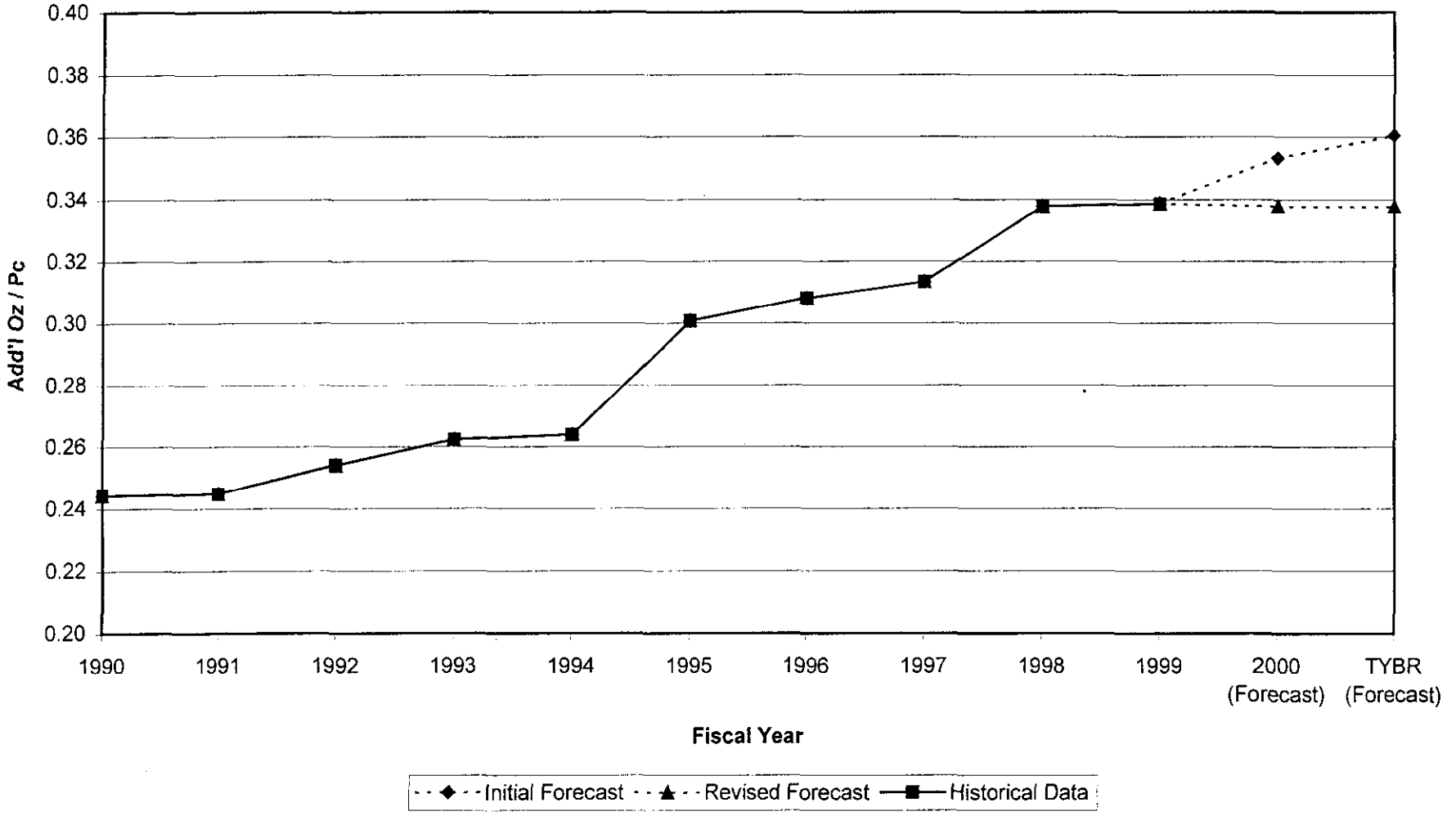
Attachment 3

Additional Ounces per Piece
Comparison of Historical with Initial and Revised Forecast Data
0-11 Ounce Letters (Forecasts Exclude Migrating Mail)

	Initial Forecast & Historical Data (Forecast in Box) Add'l Oz/Pc	Annual Percent Change	Revised Forecas & Historical Data (Forecast in Box Add'l Oz/Pc	Annual Percent Change
Single Piece:				
1990	0.2443		0.2443	
1991	0.2448	0.2%	0.2448	0.2%
1992	0.2541	3.8%	0.2541	3.8%
1993	0.2622	3.2%	0.2622	3.2%
1994	0.2639	0.6%	0.2639	0.6%
1995	0.3007	13.9%	0.3007	13.9%
1996	0.3081	2.5%	0.3081	2.5%
1997	0.3134	1.7%	0.3134	1.7%
1998	0.3378	7.8%	0.3378	7.8%
1999	0.3386	0.2%	0.3386	0.2%
2000 (Forecast)	0.3532	4.3%	0.3378	-0.2%
TYBR (Forecast)	0.3604	2.0%	0.3378	0.0%
	Add'l Oz/Pc		Add'l Oz/Pc	
Workshared:				
1990	0.0749		0.0749	
1991	0.0741	-1.1%	0.0741	-1.1%
1992	0.0793	6.9%	0.0793	6.9%
1993	0.0851	7.4%	0.0851	7.4%
1994	0.0851	0.0%	0.0851	0.0%
1995	0.0524	-38.4%	0.0524	-38.4%
1996	0.0495	-5.5%	0.0495	-5.5%
1997	0.0545	10.0%	0.0545	10.0%
1998	0.0561	3.0%	0.0561	3.0%
1999	0.0577	2.9%	0.0577	2.9%
2000 (Forecast)	0.0561	-2.8%	0.0561	-2.8%
TYBR (Forecast)	0.0561	0.0%	0.0561	0.0%
	Add'l Oz/Pc		Add'l Oz/Pc	
Total 1st Class Letters:				
1990	0.1889		0.1889	
1991	0.1871	-1.0%	0.1871	-1.0%
1992	0.1908	2.0%	0.1908	2.0%
1993	0.1964	3.0%	0.1964	3.0%
1994	0.1944	-1.0%	0.1944	-1.0%
1995	0.2017	3.8%	0.2017	3.8%
1996	0.1997	-1.0%	0.1997	-1.0%
1997	0.2034	1.8%	0.2034	1.8%
1998	0.2172	6.8%	0.2172	6.8%
1999	0.2140	-1.5%	0.2140	-1.5%
2000 (Forecast)	0.2172	1.5%	0.2089	-2.4%
TYBR (Forecast)	0.2172	0.0%	0.2053	-1.7%

Sources: FY 1990-1998 - USPS Billing Determinants
FY 1999 - Attch. to OCA/USPS-T33-13(f), and Attch. to Response to POIR 13/Question 8
FY 2000-2001 - USPS-T-7, Workpaper 4, & LR-I-122 (Initial Forecast);
and USPS-T-33, Workpaper, Revised 4/17/00 (Revised Forecast)

Additional Ounces per Piece
First-Class Single-Piece Letters, 0-11 Ounces



Additional Ounces per Piece
Total First-Class Letters, 0-11 Ounces