

UNITED STATES OF AMERICA
POSTAL RATE COMMISSION

Before:

Chairman Gleiman, Vice Chairman Omas,
Commissioners Covington, Goldway, and LeBlanc

Postal Rate and Fee Changes, 2000

Docket No. R2000-1

OPINION
AND
RECOMMENDED DECISION
VOLUME 1



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RECOMMENDED DECISION

CONCURRING OPINION OF CHAIRMAN GLEIMAN
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TECHNICAL APPENDICES

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SUMMARY

In January, 2000, the Postal Service requested a general rate increase designed to raise \$2.788 billion per year. This request generated an unprecedented amount of opposition from mailer groups that questioned whether the Service accurately identified its revenue needs. The Postal Rate Commission reviewed both the detailed documentation provided by the Postal Service in support of its request, and the extensive evidence submitted by mail users. The Commission concludes that while the Postal Service does need additional rate revenues, some of the rate increases it sought were excessive.

The most important rate, in terms of postage revenue, is the single piece First-Class rate. The Postal Service asks to increase this rate from 33 cents to 34 cents. The Commission recommends this increase, which by itself will generate approximately \$1 billion. However, in order to assure that First-Class does not bear an unreasonably large share of the increase, other rates paid by ordinary citizens and small businesses, such as the postcard rate of 20 cents, and the extra ounce rate applicable to First-Class weighing more than one ounce, will not be increased. In fact, the Commission recommends that the extra ounce rate be reduced from 22 cents to 21 cents.

In this case a consortium of business mailer organizations and large individual business mail users presented wide ranging evidence that persuaded the Commission that some Postal Service expense projections were too high. As a result, the Commission recommends smaller increases for periodicals and other categories of bulk mail than the Postal Service originally requested.

The following table compares the rate increases recommended by the Commission with the increases proposed by the Postal Service.

Average Percent Rate Change

	USPS Proposed	PRC Recommended
First-Class Mail:		
Letters	3.5%	1.8%
Cards	5.2%	0.4%
Priority Mail	15.0%	16.0%
Express Mail	3.9%	3.6%
Periodicals:		
Within County	8.6%	6.8%
Regular Rate	14.2%	9.9%
Nonprofit	15.2%*	7.2%
Classroom	11.3%*	9.6%
Standard Mail:		
Regular Other	9.4%	8.8%
Regular ECR	4.9%	4.5%
Nonprofit Other	6.6%*	4.8%
Nonprofit ECR	41.9%*	18.3%
Package Services:		
Parcel Post	2.7%	2.7%
Bound Printed Matter	17.5%	17.6%
Media Mail	5.0%	6.3%
Library Rate	5.0%*	4.9%
Special Services:		
Certified Mail	50.0%	35.7%
Money Orders	8.3%	(4.1)%
Lock Boxes	9.0%	9.0%
Systemwide	6.0%	4.6%

* Estimated increase had 39 U.S.C. § 3626(a) formula not been amended by legislation enacted October 27, 2000.

The Commission's decision reflects several initiatives that warrant special mention. Although the Service filed the request in January, 2000, it based cost projections on fiscal year 1998 data. The Commission immediately asked participants whether fiscal year 1999 data should be substituted. There was broad agreement that projections would be more accurate if more recent data could be used. At the Commission's direction, the Postal Service successfully completed a basic update of its cost projections

that incorporated 1999 data while the case was in progress. Participants had an opportunity to offer supplementary evidence adjusting their presentations for this more recent data.

The use of actual 1999 costs had a number of salutary effects. The recommended rates reflect more recent actual operating results, and thus are fairer to both mailers and affected private businesses. Additionally, the update provided the Postal Service with the opportunity to correct earlier longer-range projections, identifying both underestimates and overestimates. The Service acknowledged that it should experience lower costs to process flat-shaped mail than it initially projected. The rates recommended by the Commission reflect these reductions. The Service also identified several recent events, such as increasing fuel prices, that should increase its overall revenue needs. The rates recommended by the Commission also take account of these cost increases.

One aspect of the rate request that generated substantial opposition was the claim that the Postal Service needed \$1.680 billion of additional revenue as a cushion against unforeseen events. The statute allows the Postal Service a reasonable provision for contingencies; however, many parties presented evidence that a sum of this size was not reasonable under current circumstances. The Commission has reduced the contingency amount, in part because it has been able to improve the reliability of Postal Service projections through the incorporation of more recent, up-to-date projections and actual cost data. The Commission lowered the contingency provision by \$.668 billion.

Another focus of concern was the high rate increases that would fall on mail sent by nonprofit organizations. These increases largely resulted from a statutory formula imposed in 1993. Efforts to amend this law were successfully completed with the signing by the President of new legislation on October 27, 2000. As a result of this legislation, the Commission applied a new formula to calculate rates for so-called preferred mail, reducing the increases that these mailers must pay. These differences are identified with an asterisk on the preceding table showing Average Percent Rate Changes.

The Commission believes that several issues raised during the case warrant Postal Service attention in the months ahead. The accuracy of the Service's data reporting systems is a major source of concern. Two subsystems of the Revenue, Pieces and Weight system produced markedly different Parcel Post volume estimates for the base year of this proceeding. In addition, data collection errors in the In-Office Cost System forced the Postal Service to substantially revise the costs of Media Mail (formerly the book rate). The Commission worries that these errors due to problems other than statistical variation in the basic data collection systems might not be isolated events. The Governors are urged to launch a study of "nonsample" error in the Service's data systems to complement the recent, joint (USPS/GAO/PRC) Data Quality Study that focused on potential sources of statistical error.

The Office of the Consumer Advocate suggested a number of ways to ease the inconvenience and expense associated with frequent adjustments of the rate used for sending correspondence and bill payments. These ideas merit consideration from postal management and consumer groups interested in exploring ways to make the nation's mails more attractive for business and personal correspondence.

Another continuing area of concern is service quality. The Commission heard evidence on poor or uneven quality of service and confusing or misleading advertising for Priority Mail, Express Mail, Certified Mail and Return Receipt Service. These problems affect the value of these services, and the Commission encourages the Service to take appropriate action.

Finally, the Commission notes that the Service provided the basic update along with extensive supporting explanatory materials in a timely fashion; participated in a joint USPS-Periodicals Industry Operations Review Team, and reduced its projected costs to reflect that group's findings; and devised a resolution to a rate eligibility problem raised during the case by In-County Periodicals. The Commission commends the Postal Service for its diligence and cooperative efforts during the course of this case.

I. INTRODUCTION

[1001] On January 12, 2000 the United States Postal Service submitted its request for a recommended decision on changes in rates and fees, and for certain mail classification changes.¹ The Request was docketed as R2000-1, and noticed in Order No. 1279. The Commission heard the case *en banc*, with Chairman Edward J. Gleiman serving as presiding officer. The 78 participants sponsored 178 pieces of testimony from 120 witnesses that was received during 40 days of hearings.

[1002] The Postal Service supports its Request with testimony that projects its costs forward from fiscal year 1998 (base year), and estimates that at existing rates, it will suffer an operating loss in fiscal year 2001 (test year) of \$1.719 billion. It requests rates that will allow it to generate \$2.788 billion additional revenues, of which \$0.268 billion will go to offsetting 1/9 of its accumulated prior years losses, \$1.680 billion will be used as a contingency against unforeseen events/costs.

[1003] During this case, the Commission issued four Notices of Inquiry, asking any interested party to comment or provide evidence on a specific issue, and 21 Presiding Officer Information Requests asking a particular participant (most frequently the Postal Service) to provide explanations or analyses to clarify its evidence. In several instances the Commission went further, and it issued five orders that resulted in the Postal Service providing evidence on a specific topic.

[1004] Order No. 1289, Requesting the Submission of Evidence on Periodicals Processing Costs, was issued March 28, 2000. This order presented analyses developed from information provided in response to a Presiding Officer's Information Request showing that the costs of processing Periodicals mail, even after adjusting for inflation, had been steadily rising since 1993, and that the cost of processing flat shaped

¹ Request of the United States Postal Service for Changes in Rates of Postage and Fees for Postal Services (Request).

pieces sharply rose in base year 1998. The order directed the Postal Service to provide evidence explaining these phenomena. Witnesses O'Tormey and Unger presented testimony on these topics.

[1005] Order No. 1291, Directing Witnesses to be Prepared to Answer Questions, was issued on April 6, 2000. It directed Postal Service witnesses who would be appearing to present the Service's direct case the following week to be prepared to respond to questions concerning the impact on test year results of eBillPay, a major new service initiative not mentioned in the Service's Request, that was launched by the Postal Service April 5, 2000. During hearings, witness Tayman responded to questions on this subject.

[1006] On May 26, 2000 Order No. 1294 on the Use of FY 1999 Data was issued. This order followed two notices of inquiry. It directed the Service to present through testimony and exhibits a "basic update" to its test year forecasts that incorporated actual, audited FY 1999 Cost and Revenue Analysis (CRA) data into the cost projection process. The Postal Service complied with this order submitting testimony from witnesses Patelunas, Kay, and Thress. The ramifications of this order have been somewhat controversial, and its justification and impact are discussed in more detail shortly, beginning at para. 1009.

[1007] Order No. 1299, Resolving Procedural Issues Arising from Notice of Inquiry No. 3, was issued July 31, 2000. That notice of inquiry had requested testimony or comments on the proper methodology for projecting revenue from First-Class Mail weighing more than one ounce. The presiding officer certified to the full Commission arguments offered opposing the admission of responsive testimony, and Order No. 1299 denied those objections. As a result, testimony on this topic from Postal Service witness Fronk and OCA witness Callow is part of the evidentiary record in this case.

[1008] Finally, Order No. 1300, Requesting the Designation of a Witness to Discuss an Institutional Response, was issued August 18, 2000. The Postal Service had undertaken to provide written responses to questions concerning the causes of the increased cost of processing Standard B Special Mail between FY 1998 and FY 1999.

The questions were initially posed to witness Patelunas, who had been unable to answer while on the witness stand. Following a practice allowed by the Commission, the Service submitted an “institutional” response; that is, a statement from the institution, rather than from a witness already under oath and available to respond to further clarifying questions. In this instance, further clarification was needed, and the Service was directed to identify a witness that could sponsor the written responses and answer additional questions on the subject. The Postal Service then undertook a further review of this issue, and provided additional testimony from witness Degen on this topic.

[1009] *The use of actual FY 1999 cost data.* The most significant procedural issue in this case involves the use of updated cost information. The Commission Rules require Postal Service rate requests to provide projections based on “the total actual accrued costs during the most recent fiscal year for which they are reasonably available.” Rule 54(f)(1). FY 1999 had been over for almost four months when the Request was filed, and a significant amount of 1999 data was available. Nevertheless, consistent with Rule 54(c)(1), Postal Service estimates of test year costs were based on the costs incurred in fiscal year (FY) 1998, since its final audited 1999 CRA costs had not yet been issued.

[1010] The Commission has a long-standing practice of updating to capture known and certain changes that have a significant impact on test year results. Therefore, at the earliest stage of this case, even before the initial prehearing conference, the Commission focused attention on the potential problems of developing rates based on FY 1998 costs; costs representing a period ending some sixteen months before the Request was filed. Notice of Inquiry No. 1 Concerning Base Year Data, issued February 2, 2000 described these problems and announced that participants should be prepared to discuss this issue at the prehearing conference scheduled for February 16, 2000. Written comments could be submitted one week later, on February 23, 2000. The notice suggested that participants focus on the potential obsolescence of the FY 1998 data, especially in light of the implementation in FY 1999 of the new rates and classifications established in Docket No. R97-1. At the same time, it cautioned participants to bear in mind that

substituting actual FY 1999 results for the Service's estimates would be a complex, large scale undertaking.

[1011] The general tenor of both the oral and written comments provided in response to Notice of Inquiry No. 1 was that theoretically it would be preferable to estimate test year costs using actual FY 1999 CRA costs, rather than the estimates of FY 1999 costs based on projections from FY 1998 results used by the Service. However, many of those commenting suggested that it would be wise to wait until the actual results were published so that potential disruption could be balanced against the likelihood of improved results.

[1012] On April 4, 2000, the Postal Service filed its FY 1999 CRA Report and the supporting Cost Segments and Components Report as USPS-LR-I-275 and 276.² The Commission promptly issued Notice of Inquiry No. 2 Concerning Base Year Data which provided participants with comparisons of these actual FY1999 costs with the originally filed estimates of FY1999 costs based on FY1998 data. Notice of Inquiry No. 2 again asked participants to comment on the appropriate use of the actual FY 1999 cost data.

[1013] In Order No. 1294 the Commission reviewed both its own obligations under the law, and participants' comments in response to Notice of Inquiry No.2. It then determined that at least to some degree, it should use actual FY 1999 CRA results in developing this Opinion and Recommended Decision.

[1014] The Commission identified its two primary obligations: To identify and analyze the most reliable evidence so that it could accurately estimate the Postal Service's revenue needs and develop the most fair rates to generate those revenues; and to provide all interested persons the opportunity to fully and fairly participate in the ratemaking process. No participant argued that the Postal Service's initial filing should be adopted with no use of actual 1999 cost data. All of the participants' comments espoused the use of actual FY 1999 CRA data to one degree or another, and only two,

² Supporting workpapers A and B were filed April 5, 2000, as USPS-LR--I-277 and 278. Most FY 1999 billing determinants had been submitted on March 31, 2000, as USPS-LR-I-259, and the remaining billing determinants, for Express Mail and parcel post, were filed on April 19, 2000.

the Coalition of Religious Press Associations and United Parcel Service, suggested that FY 1999 should be substituted as the base year for all analyses in the case.

[1015] The Commission noted that all of the participants responding to the notice of inquiry had recognized that actual costs are a more accurate representation of FY 1999 experience than estimates developed by rolling forward FY 1998 costs. It agreed that its decision would be improved to the extent it could use actual FY 1999 CRA cost results. It also agreed with the majority of those responding that it might not be feasible to completely revise the Postal Service request and other participant's evidence to make FY 1999 the base year for all estimates. It determined that the minimum appropriate improvement would be achieved by what has been called the "basic update" under which actual FY 1999 costs would be substituted for the estimates of FY 1999 presented by Postal Service witnesses Kashani and Tayman. The Service was directed to rollforward actual FY 1999 costs to the test year. In doing so, the Service was encouraged to update such other portions of its request as it choose. Order No. 1294, at 3-5.

[1016] The Commission directed the presiding officer to establish a revised procedural schedule that would allow the Postal Service six weeks to perform the basic update. The revised schedule provided for technical conferences and discovery on the basic update, and also afforded all participants, including the Postal Service, time to develop and present other changes to reflect actual FY 1999 results. P.O. Ruling R2000-1/71 at 1-2.

[1017] The Postal Service submitted a request for reconsideration of Order No. 1294 that restated two concerns it had raised in its responses to Notice of Inquiry No. 2. The Service contended that it would be unable to develop "a complete replacement of the base year and a subsequent roll-forward to produce new test year estimates." U.S. Postal Service Motion for Reconsideration of Order No. 1294 (June 2, 2000) at 6. The Commission had acknowledged that concern by demurring from establishing a new base year. The Service also predicted that it would not be able to provide the requested basic update using information on FY 99 costs, or refinements in its rollforward format, in the

time allotted. Furthermore, it characterized the practical effect of Order No. 1294 as nullifying much of its direct case and thereby denying it due process.

[1018] The Commission did not act on this request. If the production of actual FY 99 cost data in usable formats, the so-called basic update, had proved to be an insuperable task, and the schedule established in P. O. Ruling R2000-1/71 could not reasonably be adjusted to accommodate the needs of participants, then the concerns expressed by the Service would have been realized, and additional action would have been necessary.

[1019] To its credit, the Postal Service successfully responded to Order No. 1294. At the end of the six weeks allotted to prepare the basic update that would substitute actual FY 1999 CRA costs for the estimates used in its Request, it reported:³

As suggested, the Postal Service has been able to incorporate actual FY 1999 CRA and accounting data (“the basic update”), as well as to incorporate updates for as many other factors as practicable in the time available. These factors include inflation in labor and benefit expenses and non-personnel costs; changes in workers compensation costs, breakthrough productivity, Periodicals initiatives, e-commerce revenue and expenses, reductions in advertising expenses, and increases in expedited supplies.

[1020] In the following weeks, the Service provided appropriate supporting documentation for this update, made its witnesses available for technical conferences, and responded to written discovery. The Commission expresses its appreciation for the Postal Service’s ability both to complete the update, and to provide voluminous materials, under very tight deadlines, in response to questions from participants and the Commission. See Postal Service Brief at I-7, fn .11. As a result, the Commission has been able to improve its test year projections by using actual FY 1999 cost data.

³ Notice of United States Postal Service of Filing of Supplemental Testimony in Response to Order No. 1294, July 7, 2000, at 1.

[1021] On brief, the Service again suggests that the use of actual FY 99 costs in preference to estimates of those costs based on FY 98 operating results would be a denial of its due process rights. *Id.* at I-13. This is an extremely important allegation. The Commission views providing due process to all participants as an absolute obligation, see § 3624, and the Postal Service's views on this issue are particularly important as it may be called upon to defend the Governors' acceptance of Commission recommendations in court. Therefore, the Service's contention has been thoroughly considered.

[1022] To correctly evaluate the Service's charge, it is important to understand what is, and what is not, involved in substituting actual FY 99 costs for estimates of those costs based on FY 98 operating results in the context of an omnibus rate case.

- To estimate the Postal Service's needs in a future test year, the Commission compares projected costs with projected revenues. This involves three types of actual data.
- Estimates of volumes in the test year are made using econometric models that forecast changes to actual volumes in a recent year. Those volume estimates are used to estimate costs and revenues.
- The actual costs in a recent year are "rolled forward" through each intermediate year to the test year, incorporating the annual effect of numerous change factors such as the estimated volumes, projected wage rates and other expenses, and the impact of planned management initiatives.
- Revenues are developed by applying actual billing determinants in a recent year to estimated volumes. Billing determinants are the distribution of volume to rate cells within each subclass.

[1023] From this it can be seen that changing the "actual costs in a recent year" that are rolled forward will almost certainly have an important impact. Notwithstanding that, it is only one of the many factors that goes into projecting Postal Service test year results. The Commission knew that it was making a major adjustment, and it did so only after carefully weighing whether the change was necessary to provide a recommended decision that would be accurate and fair to all those affected by changes in postal rates.

[1024] To project accurate results, the data that are rolled forward into the test year should, to the extent possible, reflect current operations. More importantly, they should

reflect existing rates and classifications. Rate and classification changes often lead to substantially altered relative shares of volumes, costs, and billing determinants in the mailstream, causing projections based on outdated historical results to be inaccurate. For example, a new discount that attracts a substantial volume of (relatively heavy, and therefore relatively expensive) parcel mail may significantly change both costs and billing determinants. Therefore, it is particularly important that when costs and volumes data from different years are used together, that a single set of rates and classifications be in place during both years, since volumes, costs and billing determinants all change to different degrees when rates and classifications are varied.

[1025] In an ideal world, test year projections in a rate case would reflect actual volumes, costs, and billing determinants from a single recent year, a year in which existing rates and classifications were in effect. A superficial reading of the Postal Service Brief might leave the impression that its initial filing in this case incorporates unified projections from such a consistent, reliable base. In fact, that is not the case.

[1026] The Postal Service Request submitted to the Commission in January is supported by projections of costs based primarily on cost data from FY 1998. However its volume projections are based on FY 1999 data. And finally, the Postal Service uses billing determinants taken from a hybrid year that includes two quarters of actual data from FY 1999, and two quarters of adjusted data from FY 1998.

[1027] This recitation should not be interpreted as criticism. The Service presented projections based on what it viewed as the best available data when it prepared its Request. Many Postal Service witnesses attempted to adjust the data to incorporate FY 1999 results into their presentations. *See, for example*, Tr. 12/4806 (Fronk) "I then needed to make adjustments to these 1998 estimates to account for the increase in the First-Class Mail maximum weight limit from 11 to 13 ounces that took place on January 10, 1999." *See also*, Tr. 2/395 (Tayman):

I utilized the latest data available to the extent that it made a material difference to the estimates and could be incorporated without compromising the filing date.

In particular, I used actual FY 99 volume and revenue, the November 1999 DRI forecast (which resulted in actual FY 99 inflation factors and COLA unit costs calculations), and actual FY 99 health benefit premium changes. This approach yielded an FY 99 estimate of expenses which was only \$8 million different than actual expenses.

I was unable to incorporate actual FY 99 expense data because it was not available in time to update the required models, testimony, and Library References.

[1028] While updating to reflect actual FY 1999 operating results might well have been justified absent extraordinary circumstances, updating was particularly appropriate in this case as the FY 1998 CRA cost data used by the Service was of seriously reduced validity as a base for projections because of one immutable fact. In January 1999, some 3½ months after the conclusion of FY 1998, and 3½ months into FY 1999, the Postal Service implemented sweeping, disproportionate changes in the rates for all classes of mail, as well as several important classification changes.

[1029] Thus, the Postal Service Request is premised on projections of costs incurred in FY 1998 that reflect expenses for processing, transporting and delivering the mix of mail volumes experienced before rates changed. Its volumes are projected from FY 1999, during which the new, generally higher rates were in effect for almost ¾ of the year. The billing determinants used by the Service include ½ year of data during which the new rates were in effect, and ½ year of data from the previous year adjusted in an attempt to reflect the new rates and classifications.

[1030] The current postal rate structure includes numerous rate categories within each subclass designed to pass through cost differences calculated by reference to CRA data. The FY 1998 CRA cost data used in the Service's Request did not reflect the impact of the new rates and classifications. The Commission knew that the FY 1999 cost data would become available at an early stage in the case, and it had to evaluate whether due process permits, or perhaps even requires, that the cost projections initially offered by the Service be adjusted to reflect this more recent, applicable data. *See, for example*, UPS Brief at 13. The Commission issued two Notices of Inquiry seeking comments from the participants on this question, the first at the earliest stage of

proceedings, and the second after the FY 1999 data had been published. As might have been expected, the unit costs actually experienced in FY 1999 by a number of subclasses of mail varied by meaningful amounts from those projected by the Postal Service using FY 1998 cost data.

[1031] Order No. 1294 considered the participants' advice on this question, and concluded that the Commission decision would be improved if actual FY 1999 CRA costs by class and subclass could be substituted for the estimates of 1999 costs included in the Postal Service Request, and rolled forward to the test year. It further held that the Postal Service, or any other participant, should be allowed to offer such additional updates as they deemed appropriate. As noted above, the Postal Service timely filed testimony and supporting library references providing test year cost projections using actual FY 1999 CRA costs.

[1032] The Postal Service suggests throughout its initial brief that it had to replace the base year for its request, and that it could not complete this task. This overstates the situation. Order No. 1294, at 4, specifically did not require that the Service revise its entire case.

[1033] The Service used the same roll-forward methodology that it used in its initial filing to develop FY 1999-based test year costs. Tr .35/16772 (Patelunas). FY 1999 volumes were already used in the Postal Service request, and the Service filed testimony from witness Thress explaining why additional volume updates could be counter-productive. As a result, no updating of volume data was required. The Service also was relieved of any obligation to provide adjusted FY 1999 billing determinants since it had already filed billing determinants for a hybrid year ($\frac{1}{2}$ of 1999 and $\frac{1}{2}$ of 2000) during which the January 1999 rate changes were in effect.⁴

[1034] Order No. 1294 gave the Postal Service the opportunity to incorporate such other updates as it believed would more accurately predict test year results. In

⁴ See P O Ruling R2000-1/110, granting Motion of the United States Postal Service for Clarification or Reconsideration of Presiding Officer's Information Request No. 18. MPA witness Cohen provided supplemental testimony that calculated presortation-related cost differences using adjusted 1999 billing determinants for Periodicals that the Commission utilizes in projecting test year revenues for Periodicals.

response, the Postal Service presented testimony suggesting a number of updates to its initial revenue requirement estimates. Some of these changes reduce test year costs while others increase them. In total, the Service has offered testimony indicating that its test year before rates deficit will be more than \$450 million higher than it initially forecast. The Commission has evaluated the testimony justifying each new revenue and expense item, just as it evaluates all the other testimony presented in the case. The vast majority of these changes appear valid, and have been included in the Commission's projections of test year results.⁵

[1035] The Service suggests that there are other aspects of its original filing that it would have liked to revisit, and that it might have discovered other appropriate changes. Postal Service Brief at I-11. It then contends that because it did not have sufficient time or resources to review every conceivable change, the Commission should ignore both the actual FY 1999 cost data, and most of the other cost updates the Service has proposed. This argument is not persuasive. It is always true that in the limited time allowed to conduct postal rate cases there will be issues that could not be completely explored. However as a general rule, those corrections that can be made, should be made. Furthermore, the Service's initial filing included errors, many of which were corrected in the revised test year cost estimates. *See, for example*, Tr. 35/16794.

[1036] It is accepted practice for the Commission to incorporate known events that significantly effect test year projections. Actual FY1999 cost data and most of the other revisions suggested by the Service and other participants fit this description.

[1037] The Postal Service argues that updating cost projections to reflect actual FY 1999 results eliminates the foundation for its integrated Request, and virtually

⁵ The Commission was particularly concerned about one adjusted expense item, an increase in test year labor expenses developed by assuming increased wage rates resulting from a yet-to-be negotiated labor contract. During hearings, the sponsoring Postal Service witness could not confirm that upper management had authorized that apparent wage policy shift. On August 9, 2000, the Commission wrote to the Postmaster General asking for verification that the testimony was consistent with Postal Service policy. An answer was provided by Richard Strasser, Acting Chief Financial Officer, on September 1, 2000, and the Commission has accepted this projection of increased test year costs. Copies of this correspondence appear in Appendix XL.

nullifies its specific rate proposals. This simply is not the case. A review of Chapter V of this Opinion will show that the Service's proposals are the main focus of the Commission's analysis.

[1038] Omnibus rate cases normally include a number of participant challenges to the Service's cost attribution and allocation methodologies, and when one or more of these challenges are successful the estimates of attributable costs by subclass relied on by Postal Service rate design witnesses may become obsolete. The substitution of actual FY 1999 costs for the estimates initially provided by the Service is only one of several adjustments the Commission is making to the initial Postal Service filing in this case. Several proposals to change existing cost attribution and distribution methods advanced by Postal Service witnesses have been rejected in whole or in part. Nonetheless, the rate testimony sponsored by the Service is understood as being part of an integrated presentation, and it remains both relevant and material even when underlying premises change. For example, the policy reasons for limiting the size of rate increases within specific subclasses remain probative even when the levels of costs attributable to those subclasses are adjusted. As in every past omnibus rate case, all of the enunciated considerations that led to specific Postal Service rate proposals remain before the Commission, and have been carefully evaluated. This practice does not violate the due process rights of the Postal Service.

[1039] The Postal Service is entitled to file a rate request whenever it chooses, and it is entitled to a prompt response to every request for rate changes that it files. Section 3624 allows the Commission 10 months to act on such a request. The broad concept of due process includes attention to producing an accurate and timely decision, as well as to allowing a full and fair opportunity to examine the reliability of opposing evidence. In this case, the substitution of actual FY1999 costs for estimates based on historical data has improved test year cost projections. The substitution was accomplished using the rollforward and cost allocation methods that were tested as part of the Service's initial filing. All participants had the opportunity to revise their presentations to incorporate or challenge these data, and many did so. It would be unreasonable to ignore this

supplemental testimony. Some subclasses and rate categories receive smaller increases as a result of this change, while others face larger increases; however, because the recommended rates reflect actual, recent Postal Service operating experience, they are more equitable than recommendations that ignore those facts.

II. REVENUE REQUIREMENT

A. Bases of Test Year Cost and Revenue Estimates

[2001] In accordance with established practice in the Commission's rate proceedings, the Postal Service estimates its future revenue needs in this case by identifying a recently concluded fiscal year as a base period, adjusting its reported historical result through intermediate periods, and rolling results forward by incorporating the effects of numerous expense and volume factors to arrive at cost and revenue estimates in a selected test year. This process is described in the testimonies of witnesses Tayman, USPS-T-9, and Kashani, USPS-T-14.

[2002] As noted in the Introduction, the Postal Service used Fiscal Year 1998 as the base year from which to project costs and revenues. USPS-T-9at11. The Service selected Fiscal Year 2001 as the test year for ratemaking purposes in this proceeding.⁶

[2003] The Commission's determination to use the more recent Fiscal Year 1999 reported results for projecting test year costs requires new bases for arriving at those estimates. Generally, those bases consist of: (1) the "basic update" of the rollforward program sponsored by witness Patelunas; (2) recognition of other changes in estimated test year costs and revenues, many of which were provided in response to Order No. 1294; and (3) miscellaneous adjustments and error corrections to assure accuracy and maintain consistency with other Commission findings in this case.

[2004] Recognizing that the Commission might conclude it should incorporate the updated information produced in response to Order No. 1294 in its analyses and recommendations, the Postal Service argues on brief that those materials "must be

⁶ Postal Service Request, Attachment C, Rule: 54(f)(2). Under the terms of § 54(f)(2), which prescribes use of a test year "beginning not more than 24 months subsequent to the filing date of the formal request[.]" the Service alternatively could have selected Fiscal Year 2002 at the test period.

treated as a unified package” because they “do constitute a reasonably *balanced* update, in light of the circumstances.” Postal Service Brief at I-17. (*emphasis in original*) The Commission has done so by considering the Service’s suggested revisions on the merits in their entirety. The Commission has altered the Service’s new cost and revenue items only where consistency with established methodologies, or the correction of errors, so requires.

[2005] Update-related changes have been made in the following categories:

[2006] *Additional “breakthrough productivity” cost reductions.* Additional cost reductions associated with the Postal Service’s “breakthrough productivity” initiatives, quantified by witness Patelunas in USPS-ST-44, have been recognized.

[2007] *Revised “Other Programs” costs and revenues.* Adjustments have been made to reflect changes in “other programs” costs (such as advertising costs) and revenues (such as estimated revenue for e-Business programs in the test year), also documented by witness Patelunas in USPS-ST-44.

[2008] *Revised personnel cost level change factors.* Costs in appropriate segments have been increased to reflect updated wage rate information, including the Postal Service’s substitution of the unreduced Employment Cost Index (ECI) percentage value for ECI minus one percent.

[2009] *Recognition of the Field Reserve offset to cost reduction programs.* In response to Presiding Officer’s Information Request No. 14, witness Patelunas states that the update filed in response to Order No. 1294 should have incorporated a \$200 million Field Reserve offset to certain operations cost reductions, but it was inadvertently omitted. Tr .46D/21593. He further states that, had the Field Reserve been properly incorporated, the amount would have reduced total program savings, and would have applied primarily to savings in mail processing and window service clerks and mailhandlers. *Ibid.*

[2010] Rather than distributing the Field Reserve amount as proportional offsets to savings associated with the various cost reduction programs, it has been recognized as a special-purpose component of the contingency provision. See subsection D.

[2011] *Hybrid billing determinants.* In response to a request in Presiding Officer's Information Request No. 16 for revenue estimates by subclass and service that reflect FY 1999 billing determinants in the manner the Service deems appropriate, witness Mayes presented hybrid billing determinants for a year consisting of FY 1999 Quarter 3 through FY 2000 Quarter 2. Tr. 46D/21408-16. Subsequently, she also submitted a corrected and revised version of the hybrid billing determinants. *id.* at 21416-21. The Commission has used these billing determinants in their corrected form to calculate test year revenues and final adjustments.

[2012] *Other updated cost level change factors.* The Commission has used other updated indices to calculate test year cost estimates, including more recent CPI values to calculate cost-of-living adjustments and the non-personnel cost level change factors provided in witness Patelunas' Library Reference LR-I-421.

[2013] *Revised RPYL amount.* The amount of the provision for recovery of prior years' losses has been recalculated and increased to incorporate the estimated amount of the net loss in FY 2000. In the Postal Service's original filing, witness Tayman's computation includes an estimated net income of \$66 million in FY 2000. USPS-T-9 at 48, Table 53. The materials filed in response to Order No. 1294 include an estimated loss of \$325 million. Exhibit USPS-ST-44E. This change effectively increases the annual recovery amount by \$43.6 million.

B. Volume Models and Forecasting Methodology

1. The Service's Volumes Worksheets

[2014] The Postal Service is required by the Commission's Rules to accompany any general request for a change in rates with two sets of forecasts of postal volumes. These forecasts must be based upon econometric fits of economic demand functions for postal services by class and subclass. The rule setting out these requirements reads as follows:

(5) Subject to paragraph (a)(2) of this section, there shall be furnished in every formal request, for each class and subclass of mail and postal service, the following:

(i) An econometric demand study relating postal volumes to their economic and noneconomic determinants including postal rates, discounts and fees, personal income, business conditions, competitive and complementary postal services, competitive and complementary nonpostal activities, population, trend, seasonal patterns and other factors.

(ii) The actual or estimated volume of mail at the prefiled rates for each postal quarter beginning with the first quarter of the most recent complete fiscal year and ending one year beyond the last quarter of the future fiscal year.

(iii) The estimated volume of mail assuming the effectiveness of the suggested rates for each postal quarter beginning with the quarter in which the rates are assumed to become effective and ending one year beyond the last quarter of the future fiscal year.

[2015] To comply with this rule the Postal Service sponsors the testimony of witnesses Tolley, Musgrave and Thress. Witnesses Tolley and Musgrave present two sets of forecasts through the end of the government fiscal year (GFY) 2002:

[2016] “Before-rates” forecasts based on the assumption that Postal Service rates and rules remain unchanged.

[2017] “After-rates” forecasts based on the assumption that all of the rate increases proposed by the Postal Service are implemented as of October 1, 2000.

[2018] The relationship between the “before-rates” and “after-rates” forecasts is principally determined by a set of estimated price elasticities and by the differences in the price information for the two forecasts.

[2019] The forecasts are basically made at the level of mail subclasses and special services. At this level the econometric estimate of price and other elasticities may be applied in a fairly direct manner to yield forecasts of volumes by postal quarters. For First-Class and Standard A mail, volume forecasts by subclass are not sufficient because the mailstreams in these subclasses are composed of mail receiving discounts for different kinds of worksharing, including presorting and prebarcoding for automated processing. Witness Tolley’s forecasts for First-Class and Standard A mail further divide these subclasses into various major worksharing categories using share models.

[2020] The forecasts are derived from econometric models fit to time series by USPS witnesses Thress and Musgrave. The models for classes and subclasses, and the manner in which they are applied to produce forecasts, have evolved slowly since similar models and forecasts were presented by witness Tolley in Docket No. R80-1. The share model for worksharing categories first appeared in approximately its present form in testimony for the most recent general reclassification case, Docket No. MC96-1.

[2021] The Commission’s Rules have also evolved. Prior to R94-1 the Commission constructed Lotus 1-2-3 worksheets for its own use based upon the testimony of Postal Service witness Tolley and supporting library references. This was an obvious and risky duplication of effort since the Commission’s worksheets had to be produced over a very short period of time and on the basis of largely written testimony that was not always perfectly explicit in describing the Service’s calculations. Following Docket No. R90-1 the Commission addressed the problem by amending our rules. Beginning with Docket No. R94-1, the Postal Service has been required to supply the Commission with a usable

electronic version of its volumes forecasting models and methods. The language of the rules describes in detail the minimum capabilities the Commission expects to find in the Service's submissions:

(j)(6)(iii) Subject to paragraph (a)(2) of this section, there shall be furnished in every formal request a computer implementation of the methodology employed to forecast volumes and revenues for each class and subclass of mail and postal service.

(iv) The computer implementation described in paragraph (j)(6)(iii) of this section shall be able to compute forecasts of volumes and revenues compatible with those referred to in paragraphs (j)(2), (j)(3) and (j)(5) of this section for:

(a) Any set of rates and fees within a reasonable range of the prefiled and suggested rates,

(b) any date of implementation within the range spanned by the assumed date and the start of the future fiscal year,

(c) alternative forecasts of the economic determinants of postal volumes other than postal rates and fees, and

(d) alternative values of any parameters with assigned values that are based upon unverifiable judgments.

[2022] Since R94-1, the Postal Service has supplied the Commission with Lotus 1-2-3 worksheets that are similar in function to worksheets that the Commission constructed for itself in Docket Nos. R87-1 and R90-1. The worksheets are well-designed and largely self-documented with descriptors and notes that have made it relatively easy to check them for correctness and to modify them to meet the Commission's requirements. Witness Thress is the author of the worksheets.

[2023] Although the Commission has considered from time to time using alternative forecasting methods proposed by OCA and other parties, the established forecasting

methodology is the methodology that has been developed over the years by the Postal Service. The worksheets must do more than simply document the testimony of Service volumes witnesses. The Commission actually has to be able to use the worksheets during the course of a rate proceeding to modify the Service's forecasts, particularly the "after-rates" forecasts. The capabilities specified in the rules anticipate the Commission's needs and reflect past experience in making necessary changes to the Postal Service's own forecasts. Overall, the purpose of the Commission's rules is to ensure that the Postal Service's forecasting methodology is always available in a rate proceeding, even if the Commission should decide not to use it.

[2024] The Commission has rarely recommended postal rates and fees that exactly match those proposed by the Service in its filing. Adjusting the Service's volume forecasts to reflect the Commission's recommended rates is a necessary and predictable aspect of the regulatory process, since the Commission must propose rates that allow the Postal Service to just recover costs plus a reasonable contingency.

[2025] Adjustments to the forecasts for other reasons are less regular and predictable, as the Commission follows the practice of making such adjustments only when there is a demonstrated need.

[2026] In Docket No. R84-1 the Commission moved the base year forward to improve the accuracy of its forecasts of volumes, revenues and costs in the test year. Advancing the base year minimized the impact of a set of net trends with a severe downwards bias that had been inserted by witness Tolley. In Docket No. R90-1 the base year was advanced and several other changes were made to deal with an unexpected change in economic conditions. During the 10-month course of the R90-1 proceedings the economy entered a recession. This recession was not anticipated in the Data Resources Inc. (DRI) forecasts of "economic determinants" such as income and the non-postal price indexes used in the Postal Service's initial filing. The Commission substituted a later DRI forecast of economic conditions so that the test year volume forecasts would include the effects of the recession. The Commission also corrected judgmental net trends superimposed on the forecasts by witness Tolley and added billing

determinants for several proposed new categories of mail to correct the fixed-weight price indices. In principle and in practice the Postal Service's econometric models and worksheet implementations are supposed to allow the Commission to make these kinds of changes within a coordinated framework that is consistent with the econometric models upon which the forecasts must be based.

[2027] In supplemental testimony filed at approximately the mid-point of the present proceeding witness Thress disclosed that the Postal Service's econometric model and worksheets could not be used with then-current (June 2000) DRI forecasts of economic conditions to give valid forecasts of postal volumes during the test year. The reason given was that the Service's models and worksheets made no provision for a wide-ranging restatement and revision made by the U.S Department of Commerce in its historical income and consumption data. This revision rebased the DRI income and consumption series used in the Service's econometric models from 1992 dollars to 1996 dollars. Since the June 1999 DRI forecasts used in the Service's filing predated the rebasing, and any of the more recent DRI forecasts would postdate the rebasing, it was witness Thress' opinion that the Service's econometric model would have to be refit with the revised data before it could be used with a more recent DRI forecast to validly update the test year volume forecasts USPS-ST-46 at pp. 6-7. Witness Thress repeated this opinion in hearings.

(I)t is my judgement that if you are going to plug in new forecast data based on a new DRI forecast, which is based on restated Commerce Department data, that it would also be necessary for you to also plug in new elasticities which are estimated using consistent data.

Tr. 35/16861-62.

[2028] The Commission accepts witness Thress' professional judgment on this point but finds much to criticize in the Postal Service's response to circumstances that has left us to depend on DRI economic forecasts that, at the time of the Postal Service's filing, were already almost 8 months old, and now are about 18 months old. The

Commerce Department began to publish revised and rebased income and consumption data beginning in October 1999. USPS-ST-46 at p. 6. By November 1999 the Commerce Department's revisions of the historical data were still incomplete and extended back only 2-4 years according to witness Thress. Tr. 35/16851. The Postal Service could have re-estimated its demand equations to make them compatible with the revised and rebased Commerce Department series soon after November 1999, but, possibly, not soon enough to have used them for its filing. Apparently witness Thress was still using the unrevised income and consumption series to refit the demand model as late as November 1999. *Id.* at 16858.

[2029] The Postal Service filed its rate request in mid-January 2000. However, the forecasts for the filing were prepared in November and December 1999 from base year postal volumes that were supplied to witness Thress in October 1999. *Id.* at 16848. The proposed rates for the "after-rates" forecast were given to witness Thress around December 2, 1999. *Id.* at 16849. In November 1999 DRI published a new trendlong forecast that projected income and consumption for the revised and rebased Commerce Department series. At that point it should have occurred to the Service's volumes witnesses that they were using an econometric model and forecasting worksheets that would not comply with the Commission's rule 3001-45 (j) (6) (iv) quoted above.

[2030] The decision to use the June 1999 rather than the November 1999 DRI economic forecast was made in November 1999. *Id.* at 16850. Witness Thress, who made the decision, was aware of the more recent DRI forecast but chose to use the older one because it was consistent with the econometric model which had been fit to the old income and consumption series. *Id.* at 16851. Witness Thress explained the reasons for the decision at some length in his oral testimony. *Id.* at 16850-51. In November 1999, refitting the model with the revised data would have been problematic for several reasons. First, the revised data was historically incomplete although rebased income and consumption series would have been available for the entire period of the Postal Service's sample. Second, witness Thress believed that it would be necessary to reexamine the specification of the demand model and not just mechanically refit the old

equations. *Id.* at 16852-53. Third, the June 1999 and November 1999 DRI forecasts are quite different. In June 1999 DRI thought the economy would level off and perhaps enter a recession within a year. By November 1999 it had become apparent that the economy was still growing strongly so the projected growth rates of the income and consumption series had all been substantially revised upwards by DRI. *Id.* at 16853. Using the November 1999 forecast would have been expected to produce a revenue surplus in the test year at the Service's proposed rates and requested contingency since all of the income elasticities in the demand models are positive numbers.

[2031] Later DRI forecasts continue to exhibit much higher trends for the economy's main consumption and income aggregates than the June 1999 forecast used by the Postal Service. This fact is evident from the projected growth rates for GDP for the June 1999 and May 2000 DRI forecasts shown in Table 1 of USPS-LR-I-447.

[2032] The use of the old June 1999 DRI forecast in the Service's January 2000 filing would have been avoidable if the November 1999 refit of the demand equations had used the best data available at the time, which were the Commerce Department's partially revised and rebased consumption and income data. Using the most current revised data for econometric time series estimation is an obvious best practice. Witness Thress testimony shows that he tries to follow this practice at least with respect to the Postal Service's volume data.

As a general rule, we try to update the equations on a quarterly basis probably. Generally speaking, whenever we get a new quarter, whenever there is a new quarter of volume data, . . . And I think as a general rule, time permitting, I at least like to have my equations estimated using all the data I have, so that as we get a new quarter of data, if time permits, we will try to reestimate all the equations.

Tr. 35/16859.

[2033] The DRI forecasts are econometric forecasts largely derived from equations fit econometrically to the Commerce Department's consumption and income time series. DRI's practice, according to witness Thress, is to re-estimate monthly.

My understanding is that DRI would again update their model every time they came out with a new forecast. So, in the case of DRI, I believe they update their model monthly, But I think they try each month certainly to incorporate whatever new information they have got versus what they had the month before.

Id. at. 16860.

[2034] By November 1999 DRI was following the best practice of using the partially revised and rebased Commerce Department data but the Postal Service was not.

[2035] Using the most current forecast of economic variables within the Postal Service's volumes forecasting worksheets would also be "considered better practice" "all other things being equal" according to witness Thress. "In theory", using the most current economic forecast tends to reduce errors in the Postal Service's volumes forecast. *Id.* at 16854. Rule 3001-45 (j) (6) (iv) is intended to enable the Commission to follow the better practice of using the most current information, including recommended rates, base year volumes, net trends, billing determinants, implementation date and DRI forecast, when it applies the Postal Service's econometric model to forecast test year volumes and revenues. For this reason the Postal Service's econometric models and forecasting worksheets need to have a useful life that is at least sufficient for the 10-month span of a postal rate case. In this regard the forecast worksheets are no different from the worksheets that the Postal Service and Commission use to predict test year costs.

[2036] The Postal Service's econometric models and worksheets for forecasting volumes were not usable as required by the Commission's rules when filed in January 2000. The worksheets could, of course, still be used mechanically *Id.* at. 16861. But they could not be used with the DRI economic forecasts of November 1999 (or later) to yield valid forecasts of postal volumes in the test year without plugging in new elasticities that would have to be obtained by re-estimating the demand equations. *Id.* at. 16862. This puts the worksheets out of compliance with rule 3001-45 (j) (6) (iv).

[2037] It is now clear that the DRI June 1999 forecast was unduly pessimistic. The difference in growth rate for Gross Domestic Product (GDP) between the DRI June 1999

baseline forecast and a comparable DRI forecast made in May 2000 is described in a Service Library Reference filed in August 2000:

In June of 1999, DRI forecasted real GDP to grow 4.1 percent from 1999 to 2001, with 2.1 percent growth from 2000 to 2001. In DRI's baseline May, 2000 forecast (DRI's Trendlong0500 forecast), however, real GDP is projected to grow 8.2 percent from 1999 to 2001 and 3.1 percent from 2000 to 2001.

USPS-LR-I-447 at p. 1.

[2038] In June 2000 the Postal Service re-estimated its econometric model and revised the test year volumes forecasts for its own use. The revised forecasts and forecasting worksheets are all included in USPS-LR-I-447. There were produced by the Service in August 2000 at the request of the Commission when it became apparent from the oral testimony of USPS witness Thress that the Service's econometric model had already been refit using the Commerce Department's revised and rebased series Tr. 35/16854-57 and 16864.

[2039] Tables 2 and 3 in USPS-LR-I-447 show how the Postal Service's filed forecasts and the forecasts from the refitted econometric model correspond. The tables compare filed forecasts and revised forecasts of GFY volumes as follows:

- (a) *Filed Forecasts*: Derived with the filed econometric model using DRI's June 1999 baseline Trendlong forecast.
- (b) *Revised Forecasts*: Derived by computing a weighted average of DRI's baseline (55 percent), pessimistic (10 percent) and late recession (35 percent) Trendlong forecast of May 2000.

[2040] The filed and the revised forecasts differ very little in their predictions of volumes by class in the test year. This similarity in the forecasts is cited by the Service as one of the "compelling reasons to conclude that an attempt to update the volume forecast used in this proceeding is not warranted under current circumstances."

USPS-LR-I-447 at p. 3. This accords with the recommendation of witness Thress in his Supplemental Testimony USPS-ST-46 and in hearings.

[2041] The Commission has used the filed volumes worksheets and the June 1999 DRI baseline economic forecast in its forecasts of test year volumes for the rates recommended by the Commission. The Commission notes that these forecasts correspond, not to a single current DRI baseline forecast, but to an average of DRI forecasts that are heavily weighted towards pessimistic and recession scenarios. Therefore, the test year volume forecasts include a significant built-in margin for downside error.

2. The Postal Service's Econometric Models

[2042] In the early history of the Commission, the volume and revenue forecasts provided by the Postal Service on the occasion of a general rate case were almost entirely judgmental. Now, and for many years past, the Commission's rules encourage the use of economic models, historical data, and econometric methods, and discourage reliance upon ad hoc methods and unsupported judgment in the preparation of forecasts. In every general rate proceeding since R80-1, the Postal Service and the Commission have relied upon the econometric research of witness Tolley. Since R90-1, the Service and the Commission have relied upon similar research for Priority and Express Mail conducted by witness Musgrave. The demand models used by witnesses Thress and Musgrave in this proceeding are recognizable variants of earlier models developed by witness Tolley. The models offered by witness Musgrave are not materially different from similar models for Priority and Express Mail that the Commission relied upon in R94-1. Witness Musgrave's models and estimation methods are still very much as described by the Commission in the R94-1 Opinion and Recommended Decision.

[2043] On the other hand, witness Thress conducted a thorough and effective revision of witness Tolley's models and econometric practice prior to the R97-1 proceeding. Many of these revisions corrected weaknesses and defects noted by the

Commission in R94-1. In other respects, witness Thress' revisions appeared to be the result of a wide-ranging and open econometric reexploration of the underlying economic theory, the identification of suitable variables and the selection of appropriate estimation techniques for the Postal Service's volumes models. It was exactly the kind of econometric research that the Commission's Rules of Practice and Procedure for statistical evidence are intended to encourage. Witness Thress has continued to develop the Postal Service's econometric model and has eliminated several ad hoc estimation methods for cross-price and cross-volume elasticities that the Commission noted in its PRC Op R97-1, Appendix H at pp. 26-27.

[2044] Although there are many differences in detail in the equations fit for the R97-1 proceeding and the current proceeding there is nothing fundamentally new or different about the Postal Service's econometric models for forecasting volumes by class, subclass and worksharing category. Postal Service witness Thress also still uses the worksharing share model developed for the recent general reclassification proceeding Docket No. MC95-1. These models were all described and critiqued at some length in Appendix H to the Recommended Decision in Docket No. R97-1.

3. The Postal Service's Forecasting Methodology

[2045] Witness Tolley (but not witness Musgrave) believes that it is still sometimes necessary to incorporate a term for recent unexplained trends in the volume forecasts. Therefore, he augments the model forecasts for some classes of mail with a net trend intended to represent a continuation of recent volume growth that cannot be attributed to movements in population, postal rates, income and other economic variables. The source of the net trends employed by witness Tolley is a forecast error analysis program described in the Technical Appendix to his direct testimony USPS-T-6 at A-28-A-34. The estimate that is most often selected is described as a "five-year mechanical net trend 1994q4 to 1999q4." It is the average annual trend unexplained by the demand model over the last five years of the sample. Witness Tolley uses his personal judgment to

decide which mail categories will have net trends included in their forecasts and which will not. Thus, the Postal Service's volume forecasts should be viewed as dependent upon both the econometric studies performed by Postal Service witnesses Thress and Musgrave, and upon the personal judgments of witness Tolley with respect to the net trends.

[2046] The Commission has always regarded witness Tolley's error analysis program as an ad hoc method for estimating net trends that is being used in place of accepted econometric methodology. The accepted econometric methodology is to define a variable to represent a recent trend, include the variable in the specification of the demand equation, and estimate a coefficient for the variable along with the other parameters of the demand equation. The accepted econometric methodology has several advantages over witness Tolley's ad hoc procedure.

[2047] First, if a recent trend is really important then omitting a net trend variable from the demand models leaves estimates with a missing variable bias. Second, the statistical properties of all of the estimated parameters of the demand equation will be improved when an explanatory variable is added to capture an important recent net trend. Third, the estimated trend coefficient has all of the desirable properties of a generalized least squares estimate, whereas the statistical properties of witness Tolley's ad hoc estimates are unknown and may be undesirable. Fourth, the estimated net trend coefficient will have an associated "t-value" describing the accuracy of the estimate, whereas the accuracy of witness Tolley's net trends is a mystery. Fifth, the econometric methodology provides the appropriate setting for exploring refinements to the definition of the net trend variable itself. For example, witness Tolley's choice of a four or five year period for calculating net trends in his forecast error analysis is arbitrary and could easily be refined by witness Thress in the econometric research.

[2048] Witness Tolley's use of net trends to alter the forecasts has been sparing. For most subclasses, including all of the larger ones except Parcel Post, the net trend used in the forecast is one. Witness Tolley defends the use of the mechanical net trends for Parcel Post as an appropriate method for dealing with the delayed effects of a recent

UPS strike on Parcel Post volumes. However, an inspection of witness Thress' Parcel Post equation shows that a dummy variable has already been included for this purpose.

4. The Postal Service's Forecasts During PFY 2000

[2049] The time that has elapsed since the filing of the current postal rate case has provided the Commission with the usual opportunity to compare the before-rates forecasts made by witnesses Tolley and Musgrave with four postal quarters of actual volumes. In Appendix I, Table I-1, the revised "before-rates" forecasts from witness Tolley's testimony are compared directly to the volumes shown in the Postal Service's quarterly reports of Revenue Pieces and Weight By Classes of Mail and Special Services. These reports have been submitted periodically during the current proceeding.

[2050] The before-rates forecasts continue to exhibit characteristics and patterns that the Commission has come to expect from similar comparisons with observed volumes in earlier proceedings. The comparison reveals again that an excellent overall performance masks large-but-offsetting forecast errors among the individual categories. Through the four postal quarters of PFY 2000, aggregate volume is predicted with considerable accuracy for total First-Class, total Periodicals and total Standard(A) mail. Typically, the percentage errors for all of First-Class and Standard A Mail lie within a range of several percent. However, the errors for most subclasses are larger in magnitude. The errors tend to be even larger for the smaller subclasses and worksharing categories of mail. On the whole the errors exhibit a pattern that could be explained by a fair amount of sampling error in the RPW statistics. Sampling errors would affect the RPW statistics for the smaller mail categories more severely than the larger or aggregated categories.

[2051] As in most earlier proceedings a comparison of predicted to observed overall volumes of mail does not support the hypothesis that the forecasts submitted by the Postal Service will systematically understate volumes during the test year. That is, the forecasts submitted by the Postal Service do not appear to have any overall bias

through the four quarters of PFY 2000. However, as noted above, the Service's forecasts are based upon an overly pessimistic May 1999 DRI economic forecast.

[2052] Most of the differences between forecast and observed volumes do not appear to be entirely random from quarter to quarter. First, there is an evident tendency for differences to persist from quarter to quarter. This tendency for differences to persist may be explained in part by properties of the forecasting methodology used by Postal Service witnesses. This methodology forecasts off a base year rather than off the mean of the sample. Errors in the base year's RPW statistics are incorporated in the forecasts for the postal quarters that follow. For example, if the RPW volumes for Presorted Post Cards were high by 15 percent in the base year, this would be carried into the forecasts as a tendency for the quarterly forecasts of volumes to exceed actual volumes by 15 percent. Persistent differences may also be caused by incorrect net trends.

[2053] The second evident nonrandom pattern is to be seen in the errors for different worksharing categories for the same subclass. For example, in the errors for single-piece and worksharing First-Class letters and in the errors for regular presort and automation presort Standard Mail (A). The errors for these worksharing categories are very often offsetting. This means that witness Thress' share model is not doing a particularly accurate job of dividing the subclass volumes predicted by his econometric equations.

5. The Postal Service and Commission Forecasts for the Test Year

[2054] A side-by-side comparison of Postal Service and Commission after-rates volume forecasts in the Test Year is shown in Appendix I, Table I-2. The forecasts in column from left to right are: Column 1, the USPS forecast as filed using the USPS proposed rates and June 1999 DRI economic forecast, Column 2, the USPS forecast as filed with Priority and Express mail revisions, Column 3, the Commission's forecast with the recommended rates and June 1999 DRI economic forecast.

C. Changes and Adjustments to Test Year Costs and Revenues

[2055] In addition to the update-related changes summarized in subsection A., the Commission has made other adjustments and corrections in costs and revenues where they have been found to be justified. A summary of the major non-update related changes in the revenue requirement is provided at the conclusion of this subsection, following a discussion of two adjustments proposed by participants.

1. Supervisor Cost Reduction Program

[2056] DMA witness Buc proposes a reduction of approximately \$93 million in supervisor costs in this case to correct what he characterizes as a flaw in the Postal Service's rollforward model. In Docket No. R97-1, witness Buc testified that supervisors' costs should be reduced in proportion with decreases in their managed employees' work hours resulting from cost reduction programs. The Commission agreed with the proposal and recognized a net decrease in supervisory costs of approximately \$100 million, finding that the Postal Service had not effectively rebutted its factual premises with record evidence. PRC Op. R97-1, para. 2154.

[2057] Inasmuch as the Service made no such proportional adjustment to supervisory costs in this case, witness Buc reiterates his proposal on the same grounds. Tr. 22/9547-49. In response, the Postal Service sponsors the rebuttal testimony of witness Patelunas, USPS-RT-4. According to witness Patelunas, witness Buc's proposed adjustment is improper because it is inconsistent with operational realities, which effectively limit the opportunity to reduce supervisor costs in direct proportion to craft workhour savings in implementing cost reduction programs. Tr.38/17142-43. Witness Patelunas also testifies that actual supervisor costs for FY 1998 were very close to both the Postal Service's and the Commission's original, unadjusted estimate in the R97-1 case, while the proportionally adjusted estimate shows a greater variance. This, he suggests, demonstrates that the argument underlying the adjustment is invalid. *Id.* at

17144. In summary, witness Patelunas testifies that supervisor cost savings opportunities should be reviewed in the context of the functions, obligations and environment of supervision, not “merely mechanistically piggybacked on direct labor costs.” *Id.* at 17145.

[2058] Notwithstanding the testimony in rebuttal to the proposed adjustment, the Commission will retain this approach to estimating supervisor costs, resulting in a cost reduction of approximately \$97 million. Witness Patelunas’ testimony discloses operational limitations that might prevent supervisory costs from decreasing proportionately with craft workhours in implementing cost reduction programs, and the Commission welcomes more detailed presentations on this subject in future proceedings. However, Postal Service Library Reference USPS LR-I-1, “Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 1998,” contains the following statements:

Description and Rationale for Classification

* * *

It is recognized that a change in employee workhours, caused by a change in mail volume, may not be accompanied immediately by a corresponding change in firstline supervisory workhours. *However, for any substantial or prolonged change in the level of non supervisory employee effort for a given work activity, there will be an accompanying change in firstline supervisory requirements.*

* * *

Volume Variable Costs

Accrued costs for firstline supervision of mail processing activities are volume variable to the same degree as the accrued costs of mail processing personnel in Cost Segment 3.

USPS-LR-I-1 at 2-2, §§ 2.1.1, 2.1.3. (emphasis added.) These statements, which are unchanged from corresponding provisions in USPS-LR-H-1 in Docket No. R97-1, lend support to the factual premise of witness Buc's proposed adjustment—namely, that in the long run developments that decrease employee work effort should also result in decreases in supervisory work effort, and that both will be reflected in volume-variable cost changes. There may be exceptions to this linkage, as witness Patelunas testifies, but in the absence of more detailed evidence, the Commission concludes that the proportional relationship on which the adjustment relies remains valid.

[2059] Regarding witness Patelunas' argument based on actual versus estimated supervisor cost results for FY 1998, the Commission does not view the reported variances as probative evidence of the invalidity of witness Buc's proposed adjustment. Many factors can influence the amount of cost actually incurred in this category in a fiscal year, and the effect of operational cost reduction programs has not been isolated and retrospectively analyzed and reported by the Postal Service on the record. Such analysis would be useful in establishing the effectiveness of the Service's cost reduction efforts, and the Commission recommends it for use in future proceedings.

2. Proposed Disallowance for Inefficient Processing of Flats

[2060] Witness Haldi, testifying on behalf of the Alliance of Nonprofit Mailers, proposes that the Commission reduce the unit cost of Periodicals on the basis of a judgmental assessment that the Postal Service has under-invested in flats processing equipment that would have enhanced processing efficiency and thereby restrained cost increases. He testifies that the Service's spending on capital investment has been

grossly inadequate, and has led to severe shortages of mechanized and automated sorting capacity for periodical and non-letter mail and of facility space for sorting such mail. Tr. 22/9625-42. According to witness Haldi, no obstacle or countervailing consideration has prevented the Postal Service from making adequate capital commitments that would have prevented these developments. *Id.* at 9643-48. On the ground that, “[t]he Postal Reorganization Act entitles the Postal Service only to those revenues needed to cover costs under ‘honest, economical and efficient management[,]’” *Id.* at 9622 (footnote omitted), witness Haldi proposes that the Commission redress the Service’s inaction by disallowing 1.2 cents per piece for all Regular Rate, Nonprofit and Classroom periodicals mail in the test year, for a total of approximately \$94 million. *Id.* at 9650-54.

[2061] In response to this proposal, the Postal Service filed rebuttal testimony sponsored by witnesses Dowling and Strasser. Witness Dowling, the Postal Service’s Vice President of Engineering, testifies that the Service has made continuous progress since the early 1990’s toward its ultimate objective of bringing flats automation along as far as letter automation has progressed. According to witness Dowling, the Service has pursued this objective through acquiring and upgrading where possible successive generations of flats processing equipment, as well as small parcel and bundle sorters. He also states that the Service is currently developing several designs for a flats bundle collator. Tr. 46A/20476-80. Further, while witness Dowling agrees that technological advancements in processing flats have lagged behind letter automation, he states that it has not been due to a lack of commitment. He testifies that the Service and its supplier have aggressively pursued development of new flats processing technologies, but observes that not all research activities lead to viable improvements. *Id.* at 20480-81.

[2062] Witness Strasser opposes ANM’s proposed productivity adjustment on several grounds. He testifies that witness Haldi’s adjustment is based on faulty premises concerning the appropriate level of capital investment by the Postal Service and a skewed selection of FY 1993 as a base period. *Id.* at 20201-03. Further, he states the

proposed adjustment fails to account for numerous cost savings programs that inure to the benefit of Periodicals between the base year and the test year. *Id.* at 20203.

[2063] Witness Strasser observes that there are many, sometimes highly complex reasons for changes in unit costs, and states his opinion that it would not be prudent to disallow increased costs that may be due to changes in the makeup of mail or other causes. More generally, he states that such an adjustment would be unjustified in light of witness Dowling's demonstration that the Service has pursued flats automation opportunities in a responsible way. *Ibid.*

[2064] On brief, the Postal Service argues that the proposed disallowance of costs should be rejected because it is flawed factually, analytically, and legally. The Service contends that, contrary to witness Haldi's claims, the record reflects a consistent pattern of prudent investment, including research and development in pursuit of efficiency gains, that is fully supported by postal management and the Board of Governors. Postal Service Brief at II-12 through II-13. Analytically, the Service argues that witness Strasser exposed witness Haldi's failure to account for new and expanded cost savings programs for Periodicals between the base and test years, and his flawed reliance on total factor productivity and net investment rates in other industries. *Id.* at II-13.

[2065] Finally, the Service presents extensive legal argument to support its assertion that the proposed disallowance relies on a defective interpretation of the Reorganization Act. According to the Service, witness Haldi's testimony unjustifiably superimposes the "honest, economical, and efficient management" (or "HEEM") standard in § 3621 upon the § 3622 ratemaking criteria the Commission implements in rate proceedings. *Id.* at II-14-II-22. Further, the Service argues that disallowing *future* estimated costs on the basis of alleged *past* management failures would both violate the § 3621 breakeven requirement and involve the Commission in reducing the revenue requirement for disciplinary purposes, which the Court of Appeals found to be in excess of its authority in Newsweek v. United States Postal Service.⁷ *Id.* at II-22-II-24. Finally,

⁷ 663 F.2d 1186 (2d Cir. 1981).

the Service argues that the breakeven requirement in §3621 makes disallowance of actual costs because of HEEM concerns while still providing sufficient revenues a practical impossibility. In any event, the Service asserts, it has met its obligations under the HEEM standard with respect to Periodicals mail by giving special recognition to cost reduction programs in this proceeding. *Id.* at II-16-II-26.

[2066] The Commission declines to disallow any portion of the estimated costs of Periodicals mail on the basis of witness Haldi's proposal. While the Commission holds opinions on the extent of its role vis-à-vis the revenue requirement that diverge from those argued by the Postal Service—as the following subsection will elaborate—the Commission believes the facts must control the outcome of all such controversies. In view of the Postal Service's detailed testimony explaining its ongoing efforts to improve the efficiency of flats processing, the Commission finds insufficient justification for concluding that the Postal Service has incurred expenses in contravention of the honest, efficient, and economical standard of § 3621 with respect to Periodicals mail or flats generally.

3. Summary of Non-Update Changes and Adjustments

[2067] *Proportional reduction in supervisor costs.* In addition to the discussion of this proposed adjustment in subsection C.1., Appendix D, Schedule D-3, displays the calculation of this reduction.

[2068] *Increase in First-Class additional-ounce revenue.* This revenue adjustment is discussed in § V.B.1.e., and its calculation is presented in Library Reference PRC-LR-3.

[2069] *Miscellaneous adjustments in flats processing costs.* Some of these reductions were proposed by participants as decreases in Periodicals costs, and these are discussed in § V.D.2.c. The cost reduction associated with reduced flats bundle breakage is a component of the Postal Service's "breakthrough productivity" initiatives, and is discussed in Appendix D.

[2070] *Adjustments resulting from application of PRC attribution methodology.*

Applying the Commission's cost attribution methodology as discussed in various portions of Chapter III produces changes in the revenue requirement. The detailed application of these changes is presented in Library Reference PRC-LR-4.

[2071] *Further updates.* The Commission has recalculated projections of cost-of-living allowance additions to employee compensation by substituting the actual CPI-W indices for June through September, 2000, for the estimated January, 2001 and July, 2001 indices. This necessitates a recalculation of the estimated CPI-W indices for October, 2000 through September, 2001. These updates, described in Appendix D, result in increases in estimated COLA for FY 2001, displayed in Table D-2.

[2072] *Miscellaneous corrections of USPS volumes, revenues and costs.* These various corrections are documented in Appendix D and Library Reference PRC-LR-3.

[2073] *Contingency provision.* The Commission's recommendations regarding the amount of the provision for contingencies are discussed in subsection D.

D. Provision for Contingencies

[2074] Having arrived at an aggregate estimate of the costs likely to be incurred by the Postal Service in the test year, it is now appropriate to turn to a separate revenue item, the provision for contingencies. In identifying potential categories of "total estimated costs" of the Postal Service recoverable through postal rates and fees, such as operating expenses and various financial accounts, § 3621 explicitly includes "a reasonable provision for contingencies" without further description or explanation.

[2075] While the component of the Postal Service's revenue requirement included in particular rate requests as a contingency provision has been a focus of participants' presentations in past omnibus rate proceedings, the Service's proposed 2.5 percent contingency allowance has provoked extensive criticism and controversy in this case. A number of mail users and the Office of the Consumer Advocate have challenged the proposed amount as excessive, and offered testimony proposing recognition of lesser

amounts in the revenue requirement. In addition to sponsoring rebuttal testimony responsive to these challenges, the Service has presented extensive legal argument on brief concerning such fundamental issues as the scope of the Commission's authority in this area and the respective roles of the Governors and the Commission in ratemaking under the Reorganization Act. The unusual prominence of this controversy requires particular attention in this opinion.

[2076] *Postal Service Request.* In Docket No .R97-1, the Postal Service's request provided for a 1 percent contingency, which had a dollar value of \$605.5 million at the level of accrued costs estimated by the Service in that case. Witness Tayman characterized 1 percent as a "smaller" contingency, and testified that the amount represented the Postal Service's desire to keep rate increases as low as possible and below the level of growth in general inflation. He also cited the Service's recent financial success, the favorable economic climate at that time, and postal management's concern about the effect of the contingency on rate levels in support of a smaller contingency. However, he left the door open for a return to a larger contingency in the future, if necessary, because of changed circumstances. PRC Op. R97-1, para. 2024, citing USPS-T-9 at 38.

[2077] In this case, witness Tayman testifies in support of a larger proportional contingency of 2.5 percent. The dollar value of this proportion is \$1.68 billion on a test year after-rates basis. USPS-T-9 at 43.

[2078] Witness Tayman presents several rationales for what he characterizes as a "mid-range" contingency of 2.5 percent, between the 1- and 2-percent amounts included in Docket Nos. R97-1 and R94-1 and the 3.5 percent contingencies included in earlier cases. He cites the following considerations: (1) recent financial performance less favorable than in the mid-1990s; (2) volume growth below historical norms and projections accompanied by delivery network growth; (3) the challenge of achieving a 1.5 percent workyear reduction in the test year; (4) apparently significant new pressures on salary and benefit cost levels; (5) an acceleration in health benefit cost increases and the prospect of significantly more costly labor contracts; (6) the increasingly competitive

environment in which the Postal Service operates, including electronic alternatives and U.S. operations of foreign postal administrations; and (7) the Postal Service's inability to implement rates recommended in this proceeding until January, in the second quarter of the test year. *Id.* at 43-44.

[2079] Witness Tayman also provides historical variance analyses similar to those included in past Postal Service filings, which produce hypothetical test year variances ranging from -2.2 percent (or -\$1.5 billion) to 2.3 percent (or a positive \$1.5 billion). However, he states that these analyses are provided for informational purposes only, and opines that variance analyses should not be the basis for determining the need for a contingency or its size. His belief is based, in part, on recognition that "[t]he Postal Service's financial performance is under much greater pressure and is subject to substantially greater risks than it was at the time of the last two omnibus rate cases." *Id.* at 45.

[2080] *Testimonies of Participants Opposing Postal Service Contingency Proposal.* Several participants sponsored testimony opposing the Postal Service's proposal of a 2.5 percent contingency. These parties include the Association of American Publishers; the Coalition of Religious Press Associations; a consortium consisting of Direct Marketing Association, Advo, Inc., Alliance of Independent Store Owners and Professionals, Alliance of Nonprofit Mailers, Amazon.Com, Inc., American Business Media, American Library Association, Association for Postal Commerce, Association of Priority Mail Users, Inc., Coalition of Religious Press Associations, Dow Jones & Company, Inc., Florida Gift Fruit Shippers Association, Magazine Publishers of America, Major Mailers Association, McGraw-Hill Companies, Inc., Parcel Shippers Association, and Time Warner Inc;⁸ the Office of the Consumer Advocate; Parcel Shippers Association; and Val-Pak Direct Marketing Systems, Inc. and Carol Wright Promotions, Inc.

⁸ The Commission's rules encourage participants with similar interests to offer joint presentations to facilitate efficient and expeditious proceedings.

[2081] *Testimony of witness Buc.* In testimony sponsored jointly by 16 mail users and associations, Lawrence G. Buc opposes the Postal Service's contingency provision as being "neither reasoned nor reasonable." Tr.22/9531. Following a review of the Commission's criteria and actions regarding the contingency provision in past proceedings, witness Buc asserts that witness Tayman's presentation in this case provides little support for the Service's proposed contingency provision. He criticizes Witness Tayman's dismissal of the Service's variance analysis as a basis for determining an appropriate contingency level, and asserts that five of the seven considerations he cites do not provide support because they concern financial challenges that cannot be considered "unforeseen and unforeseeable events." *Id.* at 9540-44.

[2082] Witness Buc also testifies that neither the current financial condition of the Postal Service nor general economic conditions provide support for the 2.5 percent contingency provision. According to witness Buc, the financial condition of the Service as measured by its equity position is far superior in this case compared with its status in the last two cases, and it is currently ahead of its cumulative target for equity restoration. Thus, the Service is better situated to withstand adverse unforeseen events than it was in cases in which contingency requests of 1 and 2 percent were approved. *Id.* at 9544-45. Further, he testifies that projections of relevant measures of test year inflation in the form of the consumer price index (CPI-W), the Employment Cost Index (ECI), and the Producer Price Index (WPI) do not indicate the need for a higher contingency provision in this case than in the previous two. *Id.* at 9545-46.

[2083] Given the results of the variance analysis presented by witness Tayman, the financial condition of the Postal Service, the state of the economy, and the guidance provided by the Commission's decisions over the past 25 years, witness Buc submits that a reasoned and reasonable contingency in this case should be no larger than those incorporated in either of the previous two omnibus rate cases. In comparing R94-1 to R2000-1, he testifies that the variance analysis and the Service's financial condition indicate that a much smaller contingency is needed in this case than the 2 percent provision adopted in R94-1. In comparing R97-1 to R2000-1, he testifies that the same

indicia suggest a smaller provision, while the general state of the economy could support the same 1 percent contingency in this case as adopted in R2000-1. Consequently, witness Buc concludes that a reasoned and reasonable contingency is 1 percent in this proceeding. *Id.* at 9547.

[2084] *Testimonies of OCA witnesses Burns and Rosenberg.* The Office of the Consumer Advocate sponsored the testimonies of Robert Burns and Edwin Rosenberg, both of whom are affiliated with the National Regulatory Research Institute (NRRI), the research and public service organization for the National Association of Regulatory Utility Commissioners (NARUC), of which the Commission has been a federal member since 1971. Both witnesses oppose the Postal Service's 2.5 percent contingency provision, but offer somewhat different perspectives in doing so.

[2085] *Testimony of witness Burns.* Witness Burns addresses the purpose of the statutory provision for contingencies, the standards applied by the Commission in reviewing particular provisions in rate proceedings, and the adequacy of the reasons given by witness Tayman in support of the 2.5 percent contingency in the Postal Service's request. According to witness Burns, the purpose of the contingency provision is twofold: to provide a cushion against potential expenses caused by unforeseeable events, and to compensate for forecasting errors. *Id.* at 9710. Witness Burns observes that contingency reserves are used for the same purpose in the insurance industry, and are subject to a requirement that the provision be clearly related to future, uncontrollable events, rather than serving as a device to smooth out irregularities or volatility in earnings. *Id.* at 9710-11. This requirement is important, he testifies, because without it contingency reserves tend to become larger than necessary, and managers of the enterprise make less effort to limit cost increases within their control. *Id.* at 9712-14.

[2086] Witness Burns testifies that the Commission's approach to reviewing the Service's contingency request in past cases has been consistent with these precepts, by focusing on prevailing national economic conditions, requiring that postal management's subjective perception of risks be reasonably articulated, and requiring supporting substantial evidence, such as the results of variance analyses. According to witness

Burns, the Commission's prior decisions suggest that proper assessment of a proposed contingency provision rests on: (1) careful evaluation of postal management's explanation of its subjective judgment on the proposed level; (2) objective review of potential forecasting errors; and (3) consideration of external factors such as key national economic indicators and economic stability. *Id.* at 9714.

[2087] The balance of witness Burns' testimony addresses the first mode of assessment. He asserts that Postal Service witness Tayman has not articulated a reasonable basis for substantiating management's subjective judgment in favor of a 2.5 percent contingency provision. Regarding witness Tayman's reference to unfavorable recent financial performance, witness Burns notes that the 1 percent contingency approved in R97-1 allowed the Service to finish Fiscal Year 1999 with net revenue of \$363 million, notwithstanding substantial spending on Y2K computer system remediation in that period and the surrounding two fiscal years. *Id.* at 9716-17. Regarding volume growth below historical norms and the Service's planned 1.5 percent workyear reduction, witness Burns testifies that this is an area within postal management's scrutiny and control. *Id.* at 9717. Witness Burns similarly asserts that the "new pressures" on salary and benefit levels, health benefit cost increases, and labor contract costs are either within postal management's influence or subject to estimation from available indices and forecasts; he also claims witness Tayman's reference to "other uncertainties" affords no support in the form of substantial evidence.

[2088] With respect to the "increasingly competitive environment" in which the Postal Service purportedly operates, witness Burns notes that the Service's volume forecasts take such potential diversions of mail into account, and claims that witness Tayman's general reference to the Internet making inroads into mail volume is insufficient to influence the rational choice of a contingency level. *Id.* at 9718-19. Finally, on the subject of possible legislative change, witness Burns claims that the potential for an outcome beneficial to the Postal Service—in the form of increased ratemaking flexibility—appears to be at least as favorable as the potential for a negative outcome. *Id.* at 9719.

[2089] On the basis of his review of the risk factors presented by witness Tayman, witness Burns concludes that the Postal Service has failed to articulate a rational connection between potential uncontrollable risks in the test year and the proposed \$1.69 billion contingency provision. He therefore concurs with witness Rosenberg's recommendation that the level of the contingency be kept at 1 percent. *Ibid.*

[2090] *Testimony of witness Rosenberg.* Witness Rosenberg opposes increasing the contingency provision to 2.5 percent as neither necessary for the continued successful operation of the Postal Service nor in the public interest. His opinion is based on his application of public policy considerations, regulatory principles, and evaluation of witness Tayman's testimony and exhibits.

[2091] Witness Rosenberg establishes a context for his recommendations by identifying postal ratemaking under the Reorganization Act as a variant of cost-of-service ratemaking that avoids some of its shortcomings. Particularly, he observes that the Postal Service is allowed to base its rate requests on its best estimates of costs in a prospective test year, rather than being tied to historical costs; that in addition to relying on projections of future costs a contingency allowance is available to provide a margin of safety against unforeseen and uncontrollable circumstances; and that if revenue and expense estimates nevertheless prove to be off target, the resulting operating deficit can be recovered in the future through use of the prior years' loss provision. Thus, he states, the Postal Service has three different levels of protection for breaking even financially while providing good service to consumers at reasonable rates. *Id.* at 9807-09.

[2092] Witness Rosenberg characterizes the function of the contingency provision as a form of insurance against unforeseen, unexpected, and uncontrollable adverse fluctuations in revenues or expenses. Because prospective cost estimates cannot account for all possible fluctuations, the contingency provision serves as a cushion against occurrences that could not reasonably be forecasted or foreseen. Additionally, the contingency serves implicitly as a means for lengthening the time between postal rate increases. The essential question, he submits, is: What is the optimum size of the contingency? *Id.* at 9810.

[2093] According to witness Rosenberg, a disciplined analysis of the question would consider: (1) the magnitude and types of uncertainties requiring a contingency, with particular attention to the state of the economy; (2) the Postal Service's historical experience with contingency provisions of various magnitudes; and (3) the short-run and long-run effects of either too large or too small contingency provisions on the Postal Service and its managers, and on the Service's customers. Based on his analyses of these considerations, witness Rosenberg testifies that a 2.5 percent contingency is not necessary at this time, and that a 1 percent contingency provision should be recommended. *Id.* at 9810-11.

[2094] Addressing the first consideration, witness Rosenberg presents statistics to support his conclusion that conditions in the national economy are relatively stable: the United States is currently enjoying the longest economic expansion in more than half a century, and is doing so in a climate of relatively low inflation. According to witness Rosenberg, these conditions should allow the Postal Service to meet its responsibilities with a minimum contingency provision. *Id.* at 9811-15.

[2095] Regarding the second consideration, he testifies that the Postal Service has been able to achieve a positive net income over the two most recent rate cycles with contingency provisions less than the requested 2.5 percent. He notes that the Service has generated a cumulative net income of \$5.58 billion during the FY 1995-2000 period, while the contingency provision was set at 2 percent as the result of Docket No. R94-1 and 1 percent in Docket No. R97-1. On this basis, he concludes that nothing in the Service's recent operating history indicates a need for a 2.5 percent contingency provision. *Id.* at 9815.

[2096] Witness Rosenberg also asserts that adopting a 2.5 percent provision in this case would run counter to a downward trend he identifies in the contingency provision over time. He observes that the Postal Service has had nearly 30 years of experience operating under the Reorganization Act in a more businesslike manner, and that its forecasting ability is improving. Witness Rosenberg presents a chronological table

showing, he testifies, coincident downward trends in CPI increases and the percentage value of the contingency provision in successive rate cases since 1976. *Id.* at 9816-19.

[2097] Witness Rosenberg also observes that the requested increase in the contingency provision from 1 percent to 2.5 percent requires the production of additional revenue in excess of 27 percent of the total revenue requirement deficiency identified by witness Tayman. An increase of this magnitude, he believes, requires well-reasoned justification. However, he cites the inadequacies in witness Tayman's rationale addressed by his colleague witness Burns and finds no support in the variance analysis presented by witness Tayman. He notes that the proposed 2.5 percent allowance lies outside the range of that variance analysis, and that its four scenarios produce results that both on average and in total involve revenue deficiencies of less than 1 percent. *Id.* at 9820-24. Witness Rosenberg also testifies that it would be useful for the Postal Service to develop some other analytical approach for this purpose, and provides examples from the electric utility, telephone, and natural gas industries. *Id.* at 9824-26.

[2098] On the third consideration he addresses—the short-term and long-term effects of smaller and larger contingency provisions on the Postal Service, its management, and its customers—witness Rosenberg advances several reasons for concluding that larger provisions are not preferable. If the cushion provided by the contingency allowance is too thick, he states, postal management will have a diminished incentive to manage economically and efficiently because the goal of breakeven can be achieved without having to make tough decisions in the face of higher cost levels or other adverse circumstances. *Id.* at 9826-27. According to witness Rosenberg, restoration of equity would not justify erring on the side of too large a contingency provision; this function should be restricted to the prior years' losses allowance, and a shorter amortization period should be requested if the Postal Service wishes to accelerate its rate of equity recovery. *Id.* at 9830-32. He also observes that a smaller contingency provision can be achieved by shortening the Postal Service's rate cycle, which will increase forecasting accuracy by shortening the horizon of estimation. *Id.* at 9828-30.

[2099] Finally, witness Rosenberg testifies that the contingency provision should not be increased to 2.5 percent in light of impact considerations. He notes that the required additional \$1 billion will be extracted from the pockets of Postal Service customers, who will suffer a consequent lost opportunity cost. He denies that the arguable indirect benefit to customers of providing longer rate stability furthers the purpose the contingency provision is intended to serve. *Id.* at 9827-28. He also observes that increasing rates by an additional \$1 billion to fund a larger contingency provision may be counterproductive, because it would degrade the Postal Service's position in what witness Tayman characterizes as an "increasingly competitive environment," and at worst may produce a "vicious cycle" in which rising postal rates create more headroom for competitors, which would result in lower postal revenues and pressure for further rate increases. *Id.* at 9832-33, citing USPS-T-9 at 44.

[2100] Following the Postal Service's filing of information in response to Order No. 1294, OCA submitted additional testimony by witness Rosenberg in which he reconsiders his recommendation of a 1 percent contingency provision in light of the new presentation. According to witness Rosenberg, the Service's updated expense estimates may overstate the revenue requirement and the claimed revenue deficiency; in particular, he identifies the "Field Reserve" exclusion of \$200 million from target cost reductions, the shift from ECI minus one to ECI for estimating growth in labor costs, and witness Patelunas' failure to recognize actual results for FY 2000 as possible bases for reducing the estimated net loss of \$325.5 million. Tr .41/18304-08.

[2101] Witness Rosenberg notes witness Patelunas' confirmation that the revised cost level estimates, based on more recent DRI forecasts identified in a table included in the rebuttal testimony of OCA witness Thompson, are likely to be more accurate than those contained in the original filing. On this basis, witness Rosenberg testifies that the more recent forecasts support a less generous contingency provision. However, he testifies that use of the May 2000 DRI indices for fuel prices, rather than the lower indices issued by DRI in July 2000, would tend to overstate these test year expenses. *Id.* at 18308-10.

[2102] Using the test year costs presented by witness Patelunas, which he believes may be overstated, witness Rosenberg estimates that a 1 percent contingency provision would produce a revenue surplus of \$739.4 million. He states that the surplus will be even greater if costs are lower than estimated, or if the final results for FY 2000 are better than the Postal Service's predicted deficit. For these reasons, he maintains his previous recommendation of a 1 percent contingency provision. *Id.* at 18312.

[2103] *Testimony of witness Haldi.* Witness Haldi, testifying on behalf of Val-Pak/Carol Wright, opposes the Postal Service's contingency proposal as inadequately supported and excessive. Inasmuch as the Postal Service has recently added significantly to its forecasting capabilities, and the provision for recovery of prior years' losses is available in the test year, he submits that the Service should not need such a large contingency to insure against errors in forecasting. Tr.32/15784-85. Indeed, because the prior years' losses recovery mechanism serves as a retrospective contingency allowance, he states that it is not necessary to be overly conservative about protecting against any shortfall during the test year via a large prospective contingency. *Id.* at 15787. He also testifies that surpluses should not be intentionally created by inflating the contingency provision in order to fund capital improvement programs, as the Postal Service has ample borrowing authority. *Id.* at 15785-87.

[2104] Witness Haldi further testifies that the Service's proposed contingency provision is not only unnecessarily excessive, it is also counterproductive to the sound management of the Postal Service. He observes that the fixed costs of the Service's delivery network are large, and that spreading those fixed costs to keep rates affordable to all users requires large volumes of mail. He also notes the recent expressions of concern by GAO and others about the prospect of major declines in future volume because of electronic diversion. In light of these considerations, he testifies that the Postal Service needs to keep rate increases to an absolute minimum to preserve necessary volume.

[2105] Witness Haldi notes that, contrary to this recommendation, the proposed 2.5 percent contingency accounts for almost half the aggregate rate increase in this case,

which exceeds the rate of inflation. While superficially this appears to provide the Service additional cash as a cushion against inflation, witness Haldi submits that the higher rates it requires will stimulate competition based both on innovations in information technology and in more conventional media. Therefore, he asserts that the Service's proposed contingency is counterproductive, and should be reduced to no more than 20 to 25 percent of the projected test year shortfall without any contingency, *i.e.*, to between \$400 and \$500 million in this case, with any actual additional shortfall to be made up through prior years' loss recovery. *Id.* at 15787-90.

[2106] *Testimony of witness Zimmerman.* In a similar vein, Parcel Shippers Association witness Zimmerman questions the Postal Service's willingness to assess a disproportionately large contingency allowance that will drive rate increases above the rate of inflation and have "the predictable effect of killing volume, thereby spreading non-variable institutional costs over a smaller base, with resultant adverse revenue effects. . . ." Tr.29/14130. He remarks on the Postal Service's profitable operation following the R94-1 and R97-1 proceedings, in which it requested, and the Commission recommended, overall rate increases that were less than the rate of inflation in the general economy. *Id.* at 14129. If the requested overall 6.4 percent increase were reduced by 2.7 percent, the amount by which the assumed rate of inflation exceeds the CPI-W estimate, he observes that it would have the effect of reducing the increase by \$1.5 billion. Accordingly, witness Zimmerman asserts that the contingency should be reduced by at least \$1 billion, aligning the overall increase much more with the expected inflation rate in the general economy. *Id.* at 14130-31.

[2107] *Testimony of witness Stapert.* Dr. John C. Stapert, testifying on behalf of the eight-member Coalition of Religious Press Associations (CRPA), also testifies in opposition to the Postal Service's proposed contingency provision. He notes that the Coalition endorses the testimony of witness Morrow on the proper amount of contingency allowance that Periodicals should bear,⁹ but offers additional observations regarding aspects of the Service's proposal that he finds "particularly peculiar." Tr. 30/14445. He states that witness Tayman's explanation of the need for a \$1.7 billion

contingency allowance is unconvincing in light of the Service's cumulative earnings since the last two rate proceedings, and of its current revenue position. While the contingency purportedly is intended to guard against many unnamed uncertainties, witness Stapert cites witness Tayman's statement that it is reflected as a test year expense and cash requirement, and thus "[i]t is a certainty that USPS will spend every dime it can get, which hardly promotes efficiency." *Id.* at 14446.

[2108] *Testimonies of DMA witnesses Buc and Bernheimer.* Following the Postal Service's submission of supplemental testimony and other information in response to Order No. 1294, the DMA-led consortium filed the supplemental testimonies of witnesses Buc and Bernheimer, as provided for in P. O. Ruling R2000-1/71. Both testimonies address the appropriate level of contingency provision in light of the updated information provided by the Postal Service.

[2109] *Supplemental Testimony of witness Buc.* Witness Buc revises his earlier recommendation of a 1 percent contingency provision to one-quarter of 1 percent. The revision of his earlier contingency proposal is based on his review of the testimony of Postal Service witness Patelunas, USPS-ST-44. Tr. 38/17185.

[2110] According to witness Buc, there are four reasons for reducing the contingency to a fraction of 1 percent. First, he claims that witness Patelunas' use of the full value of the Employment Cost Index (ECI)—rather than ECI minus 1, used in the Service's initial presentation—as a basis for estimating the aggregate percentage pay increase in upcoming wage settlements justifies a reduction in the contingency. By increasing the basis for the wage settlement and including these increases in the various cost segments affected, he submits, the Postal Service has correspondingly reduced the risk to which it is exposed in the form of additional labor costs. Using the Postal Service's Library Reference LR-I-421, he calculates the appropriate reduction to equal \$246.6 million. *Id.* at 17187-88.

⁹ Witness William A. Morrow testifies that unique factual circumstances in this case justify application of a zero contingency markup for Periodicals. Witness Morrow's proposal is addressed in the discussion of rate design for Periodicals, Chapter V. D.

[2111] The second basis cited by witness Buc is witness Patelunas' failure to include in his revised estimates for Postal Service cost reduction programs the full amount of cost reductions to which the Postmaster General has publicly committed. Witness Buc notes that witness Patelunas' revised estimates include an additional \$544 million in cost reductions, \$456 million less than the one billion dollar "breakthrough productivity" target publicly announced by the Postmaster General, and that Patelunas conceded on oral cross-examination that the savings could exceed his estimate. *Id.* at 17188. Additionally, he observes that the cost reductions used by witness Patelunas for his test year after-rates cost forecast are \$200 million less than the cost reductions contained in the draft budget for Fiscal Year 2001. At a minimum, witness Buc submits, the contingency should be reduced by the \$200 million of cost reductions that appear in the draft budget but not in the Postal Service's response to Order No. 1294. *Id.* at 17189.

[2112] The timing of the Postal Service's revision of its cost estimates provides the third basis cited by witness Buc for reducing the contingency. With their filing less than three months before the start of the test year, witness Buc submits that the shortened forecasting horizon reduces the risk of outcomes lying outside the range of predicted increases and decreases. *Ibid.*

[2113] Finally, witness Buc asserts that the very outcome of the Postal Service's re-estimation of test year after-rates costs justifies a lower contingency. He characterizes that process as "an experiment to determine the sensitivity of the deficiency with respect to changes in inflation rates." *Ibid.* Notwithstanding the substantial increases in key inflation indices shown in Exhibit USPS-ST-44AB, and the substitution of ECI for ECI minus one for estimating wage settlement increases, he notes that the effect on Postal Service net income is to increase the deficiency from \$21.8 million in the initial filing to \$275.3 million. Even with the inclusion of \$200 million as a Field Reserve offset to cost reductions, he calculates that the increase in the revenue deficiency represents only 0.38 percent of the original estimated total of test year after-rates costs. *Id.* at 17189-90.

[2114] *Supplemental Testimony of witness Bernheimer.* Approaching postal finance from the “top down,” rather than the Service’s own “bottoms up” approach of rolling segmented costs forward from a base year for ratemaking purposes, witness Bernheimer presents an analysis of aggregate growth in Postal Service costs to support his conclusion that any contingency allowance “is unjustifiable, unnecessary, and uncalled for.” Tr .46A/20420. Inasmuch as detailed data are available for the first 11 accounting periods of FY 2000, and the Service has selected FY 2001 as its test year, witness Bernheimer states that there is sufficient information to make a very accurate estimate for the year immediately preceding the test year. Using an expense growth rate of 4.5 percent, notwithstanding the Service’s cost-cutting programs, witness Bernheimer projects total expenses for FY 2000 to equal \$64.513.5 billion, which represents a 3.9 percent increase over expenses for FY 1999. *Id.* at 20421.

[2115] Witness Bernheimer observes that the Postal Service’s revenue requirement of \$69.644.9 billion incorporates a growth rate of 8.0 percent over the estimate he calculates for aggregate expenses in FY 2000. According to witness Bernheimer, a growth rate of this magnitude is “exaggerated and unreasonable.” *Ibid.* He observes that it is inconsistent with the seven-year average of 4.3 percent in expense growth from FY 1993 through his estimated result for FY 2000, and asserts that it cannot be explained by inflationary increases in transportation or employment costs or declining productivity. *Id.* at 20421-23. He also claims that the 6.8-point difference derived by subtracting the percentage estimate of volume growth from the corresponding percentage for expense growth for FY 2001 is anomalously high in comparison with the seven-year average of about 1.3 points, and could only occur as the result of the “grossest possible mismanagement” of the Postal Service. *Id.* at 20423-24.

[2116] Witness Bernheimer submits that this result will not occur, and for that reason proposes elimination of the full amount of the proposed contingency provision from the revenue requirement. In practical effect, he observes that the reduced revenue requirement will still represent an amount approximately 5.3 percent higher than his projection of total expenses for FY 2000, the highest rate of increase in the past eight

years. At the same time, he notes, this increase would be occurring against the background of a 1.2 percent volume growth projection, the lowest rate of increase during the same period. Even with an additional reduction of \$600 million, he notes that the resulting revenue requirement of \$67.3 billion would incorporate an increase from estimated FY 2000 costs that matches the average of 4.3 percent for the past eight years. *Id.* at 20424-25.

[2117] Witness Bernheimer concludes with projections of Postal Service financial results assuming the level of expense he projects for FY 2000 and introduction of rates based on a revenue requirement that does not include a contingency provision. Assuming an average rate increase of 4.6 percent at a point one-third of the way through FY 2001, he projects a loss of \$166 million for FY 2000, a profit of \$331 million in FY 2001, and a loss of \$309 million in FY 2002. *Id.* at 20426. For the test year, with an average expense increase of 4.3 percent and average unit volume growth of 2 percent, he projects that breakeven could be achieved with an average rate increase of 2.6 percent. *Id.* at 20427.

[2118] *Supplemental testimony of witness Siwek.* AAP witness Stephen E. Siwek also addresses the contingency provision in supplemental testimony. Observing that the inflation projections and other data submitted by the Postal Service in response to Order No. 1294 are based on information one year closer to the forecasted test year, witness Siwek expects the accuracy of the Service's forecasts to have improved. He also discounts witness Patelunas' statement that accomplishing the cost reductions related to breakthrough productivity programs will be challenging and involve a higher degree of risk, noting that witness Patelunas has no personal knowledge of risks associated with these programs. Siwek asserts that the overall reduction in risk resulting from updating all cost projections overshadows any greater risk associated solely with the cost reduction programs. Accordingly, should FY 1999 cost data be used in this case, he submits that the contingency must be reduced. T r.38/17096-100.

[2119] *Rebuttal testimonies of witnesses Strasser and Zarnowitz.* On rebuttal, the Postal Service defends its proposed contingency provision in the testimonies of

witnesses Strasser and Zarnowitz. Witness Strasser responds to the parties' counter-proposals generally; witness Zarnowitz offers testimony on the future financial perils against which the contingency provision is intended to insure.

[2120] *Testimony of witness Strasser.* Witness Richard J. Strasser, Jr., Acting Chief Financial Officer and Executive Vice President of the Postal Service, devotes the majority of his rebuttal testimony to defending the proposed 2.5 percent contingency provision against the counterproposals summarized above. In general, he testifies that the proposed provision is a sound product of the Service's judgmental assessment of a variety of factors, including its expected financial condition, historical experience, the potential for unknown future adversities, and the financial, operational, and ratemaking policies established by the Board of Governors. By contrast, witness Strasser asserts, intervenors who argue that a contingency must be justified on the basis of variance analyses and other empirical information would in effect substitute their own judgments to establish a lesser allowance. Tr .46A/20182-83.

[2121] He also states that the proposed 2.5 percent allowance falls well within a range of reasonableness established in prior proceedings, in which provisions from 1.0 percent to 5.0 percent have been recommended. *Id.* at 20183-84. Witness Strasser explains the proposed increase from the 2.0 and 1.0 provisions included in the Service's requests in Docket Nos. R94-1 and R97-1, respectively, as a return to a "more normal, but still modest level" justified by changed circumstances: management challenges in Fiscal Year 2000, accelerating inflation, and greater uncertainty regarding labor costs because of contract expirations during the test year. *Id.* at 20184-86.

[2122] Witness Strasser challenges each of the arguments on which witness Buc bases his proposal of a 1 percent contingency provision. He denies that the Service's proposal lacks an appropriate framework based on quantitative measures, claiming that the Commission's criteria recognize a combination of subjective and objective judgment without necessarily relying on quantitative methods. *Id.* at 20186-88. Witness Strasser also denies that the Postal Service's improved equity position, which witness Buc says could be further improved by better management of its real estate holdings, provides any

basis for lowering the contingency. He asserts that there is no connection between the status of equity restoration and the Postal Service's vulnerability to unknown future adversities or shortfalls, and that witness Buc's claim regarding gains from improved real estate management is speculative. *Id.* at 20188-89. Witness Strasser also challenges witness Buc's testimony that the state of the economy supports a lower contingency provision, citing indications of increased inflation in DRI indices provided in Exhibit USPS-ST-44AB, witness Tayman's testimony regarding increasing competitive pressures, and the rebuttal testimony of witness Zarnowitz. *Id.* at 20189-91.

[2123] Witness Strasser criticizes the testimony of OCA witness Burns, denying his assertion that the Service has failed to articulate a reasonable basis for its subjective judgment regarding choice of a contingency provision and challenging witness Burns' analogy to the insurance industry. Unlike insurance industry reserves, witness Strasser testifies, the Postal Service's contingency allowance is designed to protect against both "known unknowns"—such as volume erosion due to the Internet or future legislation—and totally unknown adverse events. Furthermore, he states, the contingency has an important policy dimension, in that "it represents the level of risk that postal management is prepared to accept in directing the Postal Service's operations and finances." *Id.* at 20192-94.

[2124] Witness Strasser also challenges OCA witness Rosenberg's analysis in support of a 1 percent contingency provision, stating that the Commission has not established firm, objective guidelines conforming to his and witness Burns' "formalistic prescriptions for justifying the contingency." *Id.* at 20194. Furthermore, witness Strasser claims that an alternative analysis grouping the data used by witness Rosenberg more rationally supports the Service's proposed 2.5 percent contingency, rather than the lesser amount proposed by OCA. *Ibid.*

[2125] According to witness Strasser, witness Rosenberg's contention that the current economy is operating in a climate of relatively low inflation is based on a defective analysis purporting to show that inflation has both trended lower and become less erratic in recent years. First, witness Strasser notes that it relies totally on historical

inflation data, rather than the forecasted data he asserts are more relevant to the test year. Second, witness Rosenberg's analysis focuses on the Consumer Price Index, not the Employment Cost Index witness Strasser claims is more relevant to the mix of services and goods used by the Postal Service. Third, witness Strasser argues that witness Rosenberg's grouping of inflation and contingency data into five-year intervals is arbitrary and masks the true relationships between inflation and contingency amounts. *Id.* at 20195.

[2126] Witness Strasser presents a table which differs from witness Rosenberg's by grouping data by rate case test year, and by the years feeding into each test year; by including all inflation data in this Docket, rather than data through the end of 1999; and by displaying the respective ECI index for each period, in addition to CPI-W.

Id. at 20196, Table 1. According to witness Strasser, the increases in inflation indices since the Docket No. R97-1 test year support, rather than refute, the proposed 2.5 percent contingency, and taken alone could support an even higher contingency.

Id. at 20196-97. Witness Strasser also cites the recent surge in fuel prices reflected in Exhibit USPS-RT-1A as support for a higher contingency, as the Postal Service has no mechanism for imposing a price surcharge rapidly, unlike private competitors.

Id. at 20197.

[2127] Witness Strasser also disputes witness Rosenberg's assertion that the Service's recent string of positive net incomes supports a low contingency, stating a concern about the declining trend in the Service's net incomes that has developed despite recent financial successes and favorable economic conditions. He notes that the Service's response to Order No. 1294 estimates a net loss for FY 2000 of \$325 million, and—notwithstanding cost decreases expected from breakthrough productivity initiatives and increased revenues due to revenue generation initiatives—a test year after-rates deficiency of \$475 million. Witness Strasser also states that a favorable economy has not translated into strong volume and revenue growth for the Service, and may create perils in the form of additional pressure on postal wages, higher costs of borrowing, and the increased possibility of an economic slowdown. *Id.* at 20198-99. Given this high

level of uncertainty, he asserts that it would be unreasonable for the contingency provision to be any lower than 2.5 percent. *Id.* at 20197-98.

[2128] According to witness Strasser, witness Rosenberg's advice that the Service should not use the contingency provision to restore equity is misplaced as a policy matter, inasmuch as the Service's equity is currently negative to the extent of almost \$3 billion. More immediately, witness Strasser testifies that it is possible that most if not all of the contingency allowance will be consumed in FY 2001. He explains that rates will likely not be implemented until after the high-volume and -revenue Fall and Holiday mailing seasons, and that much of the remainder will be eliminated by the additional \$651.5 in estimated test year costs identified in response to Order No.1294. Other erosions could occur if volume growth continues to slow, breakthrough productivity cost savings are not realized, there is a shortfall in new revenue generation initiatives, or adverse legislation is passed. *Id.* at 20199.

[2129] Finally, witness Strasser denies witness Rosenberg's claim that the "safety nets" available to the Postal Service in the form of borrowing authority, the mechanism for recovery of prior years' losses, management's ability to control expenses, and the ability to request new rates on the basis of prospective revenue and expense estimates, should reduce the need for a contingency, as all of these factors are considered in arriving at a contingency, and none is intended to protect against incurring a loss as a result of unknown adverse event or errors in estimation. As an example, witness Strasser cites postal management's limited ability to control workhours in the face of the increase in the number of new delivery points. *Id.* at 20200.

[2130] *Testimony of witness Zarnowitz.* Dr. Victor Zarnowitz presents testimony to rebut statements by witnesses Buc, Burns, Rosenberg, and Stapert to the effect that economic conditions will continue to be stable, and that inflation will continue to be relatively low and predictable over the projected rate cycle in this proceeding. In general, he testifies that, although the U.S. economy has benefited from benevolent economic conditions since the mid-1990s, there has been a gradual increase in imbalances and

risks that has accelerated in the past and current year, resulting in a much higher level of uncertainty about the direction of the economy. Tr. 41/18190.

[2131] Witness Zarnowitz testifies that there are signs of a slowdown in current U.S. economic activity and leading indicators. First, he states that the comparatively sluggish growth of the early 1990s reduces the claim that a new pattern of noninflationary growth and noncyclical prosperity is firmly entrenched, and he underscores the continued relevance of the business cycle. Second, while there is no sign yet of a slowdown, he finds new evidence of declines in the growth of consumption and employment in the second quarter of 2000, and increases in business investment and government expenditures are likely to prove temporary. Third, and most significantly, he finds warning signs of a slowdown in the Composite Index of Leading Economic Indicators (LEI), particularly in the financial sector, the high-plateau level of the U.S. Index of Lagging Indicators, and testimony of Federal Reserve Chairman Greenspan on July 20 stating an expectation of a leveling out of demand and a dampening of the “wealth effect” that has been driving consumer spending. *Id.* at 18190-94.

[2132] Witness Zarnowitz also cautions that the remarkable combination of low unemployment and low inflation of the recent past may not last indefinitely. He observes that recent declines in U.S. inflation made possible through lower import prices must be expected to decrease with the improvement of the economic climate abroad and the sharp increase in oil prices. In addition, he states that the containment of inflation through a coincidence of favorable “supply shocks” that have depressed prices cannot be comfortably projected into the future. Also, notwithstanding the low level of increase in “core” inflation as measured by the CPI, witness Zarnowitz anticipates that action by the Federal Reserve Board will have the effect of slowing the economy, and that a “soft landing” is by no means guaranteed. *Id.* at 18194-97.

[2133] Turning to trends in cost and productivity, witness Zarnowitz observes that despite variable gains in hourly wages from 1991 through 1998, the unusually sharp rise in the ECI in 1999-2000 supports concerns that the labor market may yet tighten

sufficiently to force wage increases, leading to more price inflation or a squeeze on profits. He also notes that after variable rates of growth in most of the 1990s, productivity has stabilized and risen since 1997, although at rates that may look surprisingly moderate to the new technology enthusiasts. While profit variables have declined only mildly so far, witness Zarnowitz opines that intensified demand for wage and salary raises may squeeze profits sufficiently to produce a major slowdown. *Id.* at 18197-200.

[2134] According to witness Zarnowitz, the exceptionally strong but increasingly volatile equity markets are viewed as a bubble about to burst by some prominent finance scholars. Should market prices decline in order to reevaluate stocks to reflect more realistic profit assumptions, he cites the expectation of one observer that the Federal Reserve Board does not have the power through interest rate changes to prevent the onset of recession. Even if the apparent overvaluation of equities is justified by a new economic paradigm in which computers and other high-productivity capital goods are substituted for labor, he notes that many seasoned observers predict a tighter monetary policy and higher interest rates to counter the “wealth effect” on consumption demand. *Id.* at 18200-02.

[2135] Witness Zarnowitz also identifies three other sources of uncertainty regarding the future of the economy. Notwithstanding the Federal Reserve Board’s actions intended to keep inflation at moderate levels, he notes the sustained growth in gross domestic product, heavy investment by businesses in new equipment and software, and the continued widening of the trade deficit, which lead to uncertainties regarding further increases in interest rates. *Id.* at 18202-05. Witness Zarnowitz also testifies that after strong rates of growth in the 1995-98 period, some measures of the money supply have exhibited a low growth rate since that time, and this change could well contribute to slowing the pace of economic activity. *Id.* at 18205-06. He also sees potential perils in the low rate of personal saving, the great increase in private borrowing (including risky and expensive margin accounts), the huge level of private debt (at present more than 50 percent greater than GDP and increasing), and the high level of foreign borrowing associated with the burgeoning trade deficit. *Id.* at 18206-08.

[2136] In summary, witness Zarnowitz testifies that the gradual increase in the imbalances that tend to accompany economic booms has greatly accelerated during the past and current years, increasing the risks of a slowdown, higher inflation, higher interest rates, and possibly destabilization of the stock market. Hence he concludes that there is more uncertainty now about forecasts of the economy in the years ahead, including projections of the Postal Service. For this reason, he opines that the Service will generally need more protection of insurance against unexpected adverse events than it has in recent years. *Id.* at 18212-13.

[2137] *Arguments of the parties.* On brief, a number of participants argue for reduction of the 2.5 percent contingency provision included in the Postal Service's request. As part of its argument in favor of reducing the overall revenue requirement by at least \$1.3 billion, the DMA-led Consortium argues that the Commission bears a legal responsibility to approve a contingency provision no larger than what it determines to be reasonable; that a reasonable provision must be based on substantial evidence and should cover only unforeseen expenses and forecasting errors; that the Postal Service has not justified its proposed 2.5 percent allowance; and that the Commission should approve a contingency provision no greater than 1 percent. Joint DMA *et al.* Brief at 2-20. If the Commission projects test year costs using update estimates, the Consortium argues that the contingency provision should not exceed 0.25 percent. *Id.* at 20-21.¹⁰ The Association of American Publishers,¹¹ Coalition of Religious Press Associations,¹² Greeting Card Association and Hallmark Cards, Inc.,¹³ the Commission's Office of Consumer Advocate,¹⁴ Parcel Shippers Association,¹⁵ and Val-Pak Direct Marketing

¹⁰ In their Reply Brief of September 22, DMA *et al.* respond to the arguments of the Postal Service and amplify on their positions.

¹¹ AAP Brief at 29, 31.

¹² CRPA Brief at 5.

¹³ Joint GCA and Hallmark Brief at 24-32.

¹⁴ OCA Brief at 39-74.

¹⁵ PSA Brief at 39-41, 44.

Systems and Carol Wright Promotions¹⁶ also advocate the use of a contingency provision significantly below the 2.5 percent incorporated in the Postal Service request.

[2138] In its brief, the Postal Service argues that its proposed contingency provision is supported by substantial record evidence—primarily the testimonies of witnesses Tayman, Strasser, and Zarnowitz—and is consistent with the levels of contingency provisions recommended in earlier Commission rate decisions. Postal Service Brief at II-2-II-8. The Service claims that participants opposing its contingency provision rely on “misapprehensions of fact or judgment” and ask the Commission to substitute their or the Commission’s judgment for that of postal management. *Id.* at II-9-II-10.

[2139] The Postal Service’s position finds one defender on brief. United Parcel Service argues that the proposed 2.5 percent contingency should be approved to prevent the possibility that services bearing a low cost coverage may fall below attributable cost or fail to contribute their fair share to institutional costs in the event of cost increases beyond those forecast. UPS Brief at 92.

[2140] In its reply brief, the Postal Service presents extensive and detailed arguments regarding the respective spheres of authority of the Board of Governors and of the Commission; the mechanism by which the level of the contingency provision is properly determined; and the soundness of participants’ arguments as a possible basis for recommending a lesser amount than the contingency allowance included in the Service’s request. Postal Service Reply Brief at II-1-II-39.

[2141] First, the Service argues that the Commission’s authority to adjust the revenue requirement is severely limited, and that determination of a reasonable provision for contingencies lies outside that limited authority. The Postal Service acknowledges that the Commission has never shared the Service’s views on the limits of PRC authority over the revenue requirement generally, and has consistently disagreed that the contingency provision is outside the purview of Commission review in rate proceedings. Nonetheless, the Service reviews some of the respective institutional

¹⁶ Val-Pak/Carol Wright Brief at 80-87; Reply Brief at 23-28.

declarations on the subject of authority over the revenue requirement, and cites judicial authority bearing on the division of institutional responsibilities. *Id.* at II-3-II-14.

[2142] Second, the Service argues that the contingency provision is properly established through “a basic policy choice subjectively determined by the Postal Service and its Board of Governors[,]” as “an important element of the Postal Service’s financial policies.” *Id.* at II-14-II-15. Thus, the Service argues further, the contingency is not a cost estimate, a cumulation of cost estimates, or a variance around cost estimates, unlike other components of the revenue requirement that can be determined empirically. On this basis, the Service argues that the analytical approach taken by DMA and other proponents of a lower contingency provision does not allow a reasonable contingency to be developed, let alone quantified as equaling 1 percent or one quarter of 1 percent. *Id.* at II-14-II-20.

[2143] Finally, while not conceding as a legal matter that the Commission’s views or precedents are an authoritative interpretation of what is “reasonable,” the Service argues that the evidentiary bases on which its contingency provision rests are sound; that a new determination of reasonability must be made in the current circumstances of each case; and that there is no lawful precedent on which to base the requested reduction of the contingency provision. *Id.* at II-20-II-31. The Service also argues that neither its improved financial condition nor the state of the national economy justifies reducing the contingency; that the Service has not ignored historical variance analysis; that the contingency should not and may be reduced to encourage postal managers to control costs; and that an inadequate contingency in the face of increased uncertainty is likely to increase the need for future ratepayers to continue to subsidize current mailers through recovery of prior years’ losses. *Id.* at II-38.

[2144] *Bases of Commission recommendation.* The Commission acknowledges the primacy of the Governors’ authority to assure that rates and fees generate sufficient revenues to enable the Postal Service to perform its public mission. This authority is exercised both by the Governors’ initiation of requests for rate changes under §3622 and by their actions on the Commission’s rate recommendations as provided in § 3625.

[2145] Between these two significant events, the Commission is charged with the responsibility of producing recommendations that are in accordance with the policies of Title 39 and the ratemaking factors prescribed in § 3622(b). Section 3624 commands that formal hearing procedures, including public participation in the making of an evidentiary record, precede and inform the Commission's recommendations.

[2146] In the first rate proceeding conducted under the procedures prescribed by the Reorganization Act, the Commission concluded—contrary to the urgings of the Postal Service at the time—that its statutory responsibilities require that the Service's aggregate cost and revenue estimates be subjected to the same scrutiny as its rate proposals. In analytical terms, the Commission found that its independent review of the revenue requirement is necessary to implement the legislative intent to introduce a system of checks and balances in to the ratemaking process. PRC Op. R 71-1 at I-268-I-269. More pragmatically, the Commission concluded that:

In judging whether the Service's total cost and revenue estimates conform to those statutory policies, the Governors are entitled to the benefit of the Commission's recommendations.

* * *

The purpose of our recommendation is to assist the Governors in performing their statutory functions under § 3625. Ultimately, the Governors may modify the Commission's recommended decision But as this proceeding has plainly shown, if the Postal Service is not required to justify its estimates on the record, neither the Commission nor the Governors would be in a position to exercise their authority in a meaningful way.

Id. at I-269, I-270.

[2147] The Commission has consistently conducted its rate proceedings in accordance with this general conclusion throughout its institutional history. Regarding the contingency provision particularly, the Commission held to a congruent view, capsuled in the opinion in Docket No. R87-1:

In prior dockets, we have concluded that the subjective element of the contingency determination entitles management's determination to a good measure of deference, but that it does not render that judgment unreviewable. As we noted in Docket No. R84-1, judgment implies opinion or assessment, and is not necessarily equated to management discretion. Because the statutory requirement that a contingency be supported by substantial evidence remains in effect, management must still provide such evidence, and the Commission must still review it.

PRC Op. R87-1, para. 2072. (Citation omitted.)

[2148] In this proceeding, the Postal Service reminds the Commission of its continuing disagreement with this position, and “urge[s] that the Commission not listen to the voices that have influenced it in the past to challenge the Postal Service’s revenue requirement, or other matters, on the basis of these fundamental disagreements over statutory authority.” Postal Service Reply Brief at II-2-II-3. The Service offers its own interpretation of an extremely attenuated Commission responsibility vis-à-vis the revenue requirement, and cites judicial authority to support its views, including the view of one court that “the PRC must accede to the Board’s estimates of the Service’s revenue needs.” *Id.* at II-8, *quoting Time, Inc. v. U.S. Postal Service*, 685 F.2d 760, 775 (2d Cir. 1982).

[2149] Once again, to the extent that the Postal Service is advancing the argument that the estimates of required revenue contained in its Request are immune from inquiry and appraisal on the record, or that the Commission’s recommendations must approve them regardless of their record support, the Commission must respectfully agree to continue disagreeing in this area. The Supreme Court’s decision in NAGCP IV,¹⁷ also cited by the Postal Service, states:

Although the Postal Reorganization Act divides ratemaking responsibility between two agencies, the legislative history demonstrates “that ratemaking . . . authority [was] vested primarily in [the] Postal Rate

¹⁷ *National Association of Greeting Card Publishers v. United States Postal Service*, 462 U.S. 810 (1983).

Commission.” [Citations omitted.] The structure of the Act supports this view. While the Postal Service has *final* responsibility for guaranteeing that total revenues equal total costs, the Rate Commission determines the proportion of the revenue that should be raised by each class of mail.

462 U.S. at 821. (Emphasis added.) (Footnote omitted.) The Commission’s view of its and the Governors’ statutory responsibilities regarding the revenue requirement is fully compatible with this declaration. The Governors, in consultation with postal management, decide the magnitude of required revenues to include in Requests, in accordance with § 3621. They also exercise discretion to act on the Commission’s recommendations pursuant to § 3625; should they find, after resubmission of the Request, that the rates recommended in the decision on reconsideration will yield insufficient total revenues, they may modify the Commission’s recommendations in accordance with the record and the policies of Chapter 36. In the intermediate process that the Commission is directed to conduct, revenue requirement matters are subject to the same substantive, on-the-record review as are other issues, and the Commission will make substantive, but not final, determinations and construct its recommendations accordingly.¹⁸

[2150] In this case, on brief, the Postal Service suggests that the degree of scrutiny applied to the contingency provision in past rate proceedings has been variable, with a perceived “lowering of the bar” when the Service’s contingency proposal has been reduced from previous levels, as in Docket No. R97-1. Postal Service Brief at II-4-II-6. A “double standard” does not to operate in such circumstances. That appearance may result from the Commission’s deference to the Governors’ assessment of potential risks at that time, and the absence of participants’ initiatives to explore the subject on the record. The applicable standard of “reasonability” is the same in all cases: whether, giving due deference to the Postal Service’s judgment on the subject, the provision is rationality related to achievement of revenue sufficiency in the period under review.¹⁹

¹⁸ Other authorities cited by DMA *et al.* in their analysis of the Commission’s legal responsibility to review the contingency provision provide additional support for this position. DMA *et al.* Brief at 3-6.

Varying circumstances in different rate proceedings will require different degrees of inquiry and review.

[2151] In this case, the Postal Service supports the 2.5 percent contingency allowance incorporated in its Request with the testimony of witness Tayman, as supplemented by the presentations of witnesses Strasser and Zarnowitz on rebuttal. Other participants have made voluminous presentations on the contingency provision, challenging the Service's proposal on a variety of grounds. In the Commission's view, it is appropriate to consider all material on the record that bears on the reasonability of the contingency provision.

[2152] In Docket No. R84-1, the Commission stated:

[T]he purpose of the contingency provision set forth in 39 U.S.C. section 3621 is two-fold. First, it provides insurance against the possibility of misestimates of test year accrued revenues and expenses. As we have stated in the past, such variances are inherent in the forecasting process. Second, the provision 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 financial position of the Service or upon its operations.

PRC Op. R84-1, para. 1017.

[2153] In presenting the Service's 2.5 percent contingency provision, witness Tayman acknowledges this two-fold purpose in his statement that, "[t]his amount is judged as reasonable against unforeseen events and forecasting errors, given the magnitude of the Postal Service's operations and expenses." USPS-T-9 at 43.

[2154] Witness Tayman reports the results of variance analyses contained in his Exhibit USPS 9-J "[I]n deference to the Commission's desire to evaluate forecast errors and their sources[.]" *Id.* at 44. However, he disavows them as the basis for determining

¹⁹ In its opinion in Docket No. R84-1, the Commission stated: "In essence, a reasonable contingency provision should, then, better enable the Service to comport with the break-even requirement of §3621 which mandates that, as nearly as possible, costs equal revenues plus appropriations." PR COp .R84-1, para. 1017. (Footnote omitted.)

the need for a contingency or its size, and further opines that relying on them for predictive value “would be both irresponsible and illogical.” *Id.* at 45. “Regardless of what history shows,” he asserts, “management must be allowed to assume its responsibility to determine the amount of contingency most appropriate for achieving its goals.” *Ibid.*

[2155] This aspect of witness Tayman’s testimony is troubling for several reasons. First, while the Commission has never enshrined variance analysis of historical costs and revenues as the definitive indicator of the appropriate magnitude of the contingency provision, it has recognized its value as an empirical measure of forecasting error and the relative magnitude of unforeseen events.²⁰ The Commission adheres to its long-established opinion that, as a significant quantitative input to a blend of subjective and objective judgment, consideration of the results of variance analyses is an appropriate component of determining the reasonability of proposed contingency provisions.

[2156] Second, witness Tayman’s assertion of the supervening importance of postal management’s selection of a contingency amount “most appropriate for achieving its goals” is potentially problematical in view of the Commission’s responsibilities. Whatever management goals might be served by the selection of a particular amount for a contingency provision, the Commission’s review must be guided by the objective of providing reasonable assurance of revenue sufficiency for the Postal Service in accordance with § 3621.²¹ At the least, the Commission and the participants are entitled

²⁰ In the opinion in Docket No. R87-1, the Commission stated: “The Commission has never advocated that statistical analysis be the exclusive determinant of the proper contingency amount, nor that it should be accepted uncritically, in terms of its precision, or its ability to account for external factors. We maintain our view, however, forecasting errors have sources, and that much can be learned by systematically evaluating the behavior of those sources over time. We also adhere to our view expressed in Docket No. R77-1 that the relative magnitude of unforeseen events, including external events, over the long run will tend to display a degree of predictability, based upon historical results.” PRC Op .R87-1, para. 2077. (Citations omitted.)

²¹ Witness Tayman’s statement is a verbatim repetition of his testimony in Docket No.R97-1, suggesting that this position has become a rubric of postal management policy on the subject. Restatement of this position provides no substantive support or assistance to the Commission’s analysis of the revenue needs of the Postal Service.

to a clear identification of the nexus between specific test year management goals and revenue sufficiency, and an explanation of why achieving those goals requires the specific contingency amount requested. While the Postal Service has explained why its operations goals are expected to generate a particular level of expenses, no such presentation has been made in this case regarding the provision for contingencies.

[2157] As is evident from the results witness Tayman reports, the 2.5 percent contingency allowance he defends lies outside the bounds of the variance analyses. If the Postal Service performed any other statistical or quantitative analyses bearing on the amount of the contingency provision, they were not provided by witness Tayman, witness Strasser, or the Postal Service institutionally.²² Consequently, the Postal Service's proposed contingency provision is not based on any empirical estimate of potential forecasting error.

[2158] Part of the Postal Service's defense of its contingency provision relies on the unknown and unknowable nature of future events with potentially negative impacts.²³ However, the Commission cannot agree that the unknowability of future events puts choice of a contingency provision into the realm of purely subjective judgment. As long ago as Docket No.R77-1, the Commission stated its "view that over the long run the relative magnitude of unforeseen events (variances between estimates and actual results caused by uncontrollable events) will prospectively tend to display a certain degree of predictability, albeit not precise, with historical results." PRC Op. R77-1 at 32. (Footnote omitted.) For this reason, the Commission endorses the position of OCA witness Burns that a contingency provision must be reasonably related to a careful

²² As the OCA observes on brief, the Postal Service objected to providing responses to interrogatories from both OCA and DMA *et al.* requesting analyses and other documents relating to its contingency proposal, claiming that responsive materials were predecisional and therefore protected by the deliberative process privilege. In light of this resistance, both OCA and the Consortium argue that the record is "utterly devoid of any evidence of a 'systematic analysis' that may or may not have been made." OCA Brief at 66; DMA *et al.* Brief at 9. It is worth noting that any analyses that were actually relied on to arrive at the chosen 2.5 percent figure would no longer have been privileged, and therefore should have been provided.

²³ See, e.g., Postal Service Reply Brief at II-17-II-20.

assessment of future uncontrollable events, and confirms the importance of historical analyses of the kind performed by witness Rosenberg to make such an assessment. In the years since R77-1, the Postal Service has become significantly more skillful at projecting its costs and revenues, and it should also have developed an extensive record of the frequencies and impacts of unknowable events such as natural disasters.²⁴

Whether by variance analyses or some other reasoned, transparent technical exercise, the Commission maintains that examination of historical results is a valid and useful tool for gauging the probable magnitude of unforeseeable future events.

[2159] In addition to the results of the variance analyses, which suggest a comparatively low level of forecasting error based on historical results, the Commission's recognition of updated test year costs projected from actual FY 1999 data further reduces forecasting error. Moving the source of actual data one full year forward in time, while retaining FY 2001 as the forecast target, enhances the predictive accuracy of the forecasts by shortening their span.²⁵ Further, it justifies reevaluating the appropriate size of the contingency provision.²⁶ All other things being equal, updating costs in this case should greatly reduce the need for the contingency provision's function of insuring against the possibility of misestimates of test year accrued costs.

[2160] Lacking any additional empirical information for guidance on an appropriate contingency provision, the Commission must evaluate the subjective claims of risk the Postal Service makes in support of its selection of an increased contingency provision. As in past cases, the Commission assesses these subjective claims by examining

²⁴ Witness Burns points out that insurance companies must make this type of analysis in state regulatory forums, citing California Insurance Regulations, Title 10, § 2644.5. Tr. 22/9711.

²⁵ As OCA witness Rosenberg stated in his supplemental testimony, "the closer the Postal Service's estimates are to the forecasted period, the more accurate its forecasts are likely to be." Tr.41/18308. On oral cross-examination by counsel for DMA, Postal Service witness Zarnowitz confirmed the superior accuracy of one-year forecasts over two-year forecasts, and stated that over a two-year span forecasts "decline within this period in accuracy, quarter-by-quarter." *Id.* at 18234.

²⁶ "We agree with witness Quick that the size of the contingency should be reevaluated as the Test Year nears, if there has been a major, net reduction of forecasting error." PRC Op .R87-1, para. 2095.

evidence bearing on the Postal Service's financial condition, the state of the national economy, and other relevant factors.²⁷

[2161] Beginning with the economic climate in which the Postal Service operates, the short-term outlook for the national economy does not appear to involve any significant risk of unforeseeable financial harm to the Service. OCA witness Rosenberg testifies that the United States continues to enjoy robust growth in the longest economic expansion in over half a century. Tr. 22/9815. Although witness Zarnowitz testifies that he detects what may be precursors of a potential reduction in economic activity, on oral cross-examination by OCA he confirmed that leading indices have occasionally declined during the last five years, but in each instance the index rebounded without turning negative. He agreed with a characterization of the various data collectively as a "mixed picture," and added: "We still are in an expansion that is relatively strong compared to the '60s and '80s." Tr. 41/18286.

[2162] The chief perils witness Zarnowitz and witness Strasser identify concern the potential for cost increases driven by inflation. The Postal Service, the Consortium and OCA argue that different indices of inflation, analytical timeframes, and interpretations should inform the choice of an appropriate contingency provision. However, the Commission's update of test year costs—which employs the more recent indices used by witness Patelunas in his rollforward exercise and CPI values for periods as recent as July-September of this year—render this disagreement moot. By using the most recent information available on the record, the Commission's test year forecasts minimize uncertainty concerning the impact of misestimates of economic activity on Postal Service costs.

[2163] Regarding the financial condition of the Postal Service, the evidence appears to be mixed. The Service enjoyed net revenue through FY 1999, and has continued to improve its equity position. However, it finished FY 2000 with a reported loss; the exact amount is not available on the record, as an audited result has yet to be

²⁷ See PRC Op. R84-1, para. 1051.

publicly reported by the Postal Service.²⁸ Witnesses Tayman and Strasser also identify volume growth as an area of concern. However, in supplemental testimony explaining why the test year volume forecast initially filed by the Postal Service did not need to be updated along with cost estimates to account for actual FY 1999 data, witness Thress cited as one reason “. . . the fact that the initial forecast is performing quite well compared with the most recent actuals. . .” USPS-ST-46, at 1. This suggests a comparatively low level of uncertainty regarding potential forecast error in volume estimates for the test year.

[2164] The greatest potential source of uncertainty concerning the Postal Service’s financial results in the test year appears to be ambitious cost reduction programs. Witness Tayman cites the “challenge” of achieving a 1.5 percent workyear reduction in the test year. USPS-T-9 at 44. In addition to other cost reduction programs incorporated in the revenue requirement, the Postal Service’s updated costs for the test year reflect \$744 million in “breakthrough productivity” cost savings. Without linking an amount to any specific program, the Postal Service’s update also reflects a \$200 million Field Reserve offset to cost savings, which “recognizes the difficulty in achieving the aggressive cost reductions in FY 2001, the first year of the Breakthrough Productivity Initiative.” Tr .46D/21595, f n.2. This is a somewhat unusual, but appropriate, example of the kind of insurance against uncertainty the contingency provision provides, and the Commission believes it should be reflected in the amount of that item.

[2165] On balance, these considerations support a conclusion that a 2.5 percent contingency allowance is not necessary to assure revenue sufficiency in the test year, and thus is excessive. This conclusion is reinforced by the disproportional share of additional new revenues the proposed contingency provision constitutes.

[2166] As a table in the Brief of the OCA shows, the Postal Service’s contingency provision represents 60 percent of aggregate revenue increase requested by the Postal

²⁸ Witness Patelunas uses \$325 million as an assumed loss result in his rollforward exercise, and the Commission’s update preserves this assumption. To the extent the audited result for FY 2000 shows a smaller loss for the period, the Commission’s test year revenue requirement will be higher than necessary. It is well to keep in mind that misestimation and unforeseen events may benefit the Postal Service.

Service in this case. While the Commission has directed its scrutiny primarily to the percentage value of the contingency provision in past proceedings,²⁹ the Service's proposed allowance represents a majority of the total requested revenue increase, an unprecedented proportion of revenue burden to distribute to the classes of service without attribution on the basis of cause. As Table 2-1 shows, since Docket No. R76-1 the proportion has rarely exceeded 30 percent.

²⁹ PRC Op. R87-1, para. 2101.

Table 2-1
Comparing the Postal Service's R2000-1
Contingency Proposal with Prior Rate Cases

Case	Requested Increase in Revenue	Amount of Contingency	Contingency/Revenue Increase
R76-1	\$2.31 billion ¹	\$0.54 billion ²	23%
R77-1	\$1.97 billion ³	\$0.66 billion ⁴	34%
R80-1	\$3.75 billion ⁵	\$0.54 billion ⁶	14%
R84-1	\$3.11 billion ⁷	\$1.0 billion ⁸	32%
R87-1	\$4.3 billion ⁹	\$1.3 billion ¹⁰	30%
R90-1	\$6.16 billion ¹¹	\$1.6 billion ¹¹	25%
R94-1	\$4.11 billion ¹³	\$1.05 billion ¹²	26%
R97-1	\$2.24 billion ¹⁵	\$0.6 billion ¹⁴	27%
R2000-1 (2.5 %)	\$2.8 billion ¹⁷	\$1.68 billion ¹⁶	60%
R2000-1 (1 %)	\$1.7815 billion ¹⁹	\$0.6719 billion ²⁰	38%

Average proportion of contingency to revenue increase for the eight omnibus rate cases is 26.4%.

Source: OCA Brief at 41, Table 1.

¹ USPS Request, filed December 19, 1975.

³ USPS Request, filed July 13, 1977.

⁵ USPS Request, filed April 21, 1980.

⁷ USPS Request, filed November 10, 1983.

⁹ USPS Request, filed May 10, 1987.

¹¹ USPS Request, filed March 6, 1990.

¹³ USPS Request, filed March 8, 1994.

¹⁵ USPS Request, filed July 10, 1997.

¹⁷ USPS Request, filed January 12, 2000, at 2.

² PRC Op. R76-1 at 19.

⁴ PRC Op. R77-1 at 42.

⁶ PRC Op. R80-1, para 0138.

⁸ PRC Op. R84-1, Appendix A.9, 10.

¹⁰ PRC Op. R87-1, Appendix A.

¹² PRC Op. R90-1, Appendix A.

¹⁴ PRC Op. R94-1, Appendix A.

¹⁶ PRC Op. R97-1, Appendix C.

¹⁸ Exh. USPS 9A.

²⁰ *Ibid.*

¹⁹ The Postal Service's proposed contingency of \$1.6798 billion (Exh. USPS-9A) is \$1.0069 billion higher than witness Rosenberg's proposed contingency of \$0.6719 billion (OCA-RT-2 at 4; Tr. 41/18303). If a commensurate \$1.0069 billion reduction is made in the Postal Service's requested total increase in revenue, i.e., \$2.7884 billion (Postal Service Request at 2), then the total increase in revenue would be approximately \$1.7815 billion. $0.6719/1.7815 = 37.7\%$.

[2167] OCA's point is that the appropriate size of the contingency should be related to the size of the requested increase in revenues. The corollary is that large forecast error is more likely when projecting large changes (for example in a period of rapid

inflation) than when projecting small changes (for example during stable economic times.) The Postal Service projects small, gradual increases in operating expenses that will result in a test year deficiency in operating revenues of approximately 2.6 percent assuming no rate increase. OCA contends that as economic conditions have been shown to be stable, OCA Brief at 43-51; and other causes of projection forecast error have been dramatically reduced, *Id.* at 53–55; there is no valid justification for a sharp increase in the size of the provision for contingencies.

[2168] Table 2-2 breaks out the uses that will be made of the revenues generated by the rate increases proposed by the Service and recommended by the Commission. The Request seeks \$2,788 million in additional revenue, only 30 percent of which, \$840 million, would be used to offset increases in test year operating expenses. Twice that amount, \$1,680, is sought as a cushion against forecasting errors and unknown events.

Table 2-2
Allocation of Revenues from Rate Increase

	USPS Request \$ Millions	PRC \$ Millions
INCREASE IN REVENUE	2788 ¹	2508 ²
\$ Allocated for Contingency	1680 ³	1012 ⁴
\$ Allocated for PYL	268 ⁵	312 ⁶
Remainder to Offset Operations Expenses	840	1184

¹ Request at 2.

² Appendix C Total Revenues less TYBR revenues from Request at 2.

³ USPS-T-9 at 43.

⁴ Appendix C.

⁵ USPS-T-9 at 46.

⁶ Appendix C.

[2169] The voluminous materials provided by the Postal Service with its Request largely focus on the Service's operations and operating expenses. Initially, only two

pages of fairly general statements provided by witness Tayman, USPS-T-9 at 43-44, are offered to support the \$1,680 million additional revenues sought by the Service for contingencies. This discussion focuses primarily on potential causes of estimation error, and provides little justification for a larger cushion for unknown events. Even as supplemented by witnesses Patelunas and Strasser, there is no explanation of how much and why the contingency for unknown events is increased from the R97-1 level.

[2170] The magnitude of this amount is difficult to reconcile with the Postal Service's witnesses' expressions of concern regarding the increasingly competitive environment in which it operates. It is not the Commission's function to direct how the Postal Service should respond to competitive pressures. However, for ratemaking purposes it is difficult to interpret a perceived increase in the intensity of competition as a justification for increasing an item that will raise all rates in the aggregate.

[2171] The Postal Service has not justified a contingency provision of this magnitude on the basis of revenue need in the test year. Nor, in the Commission's opinion, would it be appropriate to defend a contingency allowance of this size on the ground that excess revenues will improve the equity position of the Postal Service, as witness Strasser suggests Tr. 46A/20199. This function is performed retrospectively by the provision for the recovery of prior years' losses, and is not a legitimate purpose of the contingency provision. Any additional revenue realized in advance of the recovery schedule through the contingency provision would constitute a test year profit, which has never been a legitimate objective of ratemaking under the Reorganization Act.

[2172] As noted above, participants have argued that the Commission should respond to the excessive contingency allowance included in the Postal Service's Request by recommending the 1 percent provision adopted in Docket No. R97-1, a fraction of 1 percent, or a zero contingency provision. Notwithstanding the reduction in potential forecasting error resulting from updating costs, the Commission finds that uncertainties surrounding the Postal Service's achievement of ambitious financial goals in the test year require a contingency provision appreciably greater than one quarter of 1 percent.

[2173] While their analytical approaches differ, several participants argue with merit that a 1 percent contingency should provide an adequate cushion to assure revenue sufficiency in the test year. OCA makes a particularly convincing argument, based on the testimonies of witness Rosenberg, that a 1 percent contingency should be sufficient during this period of economic stability and relatively low inflation, in light of 30 years' experience of ratemaking under the Reorganization Act and of the use of updated forecasts.³⁰

[2174] Nevertheless, the Commission recommends the incorporation of a 1.5 percent contingency allowance in the revenue requirement. In the Commission's opinion, this appropriately reflects the decrease in potential forecasting error resulting from use of updated costs, counterbalanced by consideration of the challenges to achievement of the Postal Service's financial goals in the test year.

[2175] In the Commission's view, a 1.5 percent contingency provision—which has a dollar value of \$1,012 million on a test year after-rates basis—is near the outer boundary of reasonability in this case. As a gauge of this limit, the Commission notes that the total amount for all test year cost reduction programs incorporated in the revenue requirement is \$1.1 billion.

[2176] As described in the previous section, II. C., the updated cost and revenue information provided by the Postal Service while this case was in progress indicate that operating expenses in the test year will be higher than initially projected. Additionally, at the rates the Commission recommends, volume losses will be reduced, and the retained volumes will add costs to the system. The Service also requests slightly more revenue for the recovery of prior years losses. These adjustments are reflected in Table2-2. Nonetheless, 40 percent of the revenues generated by the rate increases recommended

³⁰ Witness Strasser presented a table purporting to show that inflationary trends support a 2.5 percent contingency provision. Tr. 46A/20196, Table 1. However, the table presents data only for fiscal years associated with the past four rate proceedings, and the relevance of the ECI data it presents to the choice of a contingency provision is questionable, as this index is already a component of the forecasts with which test year labor costs are estimated.

by the Commission will go to funding the provision for contingencies. This is the largest ever proportion of new revenues provided to fund a provision for contingencies.

III. COSTING

A. Mail Processing

[3001] In this docket the Postal Service renews its proposal to apportion Segment 3 Clerk and Mailhandlers Costs to the Mail Processing, Administration, and Window Service Components. In doing so, it proposes to give priority to MODS information contained in IOCS tallies. As in Docket R97-1, the Commission concludes that in some instances the recorded observations of the IOCS data collectors concerning the nature and location of work activities are more reliable. The reasons for this conclusion are discussed in Section 1.

[3002] The Postal Service also proposes to estimate the volume variability of mail processing labor costs with an econometric model similar to the one presented in Docket No. R97-1. The model presented in this docket yields even lower variabilities for the analyzed MODS pools. As in Docket No. R97-1, the Commission concludes that these results are unreliable. The reasons are summarized in Section 2. The Commission adheres to the established finding that most mail processing labor costs change in proportion to volume.

[3003] The Postal Service proposes to modify its method for distributing volume variable mail processing labor costs to subclasses. It proposes to distribute the costs associated with allied not-handling tallies to subclasses in proportion to the direct tallies from all Function 1 cost pools. The Commission adheres to the established method, which distributes those costs in the same manner that the costs of direct and mixed tallies are distributed within each allied pool. The reasons for doing so are provided in Section 3.

1. Apportioning Segment 3 Costs to Components

[3004] Cost Segment 3 payroll costs are the clerk and mailhandler labor costs in CAG A-J offices. In BY 1999 these costs exceeded \$18.2 billion. The Postal Service associates approximately \$13.8 billion of these costs with mail processing. PRC LR-5, CS 3 Worksheet 3.0.1. Approximately \$10.4 billion of these costs are incurred in the more than 300 offices that collect Management Operating Data System (MODS) information. Id. Worksheet 3.1.1a. MODS records hours worked by employees while they are clocked into specific mail processing operations, the payroll costs associated with those hours, and the work effort expended in those activities, in terms of the number of piece handlings performed. Employees must be clocked into a specific activity in order to be paid. They are supposed to reclock whenever their work assignment changes. The 21 Bulk Mail Centers (BMCs) have a similar data management system called Productivity Information Reporting System (PIRS).

[3005] Subclass responsibility for Segment 3 costs is determined with data from the In—Office Cost System (IOCS). IOCS data collectors observe randomly selected workers at random instants in time. They record the worker's activity, and, if possible, identify the subclass or special service with which the activity can be associated. Each IOCS sample is called a tally. Samples are drawn by craft within each CAG. Each tally is dollar weighted so that the sum of all the weighted tally dollars equals the total labor costs in the sample frame from which the tallies are drawn. USPS-T-2 at 2-6.

[3006] In MODS offices, the IOCS tally taker also records the code of the MODS activity that the employee is clocked into. In some instances the clocked activity differs from the activity actually observed by the IOCS data collector. When a MODS code is invalid or missing, the Service may use the data collector's response to IOCS Questions 18 and 19, and/or the IOCS operation code to assign tallies to a particular mail processing cost pool. USPS-T-12 at 8.

a. Migration of Window Service and Administrative Costs.

[3007] Prior to Docket No. R97-1, the Postal Service apportioned Segment 3 costs to its Mail Processing, Window Service, and Administration components using IOCS data. In Docket No. R97-1, the Service proposed relying primarily on MODS data for this purpose. The Commission accepted some aspects of this proposed reapportionment and rejected others. In this docket, the Postal Service continues to use IOCS tallies to apportion Segment 3 costs in BMCs and non-MODS offices into Mail Processing, Window Service, and Administration components. For MODS offices, the Postal Service again proposes to apportion Segment 3 costs to components according to the MODS record of the activity an employee was clocked into even where it conflicts with the activity that the IOCS data collector actually observed being performed. Resolving all conflicts in favor of MODS data would cause \$72.2 million of IOCS-defined Window Service and \$537.6 million of IOCS-defined Administration costs, to “migrate” to the Mail Processing component. PRC LR-5, CS 3.0 Worksheet 3.01a. Migration of tallies into mail processing costs pools would change the variability factors and the distribution keys from those associated with Window Service and Administration to those associated with Mail Processing. In R97-1, the Commission rejected this proposed migration.

[3008] The Postal Service argues that the MODS operation code recorded in an IOCS tally provides a means for tying the window service and administration activities to the mail processing activities “representing ‘Function 1’ (mail processing plant) or Function 4 (station and branch) support operations.” This association with the supported activities allows a more accurate distribution of costs, according to the Service. Tr. 38/17309.

[3009] Witness Degen notes that the Commission rejected this migration in R97-1 on the grounds that it would not be consistent with the Commission’s method for determining the variability of Segment 3 costs. Witness Degen argues that such consistency is not necessary, noting that in R97-1 the Commission disaggregated mail

processing costs into operation-specific MODS pools, but did not apply the variabilities proposed by the Postal Service to those pools. Postal Service Brief at V-64-V-65.

[3010] Witness Degen asserts that the tallies where the IOCS data collector observed an employee working at the retail window while clocked into a mail processing activity are not likely to reflect the kind of retail sales activity that makes up the majority of window service activity. He argues that temporary hand off of the control of cash drawers and stamp inventories is very unlikely given the time consuming audit procedures that are supposed to be followed each time. Witness Degen states that the employees clocked into a mail processing activity but observed performing window service functions are likely to be retrieving held mail or gathering collection mail from the window. He notes that many of the migrated tallies are not-handling tallies, and argues that they should be tied to the operation into which the employees are clocked. He comments that if employees are temporarily in the window service area when observed and not handling sales items, then it is inappropriate to use a window service distribution key that is based, in part, on sale activities. Tr .38/17310.

[3011] On behalf of Periodical mailers, witness Stralberg testifies that during his visits to postal facilities as part of the advisory task force on Periodicals costs, managers consistently admit that they use mail processing clerks to fill in for window service or administrative clerks, for example, during lunch breaks, and that they do not always reclock when temporarily performing these non-mail processing activities. Tr. 24/11389. His main concern is that this phenomenon causes window service costs to be inappropriately assigned to Periodicals and other mail classes that generally do not use window service. *Ibid.*

[3012] The Commission concludes that the MODS operation code that a worker is clocked into is generally less reliable than the IOCS information on the activity that the worker was performing at the time he was actually observed. Witness Stralberg's explanation that workers do not always re-clock when temporarily switching activities is plausible. Witness Stralberg reports that supervisors told him that it is a common management practice to have mail processing clerks temporarily fill in at window service

and administration activities without re-clocking. Even witness Degen agrees that mail processing clerks may switch assignments temporarily without reclocking, although he emphasizes that the frequency with which it occurs is unknown. Tr. 38/17310. The Postal Service Inspection Service, however, reports numerous instances of misclocking within the MODS system, as witness Stralberg describes. LR-H-236 AT 18-19.

[3013] While witness Stralberg's testimony is anecdotal, the Inspection Service report tends to corroborate it. Witness Degen's assertion that strict auditing requirements deter temporary assignment of clerks to retail window service activities is speculative. The extent of this deterring effect, like the extent of misclocking, is unknown. Even if this deterring effect were absolute, however, it may not be particularly relevant. If mail processing clerks are retrieving held mail, or performing other work that would otherwise be done by regular window clerks, it is still window service activities they are performing. Likewise the window clerks involved in retail sales are also involved in activities that are part of the window service cost component. It is not relevant that at any moment one window service clerk is performing retail sales and another is performing other window service activities. Both are performing window service cost component activities. Therefore it is appropriate to treat their temporary assistance as window service activity, regardless of the precise form that their assistance takes. The fact that the IOCS tally taker actually observed the employee performing a window service or administrative task, in the Commission's view, is more meaningful than the MODS activity that the employee is clocked into.

[3014] Over 75 percent, or \$406.1 million, of the migrated Administration costs come from the single IOCS activity code 6630, which is designated as general administrative services. Given the large proportion of general administrative services for which the Postal Service proposes to override IOCS information, the Service should provide some empirical evidence confirming that the portions it proposes to migrate into mail processing solely support Function 1 or 4 mail processing operations.

[3015] Until then, the direct evidence in the IOCS codes should continue to take precedence over the MODS codes in these cost components. In his calculation of

Segment 3 costs, UPS witness Sellick uses IOCS information to reverse the migration of Window Service and Administration costs into the Mail Processing component. The Commission will use this method to reverse the Postal Service proposal.

b. Development of New Cost Pools for Non-MODS Offices.

[3016] In Docket No. R97-1, for the first time, the Postal Service disaggregated mail processing costs in MODS offices into 39 operation-specific pools. Total payroll costs were apportioned to these MODS cost pools using the MODS codes associated with each pool. The IOCS tallies from MODS offices were apportioned to the same pools based on the MODS record in the IOCS tally. IOCS tallies were used to develop distribution keys for each pool. The Commission adopted the disaggregation of mail processing costs in MODS offices into operation-specific pools, and reaffirms this recommendation in this docket. In this docket, the Postal Service retains the R97-1 division of BMCs costs into 6 pools based on IOCS data. For the first time, it proposes to disaggregate mail processing costs in non-MODS offices into 8 pools based on IOCS defined activities.

[3017] No participant opposes the proposed disaggregation of mail processing costs in non-MODS offices. UPS witness Sellick incorporates this disaggregation in his calculation of Segment 3 costs. The Commission believes that it will allow the costs in non-MODS offices to be attributed to subclasses more accurately. It accepts disaggregating the mail processing costs in non-MODS offices for the same reasons that it accepted operation-specific MODS and BMCs pools in Docket No. R97-1.

c. Consolidating Four MODS Mail Processing Cost Pools into Two.

[3018] Reversing the trend to disaggregate costs into operation-specific pools, the Postal Service proposes to consolidate four current MODS pools into two. It proposes that the cost pools currently labeled "1MISC" and "1SUPPORT" be combined into a single pool labeled "F1 Support." It proposes that the cost pools currently labeled

“LD48OTH” and “LD48_ADM” be combined into a single pool labeled “F4 Support.”

Witness Degen argues that this reorganization is warranted because the F1 Support activities only provide support services to mail processing operations in Function 1 facilities, and the “F4 Support” activities only provide support services to mail processing operations in Function 4 facilities (branches and stations). Consolidating these pools would enable the Postal Service to distribute costs in the new pools using cost drivers from the supported F1 and F4 cost pools, respectively. The Periodical mailers object to this proposed method of distributing the costs in these consolidated pools. Tr. 24/11388.

[3019] The Postal Service has concluded, but not demonstrated, that costs in the consolidated pools are caused only by the Function 1 and 4 activities they are claimed to support. The Commission needs some assurance that this conclusion is valid before it can recommend overriding the direct tally information in these pools and distributing their costs based on tallies found in other pools. Until it receives this assurance, it will treat these cost pools as separate.

2. Variability of Mail Processing Labor

a. Summary

[3020] For more than two decades, the Postal Service and the Commission have accepted the operational judgment of postal experts that mail processing labor costs rise essentially in proportion to the volume of mail processed. This implies that the volume variabilities of mail processing labor costs are approximately 100 percent. In this proceeding, the Postal Service uses an econometric model to obtain an estimate that the average volume variability of mail processing labor costs is less than 73 percent. The Commission concludes that the weight of the evidence in this proceeding supports the established finding that the volume variability of most mail processing operations is approximately 100 percent.

[3021] The record on mail processing variability is exceedingly complex. For that reason, this section of the Commission's Opinion briefly summarizes the debate, presents the Commission's conclusions in "bullet" form, and summarizes the Commissions reasoning. Detailed findings and conclusions are presented in Appendix F. The issues fall into three main areas—operational analysis, data issues, and econometric modeling issues. The evidence concerning the nature of the Postal Service's mail processing operations is analyzed in detail in Parts A and C of the Appendix. Data issues and econometric modeling issues are analyzed in detail in Part B of the Appendix.

[3022] *Operational evidence.* The validity of both the Commission's and the Postal Service's estimates of the variability of mail processing labor costs depends, first, on whether they are based on a realistic view of the way that mail processing operations are actually managed.

[3023] The Postal Service's economic consultants base their econometric model on a novel view of how the Postal Service copes with volume changes over a typical rate cycle. They assert that the Postal Service designs large cushions of excess labor into many of its processing operations in order to meet service commitments. As a result, they argue, much of the increase in volume that occurs over a rate cycle can be absorbed without increasing workhours. This, they say, largely explains the low variabilities obtained from their model, and the large economies of scale that they imply. These economic consultants also assert that the typical rate cycle is too short to allow the Service to change anything but the amount of labor it hires to cope with changes in volume. Accordingly, their model is structured to capture primarily short-run volume effects.

[3024] The view consistently expressed by the Postal Service's managers supports the established finding that mail processing labor costs change in proportion to changes in volume. They assert that when mail processing operations are running, they are typically operating at full capacity, using standardized equipment and methods. They testify that managers carefully and continually match staffing to expected workload,

rather than design cushions of excess capacity into particular mail processing operations. They agree that the Postal Service copes with volume changes that are sustained over a typical rate cycle by making adjustments to plant, equipment, and mail flows, as well as their supply of labor. These characteristics of mail processing operations imply that costs will vary in proportion to volume.

[3025] *Data issues.* In Docket No. R97-1, and again in this docket, the suitability of Management Operating Data System (MODS) data for estimating volume variability has raised considerable controversy. MODS records the mail processing operation a worker is clocked into and associates those hours with costs taken from payroll records. Since the number of unique mail pieces processed in an operation is difficult to identify, MODS records initial and total piece handlings that occur in particular operations. In manual operations, this requires the Postal Service to weigh mail in order to infer the number pieces handled, contributing substantial imprecision to the data. Postal Inspection Service audits conclude that errors in clocking data and in handlings data are common.

[3026] Although obvious errors are common in MODS data, the Postal Service argues that it effectively screens these errors before using them to estimate variability. It argues that its statistical results pass standard diagnostic tests, implying that the data is reasonably error free.

[3027] UPS and the OCA have an opposing view. They argue that because obvious errors in the MODS data are common, but their source is unknown, one must assume that errors that are not obvious, and therefore are not detected, are also common. This, they argue, results in a substantial risk that the Postal Service's econometric estimates exhibit "errors-in-variables" bias, which reduces its variability estimates.

[3028] The Commission concludes that a substantial risk of "errors-in-variables" bias remains after witness Bozzo's data screens. As long as this risk remains substantial, the Postal Service's econometric estimates of variability cannot be regarded as reliable.

[3029] *Modeling issues.* The Postal Service argues that witness Bozzo has corrected the flaws identified by the Commission in the Postal Service's model presented in Docket No. R97-1. UPS and the OCA argue that the most serious flaws remain. They argue that the model still reflects transient effects, such as temporary variations in the intensity of workeffort in manual operations, rather than reflecting cost effects that are sustained over a rate cycle. They also argue that many of the variables that witness Bozzo's model treats as independent of volume are, in fact, affected by volume, rendering its results invalid. The OCA argues, in particular, that witness Bozzo's model erroneously assumes that capital and equipment are not affected by changes in volume over a rate cycle, and that the model is therefore mis-specified.

[3030] The Commission concludes that witness Bozzo's model, like the R97-1 model, reflects short-run, transient effects, and improperly assumes that capital and equipment are not affected by changes in volume that occur over a rate cycle. Evidence is compelling that the Bozzo model is mis-specified, because it implies that capital is reducing, rather than increasing, the productivity of mail processing labor.

[3031] In Docket No. R97-1, the Postal Service presented for the first time an econometric model depicting the relationship of work hours to piece handlings in specific processing operations. This model was fit to data mostly reported by the Service's Management Operating Data System (MODS) by USPS witness Bradley. Based on this model, the Postal Service estimated that the overall volume variability of mail processing labor was only 81 percent. In this docket, the Postal Service has presented similar models fit by witness Bozzo to data from the Postal Service's MODS system. These new models estimate that only 72.8 percent of the costs of mail processing labor are volume-variable. Mail processing labor costs constitute a very large part of the Postal Service's total costs. Replacing the Commission's 100 percent variability with the Service's econometric estimates would reduce the costs attributed to subclasses and increase the costs the Commission regards as institutional. This transfer of about \$1.8 billion would be large enough to have a significant impact on the Commission's recommended rates.

[3032] Many parties have contributed testimony that the Commission has considered in its evaluation of the Postal Service's proposal. This proposal is presented or defended by Postal Service economics witnesses Bozzo, Degen, and Greene. The Commission has also considered the testimony of Postal Service operations and management witnesses Kingsley, O'Tormey, and Unger. The proposal is opposed by OCA witness Smith, UPS witness Neels, and MMA witness Bentley. It is supported by witnesses Elliot, Stralberg, and Cohen, representing the Periodical mailers' group.

[3033] Based on the record, the Commission reaches the following findings and conclusions regarding the volume variability of mail processing labor:

- The long-standing conclusion that the cost of mail processing labor varies in proportion to the volume of mail processed flows from the basic analytical insight that each piece or container of mail requires individual handling at each workcenter, and such handlings are replicated as volumes rise. This basic insight applies to automated and mechanized as well as manual processing activities, since throughout the network, processing equipment is typically operated at or near capacity, according to standard operating procedures.
- The Postal Service presents counter theories to explain its estimates of low variabilities in manual sorting operations, allied operations, and some automated operations. It hypothesizes that large proportions of excess labor capacity are designed into these operations, allowing them to absorb increased volumes without increasing workhours. These hypotheses are contradicted by postal managers, who testify that they meticulously match staff to workload, and use overtime to process unexpected surges in volume.
- Startup/shutdown costs are insignificant in manual and most machine-based operations. They might be significant in FSM, SPBS, and parcel sorting. The number of startup/shutdown cycles in these operations, however, is likely to vary partially with volume. For example, rising volumes can cause sort schemes to shift from manual to machine-based processing. They can also increase the number of machine-processed schemes that are run in parallel. Some attempt to quantify the amount of fixed setup/shutdown time should be provided in future proceedings.
- Witness Bozzo's low labor demand variabilities imply labor productivities (percent change in output for a percent change in labor) that are well above 100 percent for most modeled operations. They also imply that there are very large economies of scale in mail processing. Such labor productivities and scale economies are implausibly high. If true, they imply that a major reorganization of the mail

processing network is needed to exploit these remarkable labor productivities and scale economies.

- Adopting witness Bozzo's low labor variability estimates would result in greatly reduced estimates of savings from mailer worksharing. This would require dramatically smaller worksharing discounts, and undermine the viability of the Postal Service's worksharing program. This provides an additional reason that the Commission would need to be assured that witness Bozzo's results are reliable, before it accepts them.
- Witness Bozzo's models are based on MODS data in which obvious errors are common, but whose source cannot be identified. This strongly implies that errors that are not obvious, and therefore are not detected, are also common. This presents a substantial risk that data errors have biased witness Bozzo's results.
- Witness Bozzo's model corrects some of the flaws in the Docket No. R97-1 model, but the most serious flaws remain. The Bozzo model includes key variables (the manual ratio and capital index) that are likely to be codetermined with work hours. This implies that in order to avoid a simultaneous equations bias in the estimate of variability, a method of estimation different from that applied by witness Bozzo must be used.
- Volume-induced changes in the Postal Service's plant, equipment, and mail flows occur over the typical rate cycle. Their contribution to the demand for mail processing labor has been excluded from the Postal Service's econometric model. As a result, the model narrows its focus to a subset of volume effects, yielding the wrong estimate of variability.
- Witness Bozzo's estimated capital productivities are negative, which is nonsensical. Negative productivities imply that capital and workhours could both be reduced without affecting the amount of mail that is processed. A model that so poorly estimates the effect of capital on labor costs is unlikely to have correctly measured the effect of volume on labor costs.
- Witness Bozzo's models assume that the number of piece handlings performed in an operation is proportional to the volume of mail processed in that operation. The record contains econometric evidence that the number of handlings performed in various mail processing operations increases faster than the volume of mail processed. There are also operational reasons for expecting that the number of handlings increases faster than volume. The depth of sort attempted in a machine-based operation, and therefore the number of re-handlings performed in that operation, depends on the volume of mail that is destined to a given area. Witness Bozzo's variabilities are not reliable as long as the proportionality of piece handlings to volume is in doubt.
- The large number of econometric models presented on this record and their widely varying results are illustrated in Table 3-1. They range from an average

variability of 66 percent for witness Elliott's Model A, to an average variability of 139 percent for witness Neels' shape-level adjusted model. The Commission does not consider any of these econometric model results to be reliable. In the Commission's view they all run a substantial risk of bias from the suspect piece handling data on which they are based.

Table 3-1
Sample of Econometric Variabilities (%) on the Record

Cost Pool	Bozzo Model A (1)	Bozzo Pooled Model (2)	Bozzo Between Model (3)	Neels with MODS Level Correction (4)	Neels with Shape Level Correction (5)	Elliott Model A Site Effects (6)	Elliott Model B Time Effects (7)	Elliott Pooled Model (8)
Auto/Mech.								
BCS	90	93	104	187	185	85	100	103
FSM	82	91	103	126	108	64	104	104
LSM	95	92	91	102	197			
OCR	75	86	110	120	155			
SPBS	64	72	89	135	135	67	87	87
Manual								
Flats	77	84	96	78	102	52	94	95
Letters	74	85	91	90	152	59	91	91
Parcels	52	65	73	135	135			
Priority	52	64	75	53	53			
Composite	77	86	96	120	139	66	96	97

Sources:

- (1) USPS-T-15 at 119-120
- (2) USPS-T-15, Appendix F
- (3) USPS-T-15, Table E-1/2 at 119-120
- (4) Bozzo's Model A with Neels' MODS Level Adjustmeng Factor. Tr. 27/12835
- (5) Bozzo's Model A with Neels' Shape Level Adjustmeng Factor. Tr. 27/12835
- (6), (7), & (8) Tr. 43/18659

[3034] Basic economic and econometric theory, coupled with an operational understanding of how the Postal Service processes mail, provides the basis for the Commission's evaluation of witness Bozzo's estimated variabilities. Witness Bozzo describes his equations as short-run derived demand functions. Economic theory

prescribes the general properties of the price elasticities, productivities, and returns to scale exhibited by such functions for a firm that is managed efficiently. Econometric theory provides a basis for evaluating the reliability of witness Bozzo's estimates. This is not just a matter of statistical accuracy. If witness Bozzo's estimation methodology is not appropriate for his model or sample, econometric theory indicates that the result will be biased and unreliable estimates of the structural parameters of his models. Witness Bozzo's variability estimates are so far below the proportional relationship that is expected that they are either reflections of a biased model, or the Postal Service operations exhibit an implausible degree of waste.

b. Operational Findings

[3035] Record descriptions of the technology and methods that the Postal Service applies in its mail processing plants supports the finding, long accepted by both the Postal Service and the Commission, that mail processing labor costs vary about in proportion to the volumes of mail processed. This expectation is based upon several fundamental observations about mail processing operations.

[3036] First, the operations are mostly piece-by-piece sorting, cancellation, preparation, and allied processes that run at nearly uniform average output rates per workhour. This seems to be true whether the processes are mechanized or automated. It should be true of manual processing as well, averaged over the period of a typical rate cycle. Second, there is little labor time that can be identified as downtime or slack time, in the sense that the activities are fully staffed but processes are not actually running at full capacity. Mail processing labor is mobile within a plant, so an activity would not normally be staffed when mail is not actually being processed. Third, the activities ought to exhibit nearly constant returns to scale in the long run. Over this time, it should be possible to deal with an increase in volume by increasing proportionately all of the personnel, floor space, machines and other equipment located at a plant or by just replicating processing plants. Fourth, short run variabilities eventually should be higher,

not lower, than 100 percent because of the law of diminishing returns. If volumes are increased with some capital inputs held fixed, labor productivities should fall, and labor variabilities rise, as diminishing returns are encountered. Finally, proportionate changes in both labor and capital in response to volume changes are feasible within a 3-to-4-year rate cycle. The capital found at the Service's mail processing plants is fixed only over a run that is shorter than a typical rate cycle.

[3037] *The Postal Service's operational witnesses.* In the current docket, Postal Service witnesses Kingsley, O'Tormey, and Unger have provided the Commission with fairly complete, generic descriptions of the actual planning, organization and operation of the Service's mail processing plants. These witnesses are Postal Service management personnel who appear not to have focused on the implications of their testimony for attributing mail processing costs. They generally confirm the observations that underlie the long-held expectation that mail processing labor is approximately proportional to volume. For certain processes, they confirm these observations in some detail.

[3038] Postal Service consultant witness Degen has also provided the Commission with descriptions of the mail processing system. Witness Degen's descriptions conflict in several crucial ways with the descriptions provided by the Service's own management personnel. First, witness Degen claims that the configuration and operation of a processing plant is determined almost entirely by the plant's location within the Service's network rather than by the volume of mail that it processes. The testimony of witnesses Kingsley, O'Tormey, and Unger confirms that the Postal Service's processing network is configured as it is as a means of responding to volume in an optimum way. In doing so, it employs standard equipment, standard criteria for staffing, and standard guidelines for organizing mail flows through all of its plants.

[3039] Second, witness Degen regards the capital equipment at processing plants as predetermined and effectively fixed over a typical rate cycle. The testimony of the Postal Service's operations witnesses, however, describes space expansions, equipment installations, replacements, and removals taking place within periods of time that are generally shorter than a rate cycle. Finally, witness Degen argues that the low

variabilities that witness Bozzo estimates for specific processing operations are reasonable. He does this by identifying specific kinds of downtime, waiting time, or slack time that he believes exist in various processing operations that cause the operation not to be operated at full capacity a sufficient portion of the time to account for witness Bozzo's low variabilities.

[3040] Postal Service operations witnesses testify that the Postal Service enforces productivity standards throughout its mail processing system with regard to equipment and staffing that essentially rule out under-used equipment or under-employed workers. Plant managers also use their equipment efficiently by not conducting processing runs that are too short to justify the necessary startup and teardown times. One would not expect to see downtime or slack time accounting for over 27 percent of labor time, as witness Degen's explanations of witness Bozzo's variabilities indicate.

[3041] *The operational theories of the Postal Service's economic witnesses.* The non-volume-variable time hypothesized by witness Degen consists of setup and teardown time for processes that use mechanized or automated equipment, workers assigned to create excess capacity at gateway and backup operations, workers engaged in mail movement and sweeping activities at the end of runs, and manual processing conducted below the optimal sustainable pace ("discretionary effort"). For example, the volume variabilities of 75.1 percent for the Optical Character Reader (OCR) operation, and 64.1 percent for the Small Parcel Bundle Sorter (SPBS) operation imply that the workers engaged in these activities are sorting at less than capacity at least 24.9 percent, and 35.9 percent of the time that the operations are staffed.

[3042] The pattern found in witness Bozzo's variability estimates of specific mail processing operations is also difficult to explain. Witness Bozzo finds that workhours in manual operations, where mail is necessarily handled by workers one piece at a time, are less volume-variable than man hours in automated operations, where it is the machines that do the piece-by-piece work. However, it is the automated operations, if any, which ought to exhibit the lower variabilities. To explain this result, witness Degen

hypothesizes implausibly large proportions of excess labor capacity in manual operations.

[3043] Witness Degen's analysis accords with the Postal Service's new mail processing variability estimates but conflicts with the testimony of the Service's own operations witnesses. The testimony of the operations witnesses fails to confirm that the percentages of downtime or slack time in mail processing are large enough to explain witness Bozzo's variabilities. This conflict is clearest with respect to manual operations where witness Degen hypothesizes especially large amounts of slack time in order to explain especially low volume variabilities.

[3044] Witness Degen's analysis depends upon several assumptions that are unfounded. These are, first, that the floor space, equipment and other capital found at mail processing plants are all fixed for the duration of a rate cycle. Apart from building or rebuilding complete plants, the record indicates that space and equipment at mail processing plants are variable within a rate cycle. Second, witness Degen assumes that the elements of downtime or slack time are truly fixed rather than variable with volume. This assumption has been challenged by non-postal witnesses who have pointed out several serious defects in witness Degen's interpretations. The record indicates that most of the downtime or slack time hypothesized by witness Degen will actually vary nearly proportionately with volume over a typical rate cycle. And, third, witness Degen simply assumes that the downtime or slacktime that he identifies is large enough to explain a pattern of variabilities as low, particularly for manual operations, as those proposed by witness Bozzo in this proceeding. There is little empirical evidence in witness Degen's testimony or in the testimony of any other Postal Service witnesses that corroborates his assertions of large blocks of underused processing time.

[3045] *Conflicts between the Postal Service's econometric estimates and economic reality.* Perhaps the least credible feature of witness Bozzo's estimates are the productivities that they imply for labor and capital inputs at processing plants. Productivity is the marginal rate at which an input contributes to output, with all other inputs held constant. Productivities are the reciprocal of witness Bozzo's variabilities. In

the case of witness Bozzo's estimates, these would be the elasticity of piece-handlings with respect to work hours and with respect to his index of capital. All of witness Bozzo's piece handling elasticities with respect to workhours are greater than one, and all-but-one of his piece handling elasticities with respect to capital turn out to be negative. The overall picture that these elasticities present is that the Service's mail processing plants are so badly under-staffed and over-capitalized that they are actually wasteful. For example, the elasticities that derive from witness Bozzo's estimates for Flats Sorting Machines (FSM) are 1.224 (work hours) and -0.061 (capital). According to these elasticities labor and capital can simultaneously be reduced without affecting FSM piece-handlings at the Service's mail processing plants. As it happens the Postal Service is engaged in adding 175 new AFSM-100s to the 812 FSM 881s and 340 FSM 1000s now in service. Witness O'Tormey stated "we have told the field our expectations are you are going to lose 23 employees per machine." Tr. 21/8374. According to witness Bozzo's estimates, processing plants would have to add employees just to process the same number of flats after receiving the additional machines.

[3046] The picture of mail processing operations painted by operations witnesses and the picture painted by witness Bozzo's estimates are different. One can reasonably infer constant returns to scale and volume-variabilities of around 100 percent from the testimony of the operations witnesses. On the other hand, the volume variabilities proposed by witnesses Bozzo are around 72.8 percent. Witness Bozzo's variabilities fall so far below 100 percent that they imply that very large economies of scale in mail processing operations remain unexploited. It is difficult to reconcile unexploited economies of scale with several basic facts. One is that larger mail processing facilities typically require more hours to process a given amount of mail than smaller facilities. If there are large economies of scale, exactly the reverse should be true. The most puzzling fact of all is the obvious lack of concentration we can see in the Postal Service's network of mail processing plants. The Service's processing network is decentralized, consisting of over 375 plants, and is growing at the rate of about one new plant per year. The large economies of scale implied by witness Bozzo's variabilities should mean that

the Postal Service has a strong economic incentive to consolidate its mail processing in a much smaller number of efficient large plants. Yet there is not the slightest indication in the testimony of witnesses Kingsley, O'Tormey and Unger that the Service believes it can reduce costs by consolidating plants.

c. Econometric Findings

[3047] The Postal Service's econometric model suffers from several serious technical flaws, any one of which could render its results anomalous and unreliable. First and foremost, there is a basic problem with the raw data with which the Postal Service has built its models of mail processing labor variability. There is no effective way to determine whether the accuracy of the MODS measurements for piece handlings and work hours is good, fair, or poor. A high frequency of apparently anomalous observations provides strong circumstantial evidence that errors pervade the piece-handlings data. If they do, and if the screens used by witness Bozzo do not succeed in deleting most of the erroneous data, then econometric estimates based on these data will contain an "errors-in-variables" bias that could be large.

[3048] In Docket No. R97-1, witness Bradley assumed that all of the control variables found in his equations would control only for non-volume effects on work hours. Among witness Bradley's controls was the ratio of manual piece handlings to piece-handlings in all manual, mechanized and automated operations (the Manual Ratio). The record provided grounds for concluding that these variables would be indirectly affected by volume changes over a rate cycle. In this docket, witness Bozzo likewise assumes that the controls only remove non-volume effects from work hours. Witness Bozzo has added a network proxy (possible deliveries) and a plant-level index of capital to the list of controls which are assumed to be unaffected by volume changes over a rate cycle. The same reasons for concluding in Docket No. R97-1 that the Manual Ratio is volume-variable applies in this docket as well. In addition, the testimony of the Postal Service's own operations witnesses provide ample justification for concluding that

witness Bozzo's new capital variable also is likely to be affected by changes in volume over the rate cycle. Elsewhere in the Postal Service's Base Year and Test Year calculations, capital is regarded as volume variable.

[3049] Witness Bozzo's index of capital provides particularly compelling grounds for concluding that his model is technically flawed. All but one of the capital elasticities witness Bozzo estimates for mail processing work hours have impossible positive signs; most are also statistically significant. If the Postal Service's investment behavior is rational, it will not have acquired so much capital that capital productivities become negative.

[3050] Industrial capital is difficult to measure and witness Bozzo's index may not be a good index even at the plant level. His index is clearly an imperfect proxy for the capital in use in specific operations. Even if his capital index were a good variable, serious problems would remain. Capital is codetermined with labor rather than predetermined, as assumed by witness Bozzo. In this respect, witness Bozzo's treatment of capital is excessively short run. This mistake adds a well-known simultaneous equations bias to the list of things that might have gone wrong. Any of these flaws, and others, could account for the negative capital productivities implied by his estimates.

[3051] The Commission concludes that the mail processing system that witness Bozzo has modeled differs substantially from the one observed in the real world. The weight of the evidence in this proceeding continues to support the long-established finding that mail processing labor variabilities are approximately 100 percent.

3. Distributing Mail Processing Labor Costs to Subclasses

a. The Commission's Docket No. R97-1 Distribution.

[3052] In the preceding section on the volume variability of mail processing labor costs, the Commission explained its reasons for concluding that these costs are likely to

rise in proportion to the volume of mail sorted to its destination. To directly estimate the portion of variable mail processing labor costs that each subclass causes, it would be necessary to associate the volume of each subclass with the labor hours required to sort that volume to its destination. The Postal Service does not know the volume of each subclass that is processed in particular operations. Instead, its In-Office Cost System (IOCS) “tallies” record subclass information. Tallies are randomly sampled instants in time in which a data collector observes a worker and records the processing operation that he is engaged in, and, if discernible, the subclass of mail that is being processed. Each tally is given a dollar value so that the sum of dollars equals the clerk and mailhandler labor costs for each component of the sample frame.

[3053] To yield an economically meaningful estimate of the marginal costs of mail processing by subclass, IOCS tallies are assumed to be the equivalent of the workload-weighted subclass distribution of pieces in a given operation. It is necessary to further assume that IOCS tallies are proportional to subclass volume. See PRC Op. R97-1, paras. 3153-3155.

[3054] In Docket No. R97-1, the Postal Service and UPS proposed that mail processing activities in MODS offices be separated into over 40 pools that are thought to exhibit a homogeneous response to changes in the volume of mail processed. The sum of the tally dollars in each MODS pool was adjusted to be consistent with the payroll costs that were recorded in that pool. *Id.*, at paras. 3067-3071. Non-MODS offices were treated as a single cost pool, and BMC costs were disaggregated into six pools, according to the information contained in IOCS tallies.

[3055] In Docket No. R97-1, an IOCS tally was assigned to a MODS pool according to a three-digit MODS operation code. Where the MODS operation code indicating the activity a worker was clocked into conflicted with the activity observed by the IOCS tally taker, the Postal Service proposed that the MODS code override the IOCS tally. In most instances, the Commission accepted participants’ arguments that the information provided by the IOCS tally was more reliable than the MODS clocking system, and distributed the costs of the tally accordingly.

[3056] An IOCS tally can be associated with a subclass directly or by inference. A worker might be observed with a piece of mail of an identified subclass in his hand, pushing a container holding only one subclass, or handling a tray in which the subclass of the top piece is identified and assumed to be representative of the entire contents. This would be considered “direct” information associating the tally with the subclass. If a worker were observed handling a container of mail whose subclass content could not be determined, this would be a “mixed mail” tally. If a worker was observed not handling any mail (on break, clocking out, etc.), this would be categorized as a “not handling” tally.

[3057] In FY 1998, direct tally costs accounted for 41.8 percent, mixed mail tallies for 12.2 percent, and not handling tallies for 46.1 percent of total mail processing tally costs in MODS pools. Tr.24/11371. In Docket No. R97-1, the Postal Service proposed that the subclass distribution of mixed mail tallies be assumed to match the subclass distribution of direct tallies within a MODS pool. It assumed that “not handling” tallies matched the subclass distribution of direct and mixed tallies combined, within a pool.

[3058] The Commission distributed tally dollars according to these assumptions of subclass responsibility for operations in which the presence of pieces of a subclass could be assumed to be the cause of the labor costs in that pool. Generally, these consist of sorting operations. For “allied” operations, however, the Commission concluded that the fact that a percentage of directly identified pieces belonged to a particular subclass did not provide a reliable inference that the subclass was responsible for mixed mail and not handling tallies in the same proportions. One reason was that some allied functions are internal to each allied pool, while others primarily serve other pools. The Commission decided that distributing mixed tally dollars in allied pools in proportion to the IOCS direct tallies across all pools would better reflect the diverse sources of workload that drive labor costs in allied pools.

[3059] Another feature of the Postal Service’s proposed distribution scheme in Docket No. R97-1 was its stratification of MODS pool tally dollars by the type of “item” and “container” that is associated with the tally. The rationale was that particular mail shapes and subclasses are more likely to be found in particular types of items or

containers, so that it is more accurate to distribute unknown item tallies to subclasses in the same proportions as known item tallies of the same type are distributed, and to distribute unknown container tallies in the same proportions as known container tallies of the same type are distributed. PRC Op. R97-1, para. 3165.

[3060] In Docket No. R97-1, the Commission concluded that distributing the cost of mixed mail and not handling tallies in proportion to the direct tallies within a given pool carried with it a greater risk of selection and assumption bias when this procedure is applied to allied pools than when it is applied to distribution pools. 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 more likely to be obscured. The Commission recognized that subclasses of mail that are typically presorted might be over-identified in allied operations because they are typically presented in identical containers. The Commission also recognized that presorted mail might be under-identified to the extent that it is bypass mail that appears in mixed items or containers. *Id.*, paras. 3170-3173. It concluded that there is a greater risk that there is such “assumption” bias in allied operations, despite stratification. The Commission concluded that a distribution of unknown allied tallies on direct tallies across all pools would help reduce this risk.

[3061] An added consideration persuading the Commission in Docket No. R97-1 not to distribute allied mixed mail and not handling tallies entirely on direct tallies within each allied pool is the fact that direct tallies are a relatively small percentage of total tallies in those pools. When direct tallies are few, the risk that they do not accurately indicate subclass responsibility for mixed mail and not handling costs is magnified. *Id.*, paras. 3145-3146.

b. Treatment of Allied Mixed Mail Costs.

[3062] In this docket, the Postal Service states that, apart from container handling on the platform, it would prefer that mixed mail tallies in an allied operation be distributed to subclasses in the same proportions as the direct tallies in that operation. It says,

however, that it would accept a distribution of allied mixed mail tallies over the direct tallies in all Function 1 pools if it were done within item and container strata. The Periodical mailers favor a broad distribution of allied mixed mail tallies, but still express concern that item and container strata in allied pools may increase rather than decrease potential bias. As in Docket No. R97-1, they prefer to use shape inferences from the IOCS rather than rely on item and container strata. Tr. 24/11377-78.

[3063] Postal Service witness Degen purports to have demonstrated that distributing mixed mail tally dollars within item and container type does not present a risk of bias that is large enough to warrant further investigation. He addresses the Periodical mailers' claim that their mail is over-represented in direct tallies in allied operations because it is more likely to appear in identical items or containers, making it easier to identify. He also addresses their claim that Periodicals are more likely to be counted when they appear in mixed items or containers, because they are more likely to have only a few, large pieces per item or container, and therefore are easier for an overworked IOCS tally taker to count. Witness Degen's response, in effect, is that it does not matter how large a bias against Periodicals is imputed by assumption from direct tallies to mixed, non-empty item tallies, since mixed, nonempty item costs have so little effect on the cost of Periodicals. USPS-T-16 at 59-61. He similarly argues that it hardly matters how biased the distribution of non-identified mixed container tally costs to Periodicals might be, since those costs have such a small effect on Periodicals. Id. at 63-64.

[3064] It might be true that the costs represented by mixed, non-empty items and non-identified container tallies have only a small impact on the total mail processing costs of Periodicals regardless of how they are distributed. This, however, is somewhat beside the point. The Periodical mailers' R97-1 arguments were that the direct tallies themselves present a substantial risk of bias against workshared mail, and if this bias is extended to mixed mail and not handling tallies, it magnifies whatever bias is in the direct tallies. PRC Op. R97-1, paras. 3167-3168. Witness Degen has offered nothing new to refute their argument that this risk of bias in the direct tallies is substantial. If it is substantial, then all of the various mixed mail strata that are distributed on the basis of

direct tallies involve a substantial risk of bias as well. Witness Degen addressed only a few of those strata, and only the effect of those few on Periodicals. He did not show that bias in other strata would have only a small effect on Periodicals, or on other subclasses. In Docket No. R97-1, the Commission attempted to limit this risk by using direct tallies from all MODS pools to distribute allied mixed mail costs. It will continue to do so in this docket, for the same reason.

[3065] Distributing allied mixed mail costs on direct tallies from all MODS pools, as the Commission did in Docket No. R97-1, was a compromise. This compromise recognizes that the causal link between direct tallies and processing costs in allied pools is ambiguous. It also recognizes that there is a greater risk of selection and assumption bias in the direct tallies in allied pools than in other pools. In order not to extend whatever bias exists in those direct tallies to allied mixed mail distribution, the Commission recommends using direct tallies from all pools to distribute allied mixed mail tally dollars to subclasses.

[3066] The Commission's Docket No. R97-1 distribution was a compromise in another sense. It did not distribute allied mixed mail costs within item and container strata, but used shape information provided by the IOCS instead. Using IOCS shape information rather than item and container shape associations was proposed by Periodicals mailers in Docket No. R97-1, and again in this docket. Tr. 24/11377-78. The Commission uses shape information from the IOCS again in this docket because item and container shape and subclass associations are less reliable in allied operations than in non-allied operations, and carry a risk of bias that is not limited to the non-empty item and unidentified container bias that witness Degen asserts are *de minimus*.

[3067] Other areas of potential bias in item and container stratification remain a concern despite witness Degen's arguments to the contrary. For example, witness Degen cites a 1995 platform study by Christensen Associates that sampled the subclass distribution of items in containers at eight processing plants to see how closely they matched the subclass distribution of direct items not in containers. The results are presented in Table 8 at page 66 of USPS-T-16. Witness Degen asserts that they show

no evidence of bias. The sample results, however, are substantially different from the IOCS results for a number of subclasses. The subclass share of Priority and Express mail combined was 2.6 percent of the total in the IOCS compared with 11.4 percent of the total in the sample. The subclass share of Standard A was 32.7 percent in the IOCS compared with 25.3 percent in the sample. The share of First-Class Mail was 50.6 percent in the IOCS, but 45.7 percent in the sample. For what it is worth, the Christensen study suggests that distributing the cost of items in containers on the tallies for direct items outside of containers rather than relying on IOCS information substantially benefits Priority and Express Mail and significantly penalizes First-Class and Standard A mail. The Christensen study does little to reduce concerns that such stratification might be biased.

[3068] Witness Degen concedes that the use of full containers within a cost pool may not accurately indicate how empty containers are used in that pool. To address this concern, he demonstrates that it makes little difference whether the costs of empty containers are distributed using tallies for full containers from within pools or across pools, except to Special Standard Mail. *Id.* at 68. He also purports to show that distributing the cost of empty items on non-empty item tallies yields a distribution of Periodical costs among items that appears “reasonable” to him. *Id.* at 62. This falls well short of a demonstration that the inferred subclass distribution of empty items is accurate.

[3069] Taken together, witness Degen’s arguments confirm the risk of bias as much as they dispel it. They suggest that if each item and container combination is viewed in isolation, it doesn’t matter how its costs are distributed. They do not provide sufficient grounds for changing the Commission’s approach to distributing allied mixed mail costs.

c. Treatment of Allied Not Handling Costs.

[3070] The participants agree that they would prefer to see allied not handling costs distributed to subclasses on the basis of direct tallies in all Function 1 MODS pools.

They do not agree on the reasons. The Postal Service proposes that allied not handling costs be distributed on direct tallies across pools to compensate for its proposal to treat allied mail processing labor costs as 100 percent volume variable. Witness Degen explains that he believes the variability of allied labor is less than the variability of labor in distribution operations, but that the Postal Service did not develop econometric models of allied operations that it is willing to sponsor. It characterizes this as a “compromise” that yields results similar to those that it would have proposed had it sponsored models of allied cost pool variability. *Id.*, at 69.

[3071] The Periodicals mailers support a broad distribution of allied not handling costs on the theory that not handling costs reflect excess staffing of allied operations, the need for which is caused by preferential mail. They argue that distributing these costs on the basis of direct tallies across all Function 1 pools helps to distribute these costs back to the preferential classes that cause them. Tr .24/11373-76.

[3072] In Docket No. R97-1, the Commission distributed the costs of allied not handling costs using a combination of direct tallies within each allied pool and the broad distribution of allied mixed mail tallies that is based on direct tallies across all pools. Not handling costs consist largely of break time and the time it takes to clock in and out of operations during a shift. It was the Commission’s view in Docket No. R97-1, and it remains the Commission’s view, that such costs are more causally related to the number of employees in a given allied operation, and the time that those employees spend in that operation, than they are to mail processing operations in general. Accordingly, the Commission continues to distribute allied not handling costs on the combination of within-pool direct tallies and across-pool direct tallies used to distribute the cost of mixed mail. This partially spreads allied not handling costs beyond the allied pool where they were incurred, but it does not completely sever the relationship between allied not handling costs and the pool where they were incurred.

d. Distributing Support Costs.

[3073] In Docket R97-1, and again in this docket, the Commission recommends apportioning Segment 3 mail processing labor costs to mail processing, window service, and administrative components, using the information provided by IOCS tallies to determine what operation a worker was part of when tallied. Where the IOCS information was in conflict with the clocking information provided by the MODS system, the Commission concluded that the IOCS data collector's direct observations were more likely to be accurate than the self-clocking information provided by the MODS system.

[3074] Since the Commission leaves costs in the mail processing, window service, or administration component where IOCS information indicates they belong, it is appropriate to use direct tallies from the MODS pool where the IOCS indicates they belong as the basis for distributing the mixed mail and not handling costs found in each pool.

[3075] Postal Service witness Degen argues that it is conceptually superior to distribute costs in the MODS Function 1 and Function 4 "support" pools according to the subclass distribution of the volume variable costs in the pools that they support. He argues that the direct tallies indicating that administrative clerks were observed processing mail or performing window service functions are "incidental" to their administrative duties. Therefore, he argues, they are not accurate indicators of the cause of the costs incurred in those support operations. He proposes that such direct tallies be ignored when distributing the costs of these support pools. USPS-T-16 at 55-57. The Periodical mailers prefer that costs be distributed on the basis of these direct tallies. Periodical Mailers' Initial Brief at 28.

[3076] The Commission rejects this proposal, but its rejection is not definitive. The reasons offered by witness Degen for concluding that direct tallies in these support pools do not indicate causation were thin and conclusory. The Commission needs a more informative discussion of the activities actually performed in these support pools in order

to independently evaluate witness Degen's assertion that direct tallies found there do not indicate causation.

e. Drawing Inferences from IOCS Questions 18 and 19.

[3077] Question 19 data provides an indication of the location of a worker at the time he was tallied by the IOCS data collector. The Periodical mailers argue that this information sometimes can be used to infer what operation, and what shape of mail, a mixed mail or not handling tally should be associated with. Tr .24/11384-86. Witness Stralberg argues that Question 19 data can be extended beyond its traditional use to support inferences about employees tallied while on break or handling empty containers. Id., at 11378-79. He argues that this can be done separate from, or in conjunction with, the Postal Service's use of item and container strata to draw similar inferences. Witness Stralberg shows that the Question 19 data often conflict with the item and container inferences drawn by the Postal Service. He concludes that this provides grounds for doubting the accuracy of inferences based on item and container. Periodical Mailers' Initial Brief at 27.

[3078] Witness Degen argues that Question 19 data provide no information on the causal relationship between accrued costs and mail subclasses. He argues that this is especially true when the worker is clocked into Function 4, non-MODS, allied, or support cost pools. He asserts that activities in those pools are not location specific because workers in those activities are required to move among activities transporting full or empty containers. He argues, for example, that when a platform worker who is creating a parcel sorting corral is tallied retrieving an empty hamper from a BCS operation, Question 19 will report the BCS location. He argues that it would be erroneous to infer from Question 19 location information that letter mail should be charged for the costs of setting up a parcel sorting operation. Tr .38/17324-25.

[3079] The Commission agrees that care must be taken to avoid drawing weak and unsupported shape and subclass inferences from the location information in Question

19. Accordingly, it does not endorse a mechanical application of Question 19 data to distribute the costs of location-ambiguous activities to subclasses.

[3080] The Periodical mailers also argue that IOCS Question 18 provides information indicating that employees clocked into mail processing operations were actually working at postal windows. Witness Stralberg proposes to trust what the IOCS data collector saw, and distribute the costs according to a window service, rather than a mail processing distribution key. This proposal would be relevant if the Commission were migrating window service tallies into mail processing cost pools on the basis of clocking information from the MODS system. The Commission leaves window service tallies where the IOCS indicates they belong, and applies a window service distribution key to these costs. Witness Stralberg's proposed adjustment is therefore moot.

B. City Delivery Carrier Street Time Costs

1. Summary

[3081] In this docket, the Postal Service proposes to use a survey designed to produce engineered time standards to replace a survey that the Commission has used since Docket No. R87-1 to apportion the accrued costs of city delivery carrier street time activity to basic functions. It also renews challenges that it first made in Docket No. R97-1 to the established methods by which the Commission estimates volume variable runtime, and elemental and coverage-related load time. For reasons explained below, the Commission finds the engineered time standards survey results to be unsuitable for use in ratemaking. It also rejects the Postal Service's renewed challenges to the established methods for estimating volume variable route time, access time, and elemental and coverage-related load time.

[3082] UPS witness Luciani introduced three proposals to modify the treatment of parcel costs. He proposes that the time carriers spend sorting and loading parcels in their trucks at the DDU be calculated as in-office time. Currently, these costs are treated as support costs and have much lower volume variability than in-office time. Further, Luciani proposes that the labor costs for routes designated as "Exclusive Parcel Routes" be totally attributed to the Zoned Parcel Post mail subclass. Lastly, he proposes that elemental load costs for parcel shaped mail be distributed to subclasses on the basis of weight. As discussed below, the Commission rejects these proposals based on evidence introduced into the record that shows these costs should continue to be handled as in recent dockets. See Sections 5, 8 and 9.

[3083] Witness Nelson, on behalf of the Publications Group, proposes to alter the analysis he conducted for the Postal Service in R97-1 regarding the variability of Motorized Letter Routes. This led witness Baron to present supplemental testimony on behalf of the Postal Service that disputes witness Nelson's proposal and then proceeds to develop arguments for totally eliminating this variable cost element. The Commission

finds merit in witness Nelson's proposal but rejects witness Baron's arguments. This is discussed in Section 7.

2. Postal Service Engineered Standards (ES) Data Proposals

[3084] The Commission's Opinion in Docket No. R97-1 comments as follows on the data parties were forced to rely upon to attribute city delivery carrier street time costs.

[T]he 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.

PRC Op. R97-1, para. 3225.

[3085] This opinion was soon echoed by the Data Quality Study which suggested the Postal Service ascertain if the Service's Engineered Standards/Delivery Redesign (ES) project might provide a more up-to-date source of suitable data. However, the Data Quality Study did not specifically recommend that the Postal Service and the Commission use the ES data. A.T Kearney, *Data Quality Study, Technical Report #4: Alternative Approaches for Data Collection*, April 16, 1999 at 53-56. According to MPA witness Hay, who was one of the contributors, the authors of the Data Quality Study merely recommended that the ES data be reviewed to determine its interim usefulness until new data could be provided. Tr. 27/13091-92.

[3086] The Commission does not collect postal data. That task belongs exclusively to the Postal Service and its contractors. By Docket No. R97-1, almost all of the critical estimates that the Commission was forced to use were derived from samples that were 8 to 12 years old. Carrier street time was divided among its principal components (street support time, travel time, run time and load time) using proportions taken from the Street Time Sampling (STS) survey. This survey was conducted in 1986. Run time was subdivided into access time and route time with variabilities taken from a regression fit to data from the Curbline and Foot Access Test (CAT/FAT). The most recent CAT/FAT test

experiment was conducted in 1989. Load time was separated into elemental volume-variable load time and coverage-related load time using elasticities taken from regressions fit to the Load Time Variability (LTV) study. The data for this study were collected in 1985.

[3087] Not only were these data old, they were somewhat inconsistent. Both the STS and LTV samples can be used to derive carrier street time proportions but the actual load times derived from these two sets of data are different. Witness Crowder who recommended adoption of the LTV proportions noticed this in Docket R97-1. After considering the reasons for the differences in the load times derived from the two studies, the Commission concluded that the differences were likely to be proportional. Consequently, it would still be proper to marry load time variabilities taken from regressions on the LTV data with a load time cost pool determined by the STS proportions. PRC Op. R97-1, Appendix K.

[3088] In the current proceeding the Postal Service proposes that the ES data be used to replace the STS and LTV samples. This would be accomplished, first, by using carrier street time proportions derived from the ES data by USPS witnesses Baron and Raymond, and, second, by replacing the stop-level load time regressions fit to the LTV data with route-level load time regressions fit to the ES data. Taken together, the proposals would avoid the possibility of a mismatch in the applied definitions of load time that arises when different samples are used to apportion carrier street time and estimate load time volume variability.

[3089] The Commission rejects both of the Service's ES proposals. Postal Service witnesses have not fit satisfactory route-level regressions to the ES data. An examination of the regressions reveals a basic flaw in the econometrics: among the "explanatory" variables for load time are variables that cannot be measured without knowing load time. In effect, load time has been used to explain load time. This is a fundamental technical error that makes the ES variability estimates meaningless. For this reason the Commission must continue to use the stop-level regressions fit to the LTV sample.

[3090] This means that to apply the LTV-derived variabilities to load times calculated using the ES proportions, the Commission must be satisfied that the same definition of load time has been applied to collect and compile both data sets. Unfortunately, this does not appear to be the case. The collection and compilation of load time proportions in accordance with the Postal Service's and Commission's definition of load time was not a designed purpose of the ES survey. Most of the precautions that should have been taken to obtain a random, or at least representative, sample were omitted. The sample is too small to be reweighted. And the ES data collectors were not informed of the precise distinction between loading and access activities that the Postal Service and the Commission apply to carrier street time. Apparently, as a result, the ES load time proportions turn out to be much higher than the proportions found in the more carefully conducted STS and LTV surveys.

a. Use of Engineered Standards (ES) Data for Street Time Proportions

[3091] The Postal Service proposes to use proportions from the ES survey tallies rather than the STS proportions to divide carrier street time into its components. This switch has been the subject of a considerable proportion of the testimony in this proceeding. The reason for this interest is obvious: the ES proportions are quite different from the STS proportions, as can be seen from Table 3-2, taken from the testimony of MPA witness Crowder. Tr. 32/16179.

Table 3-2

	STS	ES
Load Time	25.15%	38.15%
Foot Run Time (FAT)	41.59%	29.49%
Curblin Run Time (CAT)	9.14%	3.92%
Drive Time	7.20%	11.01%
All Other Time (Street Support, etc.)	16.92%	17.43%

[3092] The increase in the load time proportion converts into a \$980 million increase in load time costs according to witness Crowder. *Id.* at 16146. The Commission's established methods for estimating volume variability and attributing load time and access costs would convert a very large part of this increase into attributable costs. In Docket No. R97-1 about 70 percent of load time cost was attributable in the test year.

[3093] The Postal Service's proposal and supporting testimony is to be found mostly in the testimony and library references of Postal Service witnesses Baron and Raymond. NAA witness Kent also supported the Service's proposal in rebuttal testimony. The proposal's principal critics are Periodical mailers' witnesses Crowder and Hay. Witness Crowder has provided the Commission with a particularly detailed analysis and critique of the ES survey. On Brief, the OCA supports the use of the ES data in place of STS data. OCA Brief at 133-135.

(1) Data Collection and Load Time Measurement Issues

[3094] The collection and initial processing of the ES data are described by witness Raymond. He is the President and CEO of the Postal Service contractor responsible for designing and executing the ES survey. USPS-T-13 at 1-2. Witness Raymond's direct testimony is limited to a detailed account of the mechanics of the sample selection and data collection procedures. It is apparent from his testimony that the ES survey was not designed to collect carrier-street time data for rate making. This does not mean that the ES data are automatically unsuitable, but it does mean that the ES survey has to fortuitously meet some unanticipated standards for sample design and data collection. It is the application of unanticipated standards by Periodical witnesses Crowder and Hay that forms the basis of most of the data collection and load time measurement criticisms discussed in their testimony. These issues are: 1) Did the ES data collectors apply the correct definitions of load and run time? 2) Were the data collectors all applying the same definitions? 3) Were the collectors accurate in recording the information related to load

time? 4) Does the information collected for a tally always map correctly into load time, run time, etc.?

[3095] *Correct definitions of load and run time.* There is no evidence on the record to indicate that ES data collectors knew the correct distinction between load time and run time, which is that load time begins when the carrier stops before a receptacle or door and ends as he begins to move away. Witness Hay states the distinction as follows “the load time begins at the moment that the letter carrier’s feet stop moving at the end of a walk and ends at the moment that the foot is lifted to start away from a stop.”

Tr. 27/13083-89. Witness Crowder argues that the generic terms such as “point of delivery” and “delivery/collect” corresponding to the bar codes that collectors scanned to record a tally are somewhat imprecise and interpretable. Tr. 32/16158-61.

Nevertheless, the information was collected for the purpose of identifying exactly the activity of the carrier at the moment of the tally. The data were recorded according to a bar code scheme that was sufficiently detailed in design to distinguish load time from run time activities. And most of the bar code labels do not seem to be as interpretable as witness Crowder claims. In short, the system may have worked well enough to produce load time and run time tallies according to a fairly uniform common sense interpretation of the bar codes even though the collectors plainly could not have been deliberately applying the correct specific accepted rate-making definitions of load and run time.

[3096] *Consistent application of definitions by data collectors.* Witness Crowder argues that data collectors had no written instructions, *Id.* at 16154, that there was a high rate of turnover among the data collectors during the survey, *Id.* at 16158, and that replacements were trained “on-the-job” *Ibid.* Witness Hay notes the absence of training manuals and log-books, and that training did not emphasize the distinction between run time and load time. Tr. 27/13088-89.

[3097] Witness Raymond in his rebuttal testimony disputes most of these points. He specifically denies that the training of the collectors was deficient, that extensive training was even needed, and that replacement collectors were not trained.

Tr. 39/17909-10. From witness Raymond’s rebuttal testimony it appears that the ES data

collectors were adequately trained to be efficient and effective tally takers using the bar code scanning system devised for the survey. However, the training seems to have left the collectors to interpret the bar codes for themselves. Without a set of written instructions accompanying the bar codes, it is difficult to imagine how the data collectors could have done anything else. In practice the data collectors probably did not apply the same definitions of load and run time, but the result may have been just an avoidable increase in the noise in the tally data.

[3098] *Accuracy of the collectors in recording load time?* On this question witness Crowder argues that work sampling was not the central purpose of the ES survey. Tr. 32/16152-53 and that the data collectors were very busy with tasks other than work sampling *Id.* at 16154-56. Witness Hay also argues that the industrial engineering standards applied by witness Raymond are inappropriate for cost studies. Tr. 27/13086-87. Witness Raymond has responded that work sampling was a central purpose of the ES survey. Tr. 39/17907 and that the data collectors were not too overworked to accurately record the tallies *Id.* at 17908. On this question the record includes a curious attempt by witness Crowder to ascertain the accuracy of the ES load time percentages for specific routes by examining nine videotapes of carriers taken by the ES data collectors. Tr. 32/16186-88. Witness Raymond points out so many problems with the videotapes that it appears that witness Crowder analysis is of little help. Tr. 39/17911-17. The collectors were not as accurate as they might have been nor was the survey very well designed to collect economic data, but the result here, as before, may just be unnecessary noise in the observations. We also note that unlike the MODS data used by USPS witness Bozzo to estimate mail processing variabilities, the ES data were screened for errors as it was collected. USPS-T-13 at 13.

[3099] *Mapping the information collected for a tally correctly into load time and run time.* Witness Crowder argues that this has not occurred. Witness Raymond mapped the ES tallies into STS carrier street time categories following instructions from witness Baron. In principle every possible tally would be assigned to an STS category. In practice it appears that many kinds of tallies never occurred in the sample. Witness

Crowder's objections to the procedure are that the ES code definitions are broad, imprecise, and failed to specify breakpoints, that witnesses Baron and Raymond cannot assign tallies to STS categories without imposing their own interpretations on the ES codes, that 3 location codes and 5 activity codes are "vague and interchangeable," and that no analyst could identify precisely the STS category for some of the tallies Tr. 32/16162-64. Witness Raymond's rebuttal is that "anomalous" *sic* load time tallies were rare in the sample and had mostly been categorized correctly. The miss-categorization of tallies is a likely source of error in the ES tallies, but the extent of miss-categorization is not firmly determined on the record.

[3100] The Commission's overall impression of the ES tallies, and the way that they were collected and categorized, agrees with witness Hay's assertions that the ES tallies were made to answer a different set of questions than those that were asked by the ES survey. Tr. 27/13086. With the same effort the Postal Service could easily have collected a much larger and more accurate sample for estimating carrier street time proportions if it had planned to do so at the outset. While the design and execution of the ES survey does limit the applicability of results for rate cases, the data do serve some useful purposes in understanding carrier route operations and designing new studies that can estimate street time proportions with greater confidence.

(2) Sample Size and Selection Issues

[3101] The design of a sample for the purpose of estimating carrier street time proportions should be driven by the requirements imposed by the use of the estimates in rate making. Witness Hay describes in a general way how the requirements relate to the size and selection rules for the sample. *Id.* at 13080-84. He says that the sampling frame should be designed, and random sampling undertaken within the frame, so that the sample will be representative of the population to which the estimates apply. Sampling should be random but "pure randomness is rarely attained in practice." The sample must be large enough to provide estimates with an acceptable error. Witness

Hay describes alternative sampling plans: systematic sampling, stratified sampling and cluster sampling.

[3102] The ES sampling plan was none of the above. The consideration that controlled its design was convenience. The ES sample design is described by witness Raymond USPS-T-13 at 7-9 and is roundly criticized by witness Crowder.

Tr. 32/16165-78. There were two phases to the sampling. In phase 1, the ten geographic regions each chose 3 to 5 sites (zip codes). Ten additional sites were chosen at random. Routes were chosen randomly at the sites. In phase 2 managers of the 10 geographic regions choose test sites and 8 additional sites were chosen randomly. Again, routes were chosen randomly at the sites. Altogether witness Raymond reported that 340 routes were surveyed. It later was discovered that more routes had been surveyed but the results had not been included in the ES data.

[3103] Under witness Raymond's design most of the observed ES route-days turn out to have been selected non-randomly. This fact is immediately apparent from two tables compiled by witness Crowder. *Id.* at 16166. Only 101 out of 845 route-days were selected randomly and the sample was mostly drawn from a limited number of metropolitan areas. Four cities accounted for 55 percent of the observed route-days. The amount of data that was collected but excluded from the ES sample was 175 route-days.

[3104] The *ad hoc* nature of the ES sampling plan and the unexplained deletion of route-days brings up questions that would not have arisen if the design had been conventional. The questions that arise are 1) Is the sample representative of the population? 2) Is the sample large enough? and 3) Does it matter for the proposed use of the sample?

[3105] *Representativeness of the sample.* Witness Crowder's analysis shows that the ES sample will not be representative of the population of city carrier routes. In her own words "Mr. Raymond's sample is not representative of the entire system of USPS letter routes and, in fact, is biased toward routes with a larger proportion of in office and load time." The sample is heavily weighted towards residential curblane routes. *Id.* at

16174. The ES sample favored larger ZIP codes in more densely populated areas. *Id.* at 16175. The ES sampled sites averaged 26 routes per site while the national average is 14. *Id.* at 16174. The ES sample is biased towards regions in the South and West and away from regions in the North and East. *Id.* at 16175. In fact the geographic distribution of ES routes is very different from the geographic distribution of routes in the system. According to witness Crowder “Almost 85 percent of the ES foot routes come from the New York Metro, Pacific and Great Lakes regions while only 48 percent of total system foot routes are in those regions.” *Id.* at 16176. Delivery types are somewhat different for the ES sample and the total system. The ES sample is biased towards residential NDCBU and residential central and away from other types. *Id.* at 16177.

[3106] *Size of sample.* A sample that was large enough might be reweighted to overcome the sampling biases discovered by witness Crowder. Witness Baron does a limited reweighting of the sample for this purpose. Witness Crowder points out, however, that the ES sample is much too small to be reweighted to eliminate many of the biases that make it unrepresentative. The 340 foot routes sampled are only about 0.5 percent of the routes in the system. As an example of what happens when the sample is reweighted she cites one ES foot route in the New York Metro region which, under witness Baron’s reweighting, “accounts for approximately half of the weighted load time proportion calculated for all foot routes.” *Id.* at 16176. The small size of the sample would leave an appreciable amount of sampling error in witness Baron’s estimates of carrier street time proportions even if the ES sample had been random. Witness Baron in response to an ADVO interrogatory to witness Raymond provided standard errors and confidence intervals for the proportions. ADVO/USPS-T13-23 (Tr. 18/7107). The calculations are made with formulas that assume random sampling.

[3107] *Significance of flawed sample design.* In his response to the ADVO interrogatory witness Baron attempts to dismiss concerns about the apparent non-randomness of the ES sampling plan by citing a result found in Cochran, *Sampling Techniques*, John Wiley & Sons, 1977 at 158-159. In essence, the result is this. If the routes found at the sites (zip codes) are random samples from a superpopulation of

possible routes, then any scheme for selecting sites produces a random sample of routes from the superpopulation. If the routes found at a Zip Code are random then witness Raymond's plan for selecting sites is as good as any other plan. Unfortunately, Cochran's result is not applicable to the routes found at the Service's Zip Codes. The routes at a zip code are not randomly drawn from a superpopulation. They are found at the site because of geography, demographics, mail flows and the Postal Service's organization of its network.

[3108] Witness Hay states that "no confidence levels can be ascribed to these data because no sample design was made." Tr .27/13092. This appears to the Commission to be a reasonable assessment of the effect of the ES sampling plan on the carrier street time proportions proposed by the Postal Service. Accordingly, the Commission is unable to rely on ES data to attribute the costs of city delivery carrier street time.

(3) Compatibility Issues

[3109] Compatibility issues arise when the ES proportions are combined with LTV-based variabilities. These compatibility issues are essentially the same as the STS versus LTV compatibility issues that arose in Docket No.R9 7-1. In Docket No.R9 7-1 the Commission concluded that the differences in carrier street times found between the STS and LTV surveys were proportional. The definitions of the components of carrier street time for the two surveys were identical. The survey methods, however, differed in ways that suggested that carriers went at a faster pace in the LTV survey. If this was the only difference, then MTV elasticities could be used with STS proportions.

[3110] Both witness Crowder and witness Baron have concluded that the combination of ES proportions and LTV variabilities is a mismatch. Witness Crowder has shown that the differences between the ES and STS load and run time percentages are too large to be accounted for by sampling error or by changes in the way carriers deliver mail that have occurred over the interval of time from 1986, when the STS data were collected, and 1998, when the last of the ES data were collected. Tr. 32/16179-85. The

testimony offered by USPS witness Kingsley USPS-T-10 cannot explain changes of the magnitude found between the two samples. Regarding growth in cluster boxes, witness Crowder notes that MDR stops are only 7.6 percent of all stops in the system. Regarding replacement of foot routes with motorized routes, she observes that foot routes converted to park and loop are only 10 percent of the total and that curblane routes have increased only slightly since 1986. Regarding the introduction of Delivery Point Sequencing (DPS), she says that DPS letters do not add time at load. Regarding increasing volume per delivery, she replies that average volume per delivery has increased from 5.03 to 5.44 pieces, too little to explain much of the increase in load time. Regarding mail mix effects she shows that mail mix has hardly changed since 1986.

[3111] The explanations that survive witness Crowder's analysis are that the STS and ES surveys applied different definitions of load and run time, and that the ES (or STS) proportions came from biased samples. In his rebuttal testimony witness Baron proposes to resolve the compatibility issue by deriving variabilities from the ES data Tr. 43/18701-708. In effect, the Postal Service proposes to redefine load and run time to conform to the implicit consensus definitions applied by collectors as they took the ES sample. This is not a change that the Commission would be willing to make even if the Service had been successful in estimating variabilities from the ES sample. The STS definition cited by witness Hay is correct and clear. The implicit ES definition is unclear and may be incorrect. As it is, the proposal is moot because witness Baron's ES route level load time regressions are fatally defective.

b. Use of Engineered Standards (ES) Data for Route-level Variabilities

[3112] The Postal Service's proposal to use route-level load time variabilities from regressions fit to the ES sample appeared late in the proceedings. The fully developed proposal is not found until one reaches the rebuttal testimony of witness Baron. *Id.* at 18695-713. In its initial filing the Postal Service used the ES data only to replace the STS proportions. In his direct testimony, witness Baron recommended applying LTV

variabilities to load times derived with the ES proportions. Most of the testimony of non-postal parties in this proceeding is directed to the Postal Service's original proposal. For example, MPA witness Crowder fit regressions to the ES data for another purpose before the ES data set in the Service's original filing had been supplemented with delivered volumes by shape, accountables and collectables for the routes in the ES sample. Tr. 32/16196-206.

[3113] The Postal Service's econometrics began to emerge from UPS interrogatories directed to witness Baron. At this point the Service provided the disclosures required by our rules for econometric evidence and some additional discussion in a set of unsponsored library references. USPS-LR-I-310, LR-I-386 and LR-I-402. The regressions that witness Baron regards as providing the most accurate variabilities are found in USPS-LR-I-402. From his rebuttal testimony it appears that witness Baron is the author of LR-I-402, and may have authored the other library references as well.

[3114] USPS-LR-I-310 describes how the ES tallies were combined with other volume and delivery information to create a sample for the econometrics. Out of 971 ES route-day records, 758 could be matched to time, volume, and delivery point records. Load time for the routes in the ES sample was not actually measured as part of the ES survey. Instead, it must be estimated using the ES tallies and clocked street time for the carriers on the sampled routes. Several route records were deleted from the sample because the estimated load times were zero or very close to zero. The data assembly process described in LR-I-310 will leave estimates of load time with sampling errors, but the deletions should not impart a bias if they are random. The ES sample, however, is not particularly large, so the regressions must produce moderately good fits to provide statistically reliable estimates of load time variability.

[3115] The first attempt to fit a route-level regression to the ES sample used an equation patterned after the Commission's stop-level LTV regressions. The defective result is described in LR-I-310: "virtually all estimated regression coefficients are not statistically significant", "the estimated coefficients for volumes are both insignificant and

small in absolute value”, “the estimated elasticities of load time with respect to volume are essentially zero for flats, parcels, and accountables,” and, “the overall equation seems to perform poorly as the R-square statistic from the regression is only 31 percent.” USPS-LR-I-310 at 8.

[3116] The solution to the poor fit chosen by the author of LR-I-310 is to include in the regression a set of dummy variables defined to allow the regression line to “shift” for those observations that have very high load times relative to the shape volumes.

Including these dummy variables in the regression permitted estimation of the true volume – load time relationship. Each such dummy variable was set equal to one for all observations for which the load time per piece (by shape, and for accountables) fell within the upper 10 percent of the distribution of all observations of load time per piece. The dummy variable was set equal to zero for all other observations.

Id. at 9.

[3117] All of the regressions, except for the first, include these dummy variables, or similar ones, which differ only in the choice of the upper tail percentage of the distribution. These dummy variables all plainly use load time in their measurement. Since load time is also the dependent variable of the regression, the device that the Postal Service has employed to improve the fit of its equations to the ES sample is, constructively, to use load time to explain load time. This is not acceptable econometric practice in this instance because the equations have been fit by a method, least squares, that requires rather fundamentally that explanatory variables be exogenous (determined independently of the dependent variable). The dummy variables used in the Postal Service’s regressions are not exogenous because they cannot be measured without knowing in advance the load times for the routes.

[3118] All of the statistical properties of the Postal Service’s various regression experiments are grossly inflated by the presence of the improper dummy variables. This includes all of the t-values, F-statistics, and R-squares witness Baron cites to support his proposed use of the ES regressions, generally, and cites as reasons for selecting the

particular one he uses to calculate his proposed variabilities. The statistical importance of the dummies can be seen from the t-values that are attached to their estimated coefficients. *See, for example*, Tr. 43/18706, Table 3D. The t-values for the dummies named “load time/letters dummy,” “load time/flats dummy,” and “load time/accountables dummy,” range from 6.00 to 8.99. The t-value for the “load time/parcel dummy” is 3.84. The largest t-value for any other variable is 4.72. Without the improper dummies, the Postal Service’s equation fits to the ES sample would be expected to have approximately the same statistical and economic properties as the original failed regression described in LR-I-310.

3. The Established Load Time Variability Model

[3119] The Commission uses an established model of load time variability that is derived from the testimony of technical witnesses in Docket No. R90-1. The basic elements of the model consist of sub-models that are used to identify and combine the components of volume-variable load time at the stop level and at the system level. A third basic element of the model is the mathematics that shows how the variabilities that are derived from stop-level samples relate to the parameters of the stop-level and system-level submodels. A description of the established stop-level submodel is presented in Docket No. R90-1. The system-level model is shown in a derivation by witness Crowder in her response in R97-1 to Notice Of Inquiry No.3. The connection between the submodels is described in general terms in the Commission’s R97-1 Recommended Decision.

[3120] The following mathematical description of the established model reaffirms that the three components of the model fit together as parts of a logically consistent single entity. The description also shows how the equations which the Postal Service and the Commission fit to data from the Postal Service’s Load Time Variability (LTV) study correspond to a component of the stop level submodel and relate to a component of the system level submodel.

a. Stop-level Load Time Sub-model

[3121] Load time at a stop, L , is a function F of volume at the stop, v , and the number of actual deliveries that are made at the stop, A . In practice, the stop level submodel is applied to three kinds of stops. These are Single Delivery Residential (SDR), Multiple Delivery Residential (MDR) and Business and Mixed (BAM) stops. SDR stops have exactly one actual delivery, but MDR and BAM stops can have more than one actual delivery. The function, F , is defined for a range $v \geq 1$ and $A \geq 1$ for MDR and BAM stops. If volume by shape types, accountables and collectables at the stop are zero, then actual deliveries are also zero and the stop would not actually occur. Mathematically, the Commission's Conceptual Stop Level Load Time Function is:

$$L = F(v, A)$$

[3122] The Conceptual Stop Level Load Time Function is an inconvenient equation to fit to the Postal Service's LTV sample for two reasons. First, one of the principal variables, actual deliveries A , was omitted from the sample. Instead of actual deliveries, the LTV sample recorded possible deliveries, P , for the stops included in the sample. The second reason the function, F , is inconvenient is that actual deliveries is itself volume-variable. We would certainly expect as the volume at an MDR or BAM stop increased that the number of actual deliveries would increase until it reached the number of possible deliveries at the stop. This fact makes actual deliveries an inconvenient variable to use as a control in an econometric fit of a load time equation because the volume variability of load time cannot be extracted from the result simply by using the partial derivative with respect to the volume,

[3123] The difficulties with the Conceptual Stop Level Load Time Function are overcome by transforming it. The transformation is a transformation of variables that is made mathematically by directly substituting for the variable actual deliveries, A , a function relating actual deliveries to its determinants. These determinants are volume at

the stop, v , and the number of possible deliveries at the stop, P . This function is described in the R97-1 testimony of witness Baron. USPS-T-12 at 20-21. However, the function actually has much earlier origins in the testimony of USPS witness Bradley in Docket No. R94-1. USPS-T-5 at 49-50. We use the following general statement of the Actual Deliveries Function:

$$A = A(v, P)$$

[3124] The substitution for A in the function leaves a function, that we may call the Applied Stop Level Load Time Function. The terminology is appropriate because the function, L , corresponds in form to the equations that have been specified and fit econometrically to the LTV sample.

$$L = F(v, A(v, P)) = L(v, P)$$

[3125] The Applied Stop Level Load Time Function, L , corresponds to the load time functions shown by witness Baron in his R97-1 testimony and is repeated as his equations (1) and (2) in his current testimony. USPS-T-12 at 4-5. These functions are specified as separable quadratics in v and P , *not* A . The equations, as they are fit to the LTV sample, also include other non-volume variable controls in the form of dummy variables for receptacle and container type. It must be noted that volume per stop is actually a vector, v , of volumes by shape category, accountables and collections. This complicates the application of the mathematics without altering the model in any essential way. For simplicity, in describing the established model we shall present the mathematics as though v is a single variable rather than a vector. In actual applications derivatives with respect to v become partial derivatives with respect to the components of the vector, v , and some of the equations involve sums of terms rather than a single term.

[3126] The volume variability of load time follows from the definition of the elasticity of load time with respect to volume. This definition is:

$$E_v = L_v \frac{v}{L}$$

where

$$L_v = \partial L / \partial v$$

is marginal load time. Marginal load time is just the partial derivative of L with respect to v (or the elements of the vector v) because the remaining variables in the Applied Stop Level Load Time Function are all non-volume variable. These variables are possible deliveries, P , and a collection of non-volume variable dummies. When we say that possible deliveries are non-volume variable it means that the Commission assumes that:

$$\partial P / \partial v = 0$$

[3127] Rearranging the definition of E_v shows that all of the volume variable load time, $L_v v$, in the load time for a single stop is accounted for by $E_v L$.

$$L_v v = E_v L$$

This equation also holds for a particular shape, accountables or collectibles, i.e., for any element of a vector, v .

[3128] Load time at a stop is cleanly partitioned into volume variable, $L_v v$, and non-volume variable, L_f , components by the Commission's Stop Level Load Time Sub-model:

$$L = L_v v + L_f$$

and, if v is a vector of volumes by shapes etc. indexed by i , then:

$$L = \sum_i \frac{\partial L}{\partial v_i} v_i + L_f$$

[3129] The mathematics that produces this partition does not impose any condition other than first-order differentiability on the Applied Stop Level Load Time Function. In particular, the mathematics does not require that the function L be linear in v . The equation forms used to fit L to the LTV sample are non-linear quadratic forms, and the parameters for the nonlinear components that emerge from the fits for the three kinds of stops, taken together, are different from zero at high levels of significance. If the function L is nonlinear then marginal load time, L_v and non-volume variable load time, L_f , will not be fixed constants. They will themselves be functions of volume at the stop, v .

[3130] The volume variable load time at a stop includes both a direct and an indirect effect. Differentiating the Conceptual Stop Level Load Time Function, F , with respect to v has to produce the same result as taking the partial derivative of the Applied Stop Level Load Time Function, L , :

$$L_v = \frac{\partial F}{\partial v} + \frac{\partial F}{\partial A} \frac{\partial A}{\partial v}$$

[3131] Actual deliveries are a function of volume, so the function-of-a-function rule is applied to obtain the second term. Multiplying through by v produces an equation for volume variable load time with two components:

$$L_v v = \frac{\partial F}{\partial v} v + \frac{\partial F}{\partial A} \frac{\partial A}{\partial v} v$$

[3132] The components are, first, the direct effect of volume on stop level load time with actual deliveries held constant, and, second, an indirect “deliveries” effect that operates on load time through the number of actual deliveries. The second effect arises because a change v will affect load time indirectly by changing the number of deliveries. An increase in the number of actual deliveries can be expected to increase load time even if the volume at the stop remains fixed.

$$\frac{\partial F}{\partial v} v = \text{volume-variable load time with } A \text{ fixed.}$$

$$\frac{\partial F}{\partial A} \frac{\partial A}{\partial v} v = \text{contribution to volume variable load time when } A \text{ responds to } v. \text{ This is the indirect effect on load time.}$$

b. System-level Load Time Sub-model

[3133] The Commission’s calculations of volume variable costs and the attribution of these costs to subclasses is all done at the system level, that is, for the Postal Service as an entity. Prior to R97-1 this was done somewhat naively by applying the estimated volume variabilities derived from the stop level econometrics. In Docket No.R97-1 witness Crowder presented testimony in response to the Commission’s NOI No.3 that showed that the Commission’s method was mathematically sound. The Commission’s System level Load Time Sub-model is taken directly from witness Crowder’s R97-1 testimony.

[3134] Total system load time is equal to average load time per stop, \bar{L} , times the number of stops in the system, S

$$\bar{L}S = H(\bar{v})S$$

[3135] The components of the equation are:

$\bar{L} = H(\bar{v})$ average load time at a stop

S = the number of stops in

$V = \bar{v}S$ total volume in the system

[3136] The average load time at a stop is assumed to be a function, H , of average volume per stop, \bar{v} , and, possibly, other variables that are non-volume variable and need not be shown specifically as arguments for that reason. The function ~~is~~ the Average Stop Level Load Time Function. The function, H , is *not* assumed to be the same as the Conceptual Stop Level Load Time Equation, F , or the Applied Stop Level Load Time Function, L , but is obviously closely related to them. Also, the number of stops in the system, S , may be a function of total volume in the system, V .

[3137] System-level volume variability is the elasticity of total system load time, $\bar{L}S$, with respect to total system volume, V :

$$\frac{d(\bar{L}S)}{dV} \frac{V}{\bar{L}S}$$

[3138] The derivative in this expression is obtained by differentiating the equation for total system load time:

$$\frac{d(\bar{L}S)}{dV} = \frac{dH}{d\bar{v}} \left(1 - \frac{dS}{dV} \frac{V}{S} \right) + H(\bar{v}) \frac{dS}{dV}$$

[3139] The elasticity, E_s , of the number of stops, S , with respect to total system volume, V , is defined as:

$$E_s = \frac{dS}{dV} \frac{V}{S}$$

[3140] Substituting in the expression for system-level volume variability and using $V/S = \frac{1}{\bar{v}}$ gives:

$$\frac{d(\bar{L}S)}{dV} \frac{V}{\bar{L}S} = \frac{dH}{d\bar{v}} (1 - E_s) \frac{\bar{v}}{\bar{L}} + H(\bar{v}) \frac{E_s}{\bar{L}}$$

[3141] The elasticity, E_e , of average load time per stop, H , with respect to average volume per stop, \bar{v} , is called “elemental load time variability” and is defined as:

$$E_e = \frac{dH}{d\bar{v}} \frac{\bar{v}}{H}$$

[3142] Substituting E_e in the equation for system level volume variability gives:

$$\frac{d(\bar{L}S)}{dV} \frac{V}{\bar{L}S} = (1 - E_s) E_e + E_s$$

which can be rearranged on the right-hand side to get Crowder’s equation:

$$\frac{d(\bar{L}S)}{dV} \frac{V}{\bar{L}S} = E_e + (1 - E_e)E_s$$

[3143] It can be seen from Crowder’s equation that system level volume variability is composed of two distinct effects. These are, first, the elemental load time variability E_e , and, second, a coverage-related stops effect $(1 - E_e)E_s$ that is the effect of the variability of stops on the residual from the elemental load time effect.

[3144] Nothing is assumed about the Average Stop Level Load Time Function in the derivation of Crowder's equation except that the function H exists over the necessary range (the same range as the functions F and L), and is first-order differentiable with respect to average volume per stop, \bar{v} , over its range. The function does not have to be linear in \bar{v} . The functions F and L are nonlinear in v so it would not be appropriate if the mathematics required that H be linear.

[3145] Nothing material in the mathematics changes when the System-level Load Time Sub-model is applied separately to load times for SDR, MDR and BAM stops. The mathematics is also essentially unchanged if \bar{a} and V are vectors of volumes by shape, accountables and collections. Derivatives with respect to \bar{v} and V become partial derivatives with respect to the elements of the vectors, the elemental load and stop elasticities are separately defined for the elements of the vectors, and Crowder's equation holds separately for each shape, accountables and collectables. Total elemental volume variable load time is the sum of the elemental volume variable load time by shape, accountables and collectables.

[3146] The Commission attributes elemental load time to subclasses by summing the elemental volume-variable load times for the several shapes, accountables and collectables.

$$(E_e)(\bar{L}S)$$

This sum of volume variable load times is attributed to subclasses by applying carrier street time distribution keys. The Commission attributes part of the remainder to subclasses by applying single-subclass stop proportions to the sum of the residuals. In practice, the Commission performs this arithmetic simply by adding to carrier access costs the residual of load time costs obtained by deducting elemental volume variable load time costs from total load time costs. Load time costs that are not attributed by this two step method become part of institutional costs.

[3147] This method generally attributes a sum of load time carrier costs to subclasses that is greater than the amount that would be attributed on the basis of the sum of the volume-variable stops effects by shape etc.:

$$(1 - E_e)(LS)$$

This occurs because E_s is quite small for most kinds of stops and most kinds of mail.

[3148] The Commission's System-level Load Time Variability Model was the basis for the Commission's Docket No. R97-1 explanations of the two components of load time variability.

The established analysis divides load time into two categories, each with its own 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.

PRC Op. R97-1, para. 3253.

c. Relationship Between the Stop- and System-Level Sub-models

[3149] The Applied Stop Level Load Time Function, L , from the Stop-level Sub-model and the Average Stop Level Load Time Function, \bar{L} , from the System-level Sub-model are not the same function, but are mathematically related continuous probability density function for volume per stop over the population of stops.

Then average load time per stop \bar{L} , by definition, is the expected value of stop-level load time, $L(v)$:

$$\bar{L} = \int_{-\infty}^{\infty} L(v)f(v)dv$$

The Taylor's series expansion of $L(v)$ at the average volume per stop, \bar{v} , is:

$$L(v) = L(\bar{v}) + \frac{\partial L(\bar{v})}{\partial v}(v - \bar{v}) + \frac{\partial^2 L(\bar{v})}{\partial v^2} \frac{(v - \bar{v})^2}{2}$$

[3150] Terms with derivatives higher than the second-order are truncated and are zero in any case for the quadratic forms used to fit $L(v)$ to the LTV sample. Substituting the Taylor's series expansion within the integral and moving the value of the function and derivatives that are evaluated at the mean outside the integrals produces:

$$\bar{L} = L(\bar{v}) \int_{-\infty}^{\infty} f(v)dv + \frac{\partial L(\bar{v})}{\partial v} \int_{-\infty}^{\infty} (v - \bar{v})f(v)dv + \frac{\partial^2 L(\bar{v})}{\partial v^2} \int_{-\infty}^{\infty} (v - \bar{v})^2 f(v)dv$$

[3151] The integrals on the right-hand side are reduced term by term using the standard properties of a continuous probability density function. These properties can be found in any basic mathematical statistics text and are 1) that the integral of $f(v)$ over its range is 1, 2) that the first moment of $f(v)$ is the population average (mean) of v , and, 3) that the second moment of $f(v)$ about the mean is the variance of v . These properties are stated mathematically as follows:

$$\int_{-\infty}^{\infty} f(v)dv = 1, \int_{-\infty}^{\infty} vf(v)dv = \bar{v}, \int_{-\infty}^{\infty} (v - \bar{v})^2 f(v)dv = \sigma_v^2$$

[3152] Substituting for the integrals and simplifying the result leaves the following equation:

$$\bar{L} = L(\bar{v}) + \frac{\partial^2 L(\bar{v}) \sigma_v^2}{\partial v^2} \frac{1}{2} = H(\bar{v})$$

[3153] This is the relationship between the Average Stop Level Load Time Function, $H(v)$, and the Applied Stop Level Load Time Function when L and its derivatives are evaluated at the average volume per stop. If the function L is a quadratic, the function $H(\bar{v})$ is exact because the Taylor's series has no terms higher than the second order. The function $H(\bar{v})$ will be a very close approximation anyway if $f(v)$ is a symmetric distribution since all of the odd moments about the mean are zero for such a distribution.

[3154] Notice that the two functions H and L differ by an amount that is fixed because the third-order derivative of L is assumed to be zero and because the variance of the probability density function f is a fixed value that is independent of the mean. The derivatives of the functions H and L are interchangeable in the definition of elemental load time variability:

$$E_e = \frac{dH}{d\bar{v}} \frac{\bar{v}}{\bar{L}} = \frac{dL}{d\bar{v}} \frac{\bar{v}}{\bar{L}}$$

[3155] The elemental load time variability used by the Commission and by the Postal Service is actually an approximation that is exact only if $\bar{L} = L(\bar{v})$. The approximation is the elasticity computed from the Applied Stop Level Load Time Function L at the point that corresponds to the average volume per stop \bar{v} :

$$E_e \cong \frac{dL}{d\bar{v}} \frac{\bar{v}}{L(\bar{v})} = E_v$$

[3156] This approximation is a convenience statistically because $L(\bar{v})$ is easier to compute than \bar{L} .

[3157] The Commission's method is to compute elemental load time variability separately for SDR, MDR and BAM stops. The information used for each stop type is, first, an econometric fit of the Applied Stop Level Load Time Function $L(v, P)$ and, second, the average volume per stop, \bar{v} . This is all the information that is needed to apply the approximation. If average load time, \bar{L} is known or can be estimated from other information, then the accuracy of the calculation could be improved by substituting \bar{L} for $L(\bar{v})$. The accuracy of the calculation also depends upon the success of the econometrics in fitting functions to the LTV sample for each stop type.

[3158] If v is a vector of volumes per stop by shape etc., then all of the variances and covariances of the multivariate probability density function $f(v)$ are involved in the relationship between H and L :

$$\bar{L} = L(\bar{v}) + \sum_i \sum_j \frac{\partial^2 L(\bar{v})}{\partial v_i \partial v_j} \frac{\sigma_{ij}^2}{2}$$

[3159] where σ_{ij}^2 is the covariance of v_i and v_j . The assumptions of the multi-variate case are analogous to the assumptions of the single-variate case. The Taylor's series expansion that is used in the multi-variate case is assumed to have no partial derivatives higher than the second order and all of the elements of the variance-covariance matrix of the multivariate probability density function are independent of the vector of means. Therefore, the multivariate analogue of the Average Stop Level Load Time Function also differs from the multivariate Applied Stop Level Load Time Function by a fixed amount. All of the rest of the mathematics follows with partial derivatives with respect to the components of the vector v replacing the derivative of L with respect to v .

[3160] The mathematics of the established Load Time Variability Model can be applied with only definitional changes to a model whose basic behavioral functions are defined at the route level rather than the stop level. The functions F , A , L and H would all be redefined at the route level with the number of system routes, say R , replacing the number of system stops, S . All of the necessary changes are straightforward, for example, volume per stop, v , would have to be redefined as volume per route and L as load time per route.

4. Postal Service Methodological Proposals

[3161] Postal Service witness Baron has proposed several changes to the Commission's method for determining the volume variable component of load time costs. These proposals are motivated by witness Baron's belief that the established Load Time Variability Model is flawed. In each instance the perceived flaw corresponds to a proposal made by witness Baron in testimony given in Docket No. R97-1 that was rejected by the Commission.

[3162] The Postal Service's methodological proposals are:

- That the Commission deduct a predetermined amount of fixed time per stop from load time per stop and add it to access time.
- That the Commission include in elementary load time volume variability a new "deliveries" effect that arises from regarding possible stops as actual stops in the load time regressions.
- That the Commission no longer add the residual of load time, after the deduction of elemental volume-variable load time, to access time. The entire residual of load time cost would become a part of institutional cost.

[3163] The Commission rejects the Service's methodological proposals again for reasons that differ little from the reasons stated in the R97-1 Recommended Decision. PRC Op. R97-1, paras. 3253-3307.

a. Fixed Load Time per Stop

[3164] Witness Baron reiterates at many points a belief that only an identifiable fixed component of load time at a stop should be included in the amount of load time that the Commission adds to access time. The load time that the Commission adds to access time is the residual labeled “coverage related” in the Commission’s System-level Load Time Model. Acceptance of witness Baron’s proposal would cause a considerable reduction in the amount of load time that the Commission regards as coverage-related, and a commensurate reduction in the load time that is ultimately attributed to subclasses using the single subclass stops proportions.

[3165] Witness Baron’s proposal is motivated by a misreading of the Commission’s R90-1 Recommended Decision where we described coverage-related load time as “independent of the amount of mail delivered at a stop.” PRC Op. R97-1, paras. 3276-3280. According to witness Baron the Postal Service also regards coverage-related load time as “independent” of volume: “the Postal Service has consistently asserted that the stops effect of volume on load time equals the increase in time that results from the accessing of a new stop. The Postal Service regards this block of time as independent of the amount and mix of volume delivered at that stop.” USPS-T-12 at 7. Witness Baron uniformly interprets “independent” as meaning “fixed” for all possible levels of volume although there is nothing in the Commission’s past decisions to justify such a strict interpretation.

[3166] Witness Baron’s proposal was analyzed at length in the Commission’s R97-1 Recommended Decision and it was rejected. PRC Op. R97-1, paras. 3258-3285. Witness Baron’s testimony in the present proceeding reargues his R97-1 proposal while adding nothing that is new. The proposal is still based entirely on the belief that coverage-related load time should only contain load time that is fixed per stop. Witness Baron’s own summation of his arguments can be found in his rebuttal testimony: 1.) “the residual violates the premise of the fixed-time at stops definition”, 2.) “the residual is the correct measure of coverage-related load time only if the load time equation defines load

time as a strictly linear function of volume”, and, 3.) “according to the residual formula, BY 1998 coverage-related load time per stop equaled 6.65 seconds per SDR stop, 17.35 seconds per BAM stop, and 39.90 seconds per MDR stop. These estimates are much too high to qualify as realistic predictions of fixed stop time.” Tr. 43/18683-85.

[3167] The basic technical error in witness Baron’s proposal is that it conflicts with Crowder’s equation except in the special case when the Conceptual, Applied and Average Stop-Level Load Time Functions, F , L and H are all linear. The mathematics that produces Crowder’s equation is, at the same time, a proof that the coverage-related stops effect is found by applying the stops elasticity E_s to the whole residual $(1 - E_e)\bar{L}S$ not just to a fixed part of it as proposed by witness Baron. Therefore, witness Baron’s proposal is invalid mathematics. Witness Baron’s error can be seen easily by considering the load time that would be saved if the system lost a stop but the volume at the stop was redistributed so that total system volume remained the same. The load time that would be saved would be all of the load time at the stop minus the elemental load time that would have to be added to handle the added volume at the remaining stops. This is exactly the residual found in Crowder’s equation. The residual includes the fixed load time described by witness Baron, but it also includes the accumulated effects of the curvature of the functions F , L and H when they are nonlinear in v .

[3168] OCA witness Ewen presents residual load time cost estimates in Table 2. Tr. 25/12031. They show the difference between witness Baron’s proposed fixed load time costs and the residual load time costs that arise from an application of the established method to information from the R97-1 record and the Postal Service’s response to OCA interrogatory. OCA/USPS-T12-8. Witness Baron’s fixed load time costs are only \$260,244,000 (*ibid.* line 2, column (b) “Postal Service Methodology”) while the amount of the residual in Crowder’s equation is \$1,104,406,000 (*ibid.* line 6, column (a) “PRC Methodology”). In addition, the Postal Service methodology treats only a small percentage, 7.3 percent, of the fixed load time costs as volume variable. The Commission’s use of single subclass stops proportions provides a basis for attributing

17.5 percent of the larger residual. Ultimately, the Postal Service adds only \$18,933,000 of load costs to its volume-variable costs for coverage related load time. The Commission's method adds \$192,807,000 to attributable costs for the same effect.

[3169] The large difference between witness Baron's fixed load time cost and the established method's residual occurs because the Applied Stop Level Load Time Function used by the Commission is highly non-linear. To begin with, the functional forms used in the econometrics to fit the function, $L(v, P)$, are quadratics that are separable in v and P , meaning that there are no cross-products between these variables USPS-T-12 at 4-5. When the quadratic forms are fit to the LTV sample many of the squares and cross-products between the components of the vector, v , of volumes by shape etc. receive statistically significant coefficients. The effects of these nonlinearities can be seen wherever the fitted functions are used. For example, witness Ewen shows that the "inferred stops effect" corresponding to the vertical intercept for the receptacle dummy with the lowest coefficient is negative for all three stop types. Tr. 25/12036-38. Witness Baron's own comparisons of the average FY 1998 predicted load time to the load time predicted for the average volume stop exhibit the effects of nonlinearity quite clearly for MDR and BAM stops USPS-T-12 at 17-18.

[3170] Witness Baron's method for estimating fixed load time would be unacceptable to the Commission even if it were prepared to accept his proposal in principle. His estimates of fixed load times were produced using the kind of *ad hoc* procedure that our rules for econometric evidence are designed to exclude. Witness Baron describes his procedure as follows:

To summarize, this procedure measures the stops effect as the minimum of the load times recorded during the 1985 load-time field test at stops receiving only one letter piece. I estimated this minimum for each stop type as the average of the lowest quintile of these observed load times.

Id. at 7 (footnote omitted).

[3171] As an estimator, witness Baron's procedure is neither efficient nor unbiased. It is inefficient because it utilizes only a small part of the applicable sample. For example, only 1373 of 16,037 SDR stops are one letter stops. Tr. 43/18685. It is biased because there is no reason to expect that the distribution of the load times of the lowest quintile of one-letter stops is centered at the fixed load time for all stops. All of this and other faults are evident from witness Ewen's analysis of witness Baron's estimation methods. Tr. 25/12038-42. A "revised" procedure described by witness Baron in his rebuttal testimony Tr. 43/18685-94 is *ad hoc* and seems to have most of the same flaws identified by witness Ewen in the original procedure.

[3172] *Crowder's Equation*. Witness Baron resurrects an argument, made in his R97-1 rebuttal testimony, in an attempt to discredit Crowder's equation. His argument can be analyzed in terms of the notation and mathematics of the Commission's established model. This argument is that the average load time at a stop, \bar{L} , is unequal to the value of the Applied Stop Level Load Time Function, $L(\bar{v})$, when the function is evaluated at the average volume per stop, \bar{v} . USPS-T-12 at 9-16. The two are likely to be unequal "due to the substantial non-linearity in the load time regressions" as stated by witness Baron. Although it is certainly true that \bar{L} and $L(\bar{v})$ are unequal for the fitted equations used by the Commission, the derivation of Crowder's equation is not dependant on the assumption that the functions L and H are linear or the same as claimed by witness Baron.

[3173] In his direct testimony witness Baron provides a derivation of Crowder's equation using the function $L(\bar{v})$ instead of the function $H(\bar{v})$. He observes that the two functions are not equivalent, asserts that the function $H(\bar{v})$ does not exist, and claims that Crowder's equation is incorrect. Witness Baron's basic mathematical error here is his mistaken belief that the Average Stop Level Load Time Function, ~~used~~ ^{used} in the Commission's derivation of Crowder's equation does not exist. Witness Baron's own words (but using the Commission's notation for the functions L and H) are as follows:

The claim that even though $\bar{L} \neq L(\bar{v})$ (where L is one of the load-time regressions), some other functional relationship $\bar{L} = H(\bar{v})$ also exists, is also incorrect. This claim asserts that an equation exists quantifying average load time over all stops as a function of average volume per stop. In reality, there is no alternative function to substitute for $L(v)$. For a functional relationship to exist between \bar{L} and \bar{v} , each average volume per stop (\bar{v}) must produce a unique corresponding value for average load time per stop (\bar{L}). Clearly, this requirement is violated. Each unique value for \bar{v} can be produced by a virtually infinite number of differing allocations of mail volume across total, system-wide stops. Moreover, because of the non-linearity of the relationship between load time and volume at any one stop, each such allocation of volume across multiple stops produces a different value of \bar{L} . Thus, for any \bar{v} , \bar{L} will take on many differing values. Since a functional relationship requires that \bar{L} equal only one value for each \bar{v} , \bar{L} cannot be a function of \bar{v} .

Id. at 13-14.

[3174] The function $H(\bar{v})$ not only exists, its approximate form is known for a very large class of functions, $L(v)$, and probability densities, $f(v)$, and its exact form is known for the quadratics used in the Commission's "load-time regressions". When v is a simple variable (rather than a vector) this form is:

$$\bar{L} = L(v) + \frac{\partial^2 L(v) \sigma_v^2}{\partial v^2 2} = H(\bar{v})$$

[3175] When v is a vector with elements indexed i, j the form becomes:

$$\bar{L} = L(v) + \sum_i \sum_j \frac{\partial^2 L(v) \sigma_{ij}^2}{\partial v_i \partial v_{ij} 2}$$

[3176] The existence of the function $H(v)$ was pointed out by the Commission in the R97-1 Recommended Decision. PRC Op. R97-1, paras. 3283-3289. Its derivation which is shown above requires only an elementary knowledge of mathematical statistics. The problem with witness Baron's "explanation" of why the function cannot exist is that both \bar{v} and \bar{L} are mathematical expectations defined by integrals involving a continuous

probability density function $f(v)$. His explanation is actually an attempt to apply verbal logic to solve a problem in the integral calculus and reaches an incorrect conclusion.

[3177] Witness Baron's failure to recognize the existence of the function $H(\bar{v})$ leads to another erroneous assertion about Crowder's equation. Witness Baron believes that Crowder's equation is valid only if the function L is linear in v . Actually, the functions L and H will be identical if *either* L is linear in v *or* the second-order moments about the mean of $f(v)$ are all zero $\sigma_{ij}^2 = 0$ for all i, j . If L is linear then H will be linear which would certainly simplify the mathematics of the established Load Time Variability Model, but the linearity assumption is not necessary and does not hold for the regression equations used by the Commission.

b. The Deliveries Effect

[3178] The Conceptual Stop Level Load Time Functions, $F(v, A)$, for MDR and BAM stops include actual deliveries, A , as a variable. Actual deliveries is solved out to produce the Applied Stop Level Load Time Function, $L(v, P)$, that is actually fit to the LTV survey data. The Applied Stop Level Load Time Function is more convenient because it represents all stop-level volume effects with the single variable v , since possible deliveries, P , is non-volume variable.

[3179] That the function $L(v, P)$ and not the function $F(v, A)$ was used with the LTV sample was clear in witness Baron's R97-1 Direct Testimony and is evident in any case from the LTV sample itself. Possible deliveries, P , is the variable that is recorded for stops in the LTV data set. In his R97-1 testimony witness Baron incorrectly resubstituted A for P in the Applied Stop Level Load Time Functions for MDR and BAM stops. This error is repeated in his testimony in this proceeding. According to witness Baron "[t]he Postal Service also views the deliveries variables in the MDR and BAM load time equations as actual deliveries" USPS-T-12 at 19-22.

[3180] The effect of this error on witness Baron's load time variabilities is described by witness Crowder "All volume-related stop level effects are already captured by the volume coefficients in the model. Thus, his approach amounts to attributing some of the stop level time twice and is clearly excessive and inappropriate." Tr. 32/16191-93. This assessment is confirmed by the mathematics. The function L is obtained in the established Stop-Level Sub-Model by making the substitution $A = A(v, P)$ into the function F :

$$L = F(v, A(v, P)) = L(v, P)$$

[3181] Resubstituting A for P as done by witness Baron leaves:

$$L = F(v, A(v, P))$$

[3182] Differentiating with respect to v gives:

$$L_v = \frac{\partial F}{\partial v} + \frac{\partial F}{\partial A} \frac{\partial A}{\partial v} + \frac{\partial F}{\partial P} \frac{\partial A}{\partial P} \frac{\partial P}{\partial v}$$

[3183] Since $\partial A / \partial P$ is close to one, the deliveries effect, is almost double-counted:

$$L_v \cong \frac{\partial F}{\partial v} + 2 \left(\frac{\partial F}{\partial A} \frac{\partial A}{\partial v} \right)$$

c. Elemental Volume Variability and Other Issues

[3184] The elemental load time variability used by the Commission and by the Postal Service is an approximation that is exact only if \bar{L} is the load time approximation uses \bar{L} instead of \bar{L} and is identical to the load time elasticity of volume per stop computed on the function L at the point corresponding to average volume per stop, \bar{v} :

$$E_e \cong \frac{dL}{d\bar{v}} \frac{\bar{v}}{L(\bar{v})} = E_v$$

[3185] This approximation is a convenience statistically because $L(\bar{v})$ is easier to compute than \bar{L} . An exact calculation of elemental load time variability is obtained when \bar{L} is used instead of $L(\bar{v})$ because the derivatives of H and L are the same:

$$E_e = \frac{dH}{d\bar{v}} \bar{L} = \frac{dL}{d\bar{v}} \bar{L}$$

[3186] Witness Baron sees that \bar{L} and $L(\bar{v})$ are unequal (USPS-T-12 Attachment A at 38-39) but fails to see that the derivatives of H and L are the same. This is understandable since witness Baron failed to recognize that the function H even existed. Witness Baron also cites some essentially irrelevant testimony by witness Bradley in R90-1 that ‘evaluation of a cost function at the mean volume level provides, necessarily, an *unbiased* estimator of the true volume variability’. USPS-T-12 at 39 citing R90-1, USPS-RT-2 at 10. All that this means is that E_v is an unbiased estimate. It says nothing about E_v as an approximation for E_e .

[3187] Witness Baron regards the approximation used by the Commission as a fatal flaw in the established Load Time Variability Model. In reality, it is a convenient but unnecessary approximation that can be dispensed with any time that the Postal Service wants to take the trouble. Witness Baron’s direct testimony includes an elaborate and unnecessary quantitative demonstration that \bar{L} and $L(\bar{v})$ are unequal using data from the 1998 Carrier Cost System (CCS). USPS-T-12 at 16-18. The average of the predicted load times by stop type from witness Baron’s Table 1 are estimates of \bar{L} that could be used to eliminate the approximation used by the Commission. Witness Baron’s calculations demonstrate that the Postal Service collects with the CCS all the information it needs to improve the accuracy of the elemental load time variabilities, E_e , used with the established method.

[3188] Witness Baron does not calculate volume variability correctly for his own proposal. Deducting a fixed amount from average load time per stop and adding it to

access time as he proposes requires a change in the calculation of the elasticity, E_v , that witness Baron uses as his volume variability. To avoid an error, this elasticity must be computed after the Applied Stop Level Load Time Function, $L(\bar{v})$ has been shifted downward for the deduction of the fixed time. In Docket No .R97-1, and again in R2000-1, witness Baron fails to make the necessary change in his calculation of E_v which is calculated from the unshifted function $L(\bar{v})$. The change is easy to make. In order to avoid an error in the amount of volume variable load time that emerges from his calculations, witness Baron must multiply the elasticity ~~by which~~ *by which* E_v ~~is the~~ *is the* f fixed amount he deducts from load time per stop. Without this correction his method produces volume variable load times that are too low.

[3189] Next, we note that we can find nothing in the testimony of witness Crowder in this case to support witness Baron's assertion, repeated on Brief by the Postal Service, that witness Crowder now believes that the mathematics of the System-level Load Time Sub-model presented in her R97-1 Response to Notice Of Inquiry No.3 i s incorrect. In his rebuttal testimony witness Baron claims that "Ms. Crowder's new mathematical derivation provides a critical validation of my Docket No. R2000-1 analysis showing that the residual measure of coverage-related load time is valid *if and only if* the load time is linear." Tr. 43/18680 (emphasis added). An entire subsection of the Postal Service's Initial Brief is entitled "Witness Crowder, upon whose prior testimony the Commission based its system-wide approach to coverage related load time, has now confirmed the correctness of Mr. Baron's approach." Postal Service Brief at V-87 to V-91.

[3190] The sole basis for witness Baron's assertion appears be his own analysis of a route-level model presented by witness Crowder in response to a USPS interrogatory USPS/MPA-T5-2 (Tr. 32/16233-39). The mathematics of the Commission's established Load Time Variability Model does not change in any essential way when route-level functions replace the stop level functions of the established model. Witness Crowder's

route level counterpart of the Conceptual Stop Level Load Time Function is a route-level load time function:

$$L = Vu[V, AS(V, PS)] + AS(V, PS)f$$

[3191] L is load time on the route, V is route volume, u is a function for average “unit piece handling and loading costs at the delivery point”, AS is a function for actual stops, PS is possible stops and f is fixed stop time. Witness Crowder notes that when the route-level load time function is fit to the Engineering Standards (ES) data it is in a form in which AS has been solved out:

$$L = L(V, PS)$$

[3192] This is the route-level counterpart of the Applied Stop Level Load Time Function. Possible stops, PS , is analogous to possible deliveries, P , in the stop-level model. PS is a non-volume variable control that is needed along with others to correctly fit the function. Witness Crowder observes that:

route-level load time variability measured from such a model must be of the reduced form $L_v(V, PS) * V/L$, which must include all volume effects detailed on the right hand side, including all coverage-related effects initiated by the volume change.

Tr. 32/16238.

[3193] Her “coverage-related” effects at the route-level are equivalent to the delivery effects at the stop level that are imbedded in the stop-level elasticity E_v . At the system level load time is equal to average load time per route times the number of routes in the system, say R . The number of routes, R , will vary with volume just as the number

of stops varies with volume in the established model. If we define a function for the average load time per route as $\bar{L} = H(V)$ then:

$$\bar{L}R = H(V)R$$

is the starting point for the system level submodel. All of the rest of the mathematics for the established model follows, including Crowder's equation. Elemental volume variability is the route-level load time elasticity of volume, E_v . The coverage effect is the result of applying the elasticity of R with respect to volume, call it E_r , to the residual $(1 - E_e)E_r$.

[3194] Witness Baron's attempt to derive coverage-related load time for witness Crowder's route-level model is found in Attachment A to his rebuttal testimony Tr. 43/18729-33. From beginning to end, through five pages of mathematics, witness Baron completely fails to recognize that load time at the route level must be multiplied by the number of routes to get system load time. As a result, his analysis never reaches the system level where Crowder's equation is derived.

5. Elemental Load Parcel Distribution Key

[3195] City carrier letter route costs are divided into several functions. Traversing a route is referred to as route time; deviating from the route to reach a point of delivery or collection is referred to as access time; loading the mail in a receptacle, collecting mail and/or interacting with a customer for accountable mail is referred to as load time. The remaining activities are characterized as support costs. The latter function includes the costs of carriers loading mail into their delivery trucks and driving to their routes.³¹ The

³¹ Detailed definitions of each function are given in LR-I-1, Summary Description of USPS Development of Costs by Segments and Components at 7-2.

data and special studies used to divide the city carrier letter route costs into functions are described in USPS-LR-I-1 and in the R97-1 Decision, Chapter III, Section B.

[3196] The portion of load time that varies with the volume of mail delivered at stops is referred to as elemental load cost. Regressions of volume on load time, by shape and accountable activity, are used to calculate the elemental load costs. These costs are treated as 100 percent volume variable. They are distributed by shape and accountable activity to subclasses according to the distribution of mail pieces from the City Carrier Cost System annual sample of routes.³² Coverage related load time costs is the remaining difference after subtracting the elemental load costs from the total accrued load costs. The attributable portion of coverage related load cost is the proportion of stops that are single subclass stops.

a. UPS Proposal

[3197] UPS witness Luciani observes that, in calculating avoided costs, Postal Service Witness Daniel distributes city carrier elemental load cost by weight within the First Class Presort and Standard (A) mail categories. Witness Luciani concludes that if

weight is a proper basis for reflecting cost differences within the narrow ranges from one ounce up to thirteen ounces for First Class Mail Presort and from one ounce up to sixteen ounces for Standard Mail (A), then it surely should be used in the case of the more significant weight differences between the lighter weight and the heavier weight classes of mail.

Tr. 25/11780-81.

[3198] He proposes that the distribution key for parcels be the “product of average weight and volume data from the City Carrier Cost System for each subclass of parcel shaped items.” 11781. He obtains the average weight for First-Class and Standard (A) parcels from cost studies performed by witness Daniel. He uses billing determinant to

³² The City Carrier Cost System involves an on-going sample of every tenth stop on a sample of randomly selected routes. USPS-LR-I-16 at 2-3.

estimate the average weight for parcels for other subclasses. 11777. Applying the Commission's attribution method to BY 1998 data witness Luciani's proposed distribution key would increase attributable costs by \$19.1 million for Priority Mail, and \$54.2 million for Zoned Parcel Post over the estimates in the Service's initial filing. The attributable costs of First-Class and Standard A mail would be reduced by \$25.3 million and \$50.3 million, respectively. 11782.

b. Postal Service Opposition

[3199] Citing testimony by witnesses Daniel and Baron, Postal Service witness Kay asserts that shape is the major reason that one piece of mail takes longer to load than another piece, and is the only load-cost causing factor cited on the record. Tr. 39/17760. Furthermore, witness Kay claims that the weight studies cited by UPS only provide an upper bound for the effects of weight on city carrier costs within rate categories. Witness Kay argues that larger items of the same shape may be assumed to be heavier, but the reverse may also be true. In summary, the Postal Service does not believe that the effect of weight on load costs has been demonstrated on the record. It opposes witness Luciani's proposal to use weight as a distribution key.

c. Commission Analysis

[3200] In the Commission's view it is plausible that weight is a major factor determining the time it takes to load parcels. It is at least as likely that the dimensions of the piece have a strong effect on loading time and the correlation with weight is unknown. The Commission is sympathetic with witness Luciani's argument, but data are lacking to support a shift to weight as the sole basis for the distributing costs to subclasses for parcel shaped pieces. It may be that weight should provide a basis for distributing the load costs of letter and flat size mail. Although the Commission rejects the Luciani proposal for lack of data, it urges the Postal Service to study the effect of weight on the costs of elemental load time.

6. Runtime Variability

[3201] 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 single subclass stop ratio to estimate the attributable portion of access time costs. The portion of runtime that does not vary with the number of stops accessed is generally regarded as fixed route time, which is treated as an institutional cost. A small portion of route time on motorized letter routes, however, is estimated to be volume variable, and therefore attributable.

[3202] Elasticities of runtime with respect to covered stops are derived from regression analysis of data collected in a 1988 survey known as the Curblin Access Time and Foot Access Time (CAT/FAT) Study. This study evaluated carrier activity on a random sample of 438 city carrier routes: 161 curblin 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.³³

³³ 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.

[3203] 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 Postal Service witness Colvin in USPS-T-7, and proposed again in Docket No. R97-1 and in this docket by witness Baron. The established model has the following specification:

$$\text{RUNTIME}_{it} = \alpha_0 + \beta_{1i} \cdot \text{STOPS}_{it} + \beta_{2i} \cdot \text{STOPS}_{it}^2 + \sum_{i=2}^n \alpha_i \cdot \text{ROUTE}_i + \sum_j \sum_{t=2}^5 \gamma_{jt} \cdot \text{RUNUM}_t \cdot \text{RTYPE}_j$$

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

[3204] The established model form is quadratic. The cost driver is STOPS. A separate slope coefficient is estimated for the STOPS squared variable for each route. In addition, a separate intercept coefficient is estimated for each combination of run and route type.

[3205] 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 “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 - curblane, foot, and park & loop - producing one regression for each group. See PRC Op. R90-1, para. 3052, and PRC LR-10.

[3206] Witness Baron proposes to restrict the established model to require all of the STOPS and STOPS squared 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:

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

where there are n routes, indexed by i ; 5 runs for each route, indexed by t .

[3207] As in Docket No. R97-1, witness Baron advocates imposing a single, common slope coefficient on the STOPS and STOPS squared 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.

[3208] In PRC Op. R90-1, paras. 3053-3054, 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*. The Commission noted that variations in the FAT/CAT data across routes and route types due to variations in their physical characteristics were to be expected and should be tested. The Commission tested the significance of such variations by generalizing the Postal Service's model to allow the coefficients of the STOPS and STOPS squared terms to vary by individual route. It found that this variation was statistically significant at the .01 confidence level, and that taking this variation into account significantly improved the fit of the Postal Service's model.

[3209] In Docket No. R97-1, witness Baron offered several reasons for not adopting the more general, better fitting model. He argued for example, that highly correlated route-specific coefficients that have passed an F-test for joint statistical significance should nevertheless be selectively discarded according to their individual t-statistics. The Commission interpreted his comments as recommending that they be discarded during the modelling process. In this docket, he comments that he had advocated that they be discarded after the modelling process, at the time that the elasticity of runtime is evaluated. USPS-T-12 at 25. The Commission's interpretation of witness Baron's

comments stands corrected. However, selectively ignoring the coefficients of highly correlated, jointly significant variables at the evaluation stage is no more legitimate than selectively discarding those variables during the specification stage of the modeling process.

[3210] In Docket No. R97-1, witness Baron argued that the results of the more general model were implausible. He pointed out that some STOPS coefficients were negative and some STOPS squared coefficients were positive, contrary to his expectations. The Commission commented that the focus should be on whether the combination of the STOPS and STOPS squared coefficients yield plausible results at the average number of stops. In this docket, witness Baron argues that the combination of these coefficients is not plausible for certain routes. He reports that 21.1 percent of the route-specific elasticities of curblane route running time with respect to actual MDR stops is negative, 1.9 percent is between 0.00 and 0.10, and 5.0 percent is greater than 2.00. For park and loop routes, he reports that 18.6 percent of the elasticities with respect to MDR stops is negative, 3.5 percent is between 0.00 and 0.10, and 7.5 percent is greater than 2.00. He reports that the elasticities that result from the restricted model are in a tighter range without the implausible extremes. *Id.* at 27.

[3211] The elasticity estimates produced by the more general model will be less precise, and will have a wider range of results in terms of individual route elasticities than the restricted model. A more relevant consideration than the plausibility of each individual route elasticity is whether the general model yields a more reliable estimate of elasticity at the mean for a route group. For the reasons discussed in Docket No. R97-1, the Commission concludes that the risk of imprecision in the more general model is less than the risk of bias in the restricted model. PRC Op. R97-1, paras. 3250-3252. Artificially constraining coefficients for routes to be equal, as witness Baron recommends, might produce more plausible results for individual routes, but does so at the risk of getting a biased estimate at the mean for a route group, which is the estimate of interest.

[3212] In Docket No. R97-1, despite its lower R squared statistic, witness Baron argued that the restricted model fit the data better than the more general model. In this docket, witness Baron concedes that generalizing the model significantly improves the R squared statistic while it eliminates the omitted-variables bias that exists in the restricted model. He argues, nevertheless, that

no measures were used to actually quantify the magnitude of any biases in the quadratic model. The amount of bias could be small. The careful analyst is clearly justified in refusing to uncritically regard these biases as high enough to warrant serious concern, and in refusing to regard the F Test as a conclusive guideline that must dictate the correct choice among competing regression models.

USPS-T-12 at 28.

[3213] He contends that both the degree of bias in the coefficient estimates and the precision of those estimates must be measured in order to decide how to resolve the precision/bias trade off. *Id.* at 30, fn.38. He fails to do this, however. He shows how much generalizing the Postal Service model improves the R square statistic, and characterizes the improvement as “modest.” He doesn’t characterize, let alone quantify, the amount of precision that is lost. *Id.* at 29. More tellingly, he ignores the Commission’s discussion of the adjusted R squared statistic that is designed to take into account the loss of efficiency that results from adding explanatory variables. He makes no comment on the Commission’s observation that the adjusted R square statistic for the more general model is higher than for the Postal Service model, indicating that the more general model removes bias with a relatively minor the loss of precision. PRC Op. R97-1, para. 3251, fn. 35.

[3214] Witness Baron is correct that in arguing that when econometric modelling presents a trade off between precision and bias in the estimate of interest, each case must be evaluated on its facts. The choice made is a judgment call. If the data for these route groups were taken from small samples, the risk of imprecision might be greater than the risk of omitted variables bias. Because the route group data comes from

relatively large samples, however, omitted variables bias appears to present the greater risk.

[3215] For the reasons discussed above, the Commission rejects witness Baron's criticisms of the established runtime variability model.

7. Motorized Letter Route Volume Variable Costs

[3216] The Postal Service's data collection systems provide estimates for the amount of time city carriers spend driving on a route. As volume increases, the driving time may change due to the addition of parking points for the formation of new walking loops and the addition of dismounts to deliver high volumes at individual stops. In R90-1, a variability factor was first adopted to calculate volume variable driving time costs. In Docket No. R97-1, the Commission adopted USPS witness Nelson's proposal for modifying the analysis of driving time on Motorized Letter Routes.

[3217] The R97-1 analysis by witness Nelson is based on a 1996 Motorized Letter Route survey in which supervisors classified looping/dismount parking points as being established due to volume/weight or due to other factors. Witness Nelson then classified the loop parking points caused by volume/weight as 100 percent volume variable and the other loop parking points as 0 percent volume variable. Dismounts established due to factors other than volume/weight were judged to be fixed relative to volume and given a 0 percent volume variability factor. For dismounts considered to be caused by volume/weight, witness Nelson assumes that their variability is equal to the weighted average of the first three variabilities (40.99 percent). This approach results in a 32.15 percent average variability for loop stops, 40.99 percent for dismounts due to volume/weight, and a total Motorized Letter Route variability of 40.99 percent. The following table summarizes the calculations. R97-1 Tr. 4/1347-49 and 1353.

Table 3-3
Calculation of the Volume Variability
of Loop/Dismount Driving Time Costs

Stop Type	Total Stops	Percent of Stops(%)	Volume Variability (%)
Loops Due to Volume/Weight	242,294,460	32.15	100.00
Loops Due to Other Factors	85,273,149	11.31	0
Dismounts Due to Other Factors	263,516,968	34.96	0
Dismounts Due to Volume/Weight	162,610,282	21.58	40.99 ¹
Total	753,694,859	100.00	40.99

¹ Calculated as $100 (242,294,460 / (242,294,460 + 85,273,149 + 263,516,968))$.

a. Witness Nelson's Proposal in R2000-1

[3218] For this docket, witness Nelson was asked by MPA to reexamine his R97-1 Motorized Letter Route variability analysis. This review led to a conclusion that the interactions of loop parking points and dismounts are not taken into consideration in the R97-1 calculation of the volume variability.

Basically, stops that would become *new* volume-driven dismounts in the presence of a volume increase are currently served on loops. The conversion of such stops from loop delivery points to (volume-driven) dismounts as volume increases moderates the need to add looping points. If the analysis assumes that a volume increase on volume-driven loops is accommodated entirely by an equal percentage increase in the number of loop parking points, none of the stops on those loops will need to be converted to dismounts, and the number of volume-driven dismounts will not change. In light of these considerations, if the 100 percent figure is used for volume-driven looping points, it would be most reasonable to treat volume-driven dismounts as fixed (*i.e.*, 0 percent variable).

Tr. 28/13415-16.

[3219] Employing this logic reduces the dismount variability to zero, leaving only the loop variability of 32.15 percent to contribute to the Motorized Letter Route variability.

[3220] Witness Nelson claims in this docket that “routine loops that are established on the basis of volume/weight were treated as 100 percent because of the constraints on the formation of such loops imposed by the 35-lb. weight limit on carrier satchel loads.” *Id.* at 13415. The 35-lb. argument appears to be new in this docket. It is not found in the reference to R97-1, Tr. 4/1353, that Nelson cites in his testimony as the authority for his specific computation of the Motorized Letter Route variability. Tr. 28/13415.

b. Postal Service Rebuttal

[3221] Postal Service witness Baron disagrees with witness Nelson’s logic regarding the creation of new dismount stops. He presents a new analysis that supports a variability of zero for Motorized Letter Routes. Witness Baron argues that there is no reason to assume, as Nelson does, that a new dismount stop generated by a volume increase will fall at an existing parking point on an existing loop. He argues that the dismount could fall on a non-loop segment of an existing route, and not become a parking point for a new or existing loop. Lastly, witness Baron argues that it is blatantly contradictory for witness Nelson to assume “the volume variability of ‘volume-driven dismounts’ should be regarded as 0 percent. He argues that if ‘volume-driven’ dismounts are, indeed, volume driven, then the variability of these dismounts must be greater than 0 percent.” Tr. 43/18725-26.

[3222] Having challenged witness Nelson’s proposed variability for dismounts, Baron turns to an analysis of what the variability of the loop and dismount parking points should be. He challenges witness Nelson’s assumption that a 100 percent variability for loop parking points is implied by the 35-lb. weight limit on carrier satchel loads. Baron uses data from 1,270 records of satchel weight measurements taken during the Engineered Standards. See USPS-LR-I-329 for the data. Each record lists the weight of one mail satchel that a data collector weighed at a loop parking point prior to the carrier

beginning the loop. The average satchel weight is calculated to be 11.33 pounds with only 2 exceeding 30 pounds. From this data on satchel weight, witness Baron concludes “that, for all practical purposes, there is a zero probability that a marginal (say one percent) increase in volume... would increase the weight of mail to an extent that a new loop parking point would be required. The clear implication is that the variability of loop [parking] points with respect to mail volume is likewise zero.” Tr. 43/18727.

[3223] Baron observes that carriers almost never respond to a volume and weight increases at a dismount stop by adding a new vehicle parking point. Lastly, he states that, ‘to the extent the carrier does anything at all differently due to the volume and weight increase, he is most likely to convert the stop into a loop [parking point].’

Id. at 18728. This would seem to agree with witness Nelson’s assumption that a new dismount stop is likely to become a loop parking point.

c. Commission Analysis

[3224] Witness Baron relies on Engineered Standards data that the Commission declines to use for other purposes in this docket. Setting this issue aside, to treat the average weight of 11.33 pounds as valid does not necessarily imply that the variability of loop parking points is zero. For example, other factors, such as shape or the ability to accommodate various bundles, may lead to a change in loop structure as volume increases. The fact remains that the Motorized Letter Route survey introduced in R97-1 does indicate that supervisors regard 32 percent of the stops as caused by volume/weight. While the variability of these stops may be less than the 100 percent assumed by Nelson in R97-1, assuming that it is zero would not be consistent with the supervisors’ experience. Also, as witness Baron observed when critiquing witness Nelson’s testimony, “[i]f ‘volume-driven’ dismounts are, indeed, volume driven, then the variability of these dismounts must be greater than 0 percent.” *Id.* at 18725-26. The Commission will retain the 32.15 percent variability for parking points on loops.

Analyzing only loop parking point variability can support this much variability. It is likely that discounts contribute some additional variability.

[3225] It is reasonable that many of the new discounts will fall on loops and be counted in the variability for the loop parking points. Conceivably some new discounts could occur at non-loop route segments. If so, it would increase the number of actual discounts. While no estimate is provided on what percent of new discounts would occur on non-loop segments, witness Baron implies it will be rare, since he claims the most likely outcome of a volume/weight increase is to convert a stop to a loop parking point. Because the variability of discounts would appear to be small, the Commission accepts witness Nelson's position that the variability of discounts is zero. While this may not be precisely correct, it is offset by the likelihood that the use of 100 percent variability for the loop parking points is overstated.

[3226] For these reasons, the Commission accepts for purposes of this docket a variability of 32.15 percent for Motorized Letter Route parking points.

8. Vehicle Loading Time Variability for Parcel Shaped Mail

[3227] City carriers, working in their delivery unit offices, sort letter and flat-shaped mail that is not in delivery point sequence when provided to the delivery unit. The accrued sorting time is part of the Segment 6 in-office cost in the Cost and Revenue Account System. In-office sorting costs are treated as 100 percent volume variable. USPS-LR-I-1 at 6-2. Some small parcel shaped mail that can fit in the sorting bins are sorted in the office and included in Segment 6. Other parcels, however, are taken to the carrier's truck in a hamper, or some other type of container, without sorting it in delivery sequence. Once at the truck, parcels are loaded and organized in a manner that assists the carrier to easily select them for delivery once on the route. The time loading the truck, or unloading, at parking points, is part of the support component of Segments 6 and 7. Support costs are apportioned to office time and each of the street time functions

(route, collection, access and load). The apportioned support costs are then attributed and distributed in the same manner as the associated function. *Id.* at 7-9.

a. UPS Proposal to Treat Parcel Handling as In-Office Time

[3228] UPS proposes that the time spent loading parcels at the truck be deleted from the support component and added to the in-office component. This loading time would thereby take on a much higher variability. UPS witness Luciani derives

parcel sequencing costs by multiplying the cost per piece for sequencing parcels by the volume of parcels delivered in each subclass as estimated by Postal Service Witness Harahush. The cost per piece for sequencing parcels was obtained by multiplying the city carrier wage rate by the city carrier sequencing time per parcel taken from the Postal Service's confidential Engineered Standards study. The Engineered Standards study is based on time standards rather than actual observations. In practice, city carriers are likely not yet meeting those time standards since they reflect more efficient operating procedures than are now used, Tr. 19/8122-23 (Raymond), and thus the cost per piece for sequencing parcels obtained using the results of the time standards study is a conservatively low estimate.

Tr. 25/11784.

[3229] Total attributable costs increase due to the higher volume variability of in-office costs. The resulting change in costs for each subclass is shown in Exhibit UPS-T-5C, filed under protective custody due to the use of the results from the Engineered Standards study.

b. Postal Service Rebuttal

[3230] Witness Kay of the Postal Service rebuts the UPS proposal on several grounds. She contends that:

- 1 Arranging of parcels is not equivalent to the detailed; delivery sequence sort that a carrier performs in the office based on the testimony of witnesses Raymond and Kingsley. Tr. 39/17763.
- 2 The use of a proposed, individual standard from the Engineered Standards study is not in isolation a valid measure of the time taken to sort a parcel under current carrier procedures. Costs for this function could be higher or lower when a full set of standards are introduced. *Id.* at 17764-65.
- 3 Time standards are an average cost per piece; they are not marginal costs per piece. Time standards must be multiplied by a variability to make them applicable to cost attribution. *Id.* at 17765.
- 4 Variability of in-office sorting is inappropriate for parcels, since in-office sorting is mainly of letters and flats, which are quite distinct from parcels. *Ibid.*
- 5 The time spent loading the truck covers all shapes delivered and not just parcels.

c. Commission Analysis

[3231] The Commission finds the Service's concerns credible. In particular, the use of potential standards from the Engineered Standards project is speculative. The existence of a proposed standard is not equivalent to evidence from operations on the time actually taken to arrange parcel shaped pieces at the truck. Likewise, the variability of the costs, if they could be determined, needs to be better specified. Therefore, the Commission rejects the current UPS proposal and recommends that the Service conduct a special study to determine the cost of sorting parcel shaped mail.

9. Special Purpose Route Proposal.

[3232] City carrier street time costs are divided into letter routes and special purpose routes for purposes of analysis. The latter consists of nine types of special

routes, one of which is designated as “Exclusive Parcel Post”.³⁴ The costs of each special purpose route can be individually identified in the Postal Service’s cost accounting systems. For the purposes of calculating attributable costs, however, special purpose routes are treated as a single group. Tr .6/2663-65.

a. UPS Proposal

[3233] On the assumption that the parcel routes deliver Parcel Post subclass mail, witness Luciani proposes that the entire cost of the Exclusive Parcel Routes be treated as product specific costs and be attributed to the Parcel Post subclass. Since witness Mehan applies the same attribution and distribution factors to all parcel routes, the Service attributes some Exclusive Parcel Post route costs to the Parcel Post subclass.

[3234] Given this situation Witness Luciani proposes what is characterized as a conservative attribution procedure. Namely, he proposes to assign to Parcel Post the difference between the total cost of the Exclusive Parcel Post Routes and the total Special Purpose Route costs attributed to Parcel Post. By UPS calculations this amount is \$26.5 million. Tr. 25/11786.

b. Postal Service Opposition

[3235] On rebuttal, witness Kay extracts data from the Docket No. R97-1 C study, to demonstrate that only 11.9 percent of the pieces delivered on Exclusive Parcel Post Routes are Standard (B), Parcel Post Zoned mail. Tr. 39/17769-70. In short, witness Kay demonstrates that the name of the route does not indicate that a particular subclass of mail is delivered on that route.

³⁴ A full list of the city route types is given in LR-I-1, Appendix B, at B-25.

c. Commission Analysis

[3236] Given the distribution of mail on Special Purpose Routes presented by witness Kay, it does not appear reasonable to assign all the Exclusive Parcel Post route costs to the Parcel Post subclass. Consequently, the Commission declines to accept witness Luciani's proposed attribution of these costs. It might be useful, however, if the Service could rename these routes in future versions of LR-I-1, Summary Description of USPS Development of Costs by Segments and Components, in order to avoid further confusion of this kind.

C. Rural Carriers

[3237] *Introduction.* Cost Segment 10 covers the salaries, benefits, and related costs of rural carriers. Rural carriers primarily provide delivery, collection, and retail services to customers on rural routes.

[3238] Rural routes are divided into three categories based on the way the carrier is paid. The majority of rural routes are evaluated routes for which a carrier's salary is based on time standards. These time standards are developed annually from the National Mail Count (NMC), based on route factors such as route length, number of boxes served and quantity of mail by shape. In FY 1998, 91 percent of volume variable and 83 percent of total accrued Segment 10 costs were generated by evaluated routes. Mileage routes are low-density routes for which compensation is based on route length. Auxiliary routes require less than 35 hours per week and compensation is based on the number of hours worked.

[3239] Since R90-1 the Postal Service has calculated Rural Carrier costs using data from both the NMC and the Rural Carrier Cost System (RCCS). The NMC provides rural carrier costs by activity but does not break down volumes by subclass. The RCCS is used to distribute these costs to the subclasses of mail. Before using the data to distribute costs to subclasses the Postal Service applies a mail shape adjustment to the RCCS data. The mail shape adjustment is necessitated by differences in how the NMC and RCCS define flats. The NMC defines rural letters as 5" in height or less. However, by RCCS standards a letter can be up to 6¹/₈" in height. This causes the RCCS system to code some NMC flats as letters. The mail shape adjustment is applied to the RCCS volumes to ensure that the RCCS flats percentage is consistent with the NMC flats percentage.

[3240] In Docket No. R97-1 the Commission accepted the mail shape adjustment proposed by the Postal Service. In that case the Postal Service determined the number of letters to reclassify as flats by comparing the RCCS flats volumes from the same four-week period during which the NMC is conducted to NMC flats volumes. The

Commission also accepted the Postal Service's use of systemwide rather than rural-specific DPS and Sector Segment percentages to create a separate DPS and Sector Segment distribution key. However, the Commission noted that the information systems used to develop rural carrier costs could be modified to gather more information and therefore reduce the number of sources from which data must be combined. PRC Op. R97-1, para. 3358.

[3241] Since R97-1 the Postal Service has modified the RCCS to record DPS and Sector segment volumes separately from other volumes so that distributed costs would be more uniformly related to the evaluated costs. However, in this docket the Postal Service again uses RCCS data from the four-week period during which the NMC is performed to develop the mail shape adjustment.

[3242] *Intervenor Opposition.* Periodicals Mailers witness Glick proposes the use of annual RCCS data to determine the RCCS flats percentage. Witness Glick argues that annual RCCS data are more reliable than the RCCS data for the four-week period during the NMC. The "RCCS was 'designed to produce precise annual estimates, with a sample size of over 6,000 tests', not precise estimates for any four week time period." Tr. 24/11225. The use of only four weeks' data reduces the number of RCCS tests from 6,000 to 333. Tr. 46C/20841. Moreover, use of annual RCCS data results in a lower coefficient of variation for the RCCS flats percentage. Witness Glick concludes that "because the NMC is performed during September—a month that USPS views as annually representative there is no drawback to using annual RCCS data to perform the adjustment." Tr. 24/11225.

[3243] In rebuttal testimony the Postal Service accepts witness Glick's recommendation Postal Service witness Kay confirms that "[w]itness Glick made a compelling argument to use a full year's Rural Carrier Costing System (RCCS) volume in the Mail Shape Adjustment." Tr. 39/17777 (citations omitted). Witness Kay also revises the parcel and sector segment evaluation factors to 0.500 and 0.0610 respectively. Id. at 17780. This correction accounts for errors in the CRA spreadsheets filed in

USPS-LR-I-80 and USPS-LR-I-130. These revisions cause an increase of \$8.8 million in Standard Mail (B) Base Year 1998 cost. USPS-LR I-450 and LR-I-80.

[3244] The Commission accepts the recommendation of witness Glick to use annual RCCS data to develop the mail shape adjustment. The Commission also finds witness Hay's revised rural carrier cost as presented in LR-I-50 acceptable and uses them in the cost calculation.

D. Purchased Transportation

1. Highway Transportation

[3245] *Introduction.* The costs for highway transportation services purchased under contract are included in Cost Segment XIV. The Highway Contract Support System (HCSS) contains information on “virtually” all of these contracts. USPS-T-19 at 27. The contracts in HCSS fall under 27 account numbers, each of which relates to a category of transportation, such as Intra-BMC, Intra-P&DC Regular, and Intra-CSD Regular. The basic unit of observation used in the study of highway transportation is the “contract cost segment.” Each segment “is a discrete part of a highway contract that has its own transportation specifications and its own payment type.” A total of 16,791 observations are contained in HCSS. USPS-T-18 at 22, 23, and 25. This number is large enough to permit detailed empirical analyses.

[3246] In this case, Postal Service witness Bradley, (USPS-T-18) and (USPS-LR-I-84-86), FGFSa witness Ball, (FGFSa-T-1), and Periodicals Mailers³⁵ witness Nelson, (MPA-T-3) and (MPA-LR-5) provide testimony concerning how to analyze highway costs. The testimony of witness Bradley is similar to testimony he presented in Docket No. R97-1, which was adopted by the Commission. Bradley also submitted rebuttal testimony on this topic, (Tr. 43/18380 and USPS-LR-I-452), as did witness Neels, Tr.46E/21895-917. With the exception of UPS, rather extensive discussion of this testimony is included in the briefs and the reply briefs of the parties involved.

[3247] The Commission has reviewed the testimony, the workpapers, and the arguments on brief. The Commission finds the analysis of witness Bradley to be the best available on the record. No basis has been found for making improvements to his analysis, which is analytically similar to that adopted by the Commission in Docket No.

³⁵ Nelson’s testimony is sponsored by MPA, ANM, ABM, CRPA, Dow Jones, McGraw-Hill, NNA, and Time Warner, referred to in this section as the Periodicals Mailers.

R97-1. See the extensive discussion in PRC Op. R97-1, para. 3360 *et seq.* The alternative analyses presented on the record are not sufficiently developed to be useful. In fact, the final alternative supported on brief by the Periodicals Mailers relates to a modified Nelson model, developed for curiosity's sake by witness Bradley, and Bradley warns against its use. Therefore, the model is not adequately supported by any witness and has not been subject to review on the record.

[3248] Although the Commission does not adopt an alternative analysis, some of the arguments raised by the interveners are interesting and could be developed further. The Commission does not take the position that the analytical framework or the empirical analysis adopted in this Opinion represent perfection. Empirical analyses are difficult at best and it is often the case that more than one approach seems likely to yield defensible results.

a. A Note on Methods Used

[3249] Review of the analyses proposed and the controversy on the record will be facilitated if certain aspects of the methods used are outlined up front. The goal of the analysis has been to develop attributable costs for the subclasses of mail that use the transportation. Attribution has been premised primarily on concepts of volume variability, as developed and discussed extensively by the Commission since its inception in 1970. It has not been found feasible to address directly and in one step the cost effects of specific volume changes. For example, an equation has not been developed with transportation cost as the dependent variable and the volumes of each subclass of interest as separate dependent variables.³⁶ This does not, however, reduce the usefulness or the relevance of a thought process guided by the essentials of the volume variability question. The approach selected thus far for highway transportation, and

³⁶ If such an equation were available, the unit attributable cost of, say, subclass A would simply be the partial derivative of the cost with respect to the volume of A.

developed extensively in hearings before the Commission, has been to break the analysis process into three steps.

[3250] The first step focuses on the elasticity of the cubic-foot-miles (CFM)³⁷ of capacity purchased relative to a change in the overall volume of mail using the transportation segment being analyzed. The second step focuses on the elasticity of the cost of purchased transportation relative to a change in the cubic-foot-miles of capacity purchased. This step is viewed as relating to the behavior of pricing in the transportation markets in the sense that the cost at which transportation can be procured is related to the cubic-foot-miles of capacity involved; in the parlance used in recent years in such analyses, cubic-foot-miles of capacity is called a “cost driver” of transportation costs. The product of these two elasticities and the transportation cost is the volume variable cost. The third step utilizes a distribution key to apportion the volume variable cost to the particular subclasses of mail. The Postal Service’s TRACS system provides this distribution key.³⁸

[3251] The elasticity of the first step has not received extensive empirical analysis and has thus far been taken to be 1.0. Some observers tend to view 1.0 as an upper limit for an elasticity of this kind, although it is not, since a 10 percent increase in volume could lead to a greater-than-10 percent increase in the CFM of capacity purchased. The use of 1.0 for this elasticity is based on descriptions of postal operations and contracting practices. These descriptions suggest that a CFM-of-capacity figure is developed as a requirement based on such things as length of contract, peak loads, volume fluctuations, and the nature of round trip contractor runs. The argument is that if there is a 10 percent increase in overall postal volume, there will need to be an increase in the

³⁷ Note that CFM could refer to cubic-foot-miles of capacity purchased but could also refer to cubic-foot-miles of capacity actually used. Often, CFM is unmodified but is meant to refer to the former measure. As clarified on discovery, witness Nelson refers to the former as “gross” CFM and to the latter as “net” CFM. Tr. 28/13410 and 13460.

³⁸For further discussion of this method of analysis, see: PRC Op. R97-1, para. 3376, USPS-T-18 at 44, and Bradley, Colvin and Smith, “Measuring Product Costs for Ratemaking: The United States Postal Service,” in *Regulation and the Nature of Postal and Delivery Services*, Kluwer, 1993, 133-157.

CFM-of-capacity purchased of about 10 percent. The Commission does not view this as a final answer; certain questions about it have been raised in this case.

[3252] The elasticity of the second step has been based on complex empirical analyses, using advanced econometric techniques. The Commission has used this approach since Docket No. R87-1 and it has received extensive review on the record. Both witnesses Bradley and Nelson provide econometric evidence relating to this elasticity. These will be reviewed further below.

[3253] The distribution key used in the third step is developed from data collected in the Postal Service's Transportation Cost System (TRACS), which was first introduced into rate proceedings in Docket No. R90-1. In this system, postal data collectors sample mail as it is either loaded on air transportation or unloaded from highway and rail transportation. The distribution keys are relative proportions from this sampling effort. Witness Xie, (USPS-T-1), provides testimony concerning this system. TRACS is discussed in Section D. 2 of this Chapter.

b. Background for this Docket

[3254] The history of highway transportation analysis is contained in previous Commission Opinions and is summarized in the testimony of witness Bradley. USPS-T-18 at 1-13. In early dockets, transportation costs were considered to be 100 percent volume variable. This was based on arguments that if the volume increased, a proportionate increase in transportation would be needed. This analysis did not allow for the realization of scale economies as volume increased.

[3255] An econometric analysis utilizing limited data was presented in Docket No. R84-1 and one utilizing a more extensive database was presented in Docket No. R87-1. In the latter case, the Commission based its recommendation on the econometric analysis. Although the details of the analysis became more complex and (with the HCSS in Docket No. R97-1) the database became more extensive, the roots of the analysis used in R97-1 may be traced to R87-1. The Commission summarized these roots in

R97-1, briefly as follows: 1) the HCSS data are suitable for statistical purposes; 2) the models are consistent with perceptions of operational practice; 3) the translog model applied cross-sectionally to the HCSS data reflects the entire range of cost-affecting changes and gives the kind of “longer run” volume variability considered appropriate by the Commission; 4) the translog model is preferred due to its flexibility and to the freedom it provides the data to influence the functional form; 5) CFM of capacity is an acceptable cost driver and the elasticities should be evaluated at the mean of the observed values; and 6) it is best to include route length in the equations, but it doesn’t vary much. PRC Op. R97-1, para. 3366.

c. Witness Bradley’s Analysis

[3256] The analysis of witness Bradley, USPS-T-18, follows closely the analysis adopted by the Commission in Docket No. R97-1. The only structural difference relates to an adjustment to accommodate a new organizational structure of the Postal Service. Beginning at the national level, the old structure broke down to Region, Division, MSC, and SCF. The new structure breaks down to Area, Cluster, Processing and Distribution Center (P&DC), and Customer Service District (CSD). In R97-1, the principal categories of transportation accounts were Inter-BMC, Intra-BMC, Inter-SCF, Intra-SCF, Intra-City, and Box-Route. Under the new structure, the first two and the last two are unchanged, and the middle two (Inter-SCF and Intra-SCF) are disaggregated into Intra-P&DC, Intra-CSD, Inter-P&DC, Inter-Cluster, and Inter-Area.

[3257] Bradley indicates that one response to this change would be to map the new categories into the old categories, and to keep the same basic equations. However, what he does instead is to work with the new, more disaggregated categories and to test whether the new equations are statistically different from each other. His conclusion is that they are. Within the framework of the new account categories, Bradley estimates 17 translog equations. He describes his steps as being pre-estimation, estimation, testing the structure, and checking unusual observations. USPS-T-18 at 19.

d. Witness Ball's Analysis

[3258] On behalf of the Florida Gift Fruit Shippers Association, witness Ball provides testimony concerning the appropriate attribution of purchased highway transportation costs. He refers to the need to focus on the causal relationship between costs and volume. In reference to Bradley's analysis, he says: "[he] did not take into account mail volumes being transported or any changes in the mail volume. Vehicle capacity cannot properly be used as a proxy for mail volumes. Actual or estimated mail volumes, and changes in those mail volumes, are essential elements in the determination of variability or attribution of costs." Tr. 30/14302-303. He then discusses actual trends and says that "the utilization of vehicles for transporting mail has been low for several years, and continues to diminish." Then, without explaining how one would go about doing so, he proposes that the attribution of Inter-BMC and Intra-BMC transportation be based on some figures relating to the average rate of utilization of capacity, which were provided by Postal Service witness Xie. *Ibid.* at Table A.

[3259] The argument of witness Ball relates primarily to the elasticity of CFM capacity purchased with respect to changes in the volume of mail. This elasticity was identified above as the first step in the analysis. Aside from a statement that a "proxy" relationship may not exist, Ball provides no basis for assuming that the elasticity is on one side or the other of the assumed value, *i.e.*, on one side or the other of 1.0. The Commission believes that further analysis would be desirable. It is possible, for example, that increases in volume allow increases in the rate of utilization of capacity, and thus do not cause the need for a proportionate increase in the CFM capacity purchased. The assumption that this elasticity can be approximated as 1.0, however, has been discussed extensively in the past and it is reasonable.

[3260] Witness Ball discusses a downward trend in the rate of utilization of capacity but does not say whether this trend is caused by a trend in volume. Also, the figures he relies on cover only two years. FGFSFA argues that "[t]he low and declining utilization of the transportation vehicles demonstrates that the purchased transportation costs, which

are increasing, are not variable with volume.” FGFSa Brief at 5. The nature of the causal argument here could be that volume changes (a fact not established or mentioned) are causing changes in utilization rates. Since costs and utilization rates are affected by a number of factors, a more complete analysis would be needed to establish reliable relationships.

e. Witness Nelson’s Analysis

[3261] On behalf of the Periodicals Mailers, witness Nelson provides testimony covering, among other things, purchased highway transportation costs. Tr. 28/13408-13 and MPA-LR-5. His work may be separated into three categories. First, he makes certain observations relating to the first step in the analysis, the determination of elasticity of CFM capacity relative to changes in volume. Second, he raises several questions concerning witness Bradley’s analysis. Third, he presents an alternative analysis to that of Bradley. These may be dealt with separately.

(1) Elasticity of CFM capacity relative to volume

[3262] Witness Nelson provides a discussion of the ways in which transportation systems adjust to changes in volume. One of the options is to reconfigure the system. Suppose, for example, that a truck leaves office A and makes stops at office B and C. It might off-load part of its volume at B and then drive on to C to off-load the remainder. Given a volume increase, it might be profitable to contract for two trucks, having one go the short distance from A to B, and back, and having the other go from A to C, and back. In a complex system, changes of this kind might allow, for example, a 10 percent increase in volume to be handled with only an 8 percent increase in the CFM capacity purchased. That is, the elasticity of CFM capacity purchased with respect to changes in volume may be less than 1.0. Tr. 28/13410, 13413.

[3263] Nelson is correct that these kinds of changes can be made. They relate to the first step in the analysis described above and it is possible that this elasticity is

different from 1.0. No empirical analysis is available to allow an improved estimate of this elasticity and Nelson has not provided one. The Commission would welcome such an analysis, but notes the possibility that the correct answer could be 1.0. Indeed, the assumption that it is 1.0 is based on considerable testimony concerning how the transportation system functions.

[3264] On rebuttal, Bradley discusses Nelson's speculations on the elasticity in the first step and agrees that there may be some "merit" in his arguments. Tr .43/18388. Then Bradley goes on to note that the possibility of this elasticity being different from 1.0 does not imply that there are any problems or weaknesses in the econometric models used to estimate the elasticities in the second step. Bradley is correct on this point.

(2) Criticisms of Bradley's Models

[3265] Witness Nelson discusses four potential weaknesses in Bradley's econometric models used to estimate the elasticity for the second step in the analysis. The first concerns Nelson's belief that the models do not allow for the effect of increasing vehicle size. The second concerns Bradley's use of mean-centered data. The third concerns possible circularity in the handling of power-only contracts. The fourth concerns the way Bradley handles outliers. Bradley does exclude a few observations as outliers, but the number is under 1.5 percent. USPS-T-18 at 29. Also, Bradley discussed his exclusion of these observations and analyzed the resulting effects. The Commission considers Bradley's testimony on this issue to be credible and the effect to be relatively small. Further, Bradley's treatment of outliers is similar to that of the Commission in Docket No. R97-1. Therefore, the outlier issue will not be discussed further.

[3266] *Vehicle size.* Witness Nelson describes vehicle-contracting practices, as he sees them, and explains that increased volume can often be handled by increasing the size of the truck used on a specific run. He says many runs have small trucks and that the percent increase in cost for increasing the size of the truck can be small relative to

the percent increase in CFM capacity. Nelson says Bradley's econometric models are specified in a way that makes them "inconsistent" with a system that adjusts in this way. Tr. 28/13408-11.

[3267] On rebuttal, witness Bradley argues that the data set used to estimate his model is effectively a "census of all Postal Service purchased highway transportation contracts" and thus reflects actual experience and "all historical changes in both vehicle size and trip frequency (as well as routing)." Tr. 43/18387. The results found by Bradley show variabilities well below 100 percent on many route types. Such results imply economies of scale. There must be an explanation for why such economies are available. The option to increase vehicle size is one possible explanation. Nelson has apparently not considered that his truck-size argument may be a part of the explanation for the variabilities that Bradley found, instead of an argument for why they should be lower. The Commission agrees with witness Bradley that the data set covers the kind of adjustments described by Nelson. Whether or not a different model specification might do a better job of quantifying the truck-size effect is a different issue and will be discussed further below.

[3268] *Mean-centered data.* There has been an extraordinary amount of discussion on this record of the practice of mean-centering data, which Bradley did. Nelson says he attempted to refine Bradley's models and "encountered immediate difficulties with witness Bradley's evaluation method, in which the model is estimated on mean-centered data and the variability is taken from the coefficient on the relevant first-order term." Tr. 28/13412. In response to an interrogatory positing that the difficulties were in Nelson's model and not Bradley's, Nelson said:

As shown in my Workpaper WP1 and explained in further detail in my Workpaper WP4, the inter-BMC model yielded statistically insignificant (and negative) results for the CFM variable, but good statistical significance for the squared and cross-product terms that contain the CFM variable. I concluded from this that witness Bradley's approach of evaluating the elasticity only from the (mean-centered) first-order term may produce implausible and unusable results in the context of the modified

specification being estimated, and that the results from the translog specification may be quite sensitive to the evaluation method chosen.

Id. at 13461. The problem apparently is in Nelson's model. There is no evidence that Bradley had difficulty.

[3269] On brief, the Periodicals Mailers contend that "the Postal Service's own witness, Dr. Greene, and UPS witness Neels have demonstrated the flaws in Bradley's 'mean-centering' method of calculating translog elasticities from only the first-order coefficients." Periodicals Mailers Brief at 32-33. Their Reply Brief reiterates that "Bradley's theory for relying on 'mean-centering' to simplify the computation of variabilities has been refuted by Greene and Neels, and Neels asserts that Bradley's program does not correctly implement the computation that Bradley was trying to perform." *Id.* at 22.

[3270] The Commission has reviewed this issue carefully, partly because mean-centering has been used by the Commission in the past. Postal Service witness Greene specifically states, at Tr .46E/22078, that mean-centering would give different coefficients but that the elasticities would be the same. UPS witness Neels states that mean-centering is a "computational convenience" and "shouldn't change the result." *Id.* at 21925. Short of calculating the elasticity with an erroneous formula, there does not appear to be support for the Periodicals Mailers' position.

[3271] The Commission does not accept that there are difficulties with the use of mean-centered data. Using mean-centered data is a common practice. It involves dividing each point in the data by a constant, which happens to be the mean of the data set. If mean-centering changed the elasticity, then one would get different volume-variable costs by measuring the costs in cents instead of dollars, an obviously absurd implication.

[3272] *Circularity in power-only contracts.* Power-only contracts exist primarily in BMC and plant load accounts. Nine of the 13 areas report using them in BMC contracts. USPS-T-18 at 26-27. Of 552 contracts in the BMC accounts, 185 are power only. Tr. 6/2405. Witness Nelson indicates that Bradley's "treatment of power-only contracts

appears to be circular at best.” Tr. 28/13411. He says this because Bradley (as did both Bradley and the Commission in R97-1) used an average number of cubic feet for the trailers in each region for the power-only contracts, and then used a dummy variable to account for differences between the areas.³⁹ The averages range from 2,596 cubic feet to 3,228 cubic feet. Also, witness Bradley reports being informed that the cost of the trailer is less than 5 percent of the total cost of a tractor-trailer contract. USPS-T-18 at 24-26

[3273] On rebuttal, witness Bradley explains that there are only a limited number of trailer sizes under power-only contract in each area and that the variable being used is cubic-foot-miles, not just cubic feet. Tr. 43/18389-91. Nelson has not provided a clear explanation of the nature of the problem and the effect of Bradley’s handling of power-only contracts. The Commission agrees with Bradley that they should be included in the regressions and that the use of an estimate based on a Price-Waterhouse study is appropriate.

(3) Nelson’s Alternative Model

[3274] Because he believes that the specification of Bradley’s model is inconsistent with the way route adjustments are actually made and is therefore unable to provide elasticities that quantify the actual behavior of the costs of highway transportation operations, Nelson proceeds to develop models of his own. Before actual estimation, however, he stratified the data into three groups and normalized the data for the number of runs.

[3275] Nelson reasons that contracts supplying the largest vans cannot respond to volume increases by using an even larger van. He says that the only way to expand these contracts is to add runs, and that 10 percent more runs generally cost 10 percent more. Therefore, he separates these contracts from the others and assumes that they

³⁹ Nelson’s concerns are taken to apply to BMC contracts. Bradley indicates that the trailers used in the plant load contracts are all the same size due to TOFC (Trailer on Flat Car) specifications. USPS-T-18 at 27.

have a variability of 100 percent. Tr. 28/13411-12. On rebuttal, witnesses Bradley and Neels note this stratification but do not criticize it. Tr. 43/18393-94 and Tr. 46E/21906. The Commission does not find this stratification objectionable. Such a stratification or a similar one could be part of a useful analysis. On the question of whether the assumed variability of 100 percent is reasonable, the Commission takes no position. Variabilities can be both above and below 100 percent.

[3276] Another stratification made by witness Nelson is to separate power-only contracts and to piggyback them on the variability of the remaining contracts. Tr. 28/13412. Questions relating to power-only contracts were addressed above. The Commission does not find their inclusion in the data set used for the models to be objectionable. Based on further analysis, this issue could be addressed in a future case.

[3277] Before estimating any models, Nelson normalized the data for the number of runs. This means, for example, that the cost and the CFM capacity for a contract providing 9 runs were each divided by 9. Tr. 28/13412. This procedure, in and of itself, is not objectionable. It could be part of useful analysis, depending on the modeling exercise. However, this process did give rise to questions on the record about whether the resulting observation should be weighted by the number of runs in the contract, as Nelson did.⁴⁰ *Ibid.* On rebuttal, witness Neels finds the weighting scheme to be “inappropriate.” Tr. 27/12789-90. The Commission does not take a position on weighting schemes. It is certainly true, as Neels indicates, that “[a] contract is still only one contract, regardless of how many runs it covers.” *Ibid.* at 12790 and 12787. On the other hand, if 5 separate runs, each fitting a certain cost-CFM relationship with a random disturbance term, were collected into one contract and normalized, the size of the error term would be expected to be smaller. Arguably, then, one could be more certain that that point lies near the estimated relation. This issue should receive greater attention if models are presented that focus on normalized data.

⁴⁰ Another question, not raised on the record, concerns whether the range of variation of normalized data would be smaller. Econometric models are often viewed as approximating reality over a limited range of variation of the variables involved.

[3278] Witness Nelson's actual modeling occurred in three steps. The first model adopted a translog specification and took the form $\text{cost/run} = f(\text{CFM capacity/run, route-length})$. Nowhere does he provide any discussion of why a model of this form should be able to represent how actual operations are adjusted, given a volume change. He reported difficulties with this model and rejected it. His second model adopted a log-log specification and took the form $\text{cost/run-mile} = f(\text{cube, } 1/\text{route-length})$. For this model, the data were stratified by route length, another potentially interesting stratification. Again, no discussion was provided justifying this particular specification. Tr. 28/13412. See also Tr. 43/18393-96. Again, Nelson rejected the results from this model.

[3279] Nelson's third model, and the one on which he relied for his proposed variabilities, also adopted a log-log specification and took the form $\text{cost/run} = f(\text{CFM capacity/run, run length})$. He says this model "generally exhibited a high degree of explanatory power, and high statistical significance for the variables needed to estimate the relevant elasticity." Tr. 28/13413.

[3280] As explained in considerable detail by witness Neels, Tr. 46E/21906-11, this model is a restricted form of the translog model, the latter being a model that has been used by the Commission for transportation analysis since Docket No. R87-1. When a restricted form is used, it is incumbent on the analyst to explain why the constraints and limitations in that form make it more likely to be able to infer the elasticity information desired. Aside from statements that his model corrects inconsistencies in Bradley's model, Nelson has not provided this explanation. The Commission notes that both of the "independent" variables in the equation (CFM capacity/run and run length) are influenced by changes in the run length. Therefore, the equation will encounter collinearity problems.⁴¹ Such problems cannot always be avoided, but one would prefer to face them only when the model can be strongly justified on other grounds.

⁴¹ Witness Neels suggests one way to help deal with this collinearity. T r.46E/21915.

[3281] Extensive rebuttal testimony focusing on this third model is provided by witnesses Bradley, Tr. 43/18398-418, and Neels, Tr. 46E/21905-29. According to witness Bradley, the model: 1) is not justified on a relationship recognized in economic theory; 2) is not justified on a description of how actual operations adjust to volume changes; 3) does not have a sound mathematical basis; 4) is not estimated with state-of-the-art econometric techniques; 5) was estimated erroneously; and 6) does not yield results that are robust and consistent. Neels supports many of these contentions.

[3282] Bradley then goes on to take an unusual step, which he says he takes at least partly for the sake of curiosity. In effect, he says: if I were going to build a log-log model with cost/run as the dependent variable, and avoid all of Nelson's errors, how would I do it and what would the results be? He believes the most defensible starting point would be a cost function specifying:

$$\text{Cost} = \alpha (\text{Cubic Foot Miles})^\beta$$

From this, he shows the appropriate log-log form to be:

$$\ln [\text{Cost/Frequency}] = \ln \alpha + (\beta-1) * (\text{Frequency}) + \beta (\text{Cube} * \text{Route Length}).$$

Tr. 43/18401. He estimated this equation omitting power-only contracts, using Nelson's filters, and using a corrected version of Nelson's segregation by truck capacity. Note that estimation provides a value for α , a value for $\beta-1$, and a value for β . The variability results are provided in Bradley's Table 6. Tr. 43/18414. Additional details were provided by Bradley in response to a question asked during cross examination. *See Id.* at 43/18462-64.

[3283] The Periodicals Mailers now take the position that Nelson's original analysis should be discarded and that witness Bradley's results in Table 6 should be used. Periodicals Mailers Brief at 33-34 and Reply Brief at 23-24. They take this position despite the fact that Bradley specifically warns against using these results. In fact, Bradley explains that since he gets a value for $\beta-1$ that differs from the value for β , there is a strong statistical suggestion that the specification of the model should be rejected. Tr. 43/18462-64.

[3284] The Commission is left with a recommendation on brief that a result be used, Bradley's Table 6, that is not supported on the record by any witness, that has not been reviewed or tested on the record, and that is denounced by the witness who prepared it. The Commission does not find it necessary to provide a specific assessment of every point made on rebuttal by witnesses Bradley and Neels. The Commission uses the analysis provided by Bradley in his original testimony.

2. Distribution of Transportation Costs

a. The Transportation Cost System

[3285] In this docket, as in previous cases, the Postal Service uses the Transportation Cost System (TRACS) to distribute transportation costs to mail categories. USPS-T-1 at 2. TRACS consist of five subsystems: Commercial Air, Passenger Rail (Amtrak), Network Air, Highway, and Freight Rail. *Ibid.* In this docket discussion of the distribution of transportation costs focused on purchased highway transportation. Regarding purchased highway transportation, TRACS sampling is a three-stage sample with a primary sampling unit, stop-days, defined as "all mail unloaded from a truck at one facility on a specific trip, on a specific day." USPS-LR-I-52 at 3. In the first stage, a random sample of stop-days, stratified based on facility type and whether the segment is on an out-bound or an in-bound trip, is selected. The second stage is a stratified sample of off-loaded containers, pallets, and loose items. The third stage is only applicable to wheeled containers and is a stratified sample of items from each selected container.

[3286] The sampling process gathers data on truck utilization, mail class proportions, and miles traveled. The truck utilization data are collected before any mail is off-loaded and consists of the percentage of empty floor space, space occupied by mail being unloaded, and space occupied by mail remaining on the truck. The height, length, and width of pallets are recorded along with weight and volume information related to

sampled items. These data, coupled with the origination facility and truck utilization information, are used to estimate cubic-foot-miles by mail class.

[3287] The estimation of cubic-foot-miles by mail class involves allocating empty space to the classes of mail. The Postal Service accomplishes this by ‘expanding’ the sampled mail classes to include empty space. The empty space is distributed to off-loaded mail in proportion to the estimated truck space occupied by the sampled mail.

[3288] The cost of the sampled trip is multiplied by the cubic-foot-mile proportions to estimate the cost of the trip by mail category. These costs are then expanded to represent all trips in the quarter. The distribution key is the expanded cost of a mail category divided by the total expanded cost.

[3289] *Intervenor Proposals.* Two parties, United Parcel Service (UPS) and Florida Gift Fruit Shippers Association (FGFSA) propose modifications to the manner in which TRACS distributes purchased highway transportation costs. FGFSA witness Ball criticizes TRACS in several respects. First, he contends that the allocation of Intra-BMC samples fails to reflect relative mail volumes and is biased. Tr. 30/14299; see *also* FGFSA Brief at 7. Second, FGFSA opposes the manner in which TRACS allocates empty container and vehicle space. Tr. 30/14299-300; see *also* FGFSA Brief at 7. Witness Ball argues that “expansion” penalizes mail on in-bound trips which has lower vehicle and container utilization. Tr. 30/14299-300. Third, FGFSA argues that Inter-BMC samples erroneously reflect a distribution key for DBMC parcels, which, FGFSA asserts, do not utilize inter-BMC transportation. Similarly, FGFSA contends that Intra-BMC samples erroneously reflect DBMC parcels on the in-bound trip back to the BMC, which, according to FGFSA, defies reason. Tr. 30/14300-01; see *also* FGFSA Brief at 9. Finally, FGFSA advocates the use of cubic feet in lieu of cubic-foot-miles to distribute DBMC purchased highway transportation costs for Standard (A) and Parcel Post. The predicate for this proposed redistribution is that cubic-foot-miles differs dramatically from the cubic feet reported for these mail categories. Tr. 30/14301-302; see *also* FGFSA Brief at 9-10.

[3290] UPS witness Neels criticizes the Postal Service's current method of allocating empty space, which involves the expansion of mail actually found on the sampled truck to fill the unused space. Tr. 32/16006. He argues that the "procedure places greater weight in the cost distribution process on the mail mix on trucks with lower capacity utilization." *Id.* at 16008. Witness Neels' proposal gives greater weight to the classes and subclasses of mail on the more fully loaded trucks. His approach involves determining a distribution key for the mail mix found on more fully loaded trucks, allocating empty space on the basis of this key, and then determining an overall key for the distribution of transportation costs. This approach requires identifying the more fully loaded trucks, which he accomplishes by arraying the sampled segments and finding the segments with the highest capacity utilization. To determine the fraction of segments to include, he uses the inverse of the average number of segments per trip. Tr. 32/16014. See UPS Brief at 33-34.

[3291] In addition, witness Neels argues that TRACS appears to underrepresent time-sensitive mail because it fails to include emergency or exceptional contracts, and TRACS inspectors may bypass time-sensitive mail in an effort to avoid disrupting the movement of this mail. Tr. 32/16019-22. Witness Neels outlines several problems concerning the representativeness of the TRACS distribution keys, *e.g.*, the misallocation of samples to strata, and that the sample design requires updating to reflect the Postal Service's current operating environment. *Id.* at 16025-33. Finally, witness Neels suggests possible improvements in the TRACS sampling, *e.g.*, supplementing the TRACS data with data from the Transportation Information Management Evaluation System (TIMES), and changing the sampling procedures so that all segments on a trip are sampled. *Id.* at 16034-38.

[3292] *Postal Service Rebuttal.* On brief, the Postal Service responds to each of FGFSa's contentions. The Postal Service dismisses FGFSa's claims that the Intra-BMC samples are biased, explaining that the Horvitz-Thompson type estimator used by TRACS reflects the selection probabilities and therefore produces unbiased estimates of cubic-foot-miles. Postal Service Brief at III-3. The Postal Service also rebuts FGFSa's

claims that Intra-BMC and Inter-BMC samples erroneously reflect DBMC parcels, asserting that FGFS misperceives the transportation network. According to the Postal Service, intermediate stops are made under both Inter-BMC contracts and the Intra-BMC network. In addition, DBMC parcels that are mis-sorted, mis-sent, mis-entered, or returns may be found on Inter-BMC and Intra-BMC transportation. The Postal Service asserts that the presence of DBMC parcels in the sample is indicative of the robustness of the sampling. Postal Service Reply Brief at III-9-III-10.

[3293] Witness Eggleston rebuts FGFS's proposal to use cubic feet as a distribution key. She contends, *inter alia*, that witness Ball's comparison of cubic feet and cubic-foot-miles for Parcel Post and Standard Mail (A) is invalid because it improperly compares transportation modes and rate categories, and further because it incorrectly presumes that cubic feet and cubic-foot-miles are directly related. Tr. 41/18163-64; see also Postal Service Brief at III-6-III-7, and Postal Service Reply Brief at III-4-III-7.

[3294] Witness Bradley criticizes witness Neels' proposal to revamp the allocation of empty space, contending it is flawed. However, he proposes a compromise method for allocating empty space, one that uses data on both the tested legs and the more fully loaded trucks. Witness Bradley asserts that this method is more accurate than either Neels' or the current method, and partially addresses the Commission's desire, espoused in Docket No. R97-1, to separate the TRACS calculation of cubic-foot-miles from the expansion process. This approach yields transportation cost distributions that are approximately midway between the Postal Service's and UPS's methods.

[3295] On brief, the Postal Service dismisses witness Neels' contentions that TRACS appears to under-sample time-sensitive mail as purely speculative. Postal Service Reply Brief at III-8-III-9.

[3296] *Commission Analysis.* In Docket No. R97-1, the Commission expressed several concerns about TRACS, including its documentation, potential sampling bias, and highway distribution keys. The Postal Service has endeavored to address each. First, it has improved the documentation for TRACS, adding sample design data,

estimation formulas, processes, and procedures. The Postal Service also produced final analysis files (Z-file) that facilitates review of the system by both the Commission and participants. See Postal Service Brief at III-2-III-3; and Postal Service Reply Brief at III-3-III-4. Second, the Postal Service modified its sampling of in-bound and out-bound Inter-BMC and Intra-BMC trips from 70 percent and 30 percent, respectively, to 51 percent and 49 percent, respectively. See Postal Service Brief at III-3, and Postal Service Reply Brief at 2-3. Third, in response to the Commission's concern about possible bias on in-bound and out-bound trips due to mail mix, the Postal Service revised its procedure for computing the highway distribution key to conform to the cost driver for highway transportation, namely, cubic-foot-miles. The new procedure uses separate weights for in-bound and out-bound trips. See *Id.* at III-4-III-5. In addition, the Postal Service revised its variance formula for estimating the coefficients of variation for the highway distribution keys. The revised formula results in lower CVs for the major mail categories. *Id.* at III-5-III-6. The Commission commends the Postal Service for addressing these concerns.

[3297] FGFSa's various criticisms of TRACS are unavailing. It offers only general assertions that TRACS is biased without the necessary statistical evidence demonstrating the point. Moreover, FGFSa's principal claim, that TRACS is biased because it fails to reflect relative volumes, is misplaced. As the Postal Service notes, witness Xie provides detailed information about TRACS that refutes the claim that the sample allocation must be proportional to mail volumes. See, e.g., Tr. 17/6751, 6796, and 6845-48; see also Postal Service Brief at III-3 and Postal Service Reply Brief at III-1-III-3. The Commission finds this testimony to be persuasive.

[3298] Similarly, the Commission is also persuaded by the Postal Service's response to FGFSa's contention that Intra-BMC and Inter-BMC samples erroneously include DBMC parcels. See Postal Service Reply Brief at III-9-III-10. Finally, for reasons outlined by witness Eggleston, the Commission rejects FGFSa's proposal to use cubic feet as a distribution key. See Tr. 41/18163-64 and Postal Service Reply Brief at III-4-III-7.

[3299] Witness Neels' analysis of TRACS is useful, focusing attention not only on the allocation of empty space, but also on sundry related issues. On brief, UPS limits its discussion to two of those issues, namely, Neels' allocation proposal and the sampling of time-sensitive mail. UPS Brief at 33-35. For its part, the Postal Service endorses Bradley's alternative proposal. Postal Service Reply Brief at IV-81-IV-83.

[3300] Witness Bradley's compromise proposal is well taken. It produces a distribution key that better reflects actual usage of transportation capacity. As noted, the Postal Service endorses it; UPS, while preferring Neels' proposal, finds it acceptable. Accordingly, the Commission adopts Bradley's compromise method of allocating empty space.⁴²

[3301] UPS makes a passing reference to emergency contracts and exceptional service highway movements, arguing first, that they are likely to contain a higher proportion of time-sensitive mail, and second, that if sampled they likely would result in higher Priority Mail attributable cost levels. UPS Brief at 34. While the first inference may appear reasonable, there is, as the Postal Service argues, no evidence corroborating it. Nor is there any evidentiary support for the second inference. Witness Neels indicates that these movements comprise approximately 16 percent of total transportation costs. Tr. 32/16020. On brief, the Postal Service suggests that reliably sampling these movements poses certain problems. Postal Service Reply Brief at III-8-9. Nonetheless, the Postal Service should attempt to develop a means of better reflecting the costs of these movements in its sampling results.

[3302] Finally, witness Neels' various suggestions regarding TRACS go unaddressed by both UPS and the Postal Service. *See Id.* at 16025-38. While the record is not developed regarding these suggestions, they would appear to merit more

⁴² FGFSa witness Ball contends that the current method of allocating vehicle and container empty space penalizes mail on inbound trips. Tr. 30/14299; FGFSa Brief at 8. Neither contention is adequately supported. FGFSa took no position on witness Bradley's compromise. FGFSa Brief at 8. It provided unsubstantive evidence to buttress its claim regarding the allocation of container empty space. *See* Postal Service Reply Brief at III-11-III-12.

than cursory rejection, and the Postal Service is encouraged to review them substantively.

b. Alaska Air Adjustment

[3303] Since Docket No.R90-1, a portion of the intra-Alaskan air transportation costs has been classified as institutional and removed from the attributable cost base of Parcel Post. This adjustment recognizes the unique nature of mail delivery to the parts of Alaska where road access is limited. This adjustment was reviewed and sustained in *United Parcel Service v. U.S. Postal Service*, 184 F.3d 827 (D.C. Cir. 1999). In this proceeding witness Bradley proposes a change in the calculation of the Alaska air adjustment. Rather than calculating average cost per cubic foot and cubic-foot-mile by an unweighted average as was done previously, he suggests using a weighted average. USPS-T-18 at 59-61. The proposal is unopposed and the Commission accepts it.

c. Air Transportation Network

[3304] The Postal Service operates three dedicated air networks devoted to the transportation of mail. The Eagle network is a hub and spoke operation, located in Indianapolis, Indiana, which links approximately forty cities. See USPS-T-1 at 13, USPS-T-19 at 1, and Tr. 32/15596. The Western network is also a hub and spoke operation, located near Oakland, California, connecting approximately a dozen cities in the western United States. *Ibid.* The Christmas network, which operates for the two weeks prior to Christmas, is a daytime operation designed to transport expedited mail volumes. *Ibid.*

[3305] The Postal Service divides the costs of each of these networks between network premium costs and volume variable, non-premium costs. For each network, the network premium cost is the difference between the actual cost of each network and the hypothetical cost of providing the same service via passenger (commercial) air. As proposed by the Postal Service, the premium costs associated with the Eagle and

Western networks are treated as incremental to Express Mail. See, e.g., USPS-T-22 at 34. As initially reported by the Postal Service, the network premium costs were \$102 million for the Eagle network and \$22.7 million for the Western network. USPS-LR-I-57 at 1. The premium cost of the Christmas network is treated as incremental to Priority Mail. USPS-T-19 at 2.

[3306] In this proceeding, the Postal Service proposes two changes in the manner in which it calculates premium costs. First, for each network, the Postal Service proposes to calculate the linehaul portion of the premium costs based on origin-destination great circle miles in lieu of aircraft route miles. This will make the calculation of premium costs consistent with the manner in which passenger air linehaul costs are incurred. *Ibid.* The second change concerns the use of certain Eagle planes during the daytime, “Daynet turns” in the Postal Service’s lexicon. These daytime operations, which began in PQ 2 of FY 1998, “were designed to substitute for passenger air transportation, to better meet the service commitments of so-called two and three day mail (non-local First-Class and Priority Mail).” *Id.* at 4. The estimated cost of the Daynet turns was eliminated from the Eagle network costs and assigned, within Cost Segment 14, to the Passenger Air cost pool. *Ibid.* See also USPS-LR-I-60 and USPS LR-I-1 at 14-1 *et seq.* for a general discussion of Cost Segment 14.

[3307] Witness Neels, on behalf of UPS, proposes that the network premium costs associated with the Eagle and Western networks should be attributed to Priority Mail in addition to Express Mail. See Tr. 32/15996-16004. In support of this position, witness Neels compares the base year volumes of Express Mail and Priority Mail carried on these networks, and concludes that the Postal Service would be unlikely to incur the premium costs of operating these networks, as currently configured, solely to transport Express Mail. According to witness Neels, Express Mail represents 24 percent of the Eagle network volumes and 9 percent of the Western network volumes compared to 47 and 54 percent, respectively, for Priority Mail. *Id.* at 15998. Witness Neels contends that the networks are sized to handle both Express Mail and Priority Mail volumes. He gives no credence to the Postal Service explanation that its decision to upgrade capacity on

the Western network using Boeing 727s was a product of the bid specifications. He argues that the configuration of that network was driven by the need to improve Priority Mail service. *Id.* at 15999-16001. In addition, he argues that smaller aircraft could serve both networks. Based on these arguments, witness Neels proposes to increase the FY 1998 allocation of domestic air costs to Priority Mail by approximately \$65 million, while reducing the allocation to Express Mail by approximately \$93 million. *Id.* at 16004. In percentage terms, the reallocation results in a 60 percent decrease in domestic air costs allocated to Express Mail and a 13 percent increase to Priority Mail. On brief, UPS reiterates witness Neels' testimony, while characterizing the Postal Service's arguments as red herrings. See UPS Brief at 29-33, and UPS Reply Brief at 35-38.

[3308] The Postal Service, through the rebuttal testimony of witness Pickett, contends that witness Neels' arguments are predicated on misunderstandings of postal operations. See Tr. 43/18531-38. For example, witness Pickett indicates that both aircraft speed and load characteristics, *i.e.*, the ability to accept containerized loads, are critical considerations in the efficient operations of both networks. Witness Pickett states that the Boeing 727, while not the only aircraft that would have satisfied the Postal Service's requirements, proved, on balance, best suited for the Postal Service's needs for reasons, among others, of compatibility between the networks, cost, and flexibility. Regarding the volumes transported on each network, witness Pickett notes that the relative share of Express Mail increased in FY 1999, but, more importantly, that the average annual volumes mask the need to serve swings substantially exceeding the average. Witness Pickett also points to the recent implementation of the Priority Mail Processing Center (PMPC) network as an indication that the Eagle network is not caused by Priority Mail. This follows, according to witness Pickett, because the advent of the PMPCs has not caused a reconfiguration of Eagle flights in the affected areas. *Id.* at 18536-37. Witness Pickett concludes that "overnight dedicated air networks are absolutely needed to support a guaranteed overnight product." *Id.* at 18538; see also Tr. 17/6718-19.

[3309] Addressing this issue in Docket No. R97-1, the Commission concluded that a causal link exists between the guaranteed overnight service and the network fixed costs that required the fixed costs of the Eagle and Western networks be attributed to Express Mail. PRC Op. R97-1, para. 3399. In addition, the fixed cost of the Christmas network was attributed to Priority Mail. Based on testimony in that docket, the Commission concluded that fixed network costs should be attributed solely to Express Mail since if it were eliminated, the Eagle and Western networks would not be retained, and Priority and First-Class Mail would be transported via commercial air without degrading service quality.

[3310] As UPS notes on brief, the Commission's finding in Docket No. R97-1 represented a departure from earlier decisions. UPS Brief at 29, 31. The Commission's conclusion, however, was based on testimony that the Eagle network would cease operations if Express Mail were eliminated.

[3311] The Commission is not persuaded by witness Neels' analysis. Several factors influence this conclusion. First, the current allocation is based on causality, specifically on the evidence that the networks would no longer operate if Express Mail were eliminated. In this proceeding, the Postal Service reiterates this point, stating that the overnight networks are configured for Express Mail and without that product the overnight network would be superfluous. Tr.43/18538; see *also* Postal Service Reply Brief IV-84-IV-87. Witness Neels fails to demonstrate that this is not the case. For example, focusing largely on the Western network, witness Neels argues that larger aircraft, Boeing 727s, are used to accommodate transportation of both Express and Priority Mail. In rebuttal, however, witness Pickett outlines several inadequacies of possible alternatives ranging from the general, *e.g.*, from cruising speed and containerization, to the more specific, *i.e.*, the cities common to both networks. See *also* Postal Service Reply Brief at IV-85. Moreover, witness Pickett adequately explained why witness Neels' reliance on a 1995 memorandum for the proposition that the Western network was reconfigured to provide, *inter alia*, improved service for Priority Mail was

misplaced. Tr. 43/18537-38; see also Postal Service Brief at V-155 and Postal Service Reply Brief at IV-85-IV-86.

[3312] Second, UPS argues that the networks could be operated with smaller planes. UPS Brief at 31-32 and UPS Reply Brief at 35. On redirect, witness Neels did suggest that smaller jet aircraft could be used. Tr. 32/16133-34. Notably, however, his prepared testimony referenced only turbo props, which were not shown to be a suitable substitute for jets on both networks. See *id.* at 16116-17. While smaller aircraft were used on the Western network prior to August 1999, they are subject to limitations, e.g., range, lift, and avionics, which restrict their ability to serve the network. Moreover, there has been no showing that they could be used on the Eagle network. Finally, even if smaller jets were considered, it does not necessarily follow that network operating costs would decline. *Id.* at 16106-07; see also Tr. 45/19597 and APMU Brief at 30.

[3313] Third, witness Neels' analysis suffers, comparatively, from a less than full understanding of the Postal Service's network operations. See, e.g., Tr. 32/16101-07, 16109-10; see also Tr. 43/18535 and Tr. 32/16113. This is not meant so much as criticism but as fact, which makes the Commission reluctant to reallocate substantial amounts based on speculative, even if well-presented, theories. Fourth, under witness Neels' premise, commencement of the PMPC operations should, logically, have caused downsizing or reconfiguration of Eagle flights in the affected areas. Witness Plunkett indicates that neither occurred. Tr. 43/18537; see also Postal Service Reply Brief at IV-87. Finally, while average relative volumes are not inconsequential, the more critical inquiry, given the time constraints attendant operation of a guaranteed overnight service, is the ability to accommodate variations in demand. In that regard, the evidence is insufficient to refute the Postal Service's position, as developed by its witnesses, that, but for the need to support a guaranteed overnight product, the overnight network would be unnecessary. Tr. 43/18538; see also Postal Service Reply Brief at IV-84.

IV. PRICING

A. Introduction

[4001] Under the Postal Reorganization Act, two principal statutory provisions frame the Commission's rate deliberations. First, the Postal Service operates under a break-even constraint. Thus, the Commission's recommended rates and fees are designed to generate sufficient revenues to recover, as nearly as practicable, total estimated test year costs. 39 U.S.C. § 3621. Second, the recommended rates are based on the nine ratemaking criteria specified in section 3622(b).⁴³ The statute also identifies certain public policy considerations, which, within the Commission's discretion, may color its rate recommendations. See, e.g., §§ 101(d) and 403(c).

[4002] The nine ratemaking criteria of section 3622(b) are 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;

⁴³ Under § 3622, the Commission's authority extends to rates and fees. For purposes of this discussion, the term "rates" encompasses fees as well.

- (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.

[4003] Of these criteria, only criterion 3 is a requirement. See *National Association of Greeting Card Publishers v. United States Postal Service*, 462 U.S. 810, 820 (1983). It is the foundation of the Commission's rate recommendations, imposing two obligations on the Commission. First, recommended rates for each class or type of mail must be adequate to recover "the direct and indirect postal costs attributable to that class or type [of mail]." The Commission satisfies this requirement by recommending rates that recover attributable costs, which include volume variable costs and product specific costs, *i.e.*, fixed costs associated with one class. Second, to enable the Postal Service to break even, the recommended rates must also be sufficient to recover "all other costs of the Postal Service," *i.e.*, institutional costs. Recommended rates, therefore, must recover that portion of the institutional costs determined by the Commission to be "reasonably assignable to such class or type." Thus, criterion 3 establishes an attributable cost floor, and the recommended rates must, in total, exceed attributable costs sufficiently to enable the Postal Service to recover its institutional costs.⁴⁴

[4004] As in prior cases, the issue of attributable cost levels has generated considerable controversy in this proceeding. Several participants, including the Postal Service, OCA, UPS, MPA, and Time Warner have offered testimony. See, *e.g.*,

USPS-T-15, 16 and 17; Tr. 27/13144 *et seq.* (OCA witness Smith), Tr. 27/12770 *et seq.* (UPS witness Neels), Tr. 24/11211 *et seq.* (MPA *et al.* witness Glick), *Id.* at 11260 *et seq.* (MPA *et al.* witness Cohen), and *Id.* at 11344 *et seq.* (Time Warner *et al.* witness Stralberg). The Commission's conclusions regarding costing are contained in Chapter III.

[4005] Costs not classified as attributable are classified as institutional. The Commission applies the remaining (non-cost) criteria of § 3622(b) to assign the institutional cost burden among the various classes and types of mail. These non-cost criteria are quite broad, suggesting both standards of efficiency and equity. Indeed, as the Commission has previously observed, the non-cost (or pricing) criteria serve sometimes-conflicting objectives, e.g., one criterion may suggest lower rates for a particular type of mail, while another may suggest the opposite result. See PRC Op. R94-1, App. F at 17, PRC Op. R90-1, para. 4001, PRC Op. R87-1, para. 4096, and PRC Op. R84-1, para. 4000. The Commission considers each criterion, exercising its informed judgment to balance the competing objectives of the Act in a manner that will result in fair and equitable rate recommendations.

[4006] In prior opinions, the Commission has discussed and reviewed the statutory ratemaking criteria. For example, in Docket No. R87-1, the Commission extensively discussed the ratemaking process, including how the various non-cost criteria are incorporated in its recommended rates. See PRC Op. Docket R87-1, para. 4022 *et seq.*; see also PRC Op. Docket R90-1, para. 4000 *et seq.* and PRC Op. Docket R97-1, para. 4001 *et seq.* The Commission's intent in doing so has been twofold; first to provide sufficient detail so that participants may discern the Commission's interpretation of the

⁴⁴ Postal Service witness Mayes employs volume-variable and incremental costs. USPS-T-32 at 16-19. She marks up volume-variable costs and uses the ratio of revenue to volume variable cost for purposes of assessing revenue requirement burdens. Exhibit USPS-32B. Incremental costs are used to test for cross subsidy. Exhibit USPS-32E. Witness Bradley presents the Postal Service's method of calculating incremental costs. USPS-T-22. It is his goal "to encourage the Commission to adopt incremental costs in place of attributable costs in its costing analysis." *Id.* at iv. Witness Bradley's testimony is addressed below.

criteria, and second, to serve as benchmarks for evaluating whether the new evidence warrants a departure from prior allocations.

[4007] The relative institutional cost burden borne by each class or subclass may be measured in various ways. The process of marking up attributable costs to recover institutional costs yields a cost coverage for each subclass. Cost coverage provides a simple measure of the relative institutional cost burden borne by the different subclasses.⁴⁵ From case to case, cost coverage for one or more classes or subclasses is likely to change, sometimes substantially, due to changed circumstances, e.g., new or modified mail processing operations, sharply increased costs, or classification changes. Thus, to measure relative burdens over time, the Commission employs a markup index, which compares the markup for each subclass to the systemwide average markup. The markup for each subclass is its contribution to institutional costs as a percent of its attributable costs. As discussed below, markups, like cost coverage, may be affected by changed circumstances. Hence, any evaluation of markups over time must account, to the extent practicable, for changed circumstances. Each of these measures of relative burden is presented in Appendix G.

[4008] Postal Service witness Mayes addresses application of the pricing criteria to rate levels proposed by the Postal Service for the various subclasses. See USPS-T-32. Witness Mayo applies the pricing criteria to fee levels proposed for various special services. See USPS-T-39. Several participants advocate that the Commission should give certain non-cost criteria greater weight in recommending (higher or lower) rates. The following are illustrative. GCA and Hallmark argue, *inter alia*, that equal weight should be given to all the non-cost criteria, and urge “a fuller more effective application of the ‘ECSE’ criterion to First-Class Mail.” GCA/Hallmark Brief at 7; see *also id.* at 8 and 10.⁴⁶ UPS asserts, based primarily on value of service considerations, that the cost

⁴⁵ Cost coverage reflects the contribution to institutional costs provided by a subclass, reflected as the ratio of revenue to attributable cost.

⁴⁶ ECSE value refers to the phrase “educational, cultural, scientific, and informational value” in criterion 8.

coverage for Priority Mail should be at least equal to that of First-Class Mail. UPS Brief at 43 *et seq.* On the other hand, and also based on value of service considerations, APMU suggests that Priority Mail's cost coverage be reduced. APMU Brief at 8 *et seq.* AAP contends that Bound Printed Matter warrants a sharply reduced cost coverage based on ECSI value. AAP Brief at 3-8. MOAA makes a similar contention. MOAA Brief at 23-25. In addition, MOAA advocates a lower cost coverage and, therefore, lower rates for Standard Mail (A) ECR, citing criterion 6, mail preparation, and criterion 2, value of service considerations. As a general matter, proposed markups for classes, subclasses, and services are addressed in Chapter V. However, because of its general applicability, GCA/Hallmark's suggestion that the Commission give "equal weight to all the non-cost factors" merits brief comment. GCA/Hallmark Brief at 10.

[4009] *Citing Direct Marketing Association, Inc. v. United States Postal Service*, 778 F.2d 96, 104 (D.C. Cir. 1985), GCA and Hallmark contend that "[t]he Act does not give primacy to any single factor but requires that each be given equal weight." GCA/Hallmark Brief at 8. This interpretation misconstrues *Direct Marketing*, which, while concluding that each non-cost factor ranked equally, held only that "[a]ll factors must be considered," *DMA v. USPS*, 778 F.2d 96, 104 (citation omitted). Moreover, the suggestion that the non-cost factors be given equal weight is contrary to the statute since it would effectively strip the Commission of its discretion to apply the non-cost criteria of the Act in a fair and equitable manner. *See United Parcel Service, Inc. v. United States Postal Service*, 184 F.3d 827, 845 (D.C. Cir. 1999) (citation omitted). ("While the Commission must 'take into account all relevant factors and no others,' it need not give each factor equal weight."); *see also Association of American Publishers, Inc. v. United States Postal Service*, 485 F.2d 768, 774 (D.C. Cir. 1973). ("The [statutory] factors are reminders of relevant considerations, not counters to be placed on scales or weight-watching machines.") Hence, the Commission rejects this suggestion.⁴⁷

[4010] As noted above, attributable cost serves as a floor which the Commission marks up to determine the reasonable contribution to all other costs. In this proceeding, witness Bradley presents a new method for calculating incremental costs, which he

urges the Commission to adopt in lieu of attributable costs. See USPS-T-22. The Postal Service employs incremental costs as a means of testing for cross-subsidy. In Docket No. R97-1, the Commission accepted the incremental cost test described by witness Panzer.⁴⁸ In that proceeding, however, the Commission rejected witness Takis' calculation of incremental costs. See *id.*, para. 4053. Witness Bradley's work, along with witness Kay's calculations, represents an earnest response to the Commission's concerns with Takis' effort. The task of developing reliable incremental costs for the Postal Service, a multi-product regulated entity with public service obligations, is daunting. This is not to imply that it cannot be achieved. However, for the reasons discussed below, the Commission declines to employ the new method of calculating incremental costs espoused by witness Bradley. Nonetheless, the Commission is satisfied, based on this record, that its recommended rates are subsidy free, consistent with the statute. As the Commission observed in Docket No. R97-1, its calculation of attributable costs by subclass is a reasonable proxy for the incremental costs associated with that subclass or type of mail. Thus, "nonnegative markups are good evidence against the presence of the most elementary cross subsidies." *Id.*, para. 4024.

[4011] In sum, the Commission's recommended rates for each class or type of mail must recover its attributable costs, plus a reasonably assignable portion of all other costs. Under the Commission's costing methodology, approximately 37 percent of total costs are classified as institutional, to be reasonably assigned among the various classes and types of mail. In fulfilling that statutory obligation, the Commission balances

⁴⁷ Similarly, the Commission rejects FGFSa's suggestion that the Commission's analysis of the non-cost factors should begin with a uniform per piece contribution. FGFSa contends that Parcel Post's low value of service justifies a per piece contribution near the average. FGFSa Brief at 14. FGFSa's proposal is flawed since the average contribution per piece is heavily influenced by lightweight, letter-sized First-Class and Standard (A) Mail. Thus, a simple comparison of unit contributions fails to reflect different handling or piece characteristics, e.g., shape, weight, and distance transported, which would justify a greater or lesser unit contribution.

⁴⁸ "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." PRC Op. R97-1, para. 4022.

the competing criteria of the Act to recommend rates that are fair and equitable. This process follows the Commission's long-standing rate setting practices.

B. Pricing Overview

[4012] This proceeding presents three overarching pricing challenges. Each has significant ratemaking implications. The most broad reaching issue is the first ounce rate for First-Class Mail. Lesser, but nonetheless significant issues include large cost increases affecting certain classes and subclasses of mail and newly enacted legislation affecting the costs and rates for several subclasses of mail. Each is addressed below.

1. First Ounce Rate

[4013] Ratemaking is an iterative process which, as the Commission has explained in prior opinions, involves developing target coverages expressed, initially, in general terms, *e.g.*, near or slightly below average. That analysis begins with reference to the existing, presumptively reasonable rate structure. In addition, the Commission is cognizant of its prior recommendations. In other words, the Commission evaluates the Postal Service's Request and the intervenors' proposals in light of their affect on existing rates and also with an eye on historic relationships. Both play a role, the former to assess current developments and impact, the latter as a relative benchmark.

[4014] However, with respect to the latter, changes in postal operations, mail classifications, rate relationships, and markets may, over time, cause changes in the Commission's coverage determinations which any comparison of relative class burdens would need to consider.

[4015] The basic First-Class rate, *i.e.*, for mail weighing one ounce or less, has always been designed in whole integers. The practice is premised on simplicity and administrative convenience. The rate is used by the general public and small businesses. Postage is often purchased in small increments. It is simple to administer. No participant proposes that the Commission recommend a fractional first ounce rate.⁴⁹

[4016] The whole integer convention directly affects the ratemaking process. First-Class letter mail is the most commonly used rate, affecting nearly 100 billion pieces

of First-Class Mail, or approximately 48 percent of the Postal Service's total volume. A one-cent change in the First-Class rate will generate approximately one billion dollars, an amount that far exceeds the proposed adjustments to other subclasses and services of mail. Compounding the issue, in this proceeding, unlike some prior ones, the Postal Service has proposed to increase the first ounce First-Class rate by one cent. Thus, at the outset, in considering its pricing options, the Commission's First-Class target rates are largely limited to retaining the current \$.33 rate or recommending the one cent change proposed by the Postal Service.

[4017] The Commission closely considered, but ultimately rejected, maintaining the current rate for two principal reasons. First, spreading an additional billion dollars to the other classes and services of mail would have required rate level changes that could, in the Commission's view, cause severe economic dislocation. Second, it would have required unacceptably large increases in the other classes. Some participants, for example, suggest that the markups for Standard A Mail be increased. However, the Commission's above systemwide average increase for Standard A Mail Regular largely reflects the increasing attributable costs for that mail. A further increase necessitated by retaining the current First-Class rate would lead to an excessively high increase. Moreover, the Commission harbors some concerns that the increasing relative elasticities of demand for Standard A could render an increase of that size problematic. Nor could the remaining classes absorb the difference. Aside from any equity concerns, their volume is simply insufficient to sustain an increase of the magnitude that would otherwise be required.⁵⁰

[4018] The Commission recognizes its recommended \$.34 first ounce rate will produce a greater institutional cost contribution than under the current rate. To moderate

⁴⁹ The Commission recognizes that OCA's rate stability proposal contains elements of a fractional rate.

⁵⁰ Witness Bentley, representing MMA, a coalition of large first-class mailers, nonetheless recognizes the inherent difficulties involved in retaining the current rate. The remaining mailers would be required to bear the burden of the entire increase, a result that "would be very difficult for all other mailers to do." Tr .26/12281.

this, as discussed more fully in ChapterV below, the Commission has reduced the additional ounce rate, and, based on its analysis of the cost savings, adjusted certain workshare discounts. Moreover, the increase in the first ounce rate, 3 percent, is modest and substantially below the system average. Under the circumstances presented in this proceeding, the Commission's recommended rates for First-Class letter mail best satisfy the competing policies of the Act.

[4019] As noted above, changed circumstances, *e.g.*, classification changes, may affect coverage levels, which, in turn, may cause markup relationships to change over time. There is some evidence this has occurred in First-Class Mail as the volume of workshared mail has increased. The following table shows the relative and absolute change in the mix of single-piece and workshared First-Class Mail for several years beginning with 1988. The volume data are from the Postal Service's RPW reports.

Table 4-1
First-Class Letter Mail
(Volumes in billions)

Year	Single-Piece	Workshare	Total	Workshare as % of Total
1988	55.8	24.8	80.6	30.8
1990	56.8	27.6	84.4	32.7
1992	55.0	31.3	86.2	36.3
1994	55.0	35.5	90.5	39.3
1996	54.2	39.1	93.3	42.0
1998	54.3	40.6	94.9	42.8
1999	53.8	42.9	96.7	44.3

[4020] The trend is evident. For the entire period measured, workshared volumes have increased both in absolute terms and relative to First-Class single piece.⁵¹ That trend continues into the test year as well. Test year single-piece volume is estimated to equal 52.9 billion, while workshare is estimated at 47 billion, or in percentage terms 47 percent of total First-Class letter mail.

[4021] As workshared letters have become a greater proportion of total First-Class Mail volumes, cost coverage for the class has generally increased over time. See, e.g., Tr. 22/10195 and Tr. 26/12459, 12646. In turn, this has caused its markup to increase as well. *Id.* at 10196 and 12459. For example, from Docket No. R87-1 through Docket No. R97-1 coverage for First-Class letters has increased from 158 percent to 172 percent. Its markup index has also increased over that time, from 1.200 to 1.308.⁵² These results stem, in large measure, from setting the discounts consistent with efficient component pricing. Other factors may have caused the markup index of other subclasses to vary over time as well.

[4022] The Commission recognizes the beneficial effects of the Postal Service's automation program on reducing processing costs of First-Class Mail. Conversions to workshare have also contributed to reduced unit costs. These lower costs have benefited First-Class mailers directly in the form of below average rate increases in Docket No. R97-1 and this proceeding. In both dockets, the Postal Service proposed only a one-cent increase in the first ounce rate. In this case, that represents only a 3 percent increase. This is not to suggest that the Commission has abandoned its goal of reducing the relative burden on the monopoly class. Indeed, as indicated, the Commission has taken steps to moderate the contribution by First-Class Mail.

[4023] Two participants, in particular, argue that First-Class Mail bears an excessive institutional cost burden. Neither adequately supports its claims. OCA advocates retention of the current First-Class rate. OCA Brief at 142 *et seq.* Citing witness Callow's testimony as support, OCA argues that the institutional cost burden on First-Class Mail has increased. While the testimony is laudable in concept, it is flawed in execution. In particular, it fails to account for intervening changes, such as those

⁵¹ Based upon the Commission's analysis of the RPW data, for the period 1978 through 1999, the average annual growth rate is 0.4 percent for single-piece and 15.3 percent for workshared First-Class letter mail. For the period 1990 through 1999, the average annual growth rates are (0.4) percent and 5.2 percent, respectively.

⁵² See PRC Op. Docket No. R97-1, Appendix G, Schedule 3. The results from Docket No. R97-1 are slightly below those from Docket No. R94-1, a result that may stem from the intervening classification proceedings, including Docket No. MC95-1.

suggested above, that may cause markups to change. See *also* DMA Brief at 6-8. Nor does it account for circumstances that uniquely influenced the Commission's recommended rate levels. See, e.g., PRC Op. R94-1, para. 4107.

[4024] ABA & NAPM witness Clifton argues that the cost coverage for workshared First-Class Mail should be reduced because it is discriminatory relative to commercial Standard A Mail and to First-Class single-piece mail. Tr .26/12458. To that end, he proposes to increase discounts for First-Class Mail with the reduction in revenues made up by increasing the cost coverage for commercial Standard A Mail. *Id.* at 12463. The comparison is unavailing. First, cost coverage is applied at the subclass level, not by rate category. Second, that rate differences exist is not enough. The Commission is concerned with undue discrimination. The simple comparison with Standard A Mail is insufficient to prove the point. Third, the increase in First-Class cost coverage over time, absolutely and relatively, may manifest changed circumstances, e.g., in postal operations or mail mix. Indeed, notwithstanding the increase, it would appear that First-Class Mail's relative contribution to institutional costs has remained relatively stable since 1990. *Id.* at 12747. These are among the factors that would need to be explored in greater depth to give any credence to witness Clifton's claim.

[4025] Finally, OCA's novel, rate stability proposal merits brief comment, and, more importantly, further study. The proposal, under which the single-piece First-Class (SPFC) rate would be held constant through two rate cases, is designed to provide household mailers with greater rate stability, while providing business mailers with smaller, but more frequent rate changes. OCA Brief at 182-83. According to OCA, it is "not intended to shift costs between classes of mail or otherwise adversely affect larger mailers." *Id.* at 183. The proposal is contingent on establishing an "SPFC Reserve Account," under which excess revenues in the first rate period would offset the need to increase the SPFC rate in the second period.

[4026] The Postal Service opposes the proposal, contending that its adoption would impinge on management prerogatives. Postal Service Brief at VII-86-89. The Postal Service, however, states that the "reserve account idea is not uninteresting." *Id.*

at VII-88. DMA also opposes the proposal, asserting, *inter alia*, that it is “unworkable and probably unlawful.” DMA Brief at 9-12. See *also* Postcom/MASA Brief at 8, fn. 1.

[4027] The record is not sufficiently developed to enable the Commission to fully address the merits of this proposal, including its policy and legal implications. Consequently, the Commission declines to recommend its adoption. The proposal is, however, intriguing and merits close attention by the Postal Service. To that end, the Postal Service is encouraged to take the initiative, as it did, for example, in organizing the Periodicals Operations Review Team, to further consider this and related rate design issues affecting First-Class Mail.

2. Increasing Costs

[4028] Throughout the proceeding, the Commission evaluates evidence submitted by the Postal Service and intervenors. This process enables the Commission to focus on issues that may require special attention. As it sees fit, the Commission will issue orders requesting additional testimony to explore specific issues. In this proceeding, the Commission’s concern with increasing cost trends caused it to request the Postal Service to submit additional testimony concerning Periodicals and Media Mail (formerly Special Standard B).

[4029] In its initial Request, the Postal Service proposes a 12.6 percent increase, on average, in Periodicals rates. USPS-T-38 at 6, revised February 18, 2000. Several intervenors claim that the proposed increase is substantially greater. See Periodicals Mailers Brief at 1. In addition, they contend that the Postal Service’s proposed rates will increase postage costs for users of Periodicals by approximately \$300 million. *Ibid.*

[4030] In response to P.O. Information Request No. 4, the Postal Service provided the processing costs for various classes and subclasses of mail by shape, including Periodicals, for the period 1989 through 1999. Tr. 46-D/21807 *et seq.* After analyzing the data submitted by the Postal Service, the Commission issued Order No. 1289 requesting the Postal Service to provide detailed evidence explaining the causes of the

increase in inflation-adjusted costs of processing Periodicals since 1993. PRC Order No. 1289 (March 28, 2000) at 1. In response, the Postal Service submitted the testimony of witnesses O'Tormey (USPS-ST-42) and Unger (USPS-ST-43).

[4031] To its credit, the Postal Service organized, along with industry representatives, the Postal Service Periodicals Operations Review Team (Review Team) following the Commission's opinion in Docket No. R97-1. See Tr. 24/11166 *et seq.* The Review Team identified more than \$200 million in test year cost savings and reductions affecting Periodicals. See Tr. 38/17329. Notwithstanding these reduced cost levels, Periodicals attributable costs continue to increase. For example, from the test year in Docket No. R97-1 to the test year in this proceeding, Outside County unit costs are estimated to increase by 10.2 percent. Under these circumstances, a rate increase above the system average is unavoidable.

[4032] To the extent practicable, however, the Commission has minimized the increase by moderating Periodicals coverage. As In Docket No. R97-1, this result reflects the Commission's concern about the reported costs. In that regard, it represents a continuation of the reduced markup for Periodicals from Docket No. R97-1, and, in the same vein, is viewed as a temporary solution.⁵³ The Commission is hopeful that, longer term, the Postal Service's efforts to reduce flat processing costs will bear fruit.

[4033] Media Mail also reported sharply higher costs. As discussed in greater detail in Chapter V, the Commission sought further explanation for the increase upon finding that the Postal Service's institutional response inadequately explained its causes. PRC Order No. 1300 (August 18, 2000). In response to this order, the Postal Service submitted the testimony of witness Degen who proposes to reduce FY1999 Media Mail processing costs by 12.6 percent based on his finding that certain IOCS tallies had been

⁵³ Periodicals Mailers urge adoption of the Postal Service's variability analysis. Periodicals Mailers Brief at 36 *et seq.* As discussed in Chapter III. A., the Commission adheres to its long-standing conclusion regarding mail processing variability. While the resulting cost coverage reflects the Commission's somewhat higher attributable cost levels, that low coverage is critically dependent on the circumstances of this proceeding. Without the uncertainty surrounding Periodicals costs, a markup closer to historic levels may have been warranted regardless of the underlying variability analysis.

misidentified. Tr. 45/20051-60. The Commission's recommended rates reflect this adjustment to the reported costs. In Docket No. R97-1, the costs warranted a 9.6 percent reduction, on average, in the Commission's recommended Media rates. In this proceeding, the reported costs require an increase. The Commission, however, has moderated its cost coverage based on consideration of the non-cost criteria, including, in particular, concern over the cost increases.

[4034] Large cost increases can play havoc with mailers expectations; they also impact the Commission's coverage deliberations under criterion 4, the effect of rate increases on the general public, business mailers, and private carriers. Plainly, cost increases outside the norm, *e.g.*, in excess of inflation, wage rates, or costs for other postal products, not only limit the Commission's flexibility, but also raise concerns. Dramatic changes in costs from case to case appear more likely to affect smaller volume subclasses. This is not meant to imply that the reported costs are not valid, but simply that confidence in the data can be undermined without reasonable assurance that the data are reliable. Bound Printed Matter is a case in point.⁵⁴

[4035] As more fully addressed in Chapter V, during its coverage deliberation, the Commission considers each of the pricing criterion of the Act. Cost increases, however, have frequently been the overriding consideration in this case. Measured from the base year in Docket No. R97-1 to the base year in this proceeding, BPM unit costs have increased by more than 40 percent. BPM costs have been contested and closely examined. They have not been shown to be inappropriate or otherwise unreliable for ratemaking purposes. Given the magnitude of this increase, however, the Commission is substantially reducing BPM's cost coverage from its historic levels, *i.e.*, from approximately 136 percent in Docket No. R97-1 to approximately 114 percent in this

⁵⁴ In Appendix H the Commission comments on and suggests refinements to the Postal Service's data estimation systems. In a system with more than 200 billion pieces, accurately sampling and reporting data are monumental tasks. The problem is perhaps most acute with respect to relatively smaller subclasses and types of mail since the effects of sampling or non-sampling errors may be magnified. An examination of the Postal Service's current practices in this area would appear to be useful in various ways, including the ratemaking process.

proceeding. Under the circumstances, the coverage represents a reasonable assignment of institutional costs to BPM.

[4036] In sum, while the Commission's cost coverages are based on consideration of all the non-cost criteria of the Act, unique circumstances may compel the Commission to emphasize a particular criterion. The Commission has long practiced this policy when faced with facts that limit its ability to recommend higher (or lower) rates. See, e.g., PRC Op. Docket No. R87-1, para. 4027; PRC Op. Docket No. R90-1, para. 4017. The foregoing examples, in which the Commission's coverage was tempered, in particular by criterion 4, are further manifestation of this policy.

3. Legislation

[4037] Newly enacted legislation, PL 106-384, alters the rate relationships between certain nonprofit and commercial subclasses of mail. The nonprofit (or preferred) subclasses include: Standard A Nonprofit and Nonprofit ECR, Classroom and Nonprofit Periodicals, and Library Mail. The rate for these subclasses is to be derived by reference to its corresponding commercial subclass.

[4038] For ratemaking purposes, PL 106-384 directs that the attributable costs of the commercial (or regular rate) subclass and corresponding preferred subclass be combined. The ratemaking criteria of § 3622(b) are to be applied to the combined costs to determine the regular rate. The preferred rates fall out of this process as follows:

- Standard A Nonprofit and Nonprofit ECR rates, overall, are designed so that the estimated average revenue per piece by subclass equals, as nearly as practicable, 60 percent of the estimated average revenue per piece of Standard Regular and ECR, respectively.
- Nonprofit and Classroom rates are designed so that the postage on each mailing of such mail is, as nearly as practicable, 5 percent lower than the postage for the corresponding regular (Outside County) rate.⁵⁵

⁵⁵ The markup for Within County rates remains at one-half the markup of the comparable regular rate.

- Library rates are set so that the postage on each mailing of such mail is, as nearly as practicable, 5 percent lower than the postage for the corresponding Media rate.

[4039] In addition, PL 106-384 includes a transitional provision under which the estimated reduction in revenues from Nonprofit Standard (A) is, for purposes of this proceeding, treated as a “reasonably assignable” cost under criterion 3.

[4040] PL 106-384 is designed to address rate anomalies which were deemed to preclude application of the appropriate markup to the preferred subclasses. See S. Rep. 106-468, 106th Cong., 2nd Sess. 2-4 (2000). PL 106-384 attempts to preserve the preferred rate status of these subclasses through a different formula. The Commission’s recommended rates reflect the recent amendments to the Act.

C. Ramsey Pricing

[4041] As part of its direct case, the Postal Service submitted the testimony of witness Bernstein regarding Ramsey pricing. USPS-T-41. The testimony provides, *inter alia*, “a guideline for postal pricing based on the principle of economic efficiency.” *Id.* at 3. Several parties representing Standard Mail (A) interests endorse the use of Ramsey pricing for setting postal rates. These include MOAA (MOAA Brief at 10-12), DMA (DMA Reply Brief at 10), and SMC (SMC Reply Brief at 3, fn.1). MOAA, for example, urges the Commission to “give explicit consideration to Ramsey rate levels.” MOAA Brief at 11. GCA and Hallmark oppose the use of Ramsey pricing, contending that it is inconsistent with the Act and that witness Bernstein’s testimony is flawed. GCA/Hallmark Brief at 16 *et seq.* NAA also opposes the use of Ramsey pricing, arguing that Bernstein’s presentation should be given no weight. NAA Reply Brief at 15. *See also* UPS Brief at 45, fn.32. Witness Mayes, the Postal Service’s pricing witness, made no formal use of the Ramsey prices developed by Bernstein. USPS-T-32 at 19.

[4042] Economic efficiency is neither the exclusive nor even the paramount ratemaking objective under the Act. Hence, the premise for using Ramsey pricing is dubious at best. Economic efficiency, the Commission has observed, “is not a justification for pricing in a way that might impair basic and fundamental postal services.” PRC Op. R87-1, para. 4057. *See also Direct Marketing Association, Inc. v. United States Postal Service*, 778 F.2d 96, 103-04 (D.C. Cir. 1985). (“We disagree with the argument that Congress intended relative demand to be the benchmark for the assignment of institutional costs. Rather, it is clear that no single factor was intended by Congress to be the ‘primary’ factor in making the assignments.”) Under the Act, the Commission, exercising its informed judgment, must balance the competing ratemaking criteria of the Act. Application of a Ramsey pricing formula to a multi-product firm that includes captive, monopoly products, would be contrary to the policies of the Act as it would elevate one factor to the exclusion of all others. Therefore, consistent with its prior opinions, the Commission places no reliance on Ramsey pricing for its recommended

rates. This is not to imply that the Commission pays no heed to own-price elasticity estimates in assessing value of service issues. The Commission's recommended rates reflect consideration of all relevant statutory criteria.

D. Incremental Cost

[4043] In Docket No. R97-1, the Postal Service developed incremental costs for all mail subclasses and for six pairs of subclasses. Witness Panzar presented a methodology for calculating the incremental costs and witness Takis carried out the calculations. As noted above, the incremental cost test is used to identify cross subsidies and, in Docket No. R97-1, the Commission accepted witness Panzer's description of that test, *i.e.*, that "[t]he 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." PRC Op. R97-1, para. 4022. In Docket No. R97-1, the Commission made no use of witness Takis' incremental cost estimates because, *inter alia*, those estimates were based on cost models that the Commission rejected. *Id.*, para. 4053. Nonetheless, the Commission commended the Postal Service's effort, highlighting certain advantages of its approach. *Id.*, para. 4055.

[4044] In addition, the Commission identified several deficiencies in that approach, including, for example, that the six product combinations were inadequate, that the Postal Service failed to apply the incremental cost test, and the difficulty in converting from base year to test year using a simple ratio approach. *Id.*, para. 4056.

[4045] Witness Bradley endeavors to address the Commission's concerns. Thus, for example, the number of product combinations examined is expanded to 32; witness Mayes applies the incremental cost test; Exhibit USPS-32E; and, in lieu of a simple ratio method, the new method separates volume variable and fixed costs and applies a roll-forward factor to each. See USPS-T-22 at 42-45.

[4046] In general, the Postal Service calculates base year incremental costs as the costs that are avoided when one or more products are eliminated while the remaining postal products are still provided without changes in the operating plan. In Docket No. R97-1, the Commission questioned the validity of the assumption that the operating plan would remain unchanged if a large subclass or combinations involving substantial volumes of mail were eliminated. PRC Op. R97-1, para. 4056. Witness Bradley notes

the Commission's observation concerning this no reconfiguration assumption and suggests that "the problem may not be as general as it first seems." USPS-T-22 at 48. In support, he points to his Table 3 as illustrating the "relatively few instances in which a very large proportion of the driver is caused by a single subclass." *Ibid.*

[4047] Reference to Table 3 does not dispel the view that elimination of a large subclass or combinations involving substantial volumes would render the operating plan irrelevant. Certainly, the assumption is doubtful concerning any combination including the elimination of First Class or Standard A. Moreover, it is questionable whether the plan would remain unchanged if other subclasses or combinations, e.g., Parcel Post or Priority involving a significant portion of some cost component, were eliminated. The suggestion that the problem may not be as great as it seems is not sufficiently supported. Table 3 indicates the share of the largest product in 26 components ranges from 16.1 percent to 58.3 percent, most or all of which appear to be large enough to impact operating plans if eliminated.

[4048] The major concern with the Docket No. R97-1 proposal was a dependence on the accuracy of assumed or fitted cost functions over considerable volume ranges. The cost functions were used to sum the marginal costs avoided from eliminating product(s). Since the Commission rejected the cost functions proposed for mail processing, it was also necessary to reject the incremental costs calculated with them. In this proceeding, the Postal Service attempts to remedy the dependence on cost functions by adopting the Commission's procedures for rolling forward base year costs to the test year.

[4049] In the rollforward process, the volume effect calculations essentially assume variabilities to be constant over the range of anticipated volume changes. Witness Bradley endorses, at least implicitly, the validity of this assumption. See *Id.* at 43. ("The new method of calculating incremental cost is entirely consistent with the established methodology for calculating test-year attributable costs.") Witness Bradley further buttresses the use of a constant variability, by noting that volume reductions from eliminating even the large postal products are within the range of data in the data sets

used to calculate component cost variabilities: “In other words, data sets like HCSS, CCS and MODS all have variations in their ‘volume’ variables that exceed 50 percent of the mean value.” *Id.* at 46.

[4050] The assertion that the constant elasticity assumption frees the calculation process from the underlying cost function or method that is used to develop the variability is overly optimistic. Indeed, in another forum, witness Bradley indicates that the assumption of a constant elasticity is equivalent to assuming a cost function with an exponential form.⁵⁶ Witness Bradley recognizes that the use of a constant variability provides an approximation of the true incremental costs. USPS-T-22 at 45. Thus, the validity of the Postal Service’s assumption depends on how well the exponential cost function approximates costs.

[4051] While acknowledging that his method assumes constant elasticity, witness Bradley contends, based on previous research, that incremental costs are not sensitive to that assumption. *Id.* at 45-46.⁵⁷ In the cited research, a simulation is used comparing the costs with the translog and constant elasticity functions to demonstrate a close approximation for selected cases. The results show a close approximation for the cases examined when eliminating volumes representing less than 15 percent of the total. The results are limited to the cases examined. However, the research indicates that when more than one cost driver is involved, biases can develop that may overestimate the incremental costs. See Bradley Research at 13-14. This may indicate a potential problem in the calculation of city carrier elemental load costs due to the dependence on both pieces delivered and shape.

[4052] For the smaller subclasses, the approximation of true cost function to an exponential form may be acceptable. However, what constitutes small and what level of approximation is acceptable is not yet apparent. Additional research is warranted on the

⁵⁶ See Michael D. Bradley, Jeff Colvin, and John Panzar, “Issues in Measuring Incremental Costs in a Multi-function Enterprise, *Managing Change in the Postal and Delivery Industries*, Kluwer Academic Publishers, 1997 at 9 (Bradley Research).

⁵⁷ The reference work is: Bradley Research, *supra*, at 10-13.

sensitivity of incremental costs to the constant variability assumption, with simulations using a range of possible cost functions.

[4053] Lastly, the range of volume changes in the rollforward process is on the average 1.75 percent and on a subclass basis ranges from 0.5 to 8.5 percent. These changes are considerably less than the volumes that would be eliminated from dropping most postal products in calculating incremental costs. Therefore, it is questionable if the analogy to the rollforward process is applicable.

[4054] The Commission remains interested in continuing the development of the incremental cost test to the point that it can be applied to reliably identify cross subsidies in proposed rates. Witness Bradley's testimony improves upon witness Takis' Docket No. R97-1 application of the test, but still leaves the Commission uncertain about the impact of the assumptions of constant variability and the stability of operating plans when major postal services or major groups of services are eliminated. On the other hand, the test in the form proposed by witness Bradley ought to be a reliable test for cross subsidies among the small subclasses where the assumptions of constant variability and stability of the operating plan are less problematic.

[4055] On the whole, it appears to the Commission that the test proposed by witness Bradley would be most reliable where it is least needed. The Commission's attributable cost floor serves as an effective screen for small subclasses because incremental cost for individual subclasses equals the Commission's definition of attributable cost when marginal costs are constant. Marginal costs are approximately fixed for the small changes in cost drivers that are involved in applications of the incremental cost test for small subclasses, but probably not for the substantial changes that are involved for the large subclasses. The Commission has not employed witness Bradley's incremental cost test in this proceeding because it suspects that the results of the test may still be unreliable where deleting a subclass or combination of subclasses causes a large reduction in an important cost driver.

V. RATES AND RATE DESIGN

A. Express Mail

[5001] Express Mail is a premium service advertised as offering guaranteed next-day and second-day delivery nationwide for mailable matter weighing up to 70 pounds, but not exceeding 108 inches in length and girth. Computerized Tracking and Tracing gives customers information on the acceptance, arrival at the destination post office, and the delivery of Express Mail. If performance standards are not met, postage will be refunded. Postal Service witness Plunkett describes Express Mail service options as: (1) Next Day and Second Day Post Office to Addressee Service (representing 98 percent of Express Mail volume), (2) Next Day and Second Day Post Office to Post Office Service, (3) Custom Designed Service, and (4) Same Day Airport Service. USPS-T-36 at 2-4. The latter has been suspended for security reasons but the Service wants to retain it in the DMCS. *Id.* at 3.

[5002] Express Mail rates are unzoned and rounded to the nearest nickel. A letter rate for items weighing up to eight ounces is available. For Post Office to Addressee or Post Office to Post Office Services, the Service offers a two-pound rate for pieces that fit into a standardized flat-rate envelope. This standardized envelope, labeled as E P13F, is widely distributed at no charge by the Postal Service, *e.g.*, in post offices and through the Service's web site.

[5003] Plunkett says that Express Mail volume grew rapidly between its inception in FY 1971 and FY 1985, but that in FY 1986, volume declined nine percent. He attributes this to a 15 percent increase in rates, competition from private carriers, and airline service problems that affected Express Mail service quality. *Id.* at 5. Declines in FY 1991-93 are attributed to another rate increase, but since then volume has grown at an average annual rate of 4.6 percent. Plunkett says that the effect of rate increases

from R97-1 can not yet be measured directly; however, the before rates volume forecast (USPS-T-8, Table 1) calls for test year before rates volume to be approximately unchanged from FY 1998.

[5004] Plunkett projects Express Mail to produce a test year cost coverage of 210 percent before rates (USPS methodology), with revenues of just over \$1 billion, and costs of \$483 million including contingency. The effect of the proposed rates is to increase revenue by \$48 million. Costs increase slightly due to a modest volume increase. As a result, cost coverage after rates increases to 218 percent. To meet this cost coverage target Express Mail rates must be increased by an average of 3.76 percent. The Service proposes no structural changes to the Express Mail rate schedule.

[5005] Rate increases for each rate element were constrained to be no more than 4.5 percent, consistent with rounding constraints, and rates for Post Office to Addressee are set to be at least twice the Priority Mail rates for zone 5. The letter rate (78 percent of Express Mail volume) would be increased from \$11.75 to \$12.30, or about 4.7 percent. For pieces weighing between 20 and 35 pounds, Plunkett manually adjusts rates to preserve reasonable relationships between adjacent weight cells.

[5006] Postal Service witness Mayes states that the rate levels proposed for Express Mail are appropriate for an expedited and competitive service of relatively high value, and that the class of mail has demonstrated sufficient stability in costs and volumes to be able to endure the relatively low rate increase required to obtain this rate level. USPS-T-32 at 28 *et seq.* She contends that Express Mail's value of service (criterion 2) is very high. It receives the highest priority of delivery, uses air transportation extensively and has a substantial collection system. It benefits from tracking capability and a service guarantee. On the other hand, its price elasticity, at (1.565), is the highest own-price elasticity of all the subclasses, indicating an extremely low economic value of service. Similar expedited services provided by private companies may be viewed as more valuable because their overnight service areas are more extensive. Additionally, the Postal Service does not extend credit to its customers.

[5007] Mayes says that the 3.8 percent increase, well below the system average, will have a modest and reasonable effect on mailers (criterion 4), even considering the high own-price elasticity of demand for this product. Because of its small presence in the market for expedited delivery and its modest growth, the proposed rate increase should not have a significant effect on competitors. She notes the Express Mail rate schedule provides for separate rates depending on whether the customer picks up the Express Mail at the post office or has the item delivered by the Postal Service, and whether the piece is dropped off at the post office or picked up by the Postal Service. The customer who drops off or picks up the piece at the post office reduces postal costs and the rate schedule reflects this cost-saving activity with lower rates (criterion 6). Revenues clearly and significantly exceed the costs associated with Express Mail (criterion 3). She concludes the proposed rate level is fair and equitable (criterion 1), reflecting a consideration of all the relevant criteria, including the effects on Express Mail users as well as competitors.

[5008] On brief, United Parcel Service (UPS), after concluding that Express Mail demonstrably has a high value of service, recommends a 13 percent rate increase using FY 1998 data and a 17 percent increase using FY 1999 data. UPS Brief at 65-66. The UPS sponsored witness Luciani to perform costing analyses for Parcel Post, Priority, and Express. Tr. 25/11789-90, Tr. 38/17246.

[5009] Intervenors David Popkin and Douglas Carlson conclude there are a number of service problems with Express Mail that have widespread implications. Popkin Brief at 10-11, Carlson Brief at 24-26. Popkin says that when the Service accepts Express Mail which it knows cannot meet the guaranteed delivery time (e.g., because of a lack of transportation), it is engaging in false advertising and perpetuating a fraud on the mailing public. Carlson echoes the concern about the Service accepting Express Mail when the “guaranteed” delivery cannot be made and says the Commission should recommend that the Service develop a new class of Express Mail service guaranteeing delivery on the next day that delivery services are possible. Carlson also contends retail terminals should provide information on service commitments the Service can actually meet so

consumers can decide whether they really want to pay the premium Express Mail rates. Carlson Brief at 26.

[5010] The Postal Service in responding to DBP/USPS-62 notes that about 91.2 percent of Express Mail articles are delivered on time (Tr.21/8730) and that only 1-2 percent of those senders entitled to apply for a refund actually do so (Tr. 46C/20762). He concludes that the requested increase in Express Mail rates should be denied until the Postal Service is able to design its service to be capable of delivering what is guaranteed. The Service disagrees with the UPS proposed rate increase, saying that most of the Luciani costing adjustments are inappropriate. Postal Service Reply Brief at V-25. It also argues that UPS and Luciani did not address the statutory pricing criteria.

[5011] *Commission Analysis.* The Commission concurs with witness Mayes' assessment of the statutory criteria. Conversely, the UPS proposal, if recommended, could severely harm mailers. Both volume trends and the costs for this service have recently become stabilized, and a sharp increase in rates would disrupt those mailers that have come to rely on this service. A 17 percent increase also would harm the Service, which points out that Express Mail competes in a highly competitive market, and that large rate increases may have stunted Express Mail growth at various times.

[5012] The Commission finds that the UPS proposal is not analytically well founded. While UPS uses cost adjustments presented by Luciani to support its rate increase argument, it essentially offers nothing more than a generalized justification for its proposed pricing changes: "The Commission should adopt that rate increase in order to begin to restore Express Mail's cost coverage to a level that is more appropriate for the Postal Service's premium service offering." UPS Brief at 66. Indeed, Luciani appeared to engage in his Express Mail pricing analysis almost as an afterthought, since he states his Express Mail "calculation was performed for illustrative purposes to assist the Commission in its considerations of the UPS recommended costing changes." Tr. 25/11901.

[5013] The Commission recommends a cost coverage for Express Mail overall of 151 percent, resulting in a cost increase of 3.6 percent. Although the Commission

agrees that Express Mail has a high value of service, this view is tempered by the Carlson and Popkin arguments concerning quality of service. The Commission is concerned that the Postal Service is not properly informing consumers about the limitations of its delivery network, and that the Postal Service accepts Express Mail knowing that the published delivery standards are impossible to achieve. The Commission suggests the Service review its overall advertising and consumer information for Express Mail so that consumers are made aware of potential limitations of the service. The Commission also is concerned about the high on-time failure rate (8.8 percent), which seems inconsistent with a guaranteed service. Express Mail provides the most rapid service available from the Postal Service, but it is already quite costly, and its quality of service can not really be considered “premium”. The intrinsic value of service ascribed to Express Mail seems to justify an increased cost coverage and a markup index near the systemwide average, but not the double digit rate hike suggested by UPS.

B. First-Class Mail

[5014] *Introduction and Summary.* In this proceeding, the Postal Service proposes a one-cent increase in the rate for single-piece First-Class Mail weighing one ounce or less, thereby raising the price of the First-Class stamp from 33 cents to 34 cents. A one-cent increase in the additional ounce rate is also proposed, increasing the rate from 22 cents to 23 cents. The Service correspondingly proposes a one-cent increase for single-piece cards, increasing the rate from 20 cents to 21 cents.

[5015] The Postal Service proposes maintaining the nonstandard surcharge at 11 cents for single piece letters weighing one ounce or less, and 5 cents for presort/automation letters weighing one ounce or less. Also, the Postal Service proposes maintaining the heavy piece discount at 4.6 cents per piece.

[5016] Under the Postal Service proposal, the nonautomation presort letter discount decreases from 2.5 cents to 2 cents. This increases the price for sending a nonautomation presort letter from 30.5 cents to 32 cents. All automation letter discounts are proposed to remain at their present levels in relationship to the first-ounce single-piece rate, which effectively decreases the discount on a percentage basis in comparison to the single-piece rate. By maintaining the current discount levels, the price for sending mail in each of the four automation letter categories increases by one cent, corresponding to the one-cent increase in the single-piece rate.

[5017] The Postal Service proposes a classification change to the automation flats 3/5-digit category by splitting the 3/5-digit category into separate 3-digit and 5-digit categories. This proposal parallels the rate structure now in place for letters and cards. The proposed new rate for the 3-digit category is 29.5 cents and for the 5-digit category is 27.5 cents. The net effect is a discount increase of approximately 0.3 cents above the current 3/5-digit discount level. Also, the Postal Service proposes to increase the basic automation flats rate by one cent, from 30 cents to 31 cents.

[5018] Under the Postal Service proposal, the nonautomation presort card discount is maintained at 2 cents. This increases the nonautomation card rate from 18 cents to

19 cents. The Postal Service proposes to slightly increase the basic automation cards discount by 0.2 cents. This has a ripple effect that also increases the 3-digit, 5-digit, and carrier route card discounts by 0.2 cents in relation to the single-piece card rate, with the discount levels between automation categories proposed to remain at their present levels.

[5019] The Postal Service proposes a 3-cent discount for Qualified Business Reply Mail (QBRM) letters and cards. This maintains the current 3-cent discount for QBRM letters, and increases the discount for QBRM cards by one cent. Under the proposal, the QBRM letter rate increases from 30 cents to 31 cents and the QBRM cards rate is maintained at 18 cents. The Postal Service proposes several rate and classification changes to the QBRM accounting function, which are separately discussed in the Special Services Business Reply Mail section of this opinion.

[5020] *Overall Impact.* The Postal Service's First-Class rate proposals reflect an average class wide increase of 3.6 percent, based on increases of 3.5 percent for letters and 5.0 percent for cards. The Postal Service expects these increases to generate revenues that are 197.1 percent of its calculated volume variable costs for letters and 148.5 percent of volume variable costs for cards.

[5021] *Recommendations for Single-Piece Letters and Cards.* For the first ounce of single-piece letter mail, the Commission recommends the one-cent increase the Postal Service has requested. However, the Commission recommends maintaining the 20-cent single-piece card rate.

[5022] *The Rate for Additional Ounces of First-Class Mail (Single-Piece and Presorted.)* The Commission recommends decreasing the additional ounce rate from 22 cents to 21 cents.

[5023] *Nonstandard Surcharges, Heavy Piece Discount.* The Commission recommends maintaining the nonstandard surcharge at 11 cents for single-piece letters and 5 cents for presort/automation letters. The Commission also recommends maintaining the heavy piece discount at 4.6 cents.

[5024] *Worksharing Rates and Discounts.* The Commission recommends the nonautomation presort letters rate as proposed by the Postal Service. The Commission recommends cost-based rates for the automation letters category that are lower than the rates proposed by the Postal Service, except for the 5-digit automation letters rate. The recommended rates for automation letters are: 27.8 cents for basic automation letters, 26.7 cents for 3-digit letters, 25.3 cents for 5-digit letters, and 24.3 cents for carrier route letters.

[5025] The Commission recommends the classification change proposal to split the 3/5-digit flats category into separate 3-digit and 5-digit flats categories. The Commission recommends the worksharing rates for flats at the rates proposed by the Postal Service.

[5026] The Commission recommends maintaining the 18 cents nonautomation presort cards rate. The Commission recommends cost-based discount rates for the automation cards category that are lower than proposed by the Postal Service. The recommended rates for automation cards are: 16.4 cents for basic automation cards, 15.8 cents for 3-digit cards, 15.1 cents for 5-digit cards, and 14.0 cents for carrier route cards.

[5027] *QBRM.* The Commission recommends the proposed 3-cent discount for both QBRM letters and QBRM cards. Recommendations to reduce the per piece QBRM fees are discussed separately in Chapter 5, Section F. 4, the Special Services Business Reply Mail section.

[5028] *Intervenors' First-Class Mail proposals.* E-Stamp, Stamps.com, Pitney Bowes, American Bankers Association (ABA), National Association of Presort Mailers (NAPM), Major Mailers Association (MMA), and the Office of the Consumer Advocate (OCA) have each presented additional proposals in this docket that potentially could affect rates, classifications, or rate case procedures.

[5029] E-Stamp and Stamps.com individually propose a worksharing discount for Information Based Indicia Program (IBIP) mail. The Commission recommends, as a "shell" classification, a discount for IBIP mail where the indicium of postage is printed

directly on the mail piece. The Commission does not recommend a discount at the proposed 4-cent rate, or a discount for IBIP postage printed on labels.

[5030] Pitney Bowes proposes a one-cent discount for First-Class Mail that uses metering technology to produce the indicia of postage. The Commission does not recommend this proposal.

[5031] MMA, NAPM, and ABA&NAPM propose extending the heavy piece discount to workshare pieces weighing between one and two ounces. Each intervenors' proposal differs in applicability to letters, flats, or letters and flats. The Commission does not recommend these proposals.

[5032] ABA&NAPM propose to maintain the current additional ounce rate. The Commission recommends an additional ounce rate based on Commission methodology, but incorporating some of the ABA&NAPM suggestions.

[5033] ABA&NAPM and MMA propose changes to the First-Class automation discount rates proposed by the Postal Service. Commission recommends automation discount rates based on Commission methodology, that incorporates some of the ABA&NAPM and MMA suggestions.

[5034] ABA&NAPM propose a worksharing discount for mail collected in private collection boxes, presorted to the greatest extent possible by workshare mailers, and then delivered to the Postal Service. The Postal Service would print and sell "P" rate stamps at a 2-cent discount from the single-piece First-Class letter rate. The Commission does not recommend this proposal.

[5035] The OCA has presented several First-Class Mail proposals in this docket. The first is a renewal of the Courtesy Envelope Mail (CEM) proposal for courtesy reply mail pieces. Under the proposal, CEM mail would receive a 3-cent discount based on the QBRM cost savings. The Commission again recommends the CEM proposal as a "shell" classification. The OCA proposes the elimination of the nonstandard surcharge for low aspect ratio letters. The Commission does not recommend this proposal. The OCA proposes to retain the 33-cent First-Class letter rate. Although the Commission does not specifically recommend this proposal, the Commission has taken into

consideration the data presented in the proposal in recommending the First-Class letter rates. The OCA puts forth a First-Class single-piece rate stability proposal. The Commission does not recommend this proposal. The OCA proposes the establishment of a rates working group. The Commission always encourages informal communication between parties to resolve issues without Commission intervention. The Commission supports, but does not recommend this proposal on a formal basis. Finally, the OCA proposes that the Postal Service provide mailers with 10 one-cent make up stamps combined with an informational mailing. The Commission sees benefits in this proposal, and recommends that Postal Service management give this idea consideration.

[5036] *First-Class Letters and Sealed Parcels Rates*. Table 5-1 presents a comparison of current, proposed and recommended First-Class Mail rates.

1. Letters and Sealed Parcels Rates and Classifications

a. Preliminary Considerations

[5037] First-Class Mail consists of mailable matter weighing 13 ounces or less. All mailable matter weighing 13 ounces or less may be sent as First-Class Mail. USPS-T-33 at 5. The proposals addressed in this section affect the Letters and Sealed Parcels subclass, and the Cards subclass of First-Class Mail. The Postal Service proposals maintain the existing composition of the First-Class Mail subclasses and the major worksharing rate categories, except for a proposal to split the automation flats 3/5-digit category into separate 3- and 5-digit categories.

[5038] Postal Service witness Fronk presents the Service's First-Class Mail rate and classification proposals. *See generally* USPS-T-33. He begins his analysis with the overall revenue requirement and subclass cost coverage targets provided by Postal Service witness Mayes. *See generally* USPS-T-32. Fronk then relies on Postal Service cost witness Miller for letters and cards worksharing cost savings calculations, and nonstandard surcharge cost data. *See generally* USPS-T-24. Postal Service witness

Table 5-1
Summary of Rates for
First-Class Letters and Sealed Parcels, and Cards

	Current	Proposed	Recommended
LETTERS AND SEALED PARCELS			
Single Piece			
First Ounce	33.0¢	34.0¢	34.0¢
Additional Ounce	22.0¢	23.0¢	21.0¢
Nonstandard Surcharge	11.0¢	11.0¢	11.0¢
Qualified Business Reply Mail	30.0¢	31.0¢	31.0¢
Presorted			
First Ounce	30.5¢	32.0¢	32.0¢
Additional Ounce	22.0¢	23.0¢	21.0¢
Nonstandard Surcharge	5.0¢	5.0¢	5.0¢
Heavy Piece Deduction	(4.6)¢	(4.6)¢	(4.6)¢
Automation			
Basic Automation Letters	27.0¢	28.0¢	27.8¢
3-Digit Letters	26.1¢	27.1¢	26.7¢
5-Digit Letters	24.3¢	25.3¢	25.3¢
Carrier Route Letters	23.8¢	24.8¢	24.3¢
Basic Automation Flats	30.0¢	31.0¢	31.0¢
3/5-Digit Flats	27.0¢	N/A	N/A
3-Digit Flats	N/A	29.5¢	29.5¢
5-Digit Flats	N/A	27.5¢	27.5¢
Nonstandard Surcharge	5.0¢	5.0¢	5.0¢
Additional Ounce	22.0¢	23.0¢	21.0¢
Heavy Piece Deduction	(4.6)¢	(4.6)¢	(4.6)¢
CARDS			
Single-Piece Cards	20.0¢	21.0¢	20.0¢
Qualified Business Reply Mail	18.0¢	18.0¢	17.0¢
Nonautomation Presort	18.0¢	19.0¢	18.0¢
Basic Automation	16.6¢	17.4¢	16.4¢
3-Digit	15.9¢	16.7¢	15.8¢
5-Digit	14.6¢	15.4¢	15.1¢
Carrier Route	14.1¢	14.9¢	14.0¢

Source: Adapted from USPS-T-33 at 4-5.

Daniel develops a new weight study that Fronk relies on that is relevant to the additional ounce rate. See *generally* USPS-T-28. In addition, Postal Service witness Yacobucci develops mail processing costs for flat-shaped mail. See *generally* USPS-T-25. Mayes concludes the Postal Service presentation by discussing how the First-Class Mail rate proposals are consistent with the statutory ratemaking criteria of the Act (§3622(b)).

b. Rates for Single-Piece (Nonpresorted) Letter Mail

[5039] *First-Ounce Rate.* The Postal Service proposes a one-cent increase in the first-ounce single-piece First-Class letters rate, thereby raising the rate from 33cents to 34 cents. This is a 3.0 percent increase. The Postal Service continues the practice of proposing this rate in whole cent increments for administrative ease and to avoid unnecessary complexity for the general public. Witness Fronk asserts the rate proposal is consistent with the proposed revenue requirement and the statutory ratemaking criteria of the Act. He states: “In view of that revenue requirement, a proposal not to change this rate would impose unreasonably large rate increases in other classes of mail. Conversely, a two-cent increase in the basic rate would unfairly relieve other mail classes of their fair share of the institutional cost burden.” USPS-T-33 at 21.

[5040] *OCA’s Proposal to Retain the Current First-Class Single Piece Rate.* OCA witness Callow proposes maintaining the single-piece First Class letter rate at 33 cents. He analyzes the rising institutional cost burden of First-Class letter mail using the cost coverage, cost coverage index, and mark-up index. He then compares the institutional cost burden of First-Class letter mail with Standard A Regular mail to show a widening gap in the indices between the subclasses of mail. Callow alleges that the increasing First-Class letter institutional cost burden shown by his analysis results in First-Class letter mail contributing revenue in excess of the share found reasonable by the Commission. He concludes by proposing a 33-cent single-piece letter rate as a method of mitigating the increasing institutional cost burden on First-Class letter mail.

Tr. 22/10104-27.

[5041] Callow examines the “actual” cost coverage, cost coverage index, and mark-up index derived from Postal Service cost and revenue data over the past twelve years for First-Class letter mail.⁵⁸ He shows that the actual cost coverage has increased from 162 percent in FY 1988 to 197 percent in FY 1999, the actual mark-up index has increased from 1.256 in FY 1988 to 1.439 in FY 1999, and the actual cost coverage index has increased from 1.084 in FY 1988 to 1.177 in FY 1999. Finally, he compares the actual mark-up index and cost coverage index to each index recommended by the Commission in the four opinions issued during the time period covered by his analysis. These comparisons show the actual mark-up index and cost coverage index to be above the recommended indices in a majority of the years depicted.

[5042] Callow continues his analysis by comparing the actual mark-up index and cost coverage index of First-Class letter mail to Standard A Regular mail. For example, he shows the actual mark-up index of First-Class letter mail rising from 1.169 to 1.439, while the Standard A Regular actual mark-up index is declining from 1.080 to 0.828 for the five years beginning in FY 1995. A similar trend is shown using the actual cost coverage indices. He also depicts similar trends when comparing the First-Class letter mail and Standard A Regular mail actual cost coverage index and mark-up index to the indices recommended by the Commission in its opinions over the same time periods. Overall, Callow shows that First-Class letter mail is contributing more in absolute terms to institutional costs than Standard A Regular mail. Furthermore, over time the relative share of institutional costs contributed by First-Class letter mail is increasing relative to the institutional costs contributed by Standard A Regular mail.

[5043] Callow claims that the rising institutional cost burden of First-Class letter mail shown in his analysis has produced substantial additional revenue for the Postal Service. He alleges that the additional revenue has exceeded the revenue contribution intended by the Commission. By using a 12-year average of the First-Class letter mark-up index taken from Commission opinions, he estimates that First-Class letter mail

⁵⁸ The word “actual” is used to signify the results of witness Callow’s analysis derived from actual Postal Service data on a yearly basis. It does not signify a test year index derived by the Commission.

has contributed \$6.8 billion more than intended by the Commission over the FY 1988 through FY 1999 time period.

[5044] In conclusion, Callow proposes maintaining the single-piece First-Class letter rate at 33 cents in order to mitigate the increasing institutional cost burden of First-Class letter mail. He alleges that recommending the Postal Service's proposed rates only maintains the status quo with respect to the First-Class letter mail institutional cost burden. Furthermore, he claims that an increase in rates cannot be justified because costs for First-Class letter mail as a share of total postal costs have declined over the time period of his analysis. Finally, he states that reducing the institutional cost burden on First-Class letters would enhance fairness and equity (§36 22(b)(1)).

[5045] *Postal Service Rebuttal.* The Postal Service opposes the OCA's proposal to maintain the current 33-cent basic rate for First-Class Mail. The Postal Service argues that witness Callow ignores the fact that Commission opinions only address cost coverages during specific test years and not the intervening years. Therefore, it is only speculation as to what the Commission might have found as acceptable cost coverages during the intervening years. From this argument the Postal Service infers that witness Callow should not suggest that the Commission focus on the historical relationships between recommended and actual institutional cost burdens for First-Class Mail in recommending a level of institutional cost burden for the subclass in this case. Postal Service Brief at VII-29-VII-31.

[5046] The Postal Service argues that the success of the automation program and changes in the mail mix have made it possible to propose a single-piece rate increase that is below the rate of inflation and below the rate of increase for the postal system as a whole. Thus, the Commission should also recognize the relative percentage rate increases between subclasses, because of the limitations of focusing on relative markups.

[5047] Postal Service witness Mayes discusses the effect that mail mix has on the indices. She states that the cost for single-piece letters is increasing and the cost for workshare letters is increasing, but the aggregate cost for all letter mail is decreasing. At

the same time, the cost coverage is also increasing, given a constant revenue per piece. This can be explained by a mail mix shift to more low cost workshare letters. Tr. 11/4505-6, 4518.

[5048] Finally, the Postal Service states that if the Commission were to maintain the 33 cent rate it could not do so based on the R97-1 decision, but would have to review the criteria of the Act based on the record in this docket. It notes that witness Callow has not provided the Commission with guidance in this area.

[5049] *Other Intervenor Positions.* The contribution to institutional costs by First-Class Mail relative to the contribution to institutional costs by Standard A Mail was a highly litigated issue in this proceeding. First-Class mailers, along with the OCA, argue that the cost coverage, which is one measure of relative contributions to institutional costs, for First-Class Mail and Standard A Mail should be similar. Similar cost coverages would decrease the contribution to institutional costs by First-Class Mail, but increase the contribution by Standard A Mail. Standard A mailers are opposed to similar cost coverages and argue for a lower cost coverage for Standard A Mail, which then necessitates a higher cost coverage for First-Class Mail. One First-Class mailer, MMA, suggests increasing the first-ounce single-piece First-Class rate, which will increase the First-Class Mail contribution to institutional costs. At the same time, MMA proposes to mitigate this increase by suggesting changes to the heavy piece discount and raising the workshare discounts. The different intervenor positions as summarized below.

[5050] ABA&NAPM witness Clifton argues that the cost coverage for First-Class workshared Mail has become discriminatory relative to Standard A commercial mail and single-piece First-Class Mail. His analysis shows that since 1994 the cost coverage for First-Class presort mail has increased, and caused the cost coverage for all First-Class Mail to rise above the system wide average, while Standard A Regular mail has continued below the system wide average. He concludes that the trend between cost coverages for single-piece versus workshared mail in the allocation of institutional costs shows unfair, inequitable, and discriminatory treatment toward workshare mailers.

Tr. 26/12458-62.

[5051] On brief, Association for Postal Commerce and Mail Advertising Services Association International (PostCom/MASA) oppose the proposals offered by OCA witness Callow and by ABA&NAPM witness Clifton. PostCom/MASA states the rationales behind the proposals are not sound. It views both proposals as arguments for shifting institutional cost burdens from First-Class Mail to Standard A Mail. PostCom & MASA Brief at 6-14.

[5052] PostCom/MASA asserts that one theme of Clifton's testimony is that the cost coverage of First-Class and Standard A mail has impermissibly deviated from standards articulated in the Docket No. R90-1 decision. They also infer that Clifton may consider some of the rates at issue unlawfully violate provisions of the Act. PostCom/MASA concludes that the Commission has broad discretion and is not bound by the standards set forth in Docket No. R90-1, as allegedly argued by Clifton.

[5053] PostCom/MASA interpret Callow's testimony as arguing First-Class letter mail contributions to the Postal Service's institutional costs have exceeded the revenue contributions intended by the Commission. PostCom/MASA proffers a possible explanation for this occurrence. They argue that an internal change in the First-Class mail mix to a higher proportion of more profitable First-Class mail pieces results in contributions above the cost coverages set by the Commission. PostCom/MASA concludes that a rate freeze should not be substituted for the Commission's analysis of the statutory criteria for institutional cost coverage based on inexact volume/mix projections.

[5054] On brief, Direct Marketing Association, Inc. (DMA) also concludes the relevant statutory criteria supports giving First-Class Mail a substantially higher cost coverage than Standard A Mail. Therefore, the record also supports decreasing the proposed Standard A cost coverage relative to First Class. DMA contends that the arguments made by OCA witness Callow and ABA&NAPM witness Clifton in support of maintaining the single-piece First-Class rate are fatally flawed. The alleged common flaw is that Callow and Clifton do not base their positions on evidence on the record in

this proceeding. DMA further states that Callow and Clifton do not address the statutory pricing factors relative to this docket's record. DMA Brief at 4-9.

[5055] Greeting Card Association and Hallmark Cards, Inc. address the trend of First-Class Mail bearing an increasing institutional cost burden on brief. They argue the Postal Service effort to increase the institutional cost burden on First-Class Mail is inconsistent with considerations of fairness, the educational cultural, scientific, and informational value of First-Class Mail, and the legislative purpose of postal regulation as a protection for the captive mailer. GCA & Hallmark Brief at 1, 3-7.

[5056] Major Mailers Association (MMA) suggests that the Commission recommend the Postal Service's one-cent increase in the first ounce and additional ounce rates. MMA also suggests that the First-Class Mail revenue burden be lowered by applying the heavy piece discount to workshared letters weighing between one and two ounces, and increasing the workshare discounts. MMA witness Bentley reviews several previous decisions and concludes that the Commission is in the same situation that it faced in Docket No. R97-1. Bentley testifies that rejecting the one-cent First-Class single-piece rate proposal would have a potentially adverse impact on other mailers. "[E]ach penny decrease in the proposed 34-cent First Class rate represents about \$1 billion of net revenue loss that would have to be made up by other classes." Tr. 26/12281, *see also id.* at 12279-83.

[5057] MOAA argues against decreasing the cost coverage of First-Class Mail in relation to Standard A Mail. MOAA alleges that Clifton has disregarded past Commission decisions and uses data that ignores increases in revenue and contribution for Standard A Mail in his analysis. Therefore, no basis exists for increasing the Standard A Mail cost coverage. Tr. 44/19313-20.

[5058] *Commission Analysis.* The Commission recommends a first-ounce single-piece First-Class letter rate of 34 cents. The first-ounce single-piece rate is the most prominent rate in the eyes of the public, and has the single greatest impact of any rate on Postal Service revenue. All of the First-Class letters and flats worksharing discounts are set in relation to this rate. The additional revenue generated by a one-cent

increase from 33 cents to 34 cents is approximately \$940 million. This additional revenue is essential in meeting the Postal Service revenue requirement. Without this additional revenue, the rates of the other classes of mail would have to increase significantly to make up the revenue shortfall.

[5059] OCA witness Callow shows through a variety of indices that the contribution to institutional cost by First-Class letter mail is increasing. Postal Service witness Mayes proffers a logical explanation that some of this increase may be due to a shift in the mail mix from higher processing cost single-piece mail to lower processing cost worksharing mail. The net effect is that the contribution to institutional costs by single-piece mailers is not rising as rapidly as the aggregate of all First-Class letter mail.

[5060] This may mean that the institutional cost burden on First-Class workshare mail is increasing. However, when discounts pass through 100 percent of avoided costs to the workshare mailer, the contribution made by that mailer to institutional costs is the same as the mailer would have made without worksharing. Thus, workshare mailers and non-workshare mailers provide the same contribution, which is fair and equitable. In this case the Commission has set the majority of the recommended discounts for First-Class to pass through 100 percent of the avoided costs. This maximizes the discounts and effectively reduces the institutional cost burden on workshare mailers as much as possible.

[5061] The Commission also recommends reducing the additional ounce rate in this opinion. As pointed out by witness Clifton, there is no cost justification for the rapid relative escalation in the First-Class rates for heavy letters. This rate produces important revenue, but a reduction in the rate should further reduce the institutional cost burden on First Class Mail. Furthermore, it is consistent with the reductions the Postal Service suggests for heavy (pound rate) Standard A Mail.

[5062] The Postal Service is critical of Callow's analysis because it applies Commission recommended cost coverages to years other than test years. The Service also suggests that the Commission should look at relative rate increases between subclasses instead of comparing indices. The Commission examines rates from several

different perspectives as a check on its rate analysis and recommendations. It is not illogical to look at trends in the indices as witness Callow has, or to use Commission recommended indices as an approximation during the intervening years. What Callow has successfully done is to depict a trend. However, this trend is only one factor to be examined in a very complex process. As the Postal Service suggests, the Commission also looks at relative rate increases, and rate increases compared to the rate of inflation as other checks to its recommendations.

[5063] The Commission briefly considered fractional rates for single-piece First-Class Mail to alleviate the restrictions caused by the integer constraint and reduce the institutional cost burden on First Class Mail. Fractional rates are one of the aspects of the OCA's rate stability proposal that the Commission found interesting. However, a record was not developed in this docket that would allow the Commission to seriously consider single-piece fractional rates at this time.

[5064] Recommending the single-piece First-Class rate entails balancing several unpleasant choices. As MMA noted, each penny of this rate affects hundreds of millions of dollars in Postal Service revenue that would otherwise be assessed to other mail classes. Balancing this is the already high institutional cost contribution of First-Class mailers. On the other hand, the rate increase for First-Class Mail is in line with inflation, and is lower on a percentage basis than the system wide rate increase. For these reasons, the Commission recommends the Postal Service's proposed first-ounce single-piece rate.

c. Proposals Affecting Rates and Discounts for Workshared Mail
(Letters and Flats)

[5065] The Postal Service proposes to reduce the nonautomation presort letters discount from 2.5 cents to 2 cents. The 1999 IOCS method may have caused the costs of nonautomation presort to be overestimated. The cost savings from presortation is smaller than the proposed discount. The Service cautions that this discount may be smaller in the future. No participant comments on this proposal, and thus the

Commission recommends the suggested 2-cent discount. Also, a 2-cent discount represents a significant reduction of the current 2.5-cent discount.

[5066] The Postal Service proposes to maintain the current rate structure for First-Class automation letters, and increase the rate in each category by one cent. This results in proposed rates of 28cents for basic automation, 27.1cents for 3-digit automation, 25.3 cents for 5-digit automation, and 24.8 cents for carrier route automation.

[5067] The Postal Service estimates savings from worksharing activities using a method similar to that employed by the Commission in Docket No. R97-1. However, Postal Service witness Miller proposes some significant modifications to the accepted methodology, and proposes rates that are not strictly cost-based.

[5068] The CRA derived mail processing unit costs, which Miller uses in his model, are based on the Postal Service's proposed mail processing cost attribution as calculated by witnesses Bozzo, Degen, and Van-Ty-Smith. Tr. 7/3037. Also, the CRA derived mail processing unit costs for nonautomation presort letters and automation non-carrier route letters are isolated and utilized. In prior cases, these costs had been combined into one cost for "non-carrier route presort."

[5069] Miller reclassifies the CRA cost pools into those he deems worksharing related (proportional), worksharing related (fixed) and non-worksharing related (fixed). As in R97-1, the worksharing related proportional costs are used to calculate a proportional (multiplicative) CRA adjustment factor, and the worksharing related fixed costs make up the fixed (additive) CRA adjustment factor. These factors are applied to the modeled costs to determine the mail processing cost of each rate category for purposes of calculating avoided costs, or savings. Unique to this case is the Postal Service's proposal to exclude those pools it now defines as non-worksharing related from the determination of cost avoidance. *Id.* at 3072-74.

[5070] *Intervenor's Positions.* ABA&NAPM witness Clifton proposes letter rates of 27.4 cents for basic automation, 26.2 cents for 3-digit automation, and 24.5 cents for 5-digit automation. He justifies these rates based on his estimation of worksharing

savings, which he calculates using a method that differs from that proposed by the Postal Service. Tr. 26/12394.

[5071] Clifton advocates abandoning the use of bulk metered mail (BMM) as the benchmark for First-Class workshared mail. He argues that BMM has become a hypothetical type of mail, which does not exist in the mail stream. Mail that does not exist cannot convert to worksharing, and therefore is not an appropriate benchmark. While Clifton uses metered mail letters (MML) as the benchmark in his calculations, he claims that if his “P” rate proposal were in place, aggregate single piece letter costs would be the appropriate benchmark. *Id.* at 26/12418-22; *see also*, ABA&NAPM Brief at 18-19.

[5072] Clifton agrees with many of the Postal Service classifications of the worksharing related cost pools between proportional, and fixed. However, he argues that 12 of the pools Miller classified as non-worksharing related should instead be considered worksharing related. For each pool in question, Clifton asserts that much or most of the difference in cost between the benchmark and automation letters is due to work performed by mailers which helps the Postal Service to avoid or reduce costs. Tr. 26/12469-73.

[5073] Clifton addresses the implications of updated information provided by the Postal Service in response to PRC Order No. 1294 (May 26, 2000) in his supplemental testimony. Therein, he states that as a result of the update to FY 1999 data, avoided costs did not change appreciably from those based on F Y1998 data. He also states his belief that “other cost change factors” and “breakthrough productivity” savings incorporated into the Postal Service’s update are skewed and biased against First-Class mailers. To remedy this, Clifton suggests that if the Commission is to use the FY 1999 data, it should modify the cost data using what he terms “balanced cost reductions”. Essentially, he proposes to reduce several mail processing cost pools for First-Class automation letter mail to the level of their Standard A counterparts. Tr .45/20086-98.

[5074] The Postal Service’s supplementary response to P.O. Ruling R2000-1/116 presents cost avoidance figures based on F Y1999 costs recast using the 1998 method

of distributing IOCS tallies between automation and nonautomation letters.

Tr. 46C/21071-72. In his testimony, Clifton suggests that perhaps the best way to deal with the conflicting estimates of cost savings between the IOCS methodologies is to take the midpoint of the two. Tr. 45/20146.

[5075] MMA witness Bentley also estimates First-Class automation letters worksharing related cost savings. He proposes automation letter rates of 27.8 cents for basic automation, 26.6 cents for 3-digit automation, 24.8 cents for 5-digit automation and 24.3 cents for carrier route automation. Tr. 26/12279.

[5076] Bentley estimates cost savings using methods that differ from the Postal Service methods in three ways. He uses data based on the attribution methodology approved by the Commission in Docket No. R97-1. He argues reducing attribution increases the pricing discretion of the Postal Service. Also, he argues, the Postal Service has traditionally assigned an excessive portion of institutional costs to First-Class Mail. *Id.* at 26/12287-90.

[5077] Bentley rejects the Postal Service's proposed new non-worksharing related cost pool classification. Instead he applies the two category system used in R97-1. In his direct testimony, he questions the statistical reliability of IOCS data by specific cost pool. He argues that the accuracy of the final results is improved by including all of the cost pools in the analysis. Bentley also finds the Postal Service's explanation of the differences in excluded cost pools between the benchmark and automation letters unsatisfactory. He concludes that, if the cause of lower costs is in doubt, it is best to include the difference in the analysis. *Id.* at 12291-94.

[5078] Bentley describes mail preparation requirements that mailers must meet to qualify for discounts in his revised supplemental testimony. He asserts that some of these preparations help the Postal Service to save money in platform operations, and that these savings should be included in the estimation of savings from worksharing activities. Bentley takes exception to the Postal Service's exclusion of cancellation and mail preparation costs from the bulk metered mail (BMM) benchmark and from the cost savings estimation. He claims that BMM mailers do not face, sleeve and otherwise

prepare their mail in the same manner that workshare mailers are required to do, and so the assumption that BMM incurs no mail preparation costs is invalid. Tr.44/19087-90.

[5079] For this and other reasons, he uses metered mail letters (MML) as the benchmark, instead of bulk metered mail. Bentley states that as time has passed, the mail converting to worksharing has become less “clean.” He concludes that the mail most likely to convert to workshare no longer resembles BMM. Tr .26/12294-97.

[5080] Bentley urges the Commission to consider three attributes of presorted letters that he claims add 2.8 cents of cost savings, separate from and above the cost savings estimated in his more traditional model. He estimates that the requirement that reply envelopes enclosed in workshared letters meet automation specifications saves the Postal Service 0.46 cents per First-Class automation letter. He also estimates savings of 0.9 cents per piece resulting from the required compliance with Move Update programs. Finally, Bentley estimates that window service costs average 1.5 cents per single piece letter, and he points out that workshared mail does not incur these costs. While he does not rely on these savings to justify his proposed discounts, Bentley urges the Commission to consider them in its rate design. *Id.* at 12297-99.

[5081] Bentley states that because of the number and timing of the Postal Service’s updates and revisions, he was not able to sufficiently analyze each of the revisions on the record related to the updating for FY1999 data and the differing IOCS tally methods. Therefore, he recommends that the Commission should not rely on MMA’s updated estimates of cost savings, and instead insert whatever costs the Commission accepts into his cost model. Tr .44/19077.

[5082] Table 5-2 presents a comparison of the current worksharing discount rates with the discount rates proposed by the Postal Service, ABA&NAPM, and MMA.

[5083] *Postal Service Rebuttal.* The Postal Service’s arguments in defense of its attribution methodology are discussed in the mail processing variability portion of the costing section of this decision. See Chapter II A, and Appendix F.

[5084] The Postal Service defends the statistical reliability of the cost pool estimates. The Service points out that the pools classified as worksharing-related by

Table 5-2
Comparison of First-Class Letter Mail Worksharing Discount Rates

	Current	Fronk (USPS)	Clifton (ABA&NAPM)	Bentley (MMA)
Basic Automation	27.0¢	28.0¢	27.4¢	27.8¢
3-Digit	26.1¢	27.1¢	26.2¢	26.6¢
5-Digit	24.3¢	25.3¢	24.5¢	24.8¢
Carrier Route	23.8¢	24.8¢	—	24.3¢

Source: Adapted from USPS-T-33 at 4.

Miller have the greatest number of tallies, and therefore should have the least degree of error. It states that the presence of sampling error could justify Miller's eliminating some cost pools with few tallies from the cost savings analysis. The Service also attacks Clifton's classification of cost pools as being inconsistent and arbitrary. Postal Service Brief at VII-73-VII-76.

[5085] Postal Service witness Miller criticizes Bentley's rejection of the bulk metered mail benchmark as inconsistent with his claim that he follows the method used by the Commission in Docket No. R97-1 to the extent possible. Tr. 45/19647-48. He also presents evidence suggesting that, despite the doubts of MMA and ABA&NAPM, at least some bulk metered mail does exist in the mail stream. *Id.* at 19648-49 and 19696-97.

[5086] The Postal Service has repeatedly expressed its position that the base year 1998 data used in its initial filing should be relied upon in this case. In the alternative, it takes the position that if 1999 data is used, the Commission should rely on base year 1999 First-Class Mail cost estimates that incorporate the FY 1998 IOCS methodology. Tr. 46C/21072.

[5087] *Commission Analysis.* The Commission relies on mail processing costs which do not incorporate the Postal Service's proposed cost attribution method. See Chapter II A, and Appendix F.

[5088] The Commission adopts the Postal Service's concept of excluding from the calculation of savings those cost pools which are not related to worksharing. However, activities performed to meet mail preparation standards are worksharing activities. It follows that mail processing savings which result from this work are worksharing-related savings. Because of this, some pools the Postal Service considered non-worksharing related (fixed) are reclassified as worksharing related (fixed).

[5089] The Commission continues to accept bulk metered mail as the appropriate benchmark for determining the worksharing cost savings for First-Class Mail. The Postal Service provides evidence that at least some BMM does exist in the mailstream. The Commission also views a benchmark as a "two-way street". It represents not only that mail most likely to convert to worksharing, but also, to what category current worksharing mail would be most likely to revert if the discounts no longer outweigh the cost of performing the worksharing activities.

[5090] Cancellation and mail preparation costs are affected by mail preparation activities. Therefore, the Commission does not accept the Postal Service treatment of this pool as non-worksharing related. Given that the workshared mail categories have costs in this cost pool, the Postal Service assumption that bulk metered mail actually incurs no costs in this pool is not plausible. There is no record quantification of this amount. To be conservative, the Commission uses 1/3 of the single-piece metered mail letter costs for cancellation and mail preparation as a proxy for the BMM costs, and the pool is classified as worksharing related (fixed).

[5091] The Postal Service classifies cost pools containing costs for allied mail processing operations as non-worksharing related. Postal Service witness Miller confirms that worksharing could affect the costs in platform, support, and non-MODS allied pools. Tr. 7/3152-57. The Commission finds these pools are affected by worksharing activities (including mail preparation), and treats them as worksharing related (fixed) in the calculation of First-Class Mail worksharing savings.⁵⁹

[5092] The Commission does not agree with MMA's claim that the savings from inclusion of automation compatible reply envelopes, compliance with Move Update

programs, and avoided window service should be considered in setting worksharing discounts. Including an automation compatible reply envelope in a mailpiece does not avoid mail processing costs in the original mailing. CEM and QBRM mailpieces do recognize worksharing related savings, but only when the reply mailpiece is actually mailed and undergoes mail processing. Therefore, contributions from mailpieces generated in response to a mailing are not relevant to the estimation of costs avoided by worksharing performed on the original mailpiece.

[5093] It is not appropriate to include cost savings from compliance with the Move Update program in this stage of calculating worksharing related savings. The cost pools that reflect return and forwarding costs are already included in the worksharing related cost savings estimates. Therefore, adding a separate estimate of savings from Move Update compliance would count the same savings twice. Tr. 7/3130.

[5094] In addition, the Commission continues to hold the position that window service costs are not a basis for setting worksharing discounts. Chapter V, Section B.2.b discusses a Pitney Bowes meter discount proposal essentially based on window service and stamp costs. In this discussion, the Commission agreed with the Postal Service that metered mail will not convert back into stamped mail because meter users have other reasons for applying postage with a meter. The Commission considers this a similar scenario, with mailers avoiding window costs and typically using permit indicia in place of stamps for other reasons than avoiding Postal Service costs.

[5095] The Commission uses FY 1999 costs to develop workshare savings. It uses the 1999 IOCS method for dividing tallies between nonautomation and automation letters. The 1999 IOCS method reflects a revision implemented to prevent a potential understatement of nonautomation costs, and it appears that the logic behind the change is valid. Although it expressed concern that the correction may go too far, the Postal

⁵⁹ Miller points out that platform costs are included in the calculation of destination entry discounts for Standard A letters, and so it is inappropriate to also include them in the calculation of presort and automation discounts. Tr. 7/3154. There are no destination entry discounts for First-Class Mail. Therefore in the calculation of presort discounts, platform costs are treated as worksharing related for First-Class Mail and non-worksharing related for Standard A letters.

Service does not know the potential magnitude of overstatement by the new method or understatement by the old method, and it fails to present a convincing argument supporting its preference for the 1998 method. Tr. 46C/21038-39 and 21072.

[5096] The Commission recommends discounts equal to 100 percent of the estimated worksharing related savings for First-Class automation letters and cards, with the exception of carrier route letters. The Commission recommends a one-cent discount for automation carrier route letters. This represents a doubling of the current discount of 0.5 cents, and a pass-through of 67 percent of cost savings. A larger increase in the discount is not recommended in order to avoid major disturbances in the rate structure. Table 5-3 shows the recommended discounts, cost savings estimates, and related passthroughs for First-Class Letters and Cards.

Table 5-3
Passthroughs for First-Class Workshared Letters and Cards
at Commission Recommended Rates

Category	Discount	Unit Cost Savings	Passthrough
Letters			
Presorted	2.0¢	0.4¢	500%
Automation Basic	6.2¢	6.2¢	100%
Automation 3-Digit	1.1¢	1.1¢	100%
Automation 5-Digit	1.4¢	1.4¢	100%
Automation Carrier Route	1.0¢	1.5¢	67%
Cards			
Automation Basic	1.6¢	1.6¢	100%
Automation 3-Digit	0.6¢	0.6¢	100%
Automation 5-Digit	0.7¢	0.7¢	100%
Automation Carrier Route	1.1¢	1.1¢	100%

[5097] *Recommended First-Class Mail Automation Letters Rates.* Table 5-4 summarizes the rates recommended by the Commission for First-Class automation letters.

Table 5-4
First-Class Mail Automated Letters

	Current	Proposed	Recommended
Basic Automation	27.0¢	28.0¢	27.8¢
3-Digit	26.1¢	27.1¢	26.7¢
5-Digit	24.3¢	25.3¢	25.3¢
Carrier Route	23.8¢	24.8¢	24.3¢
Additional-Ounce Rate	22.0¢	23.0¢	21.0¢
Heavyweight Deduction [†]	(4.6)¢	(4.6)¢	(4.6)¢

[†] Applicable to pieces weighing 2 ounces or more.

Source: Adapted from USPS-T-33 at 4.

d. Automation Flats

[5098] First-Class Mail automation flats currently has two rate tiers: basic and 3/5-digit presort. Postal Service witness Fronk proposes disaggregating the 3/5-digit presort tier into separate 3-digit and 5-digit tiers. The proposal is designed to recognize the additional mail preparation involved in sorting to the 5-digit level, and avoid burdening other mailers with mandatory 5-digit separations. Approximately 90 percent of the current 3/5-digit volume is sorted to the 5-digit level, and 10 percent to the 3-digit level. The basic category will continue to operate as the residual tier. Witness Fronk proposes increasing the basic rate by one cent, from 30 cents to 31 cents. He proposes setting the new 3-digit rate at 29.5cents and the new 5-digit rate at 27.5cents. The weighted average of the 3-digit and 5-digit rates is 27.7cents. This is an increase of 0.7 cents above the current 27-cent 3/5-digit rate. The proposed rates are summarized, along with the Commissions final recommendations, in Table 5-5.

[5099] Witness Fronk states that bulk automation flats rates are designed to preserve the appropriate rate relationships between automated letters and flats, and between the automation flats and the non-automation presort rate that applies to both letters and flats. With the proposed rates, barcoded flats pay less postage than

non-automation presort flats, and more postage than barcoded letters at all automation tiers. In his testimony, witness Fronk demonstrates the consistent rate relationships for two-ounce letters and flats.⁶⁰ He states that the rate proposal is consistent with the ratemaking criterion of simple, identifiable relationships among rates.

[5100] The Commission recommends splitting the 3/5-digit tier into separate 3-digit and 5-digit tiers. Participants have not opposed this proposal. The proposal is fair and equitable, recognizing the extra effort of mailers who choose to separate to the 5-digit level. It encourages mailers to sort to the greatest extent possible thereby improving Postal Service automation efficiency. The proposal also simplifies the classification schedule by making the treatment of 3-digit and 5-digit Automation Flats consistent with 3-digit and 5-digit Automation Letters. The Commission also recommends the automation flats rates as proposed by the Postal Service.

Table 5-5
First-Class Mail Automated Flats

	Current	Proposed	Recommended
Basic Automation	30.0¢	31.0¢	31.0¢
3/5-Digit	27.0¢	N/A	N/A
3-Digit	N/A	29.5¢	29.5¢
5-Digit	N/A	27.5¢	27.5¢
Each Additional Ounce	22.0¢	23.0¢	21.0¢
Heavyweight Deduction	(4.6)¢	(4.6)¢	(4.6)¢
Nonstandard Surcharge	5.0¢	5.0¢	5.0¢

Source: Adapted from USPS-T-33 at 4.

⁶⁰ The consistent relationship is more easily demonstrated for 2 ounce pieces than for 1 ounce pieces because 1 ounce pieces are subject to the nonstandard surcharge.

e. Additional-Ounce Rate Proposals

[5101] The Postal Service proposes to increase the First-Class additional ounce rate from 22 cents to 23 cents for both single-piece and presorted mail. The primary considerations in this proposal are the achievement of the revenue requirement and First-Class cost coverage. The First-Class Mail weight study presented by Postal Service witness Daniel is also loosely relied upon to protect against large disparities between the additional ounce rate and its underlying costs. USPS-T-33 at 24 (revised April 17, 2000).

[5102] In its initial proposal, the Postal Service included a test year forecast of additional ounces that was calculated using a different method than that used in previous omnibus rate cases. In prior rate cases, an assumption was made that the number of additional ounces per piece remained constant from the base year to the test year for each category of First-Class Mail (single-piece, nonautomation, automation, and carrier route). Because of the faster volume growth of lighter-weight workshared letters compared to heavier-weight single-piece letters, this method has the effect of forecasting a decline in additional ounces per piece for the letter subclass as a whole.

[5103] In this docket, the Postal Service instead initially made the assumption that the number of additional ounces per piece would remain constant for the letter subclass and for workshared letters.⁶¹ This assumption has the effect of forecasting an increase in additional ounces per piece for single-piece letters. Such a result is consistent with the migration of mail from the single-piece category to the workshare category in response to worksharing incentives. If the pieces migrating from single-piece to workshare are typical of existing workshare pieces, the migrating pieces would be lighter than the average piece of single-piece mail. The average weight of the remaining

⁶¹ There are two classification changes between the filed base year (98) and the 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 methods, and updating to the Hybrid year (99-00) as the base year for billing determinants eliminates the need to account for these changes.

single-piece mail would increase. Tr. 21/9180. The steady increase in additional ounces per piece within single-piece letters from 1990-1999 appears to support this concept. See Notice of Inquiry No.3 (June30, 2000), Attachments 3 and 4.

[5104] As part of its response to Interrogatory OCA/USPS-106(d), the Postal Service announced that it was revising its forecast of additional ounces. Tr. 21/9178-82. Essentially, it proposed to change the forecasting method from the initial, or “as-filed” method to the revised or “historical” method, which had been applied in previous omnibus rate cases. The Postal Service also corrected for the omission of revenue adjustment factors (RAFTs) from the calculation of First-Class Mail revenues. *Id.* at 9179. The RAF correction is not controversial; all commenting parties agree that it is appropriate.

[5105] To develop the record on this issue, the Commission issued Notice of Inquiry No. 3, First-Class Revenue Adjustment Factor (RAF) Error and Additional Ounce Method Change, which explains the theory and execution of the initial and revised methods, and requested the parties to comment on the merits of each.

[5106] *Intervenors’ Positions.* Postal Service witness Fronk presents testimony in response to Notice of Inquiry No.3, in which he defends the Postal Service’s revised forecasting method. Fronk asserts that the most recent empirical data (from 1999 and 2000) show that the previous trend of increasing additional ounces per piece has not continued. He points out that the initial forecast overestimated the number of additional ounces per piece in the interim periods for which actual data now is available. Tr. 34/16538-41.

[5107] Fronk also argues that, between 1990 and 1999, the two years with the largest increases in additional ounces per piece are aberrant and such increases are not likely to occur between 1998 and the test year. He explains how the increase between 1997 and 1998 may have been affected by the implementation of classification reform, and how the increase between 1994 and 1995 is partially explained by the implementation of Docket No. R94-1 and a change in the RPW sampling method. *Id.* at 16541-47.

[5108] Major Mailers Association submitted comments on Notice of Inquiry No. 3 that focused on considerations of due process and the evidentiary status of the Postal Service's revision. It claims that the Postal Service did not present the change in a manner that would make clear the impact on affected parties. MMA emphasizes its belief that the institutional response to OCA/USPS-106(d) does not meet the appropriate legal standard necessary to implement the proposed change in method. See Tr. 21/9178-82.

[5109] Finally, MMA believes that there is insufficient evidence that the long-term trend of increasing average weight of single-piece letters has come to an end to justify using the revised method.

[5110] The OCA submitted both comments and testimony in response to Notice of Inquiry No.3. In its comments, the OCA questioned the timing and analytical validity of the revised forecast. The testimony of witness Callow follows up on the issue of whether the revision is justified by the available data. Tr.36/16879-900.

[5111] Callow fits regression lines to the historical data included in Notice of Inquiry No. 3, and concludes from this analysis that the initial forecast more accurately reflects the upward trend in additional ounces per piece. *Id.* at 16886-88. When asked to compare the competing forecasts to an extension of his regression lines forward to the test year, he concluded that the results of the initial forecast track very closely with the projected trend lines. Tr. 46B/20593.

[5112] ABA&NAPM filed comments in support of the MMA and OCA comments on Notice of Inquiry No.3. ABA&NAPM oppose the revised forecasting method for the reasons cited by MMA and OCA.

[5113] ABA&NAPM propose that the additional ounce rate be maintained at 22 cents.

[5114] *Commission Analysis.* The application of revenue adjustment factors in the calculation of test year revenue for First-Class Mail is valid and necessary for the reasons described in the Postal Service's response to OCA/USPS-106 (d). No party

opposes this correction and the Commission adopts it in its First-Class revenue calculations.

[5115] The central issue in determining the appropriate method of forecasting additional ounces is the relative significance of the long-term trend of increasing additional ounces per piece and the recent data showing a slower increase. The Postal Service does not dispute the existence of the long-term upward trend. Indeed, it was this trend which apparently inspired the initial forecasting method. It instead argues that new data have convinced it that this trend will not continue, at least through the test year.

[5116] The Postal Service's argument that the long-term trend is the product of two years (1994-1995, 1997-1998) in which additional ounces per piece increased due to unique, one-time effects is not convincing. The Postal Service did not justify its implication that the one-time changes were responsible for the entire increases in the years in question. And even if these years were removed from the analysis, additional ounces per piece would still have increased in every year for single-piece, and on average for the letters subclass as a whole.

[5117] The observation made by Postal Service witness Fronk that the trend in additional ounces per piece exhibits something of a "stair-step" shape does point out that the trend is not steady from one year to the next. Tr. 34/16542. The irregular pace at which additional ounces per piece has increased suggests that examining a longer time period, over which the variations balance out, provides a more reliable picture of what is likely to happen in the future. Thus, the Commission rejects the Postal Service claim that only increases for the most recent 1¾ years (1998-1999 and 1999-Q3 2000) are relevant to what will happen in the test year.

[5118] An examination of the trend lines drawn by OCA witness Callow supports the conclusion that the initial forecasting method provides a better reflection of the long-term trend. Tr.46B/20593-95. It is worth noting that the trend line actually passes above *both* the initial and revised forecasts of single-piece and subclass additional ounces per piece in the test year. However, it is not appropriate to simply ignore the more recent data.

[5119] Therefore, in order to best reflect both the long-term trend and the current data, the Commission has forecast additional ounces for the test year using the initial method, incorporating the actual billing determinants from the Hybrid (FY99 Q3 – FY00 Q2) base year. As a result, the Commission forecasts fewer additional ounces in the test year than the Postal Service's initial filing, but more than its revised forecast.

[5120] The Commission recommends reducing the additional ounce rate by one-cent to 2 1cents. This rate exceeds the average additional ounce costs calculated by Postal Service witness Daniel of 12.42ce nts for single-piece First Class Mail and 14.8 cents for presort First-Class Mail. USPS-T-28 at 10 and 13 (Rev. March 1, 2000). The Commission recognizes that Daniel's average costs are biased upward by the effects of shape change from letters to flats as additional ounces increase. Therefore, the Commission believes that even by reducing the rate by one-cent, the recommended rate exceeds cost by a greater margin than indicated by Daniel's cost numbers. An additional consideration in this recommendation is the apparent increasing institutional cost contribution of First-Class Mail. This upward trend has been commented on by several intervenors in this proceeding. See ChapterV, SectionB.1.b. Reducing the additional ounce rate will help to mitigate the increasing burden of First-Class Mail and lower overall cost coverage of this class.

f. Heavyweight Discount Proposal

[5121] The Postal Service proposes maintaining the 4.6-cent heavy-piece discount for presort mail weighing more than two ounces. Postal Service witness Fronk states the "discount recognizes that initial additional ounces cost less for presort, but this cost difference does not continue to grow as the pieces get heavier." USPS-T-33 at31.

[5122] *Intervenor Proposals.* MMA, NAPM, and ABA&NAPM individually propose extending the heavy piece discount to the one to two ounce range. The proposals differ as to the shape of the mailpiece that the discount applies to.

[5123] MMA witness Bentley proposes adjusting the 4.6-cent heavy piece discount by allowing presort letters weighting from 1 to 2 ounces to qualify for the discount. Bentley states that his proposal will eliminate a rate anomaly between First-Class and Standard A, provide relief for 2-ounce workshare letters that cost less than the current additional 22 cents being charged, and bring rates more in line with costs without modifying the current uniform rate structure. T r.26/12305.

[5124] MMA witness Salls discusses this alleged rate anomaly that exists between First-Class and Standard A. He demonstrates that certain mailers with First-Class mailings weighing between 1 and 2 ounces will pay less postage if they are able to break up their mailing into two separate mailings—a First-Class mailing under 1 ounce and a Standard A mailing up to 3 ounces. This is anomalous, he argues, because the cost to the Postal Service is greater for two individual mailings than for a single First-Class mailing. He concludes by demonstrating that if the heavy piece discount is extended to the one to two ounce range, the price difference between a single mailing and two individual mailings will narrow to the point where there is no incentive for a mailer to break up its mailing. *Id.* at 12261-64.

[5125] NAPM witness MacHarg proposes adjusting the 4.6-cent heavy piece discount by allowing presort flats weighting from 1 to 2 ounces to qualify for the discount. MacHarg demonstrates what he alleges is an anomaly in the flats rate structure. He examines the total discounts available to flats in the under one ounce, one to two ounce, and greater than two ounce ranges. As a starting point, he uses the regular non-presort price in each weight range. He considers the effects of the reduced presort nonstandard surcharge in combinations with the heavy piece discount and the discount rates for both 3-digit and 5-digit presort categories. From his analysis he shows that the available discount for the one to two ounce range is approximately one half the total discount available in the under one ounce range and the over two ounce range. He argues that extending the heavy piece discount to presort flats weighting from 1 to 2 ounces would alleviate the problem and at the same time encourage workshare mailers to prebarcode the prevalent second ounce flats. *Id.* at 12146.

[5126] ABA&NAPM witness Clifton proposes adjusting the 4.6-cent heavy piece discount by allowing both presort letters and flats weighting from 1 to 2 ounces to qualify for the discount. He alleges the effect of his proposal is to align presort extra ounce rates in the lighter weight ranges with presort costs, making the rates for this mail closer to being cost based. *Id.* at 12456-57.

[5127] *Commission Analysis.* The Commission has not been presented with convincing evidence that letter mail in the 0 to 1 ounce range is processed any differently than letter mail in the 1 to 2 ounce range. The same is true for flats in these weight ranges. Thus, additional worksharing savings to the Postal Service have not been shown that warrant extending the heavy-piece discount into the 1 to 2 ounce range for letters or flats. The Commission recommends maintaining the current 4.6-cents discount for presort mail weighing more than two ounces.

g. First-Class Mail Nonstandard Surcharge Proposals

[5128] *Postal Service Proposal.* The Postal Service assesses a nonstandard surcharge on First-Class Mail weighing one ounce or less if the aspect ratio (length/height) of the mailpiece does not fall between 1:1.3 and 1:2.5 inclusive, or if the mailpiece exceeds 11.5 inches in length, 6.125 inches in width, or 0.25 inches in thickness. The nonstandard surcharge is important to signal the mailer that the cost of processing nonstandard mailpieces is higher. If the fee is not set sufficiently high, the mailer may not receive this signal. If the fee is set too high, the fee may appear to punish those mailers who cannot alter the shape of their mailpieces. Some standardization of mailpieces is necessary because mail processing operations could be adversely affected by a large number of nonstandard mailpieces. The Postal Service proposes maintaining the nonstandard surcharge for nonpresort mail weighing one ounce or less at 11 cents and the nonstandard surcharge for presort mail weighing one ounce or less at 5 cents. USPS-T-33 at 27-30.

[5129] In Docket No. R97-1, the cost analysis supporting the Postal Service surcharge proposal drew criticism. Witness Miller makes progress in addressing these concerns. However, the estimates do not achieve the ideal of completely excluding the affect of the cost of pieces weighing over one ounce from the nonstandard cost calculations. Miller assumes that all nonstandard letters are processed manually, recognizing the fact that this may not always be true. He states that this assumption has little impact on the total results because nonstandard mailpieces are overwhelmingly (75-85 percent) flats shaped. Thus, nonstandard flats shaped mailpieces are the primary cost driver. USPS-T-24 at 19-24.

[5130] The Commission criticized the use of average CRA mail processing costs as a proxy in Docket No. R97-1. In response to this criticism, witness Daniel reports mail processing unit costs for mail pieces that weigh less than one ounce. However, Miller's analysis of this data indicates it is difficult to estimate CRA mail processing costs by both ounce increment and shape for low volume categories such as nonstandard First-Class Mail. Furthermore, use of this data results in a higher cost than using the average mail processing unit costs. Thus, the average mail processing unit costs were used in this docket.

[5131] Miller calculates a weighted nonstandard cost for both nonstandard single piece letters and nonstandard presort letters using FY 1998 volume percentages by shape. He estimates the additional cost for nonstandard single piece letters is 23.343 cents and the additional cost for nonstandard presort letters is 9.196cents.

[5132] *OCA Proposal to Eliminate Non-standard Surcharge on Low-Aspect Ratio Letters*. Witness Callow presents the OCA's proposal to eliminate the nonstandard surcharge on low aspect ratio mail. He defines low aspect ratio mail as mailpieces with aspect ratios between 1:1 and 1:1.3 inclusive. He alleges that advances in technology have made the surcharge obsolete for low aspect ratio mail, and this renders the underlying cost estimates unrealistic. Tr. 22/10147-67.

[5133] Callow asserts it is not reasonable to assume 100 percent manual processing of low aspect ratio letter mail. He cites the existence of a barcode on a

delivered low aspect ratio mailpiece as evidence of at least some processing on automated equipment. Callow develops probabilities for successful processing of mail on the Advance Facer Cancellor System (AFCS) that separates out mail not appropriate for further processing on automated equipment. He develops a linear model, assuming a square mailpiece has a 50 percent chance of remaining in the automation mail processing flow, and an 1:1.3 aspect ratio mailpiece has a 100 percent chance. Callow uses the Postal Service manual mail flow model developed by Miller, and the probabilities discussed above to determine low aspect ratio nonstandard letter mail costs. Callow's calculations show costs associated with processing low aspect ratio nonstandard letter mail that are lower than the costs developed by the Postal Service, and lower than the proposed surcharge for nonpresort mail. Costing evidence for presort nonstandard mail has not been presented.

[5134] *Postal Service Rebuttal.* Witness Miller presents the Postal Service argument for maintaining the nonstandard surcharge in its present form, including for low aspect ratio letter mail. He addresses Callow's primary contentions that today's mail processing technology can successfully process low aspect ratio letters, and that there is no cost basis to support a charge for low aspect ratio mail.

[5135] Miller discusses the variety of mail processing equipment utilized by the Postal Service and the process for deploying new equipment—one piece at a time. He explains how the standardization of mailpiece characteristics has enabled the Postal Service to transition to new equipment as the mail flow changes. He argues that even if mail processing equipment is more sophisticated than in the past, it operates at greater mail flow speeds. Thus, it is not logical to assume that nonstandard mailpieces that were a problem in the past low speed environment are no longer a problem in today's higher speed environment. Tr. 45/19675-82.

[5136] Miller notes that every cost cell in Callow's analysis contains costs greater than the average single-piece letter mail processing cost. Thus, additional costs are incurred to process low aspect nonstandard letter mail. Furthermore, entering Callow's adjusted mail processing cost of 18.6 cents into Miller's nonstandard surcharge formula

results in 22.414cents representing the additional weighted cost by shape for nonstandard single-piece mail. This is still higher than the 11-cent fee proposed by the Postal Service.

[5137] *Commission Analysis.* The Commission recommends maintaining the nonstandard surcharge for nonpresort mail weighing one ounce or less at 11 cents and the nonstandard surcharge for presort mail weighing one ounce or less at 5 cents. The cost analysis used by the Postal Service shows some of the same infirmities as presented in the previous docket. However, it is also evident that the Postal Service has taken steps to analyze and improve the methodology used. Considering the primary purpose of this fee is to send a signal to mailers to standardize mailpieces because of the implications that standardization has for providing a low-cost environment for processing mail, and that the proposed rates are below estimated costs, the proposed fees are acceptable.

[5138] OCA witness Callow has provided a novel approach for calculating costs for low aspect ratio nonstandard mail. However, the underlying assumptions made, such as the probability for successfully processing low aspect ratio mail on automated equipment, have not been supported in the record. This costing methodology requires more development before it can be reliably used in a rate proceeding. Furthermore, as the Postal Service has stated, Callow shows that there is some additional cost associated with low aspect ratio mail.

[5139] The Commission does not recommend the elimination of the nonstandard surcharge for low aspect ratio mail. It is not reasonable to assume that because modern mail processing equipment is more technologically advanced, it can reliably process low aspect ratio mail. The record does not contain any evidence that relates technological advancement with the ability to process low aspect ratio mail. Evidence that a small quantity of mailpieces have successfully been barcoded does not indicate the overall machinability of low aspect ratio mailpieces through the complete automation cycle. A comprehensive study, or information from mail processing equipment manufacturers on the capabilities of their equipment, could aid in this analysis. However, it is reasonable to

assume from an operations viewpoint that it is desirable to have some mailpiece standardization to facilitate processing of mail using the various and ever changing pieces of mail processing equipment. The Commission has no doubt that a low aspect ratio mailpiece may be successfully processed on some pieces of mail processing equipment. However, this fact is not sufficient to recommend a classification change that may adversely effect overall mail processing operations.

h. Rate Summary

[5140] The Commission finds that the 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 by \$16.0 billion. Thus, recommended rates will recover all attributable costs, in compliance with § 3622(b)(3).

[5141] First Class Mail also will contribute to institutional costs consistent with the comparatively high value of service (§ 3622(b)(2)) for mail in this subclass. Postal Service witness Mayes notes First-Class Mail is sealed against inspection and receives forwarding at no additional charge. It receives a high priority of delivery relative to other non-expedited classes of mail. It also benefits from an extensive collection system, and may travel by air for deliveries at considerable distances. USPS-T-32 at 20.

[5142] The impact of the recommended rate changes is modest (§ 3622(b)(4)). Although the first-ounce single-piece letter rate increases by one-cent, other First-Class rates were either maintained or reduced to mitigate the cost burden on First Class Mail. For example, the additional ounce rate was reduced by one-cent, the Qualified Business Reply Mail cards discount was increased by one-cent, and the nonstandard surcharge, heavy piece discount, and single piece cards rates were maintained at their current levels. The average increase for the Letters and Sealed Parcels subclass is 1.8 percent, which is below the system wide increase of 4.6 percent.

[5143] Available alternatives (§ 3622(b)(5)) are somewhat limited for mailers in the Letters and Sealed Parcels subclass. Nevertheless, witness Mayes notes non-postal alternatives are available. These include growing use of facsimile machines, computers incorporating faxing capability, the Internet, and the acceptance of electronic payment options. *Id.* at 21-22.

[5144] The recommendations recognize mailers' worksharing efforts, in accordance with § 3622(b)(6), through presorting and prebarcoding discounts. In most cases, the recommended letters and cards automation discounts pass through close to 100 percent of the recognized cost savings. Also, the Qualified Business Reply Mail discount has been increased for cards reflecting the efforts of the card recipient. Furthermore, the "shell" recommendations for CEM and IBIP mail recognize the automation compatibility features of those mail types.

[5145] The division of the automation 3/5-digit flats category into separate 3-digit and 5-digit categories adds some complexity to the First-Class schedule (§ 3622(b)(7)). The Commission finds this acceptable, given that the structure of the automation flats category will now parallel the structure of the automation letters and automation cards categories, and the mailers that use these categories tend to be the more sophisticated mailers. The "shell" recommendations of CEM and IBIP mail also adds complexity to the schedule, but does not unduly complicate the schedule because their use will be voluntary.

[5146] The Commission 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 1.342. This is slightly higher than the 1.307 markup in Docket No. R97-1. The Commission finds that the markup index in this case is appropriate on the record that has been developed in this case.

2. Letters and Sealed Parcels Classification Proposals

a. Single-Piece Automation Compatible Classification Proposals: CEM and IBIP

[5147] Three proposals are presented to the Commission for consideration concerning discounts for First-Class single-piece automation compatible letter mail. The OCA proposes a discount for Courtesy Envelope Mail (CEM). The proposal is substantially the same as the CEM proposal that the Commission recommended as a shell classification in the previous omnibus rate case. E-Stamp proposes a discount for letter mail with postage printed directly on the envelope by systems meeting the requirements of the Information Based Indicia Program (IBIP). Stamps.com proposes a discount, similar to the discount proposed by E-Stamp, for mail meeting the IBIP requirements with postage printed directly on the envelope. Stamps.com also proposes a discount for mail meeting the IBIP requirements with postage printed on labels.

[5148] CEM mail pieces and IBIP mail pieces share many of the same physical characteristics. Both mail pieces have machine printed addresses, facing identification marks, proper barcodes (and ZIP Codes), and are automation compatible. CEM mail piece addresses will be reviewed by the Postal Service for accuracy, whereas every IBIP address is verified against a Postal Service approved database. Furthermore, CEM and IBIP mail pieces share similar physical characteristics to QBRM mail pieces, and thus should potentially have similar mail processing costs. The Commission considers CEM and IBIP mail as different species in the same genus.

[5149] The Commission recommends a shell classification for CEM mail. The Commission also recommends a shell classification for IBIP mail with postage printed directly on the envelope, but not for postage printed on labels. The Commission finds the QBRM analysis relevant in considering cost savings for either CEM or IBIP mail.

(1) CEM Proposal

[5150] *OCA's Renewal of CEM Proposal.* OCA witness Willette renews and refines the Courtesy Envelope Mail (CEM) proposals OCA has presented in previous proceedings.⁶² Willette describes CEM mailpieces as preprinted, self-addressed business reply envelopes that bear a facing identification mark, a proper barcode, a proper ZIP Code, and an indicia identifying the mailpiece as eligible for the CEM rate. The mailpiece also must meet automation compatibility standards and be approved by the Postal Service. The OCA proposes a discount of 3 cents for qualifying mailpieces based on the proposed 3-cent discount for Qualified Business Reply Mail (QBRM). Willette argues it was demonstrated in Docket No.R97-1 that the cost avoidances associated with CEM and QBRM are the same. Furthermore, CEM does not require the QBRM accounting function, thus no accounting fee is involved. The CEM discount will not extend to cards. A key element of the proposal, as with its predecessors, is that the mailer affixes a Postal Service issued CEM stamp to the mailpiece in a denomination reflecting the CEM rate. Tr .23/10727-65.

[5151] The main features of the instant CEM proposal are identical to those presented in Docket No. R97-1. Willette offers CEM as a method to slow the diversion of bill payment mail to other forms of payment, such as electronic payment, by providing consumers with a convenient and less expensive way to return bill payments by mail. She says that CEM offers mailers the opportunity to directly share in the benefits of technology advances within the Postal Service. Also, CEM more closely aligns Postal Service costs with rates for household mailers. Furthermore, she claims CEM is relatively simple to implement, because providers of CRM envelopes would only need to signify on the mailpiece that the consumer could choose to apply a CEM stamp.

[5152] Willette estimates there are approximately 10 billion potential CEM mailpieces. If all of these mailpieces convert to CEM, the revenue impact could reach \$300 million. She estimates the cost of an educational campaign to inform consumers

⁶² Witness Willette provides a history of CEM as Appendix A to her testimony. Tr. 23/10752-65.

on the proper usage of CEM to be similar to the telemarketing fraud campaign, which cost \$9.2 million. Generally, underpayment of postage does not appear to be a problem for the Postal Service. Willette states that overpaid postage recently exceeded underpaid postage by \$204.6 million. Therefore, it is reasonable to assume that mailers will err on the conservative side when applying postage. Furthermore, some mailers do not want to keep two denominations of stamps on hand, inferring that mailers may continue applying full rate First-Class stamps to CEM envelopes out of convenience. This will act to reduce the revenue loss.

[5153] *Postal Service Rebuttal.* The Postal Service opposition to the CEM proposal is presented through the rebuttal testimony of witnesses Miller and O'Hara. Miller discusses the operations problems the Postal Service might have with CEM and the revenue impact of the CEM proposal, and O'Hara discusses the benefits of an averaged single-piece First-Class Mail rate.

[5154] Miller disagrees with the OCA premise that a CEM discount is a fairly modest concept of sharing the benefits of automation compatible mail with the public. He says that First-Class mailers already benefit directly from the letter automation programs that the Postal Service has implemented. He maintains that this CEM proposal is virtually no different than the Docket No.R97-1 proposal, with the exception of understated education costs. Miller states that the Postal Service maintains the same position in opposition to the CEM proposal as it did in Docket Nos. R87-1, R90-1, MC95-1, and R97-1. Tr. 45/19650-62.

[5155] Arguments against the CEM proposal focus on four areas. Miller alleges that CEM will unnecessarily complicate the nation's mail system, will result in a loss of revenue that would have to be recovered, will result in additional costs to the Postal Service that also would have to be recovered, and will not fairly and equitably distribute postage costs. He outlines potential complications to the mail system such as envelope standardization and design issues, customer confusion, stamp manufacturing and distribution problems including the possibility of multiple make up stamps, and enforcement concerns.

[5156] Miller discusses several areas of cost and revenue losses that will have to be recovered. He concludes that if every CRM mailpiece converts to CEM, the revenue reduction could approach \$300 million. Miller estimates that short paid mail due to mailers applying CEM stamps to non-CEM letters may result in a revenue loss of between \$11 and \$76 million. He proposes that a public education program would be required that is estimated to cost \$33 million. This does not include the costs to train Postal Service personnel. He estimates that window service costs, including CEM stamp purchases and CEM inquiries, may increase by \$19 million. Miller states that CEM would require an increase in the revenue protection program of \$70 million to \$267 million to ensure proper usage of CEM stamps. This range is based on the percentage of short paid mail varying from 2 percent to 7.35 percent. He concludes that it would not make financial sense for the Postal Service to spend in the range of \$122 million to \$300 million to realign a maximum of \$300 million worth of postage.

[5157] Miller argues that CEM would not fairly and equitably distribute postage costs. He says the CEM proposal is one-sided because it does not propose a higher rate for high cost mail pieces such as handwritten letters. Therefore, inequities would be created because mailers who choose not to use CEM stamps will be perceived as paying more than their fair share of postage. Finally, he says revenue losses and CEM related costs would have to be recovered. He states that it is ironic that businesses supplying CEM envelopes may end up paying higher rates on the mail they send out containing CEM return envelopes, and pass these costs back onto their customers. *Id.* at 19662.

[5158] O'Hara explains how single-piece First-Class mailers benefit from an averaged first-ounce rate, and why the CEM proposal should be rejected. He states that the general mailing public already benefits from a single-piece rate that is lower than it would have been absent automation. He concludes that the letter automation projects implemented over the last decade have had a direct impact on the rates paid by residential and small business mailers by keeping proposed rate increases at moderate levels. He discusses the benefits, which the Commission has also recognized, of an averaged first-ounce rate for the multitude of mail characteristics that make up

single-piece First-Class mail. He also distinguishes the characteristics of QBRM from the characteristics of CEM and the problems that a two-stamp system may cause. Finally, witness O'Hara argues there is no evidence to support the premise that the public would prefer a two-stamp CEM system to the current one-stamp system. He cites research presented in Docket No. R97-1 by witness Ellard which he interprets to show that 86 percent of the respondents preferred a one-stamp system given the possibility of an additional increase to the regular single-piece stamp rate. T r.46E/21944-49.

[5159] *Commission Analysis.* The instant CEM proposal contains many of the same arguments and counter arguments that were presented in Docket No. R97-1. This is understandable, with the instant proposal being essentially the same as what was presented in the last docket. In Docket No .R97-1, the Commission recommended CEM as a "shell classification," and allocated \$33 million for educational efforts related to CEM. On balance, the Commission again finds CEM beneficial to the mailing public, and again recommends CEM as a "shell classification." A 3-cent discount, equivalent to the proposed QBRM discount, is appropriate for CEM. The Commission finds much of the analysis contained in the Docket No .R97-1 Opinion relevant to the instant proposal, but also finds is necessary to review several of the arguments made in this proceeding.

[5160] The record consistently shows that mailers using stamps have a tendency to overpay postage. This is evident in the net dollar surplus of overpaid versus underpaid mail. This historic tendency, along with the probability that some mailers will find a two stamp system inconvenient, and apply full rate stamps to all of their mail, make it very unlikely that CEM will result in an underpayment problem for the Postal Service. Nevertheless, if Miller's argument is accepted, and additional amounts must be expended for enforcement, his cost estimates do not withstand scrutiny. Using his most conservative estimates, he argues that the Postal Service may spend \$70 million to protect an estimated \$10 million in short paid revenue due to misuse of the CEM stamp. It defies logic, and good business practice, that a business would spend seven times as much on enforcement as the revenue at risk. The grossly overstated costs presented serve to undermine the credibility of the Postal Service's objections to implementing

CEM. The Commission has consistently found that mailers want their important business mail to reach its destination. Thus, even minimal enforcement efforts should reinforce proper CEM stamp usage.

[5161] Miller argues that public education on the proper usage of CEM will require \$33 million, versus the \$9.2 million estimated by witness Willette. The Commission recognizes that an educational campaign will have to be developed, but does not agree that it will be an overly onerous task. Furthermore, the Commission notes that \$33 million has previously been allocated for this purpose in Docket No. R97-1.

[5162] The Commission reviewed Postal Service witness Ellard's research presented in Docket No. R97-1 and found it to be unconvincing. This was acknowledged by witness O'Hara in this docket. *Id.* at 22021. Nevertheless, witness O'Hara continues to interpret witness Ellard's research to infer that a majority of mailers prefer a one-stamp system. The Commission disagrees that this conclusion can be reached based on witness Ellard's research.

[5163] The Commission continues to see benefits in a CEM classification. CEM will allow mailers to directly share in the benefits of automation to a greater extent than they enjoy now. The impact on envelope suppliers of converting CRM envelopes to CEM envelopes appears minimal. CEM shares many of the efficient mail processing characteristics of QBRM mail. Overall, the Commission finds that the potential problems and additional costs associated with CEM have been overstated. For these reasons, and consistent with the reasoning and recommendation of Docket No. R97-1, the Commission recommends CEM as a "shell classification." The Commission also finds that the cost savings analysis supporting a 3-cent QBRM discount could naturally extend to CEM.

(2) IBIP Discount Proposals

[5164] *E-Stamp Proposal.* E-Stamp witness Jones proposes a 4-cent discount for what he describes as Category 2 Open System PC Postage letter mail. PC Postage

allows a mailer to print postage using a personal computer and either a laser or inkjet printer. Postage is purchased via the Internet through a Product Service Provider such as E-Stamp, Stamps.com or Pitney Bowes.

[5165] PC Postage is provided through either an open or a closed system. Closed systems are conceptually similar to postage meters. Open systems have greater requirements for address cleansing, delivery point POSTNET barcodes, and indicia characteristics. Jones classifies open systems as category 1 or category 2. Category 1 systems generate postage for any mail piece created with an Open System PC Postage product regardless of mail class or mail piece characteristics, provide a certain level of address cleansing, and print a POSTNET bar code. Category 2 systems print postage directly on an envelope, utilize a FIM-D, have an address that is an exact match to the AMS CD-ROM database, and have a full delivery point POSTNET bar code printed with the address as well as the delivery point included in the indicia. It may be used on First-Class Mail that does not weigh more than the 3.3103 ounce automation breakpoint. Jones alleges that the only difference between bulk mail preparation and PC Postage is the lack of presorting. He concludes that a lack of a discount for PC Postage will stand in the way of PC postage gaining full acceptance. Tr.29 /13638-55.

[5166] PC Postage may be printed on florescent labels or directly on an envelope. Jones does not propose a discount for PC Postage printed on fluorescent labels. He states that florescent labels make the FIM unusable and do not allow the same efficiency in the sortation process.

[5167] E-Stamp witness Prescott explains the reasons for providing information based indicia (IBI) mail with a discount, develops the proposed cost savings associated with IBI mail, and recommends a passthrough percentage for the proposed discount. He develops IBI cost savings for letters based on information contained in USPS-LR-I-81, and alternatively from information contained in Postal Service witness Miller's testimony. He also develops IBI cost saving for flats. *Id.* at 13753-70.

[5168] Postal Service LR-I-81 develops mail processing costs related to First-Class letters. Prescott uses this information to calculate a cost savings for single piece

automation mail, inferring that this is equivalent to IBI mail. First he calculates a cost savings of 6.28 cents for presorted automation BMM by subtracting the 4.06 cents per piece cost for presorted automation BMM from the 10.34 cents per piece cost for presorted non-automated BMM as presented in LR-I-81. Because IBI mail is single piece and not presorted, he subtracts an additional 0.13 cents to eliminate the cost savings associated with presortation. The cost savings for presortation are calculated by subtracting the 10.34 cents per piece cost for presorted non-automation BMM from the 10.47 cents per piece cost of single piece BMM also presented in LR-I-81. Prescott arrives at a final cost savings of 6.15 cents for single piece automation, or IBI equivalent mail. With a 4-cent discount, Prescott proposes to pass through 65 percent of the 6.15 cents cost savings.

[5169] Postal Service LR-I-481 updates LR-I-81 to reflect FY 1999 data. On brief, E-Stamp incorporates this new data into Prescott's calculations. Using the new data, the net savings for single piece automation is reduced from 6.15 cents per piece to 4.86 cents per piece. E-Stamp Brief at 7.

[5170] As an alternative, Prescott calculates a worksharing related cost savings based on witness Miller's analysis of the differences in mail processing and delivery costs for First-Class letters. First, Prescott determines a cost savings for automation presort letters of 5.115 cents per piece by subtracting the 8.603 cents per piece cost of automation basic presort letters from the 13.718 cents per piece cost of non-automation presort letters contained in witness Miller's analysis. From this he subtracts the cost avoided by presortation of 0.091 cents per piece. He calculates the costs avoided by presortation by subtracting the 13.718 cents per piece cost of non-automation presort BMM from the 13.809 cents per piece cost of non-presort BMM. Removing the costs avoided by presortation from the cost savings due to automation of presort letters results in a 5.024 cents per piece worksharing related cost savings due to automation. This is his estimation of cost savings for IBI mail. Prescott proposes to pass through 80 percent of the 5.024 cents cost savings, with a 4-cent discount. On brief, E-Stamp states it did

not have sufficient information to update this cost savings analysis to reflect FY 1999 data.

[5171] *Stamps.com Proposal*. Stamps.com witness Heselton proposes a slightly different discount for Information Based Indicia (IBI) PC Postage mail. He similarly proposes a 4-cent workshare discount for IBI prepaid letter mail when postage is printed directly on a mailpiece. However, he also proposes a discount of 3-cents for IBIP mail when the postage and addressing information is printed on labels and then applied to the mailpiece.⁶³ His proposed lower discount for printing on labels allows for the possibility of error in applying address labels to the mailpiece. Tr.23/10451-93.

[5172] In support of Heselton's discount proposal, Stamps.com witness Kuhr describes the Stamps.com Information Based Indicia PC Postage product. His testimony includes a description of the Information Based Indicia Program (IBIP), the requirements for registering with Stamps.com and the Postal Service to use PC postage, the mailpiece requirements and process of printing PC postage, and the Stamps.com quality assurance measures. *Id.* at 10297-333.

[5173] Stamps.com witness Heselton uses a different methodology to calculate cost avoidances than E-Stamp witness Prescott. However, he states that his pricing methodology is applicable to both the Stamps.com and the E-Stamp discount proposals. Heselton calculates an IBIP mail cost avoidance of 4.13 cents. He analyzes cost avoidances in remote barcode system and mail processing costs, return-to-sender costs, and carrier delivery costs. *Id.* at 10451-93.

[5174] Heselton claims that letters prepared under IBIP and QBRM procedures meet essentially the same standards for automated processing, are entered as single piece mail, and therefore avoid the same processing costs. He estimates IBIP

⁶³ Witness Heselton's testimony states: "I propose a 4 cent workshare discount for First Class single-piece letters *and cards* prepared and addressed according to IBIP procedures: four cents per piece when printing is directly on the piece, and 3 cents per piece when printing is on labels affixed to the piece." Tr. 23/10457 (emphasis added). Witness Heselton does not develop IBIP worksharing cost avoidance figures for First-Class single-piece cards. Until such time as cost avoidances can be shown, the Commission will not consider an IBIP discount for First-Class single-piece cards.

preparation of letters to automation standards results in 2.99 cents of avoided cost per piece. This is based on Postal Service witness Campbell's cost avoidance estimates for QBRM mail using Commission methodology from Docket No. R97-1. On brief, Stamps.com notes that updated Postal Service QBRM costs have ranged from a high of 4.48 cents per piece (USPS LR-I-471 (L)) to a low estimate of 2.60 cents per piece (USPS LR-I-480 (L)).

[5175] Next, Heselton estimates that IBIP mail processed through the AMS database avoids an additional return-to-sender cost of 1.14 cents per piece. He also discusses costs avoided in delivery by eliminating address deficiencies that require additional effort above properly addressed letters. He states that this cost avoidance should amount to several cents, but he does not include this estimate in his final cost avoidance. He concludes that IBIP mail avoids 2.99 cents per piece in mail processing costs equivalent to QBRM, and 1.14 cents per piece by eliminating address deficiencies for a total cost avoidance of 4.13 cents per piece.

[5176] Heselton concludes his testimony by arguing that an IBI mail discount meets the classification, ratemaking, and policy requirements of the Act. Included in this discussion, he contrasts previous Citizen's Rate Mail and Courtesy Envelope Mail proposals with the IBI mail proposal. He states that an IBI mail discount will not de-average rates and therefore there is no significant rate impact on other mailers as in the previous proposals. On brief, Stamps.com explains this by stating that the rates proposed by the Postal Service do not consider the cost savings and efficiencies related to PC Postage. Therefore, an IBIP discount will not de-average rates or increase the rates of any other class of mail.

[5177] Stamps.com witness Lawton performed a retrospective study of Stamps.com customers to determine how PC postage has affected their processing of outgoing mail. Specifically, she studies if customers use postal services more while visiting actual post offices less, and if customers address their mail with greater accuracy and with greater automation compatibility. She concludes that Stamps.com customers are more aware of services offered by the Postal Service, use Express Mail and Priority

Mail more frequently, and visit the post office less (an estimated 1,000,000 fewer visits each month). She also concludes that mailers usually did not include POSTNET barcodes, FIM codes, or 9-digit ZIP Codes prior to becoming Stamps.com customers. *Id.* at 10359-78.

[5178] *E-Stamp and Stamps.com Joint Survey*. E-Stamp and Stamps.com jointly sponsor the testimony of witness Boggs. Boggs interprets and presents the results of research conducted by International Data Corporation on small business and home office postage usage, and on market forecasts for current and future usage of PC postage and products. He estimates that total spending by small businesses and home offices on postage will increase from almost \$11.6 billion in 1998 to \$16.3 billion in 2003 with small businesses accounting for the largest share of the postage spending. Total spending on PC postage will grow from \$8.2 million in 1999, to \$292.8 million in 2000, to \$1,632.3 million in 2003. Boggs estimates that PC postage will come to represent over 10 percent of total postage spending by small businesses and income generating home offices with the largest share coming from small businesses. Finally, Boggs reports on small business attitudes towards PC postage. He states that more than one PC owner in 10 indicated they were very or somewhat interested in the PC postage concept. Tr. 29/13814-58.

[5179] *Postal Service Rebuttal*. The Postal Service opposition to the IBI discount proposals is presented through witnesses Miller, Staisey, and Gordon. Miller addresses the worksharing cost savings estimates and the mail processing of IBI mail. Staisey comments on the surveys performed by witnesses Boggs and Lawson. Gordon discusses revenue security, PC Postage revenue projections, and discount implementation concerns.

[5180] Miller outlines the fee structures for using E-Stamp's or Stamps.com's IBI product. He concludes that it is not coincidental that a 4-cent discount will offset the fees charged by each of the companies. This would imply a net zero cost to PC Postage customers. He then proceeds with analyzing the worksharing cost avoidances

presented in the discount proposals, and the mail processing characteristics of IBI mail. Tr. 45/19670-75.

[5181] Miller alleges that witnesses Prescott and Heselton have overstated worksharing related savings. Prescott uses two different methods to calculate cost avoidance. His first method calculates the cost difference between non-automation presort letters and automation non-carrier route presort letters. Miller states that non-automation presort letters is a CRA rate category in itself, whereas automation non-carrier route presort letters aggregates costs for automation basic, 3-digit, and 5-digit presort letter rate categories. He compares the characteristics of these categories, inferring that the features of each category are so different that it is doubtful a comparison could isolate the cost savings for IBI mail. Prescott's first methodology attempts to remove the cost associated with presortation from the above calculation by examining the difference between BMM letters and non-automation presort letters. Miller states that these categories are also vastly different inferring that they should not be compared.

[5182] Prescott's second approach for calculating a worksharing related savings estimate is to compare the difference between non-automation presort letters and automation basic presort letters using data from Miller's testimony. Miller alleges that this approach has the same flaws as the first approach.

[5183] Heselton's approach relies on QBRM and return-to-sender cost avoidances to estimate savings. Miller states that the QBRM benchmark is handwritten mail, whereas Heselton indicates that two thirds of IBI mail may convert from machine printed/typewritten mail. On brief, the Postal Service contends that a weighted average reflecting the true mix of mail converting to PC Postage should have been used as a benchmark. Postal Service Brief at VII-60. In addition, the mailpiece that is used to calculate QBRM cost avoidance is processed through different operations than an IBI mailpiece. Hence, basing IBI mail cost avoidance on QBRM applies an incorrect benchmark and results in an overestimate of IBI mail cost avoidance.

[5184] Finally, Miller asserts that a cost savings based on a machine printed benchmark would result in little to no savings because mail processing operations are not currently configured to capture PC Postage savings. He traces an IBI mailpiece from the Advance Facer Canceler System (AFCS), to the Multi Line Optical Character Reader Input Sub System (MLOCR-ISS), to the outgoing secondary operation. He states that under the current configuration, the FIM "D" marking has little impact on how a mailpiece is sorted on the AFCS. If the IBI mailpiece did not go through the MLOCR-ISS, it would still likely incur an additional processing step in the outgoing secondary operation. Thus, there would be little to no cost savings using the current mail processing configuration.

[5185] Witness Staisey offers critiques of the surveys conducted and conclusions drawn by E-Stamp and Stamps.com witness Boggs and Stamps.com witness Lawson. Staisey states that Boggs' survey fails to provide respondents with a comprehensive description of the PC postage concept such as how PC postage actually works, its specific characteristics, the benefits/burdens, and pricing information. The result of this is that the responses provided by the sample of small businesses regarding their interest level in PC postage are not made with a complete understanding of the product. Therefore, conclusions from the survey concerning interest level are not valid or reliable. She also concludes that the 16.5 percent survey response rate is low and does not allow for conclusions that are indicative of the total small business population. Furthermore, Staisey alleges that Boggs, in analyzing the survey data, inappropriately relies on expert opinion to arrive at his conclusions and implications concerning PC postage.

Tr. 45/19931-34.

[5186] Staisey states that bias in Lawson's survey and questionnaire, and flaws in the methodology that she uses lead to invalid conclusions. The design of Lawson's study was intentionally retrospective. Staisey questions whether Lawson can draw a conclusion on how Stamps.com has changed how customers run their postal processes given the high risk of response error due to the poor recall of respondents in a retrospective survey. Staisey is critical of the survey questions concerning the reduction in the number of trips to the post office. Respondents that indicated they made fewer

trips to the post office were asked to quantifying the number of fewer trips made. Respondents that indicated they made more trips were not given the option to quantify this number. She concludes that this will bias the results in favor of overestimating fewer trips to the post office. In this line of questioning, the survey also did not specify a time frame for reporting the number of trips, or provide a relative comparison of trips made before and after beginning use of Stamps.com. Staisey notes other areas of the survey where respondents showed confusion as to the time orientation of the questions. She also cites methodology flaws such as a low 20.4 percent response rate and problems with a lack of clarity in survey questions. *Id.* at 19927-31.

[5187] Witness Gordon is the Manager of the Information Based Indicia Program at the Postal Service. He discusses revenue security, PC Postage revenue projections, and discount implementation concerns. He provides a brief history of the IBIP where he states that the development of IBIP is primarily related to revenue security. Thus any changes to IBIP systems, such as implementing a discount, would be subject to Postal Service processes and procedures to ensure that the products meet Postal Service security requirements. He outlines concerns with the implementation process of PC Postage vendors modifying their product to incorporate a discount, and the Postal Service approval cycle. He alleges this is a fairly complex process that may take 6 to 12 months to implement after the Governors recommend a change. *Id.* at 20008-20.

[5188] In conclusion, Gordon questions the revenue projections made by witness Boggs. Boggs projects \$292.8 million in revenue from PC postage in calendar year 2000. Gordon presents actual data from the Postal Service IBIP database. He states that nearly 321,000 customers representing six different PC product vendors have generated \$29.8 million in postage revenue in FY 2000 to date (through AP 11). He estimates that approximately 57.3 percent of this is First-Class Mail revenue. He ends by discussing the need for an awareness campaign that would be implemented to inform Postal Service personnel of any IBIP changes.

[5189] *Intervenor Comments.* Intervenor Carlson opposes the proposed discounts for IBIP mail. He alleges that IBIP letters are not sufficiently distinctive from other

non-courtesy-reply single-piece First-Class letters that are typewritten or computer printed, automation-compatible, and often contain delivery-point bar codes. He claims that IBIP mail and typewritten mail currently undergo the same mail processing. Therefore, IBIP mail should not receive a discount when other automation compatible mail does not receive a discount. Carlson Brief at 21-22.

[5190] *Commission Analysis.* The Commission recommends a “shell classification” for IBIP prepared mail. The recommendation is applicable to First-Class letter mail with postage and addressing information printed directly on the mailing envelope, and otherwise meeting the requirements of the Information Based Indicia Program. The mail piece must be automation compatible and not exceed the 3.3-ounce automation breakpoint in weight. It must utilize a FIM, have an address that has been verified against a Postal Service approved database, and have a full delivery point POSTNET barcode. At this time, the Commission recommends that this classification exclude IBIP prepared mail where postage or addressing information is applied with labels. Although the Commission does not recommend a specific discount for IBIP prepared mail, it finds that the cost savings analysis for QBRM may be applicable in calculating an appropriate discount.

[5191] The basis of this recommendation is the belief that IBIP mail offers the potential for real Postal Service mail processing cost savings. IBIP mail that meets the characteristics described in the recommended shell classification is fully automation compatible, clean mail, with the additional benefit of address hygiene. When examining an IBIP mail piece, there are many similarities with QBRM mail such as machine-printed addresses, facing identification marks, proper barcodes (and ZIP Codes), and at least theoretically, correct addresses. These features were very pertinent in recommending a discount for QBRM, and also should be applicable to IBIP mail.

[5192] The Commission is not recommending a discount rate at this time, but has carefully considered the approaches for analyzing cost avoidances contained in each IBIP proposal. The Commission does not accept E-Stamp witness Prescott’s cost methodologies used to calculate cost savings associated with IBIP mail. Prescott uses

Postal Service models in a way that they were not intended to be used. As the Postal Service highlights, Prescott also uses cost categories that may not be directly comparable, thus skewing the results of his analysis. Without careful analysis, this approach may lead to unexpected and unreliable results.

[5193] Stamps.com witness Heselton bases his cost avoidance estimates on the Postal Service cost avoidance estimate for QBRM and avoided return-to-sender costs. The Commission has not considered avoided return-to-sender costs as worksharing related, and a convincing argument for why the Commission should consider these costs worksharing related has not been made on this record. The Commission does find it appropriate to analyze cost avoidances in similar terms to the QBRM cost avoidance analysis due to the physical similarity of the mail pieces, and the potential similarity in mail processing costs.

[5194] The Postal Service argues that current mail processing operations are not configured to capture the potential mail processing cost savings associated with IBIP mail, and the current volumes do not justify making mail processing equipment and mail flow changes necessary to realize those savings. Postal Service Brief at VII-62-VII-63. The Commission has not been presented with any rationale for why the Postal Service could not modify the current mail flow to take advantage of the IBIP mail piece characteristics given sufficient volumes. Postal Service witness Gordon has reported that IBIP has generated \$29.8 million in postage revenue in FY 2000 to date (through AP 11). Thus, if the optimal mail processing scheme is not in place, the immediate revenue impact should be minimal. The current low volume should provide the Postal Service with an opportunity to develop, test, and experiment with different mail flows to determine what is best for IBIP mail and prepare for the future. The Commission does not place much weight on the Postal Service's argument, because if volumes increase, it should be in the best interest of the Postal Service to process this mail as efficiently as possible and put the appropriate mail processing procedures in place. The Service can refine applicable cost avoidance estimates, and propose an appropriate rate discount, while it tests and creates procedures for capturing IBIP cost savings. This is one of the

advantages to establishing a shell classification prior to implementing a new rate discount.

[5195] Finally, Stamps.com proposed extending a discount to IBIP mail that is prepared with labels. At this time, the Commission does not recommend that the IBIP classification apply to IBIP prepared mail that utilizes labels for applying postage or addressing information. As witness Jones states, the labels make the FIM unusable, therefore this type of IBIP mail should not have the same mail processing efficiencies as IBIP mail with the postal information printed directly on the envelope. There is a further risk that mailers may misapply the labels in a way that may negatively affect the automation compatibility of the mail piece.

b. Meter Technology Discount Proposal

[5196] Pitney Bowes proposes a one-cent discount applicable to the first ounce of First-Class single-piece mail that has postage affixed by metering technology. Throughout the proposal, First-Class Mail is understood to refer to First-Class letters, cards, flats, and irregular parcels and pieces (IPPs). Metering technology is understood to refer to both stand-alone dedicated postage evidencing devices (e.g., postage meters) and PC postage devices (e.g., a personal computer and printer connected via the Internet applying Information Based Indicia Program (IBIP) postage).

[5197] The Pitney Bowes proposal is presented through three witnesses. Witness Martin introduces the one-cent discount proposal and provides rationale on why the Commission should favorably recommend the discount. Witness Heisler sponsors a marketing survey that is used to estimate the mail volume that will convert from postage stamps to metering technology under three different discount levels. Witness Haldi estimates the Postal Service cost savings realized through metering technology and calculates the potential economic impact of the proposed metering technology one-cent discount on First-Class mail.

[5198] Witness Martin identifies a need to provide innovative services to small office, home office, and residential mailers. These mailers may have individual mailings that are too small to qualify for bulk discounts. She alleges the evolution of metering technology now makes it possible to recognize the worksharing efforts of small office, home office, and residential mailers. Furthermore, a metering technology discount could benefit mailers and the Postal Service by encouraging migration from stamps to metering technology, as stamps are the most costly method of collecting revenue and evidencing payment of postage. Tr .23/10558-66.

[5199] Martin characterizes the cost of creating, distributing and selling stamps as very substantial in absolute terms, and as a percentage of revenues collected. She contrasts this against the lower cost of collecting revenue through metering technology. Recent metering technology innovations such as digital postage meters with remote resetting, and PC postage, further help lower the cost of collecting revenue. The use of metering technology also reduces pressure on window service operations and increases “what is widely recognized to be [the] cleanest type of mail in the First-Class mainstream.” *Id.* at 10565. Martin concludes that a one-cent discount is conservative because it represents less than one-half of the cost savings calculated by witness Haldi, and because conservative assumptions are used to estimate migration from stamps to metering technology.

[5200] Witness Heisler sponsors and explains market research conducted by Opinion Research Corporation International on behalf of Pitney Bowes Inc. The market research, conducted via survey, measures household and non-household reactions to possible postage discounts for metered single piece First-Class Mail. The postage may be affixed by either a postage meter, or by a personal computer via the Internet (PC postage). The study indicates there is a “substantial” market interest in PC postage and postage meters when associated with a one-cent discount on First-Class postage by households and small businesses that are currently not using meters. *Id.* at 10582-604.

[5201] Two telephone studies were conducted, a household study and a non-household study. The household study examines qualifying household reaction to

discounts on PC postage for First-Class Mail. The non-household study divides the survey population into two approximately equal groups. One group was asked for reaction to discounts on PC postage for First-Class mail, and the other group was asked for reaction to discounts on "postage meter" mail for First-Class mail. Each of the non-household subgroups were further subdivided into qualifying businesses with 25 or fewer employees, or qualifying businesses with 26 to 50 employees.

[5202] Survey respondents were asked a series of qualifying questions, and a question about current First-Class Mail volume. They were read a concept statement about postage meters, or PC postage, as applicable. The respondents were then asked how likely they would be to use the concept described at three different price levels: no discount, a one-cent discount, and a two-cent discount. The responses were ranked on a scale of one to five with one being not likely at all, and five being extremely likely to use the concept described. Once a respondent answered that he or she would be extremely likely to utilize a concept at a given price level, they were not asked about a higher discount price level.

[5203] The survey data underwent processing and weighting, including the application of an 80% intent factor, before being converted into mail volume estimates. The mail volume estimates summarized in Table 5-6 represent the estimated volume of mail converted from postage stamps to metered mail at a no discount level and a one-cent discount level, by category of customer.

[5204] Witness Haldi testifies on the high transaction costs associated with the use of stamps to collect revenue and evidence postage. He also explains how a one-cent metering technology discount will assist the Postal Service lessen its dependence on stamps and encourage customers to use low cost automated forms of evidencing postage. He states that transaction costs for stamped mail and metered mail are now averaged. Because of this, a mailer that incurs the cost of obtaining a metering device that helps reduce Postal Service costs, does not receive any recognition or benefit. He notes that the introduction of low cost, low volume meters, and PC postage has made metering technology an affordable option for households. Tr. 29/13888-943.

Table 5-6
Results of Witness Heisler's Study
First-Class Mail Volume Affected
(in Pieces of First-Class Mail)

Category	No Discount	One-Cent Discount	Combined No & One-Cent Discounts
Household-PC Postage	336 million	1.1 billion	1.436 billion
Non-Household – PC Postage			
25 Employees or Less	216 million	2.3 billion	2.5 billion
26-50 Employees	29 million	71 million	100 million
Non-Household – Postage Meter			
25 Employees or Less	0	3.4 billion	3.4 billion
26-50 Employees	6.8 million	111 million	118 million

Source: Adapted from PB-T-3.

[5205] Haldi contends that the proposed discount will help the Postal Service to promote and retain its highly profitable First-Class Mail product while avoiding some of the problems of the OCA's Courtesy Envelope Mail proposal. Metering technology does not require a customer to maintain an inventory of two stamp denominations, and because a customer does not have to be vigilant about which stamp to use, Postal Service revenue would be protected from use of the wrong stamp. Haldi explains that the differences in transaction costs, and mail processing and delivery costs have previously been recognized. Qualified Business Reply Mail (QBRM) recognizes lower mail processing and delivery costs, but assesses an accounting fee of 5 cents per piece to cover transaction costs. The metering technology proposal examines just the transaction costs.

[5206] In developing the cost savings associated with metering technology, Haldi compares the attributable cost of stamps to the attributable cost of metering technology. He limits the attributable cost of stamps to stamped envelopes and cards, window time, indirect costs, stamps and accountable paper, fees for managing the stamp consignment

program, credit card fees, and several miscellaneous items. He limits the attributable cost associated with meters to window time, as meters do not require Postal Service supplies. Haldi calculates an attributable cost of stamps and accountable paper of \$746 million. He concludes this is substantially greater than the calculated attributable cost of \$6.3 million for meters. In terms of the proposed 34-cent First-Class rate, the attributable transaction cost for stamped mail amounts to approximately 6.7 percent of the revenue collected, or 2.3 cents per piece. The attributable transaction cost for metered mail is negligible in comparison.

[5207] Haldi proposes a one-cent metered mail discount. This corresponds to a 44 percent passthrough of the 2.3-cent attributable transaction cost that is avoidable by not using stamps. He states that a higher discount could be supported, but a higher discount at this time may force the rate for first ounce First-Class stamped mail to increase from 34 to 35 cents.

[5208] The effect of the proposed one-cent discount is estimated to be a net reduction in revenue during the test year of \$156.5 million. Haldi first explains there will be an approximate \$245 million reduction in revenue from implementation of the discount for existing metered mail. Additionally, revenue will be reduced by another \$49.5 million from the 4.954 billion pieces of mail that convert from stamps to metering technology. The number of mailpieces that will convert is estimated using Heisler's study that projects the household PC postage respondents and the non-household postage meter respondents that would convert with no discount and with a one-cent discount. The 2.6 billion mailpieces attributable to the non-household PC postage respondents are not included because the survey is not able to resolve the volume overlap between non-household postage meter respondents and the non-household PC postage respondents. The gross revenue reduction thus amounts to \$294.5 million.

[5209] Offsetting the revenue reduction are the cost savings from additional use of metering technology and the increased volume from the reduced rates. Assuming 4.954 billion pieces of mail convert to metering technology and the previously calculated attributable cost savings of 2.3 cents per piece, the resulting attributable transaction

costs savings will be \$114 million. The proposed discount should also negate the mail volume loss caused by a one-cent increase in the First-Class rate. The avoided loss is estimated at \$24.1 million from this affect. By combining the gross revenue reduction with the above offsetting factors, Haldi concludes the net revenue reduction associated with a one-cent metering technology discount is \$156.5 million.

[5210] *Postal Service Response*. The Postal Service opposes the one-cent metering technology discount proposed by Pitney Bowes through the rebuttal testimony of witness Miller. Tr .45/19665-69. Witness Staisey also provides further support of the Postal Service position in her rebuttal testimony by offering a critique of the marketing survey performed by Pitney Bowes witness Heisler *Id.* at 19921-27.

[5211] Witness Miller provides a brief history of the postage meter and explains how postage meters were originally developed to save the mailer mail clerk costs, not to save the Postal Service costs. Since the advent of the postage meter, many forms of evidencing postage and methods of distributing stamps have been made available to the public. Arguably, some may claim that each of these evidencing or distribution methods has different costs that should be reflected in the rate schedule.

[5212] In Docket No. R77-1, the Commission did not include the cost associated with stamp procurement in determining presort mail cost avoidance. The Commission reasoned that if “presorted first-class mail were not presorted, it would still be metered or imprinted and deposited in bulk. Therefore, these cost effects are present regardless of presorting and are not properly included as avoided costs.” PRC Op. R77-1 at 258-59. (footnote omitted). Miller argues that the proposed discount presents a similar situation because meter users find meters to be the most convenient and cost effective method of evidencing postage. Pitney Bowes does not present a compelling basis to define worksharing as including stamp-related costs because without a discount, this mail will continue to be metered.

[5213] Miller makes a final argument that First-Class workshare mail, Standard Mail A workshare mail and PC postage also avoid stamp manufacturing and distribution

costs. If the discount were consistently extended to these classes of mail, the revenue loss to the Postal Service would be very substantial.

[5214] Staisey argues that the conclusions Pitney Bowes witness Heisler draws from his research are misleading due to flaws present in his survey questionnaires, and the methodology used to analyze the survey responses. She states that all basic factual and neutral information should be provided to a survey respondent concerning the product under consideration to allow for an informed decision on the likelihood of adopting the product. However, in Heisler's survey, multiple sources of bias in the description of the product has led to an oversizing of the metered postage market. Staisey finds bias in the survey concept statement, product description, failure to describe the additional burdens of using PC postage, and failure to describe the net savings/cost to the respondent.

[5215] Another area that Staisey critiques is the methodology of analyzing the survey results. She states that the small sample size and small number of positive respondents preclude meaningful estimates of pieces of mail affected by PC postage. She also states that a survey response rate has not been provided to assess the degree to which the survey results are representative of the population surveyed.

[5216] *Commission Analysis.* Implementing a one-cent discount could result in the immediate revenue loss of approximately \$245 million from metered mail that converts to the new rate. Haldi, using volume estimates from Heisler's survey, calculates offsetting savings that may reduce the net test year revenue loss to \$156.5 million. However, Postal Service Staisey is notably critical of Heisler's survey and its ability to accurately predict conversion rates to metered mail. The Commission agrees with Staisey's criticism up to a point. Her comments on customers not having enough information on total product costs to make an informed decision, and the reasonableness of the small sample size used to predict large mail volumes appear logical. However, she may be overly critical of certain aspects of the survey related to customer knowledge and customer ability to follow a consistent line of questions. The Commission also notes that the survey does not specify a time period over which new customers may adopt metering

technology. Because of this, the Commission concludes that the net test year revenue loss may be substantially higher than the loss predicted by Haldi.

[5217] A revenue loss of hundreds of millions of dollars is substantial and would have to be recouped elsewhere. Haldi limits the cost savings passthrough to 44 percent because he concludes a higher passthrough would likely necessitate a further increase in the stamped single-piece rate. Deaveraging the single-piece First-Class rate under this proposal, with the possibility of a higher single-piece stamp rate, is a concept that the Commission views as non-beneficial to the majority of users of First-Class stamps.

[5218] The Commission previously has not recognized cost avoidance associated with stamp manufacturing and distribution as worksharing related. The Postal Service argument that metered mail will not convert back into stamped mail if no discount is established appears correct. Most meter users have other reasons for using meters than the possibility of a single piece First-Class discount. Although metered mail may save the Postal Service stamp costs, it cannot be concluded that these costs are in the same category as historically recognizable worksharing costs.

[5219] Individual pieces of single-piece First-Class Mail may be differentiated by many mail characteristics, including means of paying of postage. Each characteristic may result in a different cost to the Postal Service. The different distribution channels for stamps also have different cost characteristics. In this rate case, there are several proposals, other than the metered mail proposal, that could increase the complexity of the rate schedule. This could create an undesirable situation where a multitude of mailpiece characteristic have to be examined before determining a proper postage rate. See § 3622(b)(7) and § 3623(c)(5). The Commission must consider all aspects of a classification proposal, such as the metered discount proposal, before making a recommendation that inevitable will complicate the rate schedule.

[5220] A metered mail discount potentially may discriminate between different single-piece First-Class mailers. Persons with the means to afford metering technology, by their status, would be given lower postage rates without providing any recognized cost savings to the Postal Service. Persons that can least afford technology, and the

price of postage, would be forced to pay higher rates. From this vantage point, the proposal may not be fair or equitable to all single-piece First-Class mailers. § 3623(c)(1). The possibility that this proposal may further increase the stamped mail rate due to deaveraging compounds this problem.

[5221] In conclusion, implementing the metered discount proposal could result in a significant test year revenue reduction that would have to be recouped, burdening other types of mail. Furthermore, the costs associated with payment of postage are not an appropriate basis for worksharing savings. Finally, providing a discount to mailers that can afford to purchase certain technology that reduces only stamp costs is not fair or equitable to all users of single-piece First-Class Mail. Therefore, the Commission does not recommend the Pitney Bowes one-cent metered discount proposal.

c. “P” Rate Proposal

[5222] *ABA&NAPM Proposal.* ABA&NAPM witness Clifton proposes a 2-cent discount for the first ounce of “P” rate mail. He describes “P” rate mail as First-Class letter mail using a “P” stamp or “P” meter imprint as indicia of postage. Under the proposal, a consumer places “P” rate mail in a private collection box. The mail from the private collection box is collected by a workshare mailer such as a presort bureau. The workshare mailer prebarcodes and presorts the collected mail to at least the basic presort level. The workshare mailer then delivers this mail to the Postal Service for final processing and delivery. The Postal Service credits the workshare mailer the difference between the final level of presort and the discounted “P” rate. This proposal benefits the Postal Service by providing a higher quantity of prebarcoded, presorted mail that can be more efficiently and cost effectively processed. Tr. 26/12435-42.

[5223] Clifton envisions that workshare mailers would contract with the owners of property such as churches, gasoline stations, grocery stores, and banks for the placement of private collection boxes for the collection of “P” rate mail. They would also implicitly be responsible for acquiring or modifying mail processing equipment to process

the “P” rate mail. Clifton states that it would take about a year to work out the details between the Postal Service and the private sector, produce an advertising campaign, and contract for the manufacture and placement of private collection boxes. Therefore, it is unlikely that “P” rate mail will influence Postal Service revenue and volume for Test Year 2001. Clifton further proposes that the Postal Service be authorized and funded to sustain a public relations campaign about the availability and proper use of the “P” rate. It is also implicit in the proposal that the Postal Service would develop, manufacture, and sell the “P” rate stamps.

[5224] *Postal Service Rebuttal.* The Postal Service opposition to the “P” rate proposal is presented through the rebuttal testimony of witness Miller. Miller questions whether the presort industry is capable of processing “P” rate mail. He argues that presort bureaus/Multi Line Optical Character Reader (MLOCR) qualified mailers do not currently house cancellation equipment such as the Advance Facer Canceler System (AFCS) that would be required to cancel the “P” rate stamps. Miller also alleges it is not clear, as MacHarg states, whether presort bureaus can modify MLOCR’s to efficiently cancel and process “P” rate mail. Furthermore, he questions the capacity of the presort industry to finalize “P” rate mail in volume using Remote Computer Read (RCR)/Remote Bar Code Sorter (RBCS). He expresses a concern that the Postal Service may receive large quantities of mail with little to no worksharing being preformed because of the questionable capacity of workshare mailers. Tr .45/19662-65.

[5225] Miller highlights several areas where information is needed to help analyze the proposal. He states there are no “P” rate volume forecasts to determine the revenue impact on the Postal Service. There is no presort industry equipment inventory to analyses the industry capability. Also, the discount is difficult to analyze because it is not based on a cost savings estimate. He concludes by arguing that the “P” rate suffers from the same two-stamp problems as the CEM proposal. If the “P” rate and CEM proposals were both implemented, the Postal Service would then have to contend with three alternative basic rate First-Class Mail stamps.

[5226] *Commission Analysis.* The “P” rate proposal is a novel idea that possesses some benefits. A discount rate is made available to individual mailers that allow them to share in the benefits of worksharing and the Postal Service automation program. Workshare mailers would have access to a new source of business that has the potential to provide substantial and somewhat continuous revenue. Finally, the Postal Service may benefit through receiving a higher quantity of workshare mail that is more economical and profitable to process. Although the benefits highlighted above are worthwhile, there are drawbacks to the proposal, and many potential unresolved or unanswered questions. Many of the issues are highlighted below, but more issues are sure to arise if this proposal is further developed. Although conceptually simple, this proposal contains many complex issues that must be resolved. Until this proposal undergoes substantial further development, the Commission cannot recommend the “P” rate.

[5227] Clifton was presented with several issues during his oral testimony that are indicative of the issues that need to be discussed and resolved such as:

- The service standards for “P” rate mail. T r.26/12726.
- The Postal Service handling of “P” rate mail deposited in Postal Service collection boxes. The potential return of this mail to presort bureaus. The selection of presort bureaus for this returned mail. *Id.* at 12688-90.
- The requirements with respect to handwritten versus typed addressing. The projected “P” rate volumes. The handling of non-readable mail. *Id.* at 12724-26.
- Potential problems with multiple make up stamps when First-Class rates change. *Id.* at 12681-82.
- The magnitude of the potential savings for a mailer in using the “P” rate stamp. *Id.* at 12682-83.

This sampling represents only a few of the issues that would have to be resolved before the Commission could consider recommending the “P” rate proposal.

[5228] The proposed “P” rate program places burdens on the Postal Service. The burdens include, but are not limited to, a public relations campaign, the manufacture and sale of “P” rate stamps, and revenue protection and enforcement issues. Clifton proposes that the Postal Service fund and sustain a public relations campaign informing

the public about the “P” rate program. A budget has not been proposed or estimated. Nevertheless, without “P” rate volume and revenue projections, the reasonableness of this campaign cannot be analyzed in relation to the total program. Furthermore, the Postal Service has to support and be shown to benefit from the “P” rate concept if it is expected to mount an effective public relations campaign.

[5229] In this proposal, the Postal Service will be selling a product, represented by the sale of a “P” rate stamp, in which a third party is providing a crucial part of the service. The record is not clear as to the conceptual or legal relationship between the Postal Service and the multiple third party workshare mailers. It is also not clear if this relationship could be explained to a consumer without risking the reputation of the Postal Service if mail delivery problems arise with one or more workshare mailers. There is a further possibility of customer confusion about the status of the “P” rate stamp. May a customer that purchases a “P” rate stamp from the Postal Service apply the stamp toward regular First-Class postage and deposit such mail with the Postal Service. For the reasons discussed above, the Commission finds this proposal premature, and does not recommend implementation of the “P” rate proposal at this time.

d. Rates Working Group Proposal

[5230] The OCA proposes that the Postal Service sponsor a “Rates Working Group” to discuss ratemaking issues between rate cases. OCA witness Gerarden cites the complexity of rate cases and the short ten month rate case time frame as reasons why it would be beneficial to convene a group to discuss ratemaking issues in the interim periods between rate cases. The working group could be used to discuss novel, complex, or difficult issues and to build consensus in a neutral rather than an adversarial setting. He offers as support his opinion that the Postal Service is contemplating shorter intervals between rate cases. He concludes that this will place an even greater burden on participants to quickly analyze and respond to complex rate case proposals.

Tr. 29/13581-85.

[5231] Gerarden proposes that the Rates Working Group be organized by the Postal Service, and function under ground rules established by the Postal Service and the participants. The focus of the group should be on technical, not legal issues. It should not be a forum for discovery, or indirectly used as a litigation weapon, and should not be viewed as a substitute for the Postal Rate Commission. It should be a good faith effort to focus on a limited number of important issues when no rate case is pending.

[5232] *Commission Analysis.* The Commission frequently suggests that parties use informal means to discuss issues and resolve problems. In this context, a Rates Working Group may benefit the free flow of information between parties and resolve issues before intervention by the Commission becomes necessary. The Commission is aware that the Postal Service already consults with various industry groups on a variety of issues between rate cases. The Commission suggests that these discussions should be as inclusive as possible so that interested parties, such as the OCA, are made aware of the discussions and invited to contribute accordingly.

[5233] The OCA proposal requests the Commission to recommend that the Postal Service sponsor a forum for discussion. This goes beyond the Commission suggesting that parties meet and informally resolve issues. A recommendation to establish a Rates Working Group will tend to formalize what should be informal discussions, and may have the unintended effect of stifling the free flow of information. This is a potential negative to recommending the proposal, along with the concern that the legal requirements for a formally recommended working group have not been addressed. Therefore, the Commission supports the idea of a Rates Working Group, but abstains from making a formal recommendation.

e. First-Class Single Piece Rate Stability Proposal

[5234] OCA witness Callow proposes that adjustments to the single-piece First-Class rate for letters and cards be limited to every other rate proceeding. The proposal is structured to accommodate OCA's perception that household mailers are

interested in longer periods of rate stability, but business mailers prefer smaller, more frequent, rate adjustments. Callow also assumes that in future years the Postal Service will file rate cases more frequently, at somewhat evenly spaced time intervals.

Tr. 22/10128-46.

[5235] The proposal requires the Commission to follow a two step process to recommend a single-piece First-Class rate that will remain in effect for two successive rate cycles. During the first rate proceeding (rate case one), the Commission would first determine an “actual rate” (AR1) for single-piece First-Class letters and cards in the same manner as it has in previous rate proceedings. This includes consideration of the test year break-even criteria, but does not require the Commission to adhere to the integer constraint.⁶⁴ The second step is to use the “actual rate” (AR1) as a basis for determining a “recommended rate” (RR). The recommended rate (RR) would be higher than the actual rate (AR1), and would conform to the integer constraint. The recommended rate (RR) is in effect based on a prediction of the First-Class revenue required to break even over two rate case cycles.

[5236] Single-piece First-Class mailers would pay the recommended rate (RR). The difference between the higher recommended rate (RR) and the lower actual rate (AR1), multiplied by the actual mail volumes, would accumulate in a single-piece First-Class “reserve account” while the rates from the first rate case are in effect.

[5237] When the subsequent rate proceeding is initiated (rate case 2), the Commission would determine a new actual rate (AR2), considering the break-even requirement, but without regard for the integer constraint. The single-piece First-Class mailers would continue to pay the recommended rate (RR) determined in the previous rate proceeding.

[5238] Callow assumes that the new actual rate (AR2) would be greater than the recommended rate (RR) that mailers pay for First-Class postage. The net underpayment of postage calculated by taking the difference between the lower recommended rate (RR)

⁶⁴ The integer constraint refers to the historic setting of single-piece First-Class rates in whole cent increments.

and the higher new actual rate (AR2), multiplied by the actual mail volumes, would be subtracted from the previously created reserve account on a periodic basis. Ideally, the reserve account would be drawn down to zero in the test year of the second rate case. If this does not happen, the reserve account balance would be taken into account in setting rates in the third rate case (rate case 3).

[5239] The proposal recognizes that if it is determined there are unacceptably insufficient funds available in the reserve account to cover predicted negative payments the Commission would have to recommend a new rate in the second rate case (rate case 2).

[5240] The OCA also proposes that workshare discounts be determined in relation to the actual rates, and not in relation to the recommended rate. Assuming that workshare discounts remain constant over the duration of the two rate case cycle and the actual rates vary, the net worksharing discount, which accounts for the difference between the recommended rate and the actual rate, will also vary. The OCA predicts that this will cause a volume shift between the single-piece rate and the workshare discount rates depending on what is more advantageous to individual workshare mailers.

[5241] *Postal Service Comments.* On brief, the Postal Service argues that the OCA proposal is founded on several unsubstantiated premises. First, the claim that the Postal Service has established a policy of requesting general rate increases every two years is incorrect. Second, Callow's assertions concerning the different interests of the general public and business mailers with respect to the timing and frequency of First-Class Mail rate increases is without foundation. The Service suggests that this proposal be shelved in the absence of a suggestion from Postal Service management that this idea should be explored. The Postal Service concludes by cautioning the Commission that it should not recommend rates in a manner that imposes an unsolicited change in long-standing rate implementation policy. Postal Service Brief at VII-86-89.

[5242] *Intervenor Comments.* On brief, DMA opposes the rate stability proposal alleging numerous legal and practical flaws. DMA questions whether the "break even" requirement of the Act could be interpreted to apply over two rate cases, and whether the

first rate case under the proposal could be appealed based on the excess revenues generated in the first test year. DMA also questions how the Postal Service management's prerogatives could be maintained when they are constrained in the second rate case to maintaining the rate which is the most important feature of the entire rate structure, the single-piece First-Class rate.

[5243] From a practical perspective, DMA says that it is highly speculative that the excess revenue generated under the first rate case will adequately offset the shortfall under the second rate case. Also, the proposal would primarily affect business mailers who may not agree that paying higher rates as a result of the first rate case is in their business interest. Finally, the proposal may distort the worksharing incentives because the actual rates would not reflect the actual cost differences. DMA Brief at 9-14.

[5244] On brief, PostCom & MASA outline several areas where the rate stability proposal needs further development, and suggests it also would be prudent to undertake a closer legal analysis of the proposal. PostCom & MASA conclude that the proposal needs further development before it can be given meaningful consideration. PostCom & MASA Brief at 8 and Reply Brief at 10-13.

[5245] *Commission Analysis.* The Commission finds some aspects of the rate stability proposal interesting. For example, the ability to set the single-piece First-Class rate without regard to the integer constraint would allow the Commission more freedom in accurately setting all other rates. However, the Commission does not recommend this proposal because the major premises of this proposal are not supported on the record, and other areas of the proposal need further development.

[5246] Through a series of interrogatories, the Postal Service explores the basis of OCA's premise that households prefer longer periods of a stable single-piece First-Class rate, and the associated confusion caused by more frequent rate changes. Tr. 22/10205-10. The Commission does not doubt that some transient confusion may exist when rates change, and that some households may prefer rate stability, especially when rates are rising. However, the answers to the interrogatories indicate the OCA is

not aware of any surveys, focus groups, or other studies conducted that quantify its premise.

[5247] For the proposal to work with somewhat predictable results, the dates pertinent to the rate case that initially implements the rate stability proposal (rate case 1), and at least the rate implementation date and the test year date for the following rate case (rate case 2) must be approximately known. OCA assumes that the Postal Service will file more frequent, regularly spaced rate cases. However, there is no record evidence that confirms this assumption. Without estimates of test year and rate implementation dates, the recommended rate (RR) could not be set with any certainty. Furthermore, even if the Postal Service agreed to file omnibus rate cases at regular intervals, the rate stability proposal would require the Commission to estimate rates over two rate cycles instead of one, adding more uncertainty to setting rates. Witness Callow acknowledges that the farther out in time one goes to look at costs the less certain the projection will be. *Id.* at 10257.

[5248] Witness Callow was requested to comment on whether the rate stability proposal violates the provisions of the break-even requirement. *Id.* at 10186-87. The break-even requirement in § 3621 states in part: "Postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service." The rate stability proposal would require the Commission to recommend rates in excess of break-even for the first rate case, and break even in the second rate case test year. Because this proposal is not being accepted for other reasons, the Commission does not reach a conclusion on whether this proposal meets the break-even requirement, but notes that this issue would have to be resolved before recommending any similar proposals.

[5249] Finally, the integer constraint as proposed by Callow also causes fluctuation in workshare discounts, and as recognized by Callow that may not be desirable. See Tr. 22/10137-44. The Commission reviews proposals from all intervenors in an omnibus rate case proceeding, and it may be possible to develop a proposal that is not subject to

the objection described in this section. The rate stability concept is the type of idea that might benefit from free discussion outside of a formal rate proceeding.

f. Proposal to Provide Mailers with 10 One-Cent Make Up Stamps

[5250] The OCA proposes that if the Commission recommends and the Governors approve a one-cent First-Class first-ounce rate increase, the Postal Service deliver an informational mailpiece to every delivery address, and include with the mailpiece ten make-up stamps at no charge. Witness Gerarden alleges this will benefit the public by spreading out the rush to purchase make-up stamps, and reduce some of the customer frustration associated with rate changes such as waiting in line to purchase new denomination and make-up stamps. It will also benefit the Postal Service by improving the process of transitioning to new rates, and improving the Postal Service's public image. Tr. 29/13572-81.

[5251] Gerarden estimates the net financial impact of this proposal will result in little to no additional cost to the Postal Service. He argues that the cost of implementing the OCA proposal should be offset by a reduction in window service costs and costs avoided by combining the proposed mailing with a mailing that the Postal Service already has planned. He estimates the costs of mailpiece production, stamp production, and saturation mailing to every delivery address to be \$13.8 million. He estimates the revenue foregone by providing the make-up stamps at no charge to be \$11.7 million. He calculates offsetting cost savings from a reduced number of window transactions to purchase make-up stamps of \$17.9 million. Assuming that the Postal Service is planning an informational mailing regardless of the OCA proposal, Gerarden offsets the OCA proposal costs by \$9.5 million as a result of combining the two separate mailings. Gerarden concludes a net saving of \$1.9 million to the Postal Service may result from implementing the OCA proposal.

[5252] *Postal Service Comments.* On brief, the Postal Service argues that the manner in which the public is informed about the rates to be implemented, and the

manner of implementation are matters left to the sole discretion of Postal Service management, and are beyond the Commission's authority to recommend rates and classifications. The Postal Service respectfully requests the Commission to defer to Postal Service management regarding this issue. Postal Service Brief at VII-86.

[5253] *Commission Analysis.* The Commission perceives the OCA proposal as a novel idea that deserves consideration by the Postal Service. Informing the public about Postal Service changes through mailings or other means may educate the public, and smooth the transition to the implementation of new rates and services. Providing make-up stamps at no charge may spread out the rush to purchase make up stamps in the month surrounding the rate change. It also may encourage the recipient to read the informational mailing and promote Postal Service goodwill. The Commission is fully aware that designing and implementing public information programs are matters left to the discretion of Postal Service management. Nonetheless, the Commission is certain that management is open to new ideas that would benefit both the Postal Service and individual mailers. In that spirit, the Commission recommends this idea for management consideration.

3. Cards

[5254] The First-Class Mail Cards subclass consists of Stamped Cards and postcards. Stamped Cards are purchased through the Postal Service as a special service. See DMCS Section 962. Postcards are privately printed mailing cards of uniform thickness that do not exceed 6 inches in length, 4-1/4 inches in width, or 0.016 inches in thickness. In FY 1998, cards generated approximately \$1.0 billion, or 3.0 percent, of First-Class Mail revenue, and represented about 5 percent of First-Class Mail volume. Over the past 10 years, volume has been relatively constant in the single piece category, with growth shown in the presort/automation category. USPS-T-33 at 8-11.

[5255] The Postal Service proposes increasing the current 20-cent rate for single-piece cards by one cent, paralleling the increase in First-Class letters.

Single-piece cards account for approximately 60 percent of card revenues. A one-cent increase retains the 13-cent gap with the single-piece letter rate and represents a 5 percent increase above the current single-piece card rate. A one-cent increase is also proposed for nonautomation presort cards. This increases the nonautomation presort rate from 18 cents to 19 cents. It retains the current 2-cent gap between the single-piece card rate and the nonautomation presort card rate and is consistent with the difference between the single-piece letter rate and the nonautomation presort letter rate. The Postal Service proposes maintaining the discount rate of 18 cents for Qualified Business Reply Mail (QBRM) cards. An 18-cent rate effectively increases the QBRM discount from 2 cents to 3 cents. Campbell calculates a QBRM cost avoidance of 3.4cents for both letters and cards. A 3-cent discount passes through roughly 90 percent of the calculated cost avoidance. *Id.* at 38-40.

[5256] The automation presort card rate structure consists of four tiers: basic, 3-digit, 5-digit, and carrier route. Miller calculates a cost avoidance of 1.68 2cents between nonautomation presort cards and basic automation cards. Fronk proposes to increase the amount of the cost avoidance passthrough, and to increase the rate difference between nonautomation presort cards and basic automation presort cards from 1.4 cents to 1.6 cents. This results in an increase in the basic automation card rate from 16.6 cents to 17.4 cents. The Postal Service proposes increasing the 3-digit card rate from 15.9 cents to 16.7 cents. This maintains the current 0.7-cent gap between the basic card rate and the 3-digit card rates, but passes through more than 100 percent of the calculated cost avoidance. The Postal Service proposes retaining the current 1.3-cent gap between 3-digit and 5-digit cards by increasing the 5-digit card rate from 14.6 cents to 15. 4cents. The proposed 5-digit card rate, as with the proposed 3-digit card rate, has greater than a 100 percent passthrough of the calculated cost avoidance. The Postal Service proposes to increase the carrier route cards rate from 14.1 cents to 14.9 cents. This maintains the current 0.5-cent gap between 5-digit cards and carrier route cards. *Id.* at 40-43.

[5257] Fronk recognizes that the calculated cost savings for 3-digit cards and 5-digit cards are now less than the proposed discounts. Thus, if the discounts were tied strictly to avoided costs, the discounts would have to be reduced. Instead, the discounts and passthroughs were selected to balance several other goals, including: achieving the Postal Service cost coverage target, recognizing the value of worksharing, acknowledging the importance of mailer barcoding, and avoiding discount level changes which result in disruptive rate impacts. *Id.* at 41.

[5258] *Intervenor Comments.* On brief, Carlson opposes increasing the single-piece card rate to 21 cents. He quotes the Docket No. R97-1 decision concerning the importance of maintaining at least one inexpensive postal category that can be widely used, and the somewhat more limited value of service that cards offer, especially in terms of privacy. In addition, Carlson argues that cards provide a lower value of service than letters based on lower on-time delivery performance (citing EXFC data). Carlson Brief at 20-21.

[5259] Intervenor Popkin alleges that stamped cards have lower mail processing costs than postcards, and are thus more cost effective for the Postal Service to handle. He argues that increasing the card postage rate to 21 cents combined with increasing the special service stamped card rate to two cents may encourage mailers to use less cost effective postcards. Therefore, he argues for maintaining the 20-cent single-piece card rate as a way to encourage mailers to use the more cost effective stamped cards, instead of postcards. Popkin Brief at 9.

[5260] *Commission Analysis.* The Commission finds the record supports retaining the current single-piece card rate of 20 cents. At this rate, test year single-piece cards revenue is estimated at \$593 million. This is nearly equal the single-piece cards attributable cost estimation of \$597 million. The recommended 20-cent rate continues to help ensure that there is at least one relatively inexpensive postal category that can be widely used by the general public, businesses, and organizations.

[5261] The First-Class cards subclass is part of the larger First-Class Mail class. In this proceeding, several intervenors comment on the increasing institutional cost burden

on First-Class Mail. See Chapter 5, Section B.1.b. Maintaining the single-piece card rate at its current level to mitigate this increasing cost burden is an important consideration in the Commission's recommendation. Furthermore, the recommendation also reflects the Commission's determination that the whole-cent integer constraint continues to be a significant consideration in establishing appropriate single-piece rates.

[5262] The Commission recommends a 3-cents discount for QBRM cards. This is the same discount recommendation as for QBRM letters and is based on similar cost avoidances. A 3-cents discount results in an 17-cents QBRM card rate.

[5263] The Commission recommends an 18-cents rate for non-automation presort cards. This maintains the 2-cents difference between single-piece cards and non-automation presort cards. The Commission recommends cost-based rates for the remainder of the worksharing tiers based on the avoided costs. The recommended rates continue to acknowledge the importance of mailer barcoding, but also recognize the decrease in avoided costs between automation 3-digit and 5-digit cards. To make rate increases as small as possible, the recommendations are based on a cost avoidance passthrough as close to 100 percent as possible, given a 0.1-cent rounding constraint.

[5264] The Commission estimates avoided costs of 1.606 cents between non-automation presort and basic automation cards, 0.562 cents between basic automation and 3-digit cards, 0.711 cents between 3-digit and 5-digit cards, and 1.111 cents between 5-digit and carrier route cards. The Commission recommends discount increments of 1.6 cents between non-automation presort and basic automation cards, 0.6 cents between basic automation and 3-digit cards, 0.7 cents between 3-digit and 5-digit cards, and 1.1 cents between 5-digit and carrier route cards. The resulting recommended rates are 16.4 cents for basic automation cards, 15.8 cents for 3-digit cards, 15.1 cents for 5-digit cards, and 14.0 cents for carrier route cards.

[5265] The Commission's recommended rates for the Cards subclass reflect an average increase of 0.4 percent. This is lower than the First-Class letters increase of 1.8 percent and lower than the system-wide average increase of 4.6 percent. It is a modest increase when considering the Docket No. R97-1 card rate increase of only 0.2 percent.

Based on the Commission's projected test-year after-rates volume, First-Class card revenue will exceed estimated attributable costs by \$256 million. Thus, card rates cover attributable costs, as required by § 3622(b)(3). The Commission's recommended 20-cent postcard rate reflect consideration of the somewhat more limited value of service that cards offer, especially in terms of privacy (§3622(b)(2)). No record evidence suggests that the recommended rates may have an unduly negative impact on mailers (§ 3622(b)(4)).

[5266] The recommended cost-based rates appropriately recognize the worksharing efforts of mailers presenting bulk presorted or prebarcoded cards (§ 3622(b)(6)). The rate schedule for cards generally provides identifiable relationships. The recommended 17-cent rate for QBRM cards parallels the discount considerations for QBRM letters. (§3622(b)(7)). Overall, the Commission finds that the card rates it recommends are fair and equitable (§ 3622(b)(1)). The markup index for Cards is .561. This is somewhat lower than the Docket No. R97-1 markup of .913 and the Docket No. R90-1 markup of .919, but close to the Docket No. R94-1 markup of .645. The Commission finds the markup index for Cards appropriate on this record.

Table 5-7
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¢
Qualified Business Reply Mail	18.0¢	18.0¢	17.0¢
Nonautomation Presort	18.0¢	19.0¢	18.0¢
Basic Automation	16.6¢	17.4¢	16.4¢
3-Digit	15.9¢	16.7¢	15.8¢
5-Digit	14.6¢	15.4¢	15.1¢
Carrier Route	14.1¢	14.9¢	14.0¢

Source: Adapted from USPS-T-33 at 5.

4. Priority Mail

a. Introduction

[5267] Priority Mail constitutes the extension of First-Class Mail for pieces weighing more than 13 ounces,⁶⁵ and is available for all mailable items up to 70 pounds in weight. Because it receives expedited handling and transportation, and offers some other features of services sold by private competitors—including delivery confirmation⁶⁶—Priority Mail competes in the two-day document and package delivery market. Consequently, Priority Mail contains both monopoly letter mail and items that competing

⁶⁵ In Docket No. R97-1, the Commission recommended an increase in the 11-ounce breakpoint between First Class and Priority Mail to provide a smoother transition between the rates for the two subclasses. PRC Op. R97-1, paras. 5234-5235. The Governors approved this recommended change.

⁶⁶ In Docket No. R97-1, the Postal Service proposed establishment of a delivery confirmation special service, to be made available for Priority Mail, Parcel Post, Bound Printed Matter, Special Standard and Library Mail. At present, Priority Mail Base Delivery Confirmation (PMB DC), which requires mailer preparation and electronic registration, is available at no additional charge; Priority Mail Retail Surcharge Delivery Confirmation (PMRS DC), a manual variant, is available at Postal Service retail counters for 35 cents. The Postal Service proposes to make Priority Mail eligible to purchase signature confirmation in this case.

carriers could carry outside the restrictions of the Private Express Statutes. Priority Mail makes a contribution to postal revenues that is disproportionate to its volume; while it accounted for only 0.6 percent of total volume in FY 1999, it contributed 7.2 percent of total revenue. 1999 Revenue, Pieces and Weight Report.

[5268] Priority Mail rates are unzoned for pieces up to five pounds, with a current 2-pound rate of \$3.20 and 3-pound, 4-pound and 5-pound rates that increase in increments of \$1.10. The rates for heavier mailings are zoned. Currently a flat-rate envelope is made available by the Postal Service that is charged the 2-pound rate, regardless of the actual weight of the contents. Pickup service is available for Priority Mail; the current fee is \$8.25. While the rate schedule extends up to 70 pounds, 74 percent of Priority Mail weighed 5 pounds or less in FY 1999, and the average postage weight was 2.0 pounds. Library Reference PRC-LR-1. In the same period, 65 percent of Priority Mail was sent at the unzoned rate for items weighing two pounds or less.

[5269] As in Docket No.R97-1,⁶⁷ Priority Mail rates are affected by costs resulting from a contract between the Postal Service and Emery World Airlines for processing, surface transportation, and air transportation of mail in a network of Priority Mail Processing Centers (PMPCs). Postal Service witness Robinson testified that the Service is currently evaluating the Priority Mail processing network, and has not decided how it will be configured in the future. However, for the purposes of this case, the Service's cost studies assume that the current network configuration of 10 PMPC sites located in the Northeast and Florida will exist in the test year. USPS-T-34 at 13. Because of the uncertainty surrounding the future of the PMPC contract after the test year, and of the Postal Service's method of accounting for contract costs, the PMPC contract raises questions concerning both the costs properly attributable to Priority Mail and the method for designing its rates. These matters will be addressed below.

⁶⁷ See PRC Op. R97-1, paras. 5278, 5322, 5329.

b. Postal Service Proposal

[5270] The Postal Service proposes an overall increase of 15 percent for Priority Mail, based on its estimated costs and witness Mayes' recommended markup of 180.9 percent over volume variable costs, or 162.7 percent expressed as a markup over incremental costs. USPS-T-32 at 25. As in Docket No.R97-1, the Service proposes to recover the costs of providing the electronic invoice variant of delivery confirmation service in the basic rates for Priority Mail. USPS-T-34 at 18.

[5271] The Service proposes increasing the two-pound rate from \$3.20 to \$3.85. For the three-, four- and five-pound unzoned rates, the Service proposes an increase from the current uniform rate increment of \$1.10 to \$1.25, to produce rates of \$5.10, \$6.35, and \$7.60, respectively. *Id.* at 9, 17.

[5272] In addition to these pre-existing unzoned rates, the Postal Service proposes introduction of a one-pound unzoned rate of \$3.45. However, the flat-rate Priority Mail envelope would continue to be charged the two-pound rate under the Service's proposal. *Id.* at 9.

[5273] For the zoned rates applicable to Priority Mail pieces weighing more than five pounds, witness Robinson develops per-piece and per-pound rate elements to allocate total volume variable costs, including an "Emery adjustment" to apportion costs associated with the PMPC contract between per-piece and per-pound elements. *Id.* at 11-15.⁶⁸ In order to mitigate the impact of the Emery contract's costs on the current structure of rate relationships in the Priority Mail schedule, witness Robinson constrains the rates she develops to remain within a five percent band around the 15 percent average rate change for Priority Mail as a whole. All such rates are then rounded to the nearest five-cent increment. *Id.* at 17-18.

[5274] Pickup service is available for Priority Mail as well as for Express Mail, and Parcel Post. Witness Robinson uses the average cost per stop for each option, which

⁶⁸ This adjustment will be described and analyzed in the discussion on Priority Mail rate design, *infra*.

witness Campbell develops, to derive a weighted average cost, which she marks up by 105 percent to produce a proposed fee of \$10.25. *Id.* at 18-19.

c. Attributable Costs

[5275] *Emery (PMPC) contract costs.* The Postal Service treats the costs of the PMPC contract as 100% attributable. The PMPC contract is solely for the delivery of Priority mail. Contract costs are incurred on a per piece basis. In response to an interrogatory from APMU, witness Robinson responded that “100% of the increase in Emery contract costs from BY 1998 to the Test Year Before Rates is the result of increased volume.” Tr .7/2695. No party has challenged the Service’s attribution of the contract costs and the Commission accepts the Service’s treatment.

[5276] *Transportation Network Costs.* Under the Postal Service’s proposal the premium costs for the Christmas network are treated as incremental to Priority mail. Under the Commission’s methodology these costs are attributed to Priority mail. The premium costs for the Eagle and Western network are treated by the Postal Service as incremental to Express mail. In this proceeding UPS suggests that these costs be treated as attributable to both Express and Priority mail. As discussed fully in section III-4 of this opinion the Commission find UPS’ argument unpersuasive and treats these costs as solely attributable to Express mail. UPS also suggests an alternative method of allocating empty space in purchased highway transportation. This alternative is discussed in Chapter III. D.

d. Cost Coverage

(1) Value of Service Considerations

[5277] Section 3622(b)(2) directs the Commission to consider “the value of the mail service actually provided each class or type of mail service to both the sender and recipient,” as gauged by “the collection, mode of transportation, and priority of delivery[.]”

However, as the subsection specifies, the Commission's assessment of value is not limited to these measures.

[5278] In this proceeding, parties have advanced conflicting views regarding what considerations are appropriate for gauging the value of Priority Mail service, as well as the proper conclusions to be drawn. In addition to the assessment of Postal Service witness Mayes offered in support of her pricing recommendation for Priority Mail, intervenors APMU and UPS sponsored testimony containing independent evaluations leading to quite different appraisals of Priority Mail's value of service and consequent recommendations for pricing the subclass. APMU contends Mayes overestimates the value of Priority Mail, while UPS argues her estimate of value is too low.

[5279] Witness Mayes testifies that "Priority Mail has a fairly high intrinsic value of service[.]" inasmuch as it receives air transportation and enjoys the same priority of delivery as First-Class letters; that the large segment of unzoned, lightweight pieces enjoy the convenience of the collection system if they are under one pound or are metered; and that the availability of Delivery Confirmation Service enhances its intrinsic value. USPS-T-32 at 26. However, she also states that Priority Mail has a lower economic value of service, as its own-price elasticity of -0.819 is considerably higher in absolute value than that of First-Class Letters in this case, and somewhat higher in absolute value than the corresponding estimate of -0.771 for Priority Mail in Docket No. R97-1. *Ibid.*

[5280] Witness Mayes also appraises Priority Mail's value of service in comparison with similar services offered by private firms. She testifies that Priority Mail does not offer all the product features associated with services offered by United Parcel Service, FedEx, and other private service providers, such as guaranteed service commitments, free insurance, and free tracking service. Nonetheless, she surmises that adding Delivery Confirmation and Signature Confirmation services to Priority Mail, as well as using the PMPC network in an effort to improve service, "may be helping to move the perception of Priority Mail service closer to the image of the services provided by the private firms." *Ibid.*

[5281] United Parcel Service witness Sappington also provides an appraisal of the quality of Priority Mail service as part of the analysis leading to his recommendation that the subclass receive the same markup proposed by the Postal Service for First-Class Mail in this case.⁶⁹ In general, he concludes that “Priority Mail provides a high level of service quality relative to First-Class Mail.” Tr .31/15241, 42.

[5282] As a matter of perspective, witness Sappington testifies that “all available direct measures of service quality and value should be studied carefully[,]” and that “[a] thorough consideration of more indirect potential indicators of service quality and value can also be instructive.” *Id.* at 15252. He also cautions that, “excessive focus on a single imperfect measure of service quality should be avoided.” *Ibid.*

[5283] Witness Sappington’s appraisal of the extent to which Priority Mail achieves its delivery service standards illustrates the rationale underlying the latter recommendation. Beginning with a table apparently indicating that Priority Mail does not meet its service standards as frequently as First-Class mail achieves its standards, he nevertheless posits that Priority Mail may systematically delivers high service quality in the form of more expeditious delivery, even though it “meets its more exacting service standard less frequently.” *Id.* at 15248. This is because Priority Mail could, illustratively, experience a “failure rate” in achieving its two-day standard of 50 percent yet still never provide slower delivery than First-Class Mail, even if the latter met its three-day delivery standard perfectly. *Id.* at 15250. Furthermore, because Priority Mail includes flats and parcels weight up to 70 pounds, and First-Class Mail includes pieces weighing no more than 13 ounces, the majority of which are letters, “even an identical delivery standard for an identical ZIP code pair may not pose an identical challenge to Priority Mail and to First-Class Mail.” *Id.* at 15251.

⁶⁹ Witness Sappington describes his recommendation as a “mitigation” of a potentially higher markup on the order of levels assigned to Priority Mail prior to Docket No. R97—*i.e.*, above both systemwide average cost coverage and the coverage assigned to First-Class Mail—because of the potential impact on users of applying such a markup to the substantially increased attributable cost per piece of Priority Mail in this case.

[5284] According to witness Sappington, these difficulties in drawing meaningful conclusions about relative service performance are further compounded by concerns about the accuracy of the data available for the purpose. He notes apparent anomalies between results reported by the Postal Service's Origin/Destination Information System (ODIS), which tracks pieces only between receipt at originating post offices and arrival at destination post offices, and superior results reported by the Priority-End-to-End (PETE) system, which tracks pieces from their entry into the mail stream up to the time of delivery to addressee. In light of these counter-intuitive results, he voices concern about the accuracy of the reported service quality statistics. *Id.* at 15851-52.

[5285] Turning to other direct measures of value, witness Sappington testifies that Priority Mail fares well when measured against standards of reliability, convenience, security, freedom from content damage, and the options available for purchase as value-added features. Illustratively, he notes that Priority Mail is sealed against inspection; enjoys the convenience of the collection system for a large segment (nearly 39 percent in FY 1999); offers packaging materials and electronic Delivery Confirmation without charge; and can be purchased with pick-up service and manual Delivery Confirmation Service for a fee. *Id.* at 15252-53.

[5286] In the areas of "collection, mode of transportation, and priority of delivery" specified as indicia of value in § 3622(b)(2), witness Sappington identifies six distinguishing features of Priority Mail: (1) the dedicated PMPC processing and transportation network, supplemented by the main mail network; (2) clearance before First-Class Mail, and thus priority in access to transportation resources; (3) air transportation for many origin-destination pairs, versus surface transportation for First-Class Mail; (4) assignment of Priority Mail typically to earlier flights on the Eagle Network and commercial airlines than First-Class Mail; (5) delivery before First-Class Mail if it is not possible to deliver both; and (6) Sunday delivery at times during the peak year-end season, which First-Class Mail does not receive. *Id.* at 15253-54.

[5287] Finally, witness Sappington identifies one form of customer behavior as an indirect measure of value of service. Citing data from this proceeding and Docket

No. R97-1, he testifies that between 1996 and 1999 the number of pieces sent as Priority Mail—even though they could have been sent more cheaply as First-Class Mail—increased from over 136 million pieces to more than 215 million. These numbers suggest to him that many customers value Priority Mail more highly than they do First-Class Mail, and their impressive growth “suggests that customer perceptions are matched by actual customer experience” *Id.* at 15254.

[5288] To the extent that its enhanced features enable Priority Mail to deliver greater value to its users than First-Class Mail provides its users, witness Sappington submits that § 3622(b)(2) suggests that the markup adopted for Priority Mail should exceed that established for First-Class Mail. *Id.* at 15254-55.

[5289] Association of Priority Mail Users witness Haldi presents a strongly contrasting assessment of Priority Mail’s value of service. He also relies on somewhat different indicia of value in making his analysis.

[5290] First, witness Haldi testifies that Priority Mail suffers from declining market share, which does not indicate high value of service. Over the past decade, he states, Priority Mail “has suffered a gradual but persistent decline in market share even while the market for expedited delivery of packages and documents has experienced strong growth.” Tr.25/11538. Priority Mail volume has grown during this period, but has slowed, in part because of rate increases and also because of response to raising the First Class/Priority weight threshold from 11 to 13 ounces. According to Mr. Haldi, this volume shift to First-Class Mail indicates that Priority Mail has a somewhat low value of service, even at the two-pound rate of \$3.20. *Id.* at 11536-37.

[5291] In terms of revenue, witness Haldi testifies that Priority Mail’s market share has remained essentially unchanged over the last three years. However, in his view this may indicate that intense price competition within the private sector has limited its gains to volume growth rather than revenue growth. Mr. Haldi also observes that Priority Mail’s market share of revenue is some 16 to 17 percentage points below its market share of volume, and interprets this as an indication that competitors have garnered more of the market for heavier weight pieces, which are charged higher rates. *Id.* at 11539-40.

[5292] Witness Haldi also testifies that the negotiated rates offered by competitors, who provide services with more desirable features than Priority Mail, may be “dangerously close” to undercutting existing Priority Mail rates. If the higher rate levels proposed by the Postal Service in this case rise above those of competitors, he opines that this may result in a loss of market share “far more dramatic” than witness Musgrave’s econometric forecast projects. *Id.* at 11540.

[5293] In addition to increased competition within the expedited delivery market, witness Haldi also testifies that the delivery performance of Priority Mail compares unfavorably with that of competitors, also indicating a lower value of service. Lacking competitive intrinsic features such as a day-certain delivery guarantee and track-and-trace capability, Mr. Haldi states that the “bottom line” for Priority Mail is whether delivery is accomplished in accordance with the public’s general expectation of overnight, two-day, or three-day delivery. *Id.* at 11540-42.

[5294] Comparing delivery performance results of First-Class Mail as measured by the External First-Class (EXFC) system and that of Priority Mail as measured by the Priority-End-To-End (PETE) system, he testifies that “no evidence indicates that efforts undertaken by the Postal Service to expedite the handling and transportation of Priority Mail over that of First-Class Mail have borne fruit.” *Id.* at 11546. He also relies on ODIS data to demonstrate that during Fiscal Years 1997 through 1999, Priority Mail performance trailed that of First-Class Mail by 5 percent or more in overnight, two-day and three-day delivery standard areas. *Id.* at 11547-48. Using one quarter of FY 1999 data from the Delivery Confirmation database, Mr. Haldi notes that these “relatively sparse” data appear to show slightly poorer performance than for the general population of Priority Mail as measured by the PETE system, and even poorer performance than First Class as measured by EXFC. *Id.* at 11548-49. Finally, he cites witness Robinson’s statistic that 29.8 percent of Priority Mail volume consists of pieces that are not identified as Priority Mail, which thus deprives users who paid its rates the advantageous handling due the subclass. This factor alone, he testified, seriously erodes the concept of Priority Mail’s enhanced “intrinsic value of service.” *Id.* at 11549-50.

[5295] Summing up, witness Haldi states that the available data show that Priority Mail has failed to equal, much less exceed, the delivery performance of First-Class Mail. He ascribes this to the Postal Service's inability to "figure[] out how to run an expedited delivery network that is capable of providing reliable, timely service." The resulting deficient performance "leads to the inevitable conclusion that Priority Mail receives no meaningful 'priority.'"⁷⁰ *Id.* at 11550.

[5296] On brief, APMU reiterates Dr. Haldi's grounds for concluding that Priority Mail's value of service puts it at an overall disadvantage in comparison with competing services offered by private firms. APMU Brief at 9-14; APMU Reply Brief at 15-17. UPS argues that Priority Mail continues to be a high-value service, citing the appraisal in witness Sappington's testimony. UPS Brief at 44-47. According to UPS, available evidence strongly indicates that Priority Mail also enjoys faster delivery than First-Class Mail most of the time. *Id.* at 48-51. UPS also argues that Priority Mail remains the dominant provider in the two- to three-day delivery market, asserting that APMU's claim of declining market share is "a myth." *Id.* at 55-56. In its reply brief, UPS reiterates its arguments that Priority Mail is a healthy, growing, and high-value service. UPS Reply Brief at 2-10.

[5297] *Commission analysis.* In the Docket No. R97-1 opinion, the Commission noted concerns regarding the value of Priority Mail service, notwithstanding its characteristics that nominally would suggest a high intrinsic value. PRC Op. R97-1, paras. 5301-08. The record of this proceeding indicates that these concerns continue to be warranted.

[5298] The data from various reporting systems presented by witness Haldi on the extent to which Priority Mail meets its expedited delivery standards illustrate several modes of non-achievement: significant failures to satisfy the respective overnight,

⁷⁰ In testimony filed in rebuttal to the recommendations of witness Sappington and other UPS witnesses, Haldi testifies that Priority Mail service is less reliable than First-Class Mail. While conceding that performance data that would enable computation of the variance in delivery times of the two subclasses are unavailable, he cites ODIS data as support for an inference that Priority Mail is likely to have a higher variance in delivery times than First-Class Mail. Tr. 45/19609-10.

two-day, and three-day delivery standards; failure to make delivery within three days for a small but not insignificant portion of total Priority Mail volume (approximately 8 percent according to ODIS data, and 9.7 percent according to Delivery Confirmation Service data); and delivery performance trailing that of First-Class Mail for five percent or more of Priority Mail volumes for Fiscal Years 1997 through 1999. Data from some systems may appear anomalous in comparison with data from other sources, as witness Sappington suggests; however, results from all systems agree in showing significant departures from Priority Mail's advertised delivery standards. The extent to which PMPC network operations contribute to these deficiencies is unclear.⁷¹

[5299] Even if Priority Mail collectively never provides slower delivery than First Class, as witness Sappington hypothesizes, Priority Mail's documented delivery performance does not justify a conclusion that the subclass delivers a high quality of service. This is because, as witness Haldi testified, the "bottom line" for Priority Mail senders and recipients is whether delivery actually meets the public's expectation of overnight, two-day, or three-day delivery.⁷² The record clearly demonstrates that the mailing public's expectations are frequently not met.

[5300] This departure from reasonable expectations is problematical, not only as a negative indicator of quality of service, but also as a matter of consumer fairness. The name "Priority Mail" itself implies a superior service, and the Postal Service advertises it as providing delivery in two to three days.⁷³ Given the documented discrepancies between published service standards and actual performance, prospective users are not

⁷¹ As witness Haldi notes, in reviewing the PMPC network's financial and operational impact the Postal Service's Inspector General found no appreciable improvement in service. Tr. 25/11511-12, *citing* Inspector General's Audit Report No. DA-AR-99-001, a redacted form of which was filed in this docket as Library Reference USPS-LR-I-315.

⁷² As witness Sappington testified, and Dr. Haldi reiterated, reliability—the consistency with which delivery performance is achieved—is also an important determinant of value of service for Priority Mail. Tr. 45/19609-10.

⁷³ For example, on the Postal Service's Priority Mail website at www.uspsprioritymail.com, the Service advertises that, "[o]nline purchases sent by Priority Mail can be delivered in 2-3 days for up to 65%* less than what the competitors charge." One must read a footnote to find the clarification: "Priority Mail average delivery 2-3 days."

equipped to make informed choices among Priority Mail, First Class, or some other service.

[5301] The Commission strongly recommends that the Postal Service review its policies with regards to consumer advertising, especially to household consumers, in planning and managing the array of service offerings it provides the public. The rates for Priority Mail are significantly above those for First Class. While there appears to be some origin-destination pairs where Priority Mail has a higher standard of service than First-Class this is not the general rule. Customers presently can not easily determine from the Service's website or from information at post offices when different service standards exist. The Service should take steps to assure that customers are not misled into purchasing a more expensive product that will not provide added service.

[5302] In addition to the documented lapses in achieving delivery service standards, Priority Mail exhibits a declining economic value of service, as measured by its coefficient of own-price elasticity. As witness Mayes testified, the own-price sensitivity of Priority Mail has risen, in absolute value, from -0.771 in Docket No. R97-1 to -0.819 in this case. Witness Sappington counsels against using this measure of economic value in assessing overall value of service for a variety of reasons, including the consequences of alleged undue protection from competition and "Ramsey Pricing in Disguise."⁷⁴ Tr. 31/15230-33. While the Commission recognizes the potential perils of undue reliance on the use of own-price elasticity to guide pricing recommendations, it remains the pre-eminent empirical measure available across all classes of postal services to gauge the economic value of each. As such, Priority Mail's increased coefficient is the best available evidence of its diminished economic value.

[5303] With regard to the market position of Priority Mail service, the evidence in this case does not appear to indicate any appreciable improvement in its status since the last omnibus rate proceeding. The Postal Service remains the dominant provider of lightweight pieces, but its market share of total pieces has continued to decline, from

⁷⁴ However, witness Sappington concedes that own-price elasticity is germane under § 3622(b)(5) as a measure of the competitiveness of the market in which the product is provided. Tr. 31/15230.

62.7 percent in FY 1997 to 61.8 percent in FY1998 and 61.3 percent through the first three quarters of FY 1999. Tr .25/11538-39, Table 8; USPS-T-34 at 6. In terms of revenue, Priority Mail's market share has been nearly static at about 45 percent, as witness Haldi observed. Tr.25/11539, Table 8.

[5304] Taken together, these indicia do not bear out the high value of service that Priority Mail's intrinsic features would otherwise imply. In the Commission's view, this conclusion justifies moderation in the assignment of institutional costs to Priority Mail. Nonetheless, the Commission finds that Priority Mail should continue to provide an above average contribution to institutional costs.

(2) Extraordinary Cost Levels Associated with the PMPC Contract

[5305] Intervenor APMU also asks the Commission to moderate the cost coverage recommended for Priority Mail in order to mitigate the impact of significant cost increases driven by the Service's PMPC contract. APMU argues that these costs are unlikely to persist beyond the Test Year, and may even be reduced during that period by the termination of the contract between the Postal Service and Emery. APMU Brief at 20-21.

[5306] APMU witness Haldi documents the cost increases associated with the Emery contract, which he characterizes as "hugely expensive." Tr. 25/11504. He notes that actual expenditures under the contract in FY 1998 were \$289 million, as compared to the Service's estimate of \$265 million in Docket No. R97-1, and that this amount was supplemented by an additional payment of \$20.8 million to Emery pursuant to a supplemental letter agreement. *Id.* at 11510. He also observes that Emery has filed pending claims amounting to more than \$685 million that would affect every year from 1998 through the balance of the life of the contract, and has also filed a lawsuit requesting, among other relief, authorization to cancel the contract and stop work prior to its expiration in February, 2002. *Id.* at 11511. In view of the escalating costs of the PMPC contract, and of Postal Service witness Robinson's testimony that the configuration of the future Priority Mail network is uncertain, witness Haldi testifies that

“it...would be inconceivable that the Postal Service would extend what it now knows to be a failed experiment.” *Id.* at 11513.

[5307] On brief, APMU argues that the high costs associated with the PMPC contract drive significant increases in test year cost estimates for Priority Mail, yet should end during the same period. Citing Postal Service responses to discovery, APMU states that increases in Priority Mail volumes handled by the PMPC network are estimated to drive PMPC contract expenditures to \$522 million in the test year, an increase of 81 percent over FY 1998 costs. APMU Brief at 20. APMU notes the Postal Service’s refusal to identify how much of the estimated \$522 million would be attributed if the same volume if Priority Mail were to be processed in-house without the network.

[5308] In any event, APMU argues, test year estimates of Priority Mail costs, which incorporate PMPC-related costs, may be excessive in the aggregate because “it is highly unlikely that the Emery PMPC network will operate throughout the Test Year.” *Ibid.* In addition to witness Robinson’s testimony regarding uncertainty as to the future processing network, and thus on Priority Mail’s cost structure, APMU cites witness Patelunas’s confirmation that postal management has directed the formulation of transition plans that would bring PMPC functions back into the Postal Service within a 90-day period. *Id.* at 21. Given such uncertainty regarding over more than \$500 million in test year costs, APMU asks the Commission to mitigate the impact of the precipitous increase in PMPC costs by restraining the markup on Priority Mail.

[5309] United Parcel Service opposes APMU’s argument that test year costs may be overstated because the PMPC contract will likely be terminated. In its Reply Brief, UPS cites the recent decision of the Federal Court of Claims which, among other rulings, denies the Postal Service the right to terminate the contract.⁷⁵ Furthermore, UPS argues, even if Emery and the Postal Service mutually agree to terminate the PMPC contract, the Service may ultimately spend more to replace Emery with a new contractor, or to do the job of processing Priority Mail itself. UPS Reply Brief at 8.

⁷⁵ *Emery Worldwide Airlines, Inc. v. United States*, Docket No. 00-173C, United States Court of Federal Claims, decision filed August 25, 2000, slip op. at 25-26.

[5310] *Commission analysis.* APMU does not ask the Commission to disallow any portion of estimated test year costs for the PMPC network. Nor would the Commission be justified in doing so, as the contract remains in legal effect and the network is expected to continue operations throughout the test period of this case.

[5311] However, as a source of significant, perhaps extraordinary, cost increases for the Priority Mail subclass, the Emery contract provides an additional reason for moderating the markup of Priority Mail on the ground of consequent impact on its users under § 3622(b)(4), as in the last omnibus rate proceeding. PRC Op. R97-1, para. 5330.

[5312] It is possible, as APMU surmises, that operational changes will enable the Postal Service to provide Priority Mail service in the future without continuing the marked escalation of costs documented in the past two rate proceedings. The Commission hopes the Postal Service will accomplish this change, in order to forestall the above-average overall rate increases that recent developments have made necessary.

(3) Other Coverage-Related Considerations

[5313] In developing a proposed institutional cost contribution for Priority Mail, Postal Service witness Mayes tempers her recommended cost coverage in light of the large increase in estimated subclass costs, coupled with the volume decrease caused by raising the maximum weight of First-Class Mail in Docket No .R97-1. She did so because of concern for the anticipated impact on Priority Mail users under §3622(b)(4). USPS-T-32 at 27. Her recommended markup corresponds to a 162.7 percent coverage of the Postal Service's estimate of Priority Mail's incremental costs, and requires an average rate increase of 15.0 percent. *Id.* at 25. Witness Mayes notes that this proposed increase is both significantly above the system average and much higher than the rate of general inflation in the economy as a whole. *Id.* at 27.

[5314] Intervenors APMU and Parcel Shippers Association (PSA) oppose this proposed level of increase, arguing that it is excessive. Based on witness Haldi's analysis of rates in the market in which Priority Mail competes, APMU argues that the

proposed 15 percent increase could affect pre-existing rate relationships sufficiently to cause major competitive damage to the Postal Service. APMU Brief at 15-18. PSA witness Zimmerman, testifying on behalf of a number of members who make significant use of Priority Mail, characterizes the proposed 15 percent increase as “astoundingly large” and “excessive” in a rate proceeding in which the overall increase is 6.4 percent. Tr. 29/14135. On brief, PSA argues that a 15 percent increase for a subclass that already has such high cost coverage cannot be justified, and that an increase of that dimension will result in the Postal Service losing market share to the aggressive tactics of its competitors. Further, it argues that such an increase will create an umbrella under which those competitors will be able to significant increase their own rates, to the serious detriment of consumers and to the competitive process. PSA Brief at 37.

[5315] On the basis of witness Sappington’s testimony, United Parcel Service argues that the cost coverage for Priority Mail should be maximized for the benefit of First-Class Mail users, and thus should be assigned a cost coverage at least as high as that for First-Class Mail. UPS Brief at 43-56; UPS Reply Brief at 1-10. According to UPS, the Commission should not heed the arguments of users regarding potential losses of volume and market share resulting from higher rates because the Commission’s primary function is “to protect mailers without any readily available alternatives to the Postal Service, not to protect the Postal Service or its market share.” UPS Reply Brief at 1-2.

[5316] The Commission recommends a cost coverage of approximately 162 percent for Priority Mail, which represents a markup index of 1.053. Actual FY 1999 Priority Mail costs were markedly higher than the Postal Service projections based on FY 1998 results. Therefore, the Commission’s estimate of Priority Mail’s test year attributable costs exceeds the Postal Service’s incremental cost estimate and this has led to a larger average rate increase than suggested by the Service.

[5317] In addition to the considerations of Priority Mail’s somewhat compromised value of service, as suggested by APMU, and the unavoidable “rate shock” caused by the high level of PMPC contract costs, discussed separately above, the Commission

finds that a recommended level of coverage slightly above systemwide average is responsive to § 3622(b)(4) and (b)(5) concerns generally. The Commission finds it appropriate to moderate Priority Mail's coverage to this level in order to protect its users—especially those users whose mail falls within the monopoly segment of Priority Mail—from the impact of even higher rate levels. It is also the Commission's opinion that restraining coverage to this level is appropriate under § 3622(b)(5) to avoid the harm that higher rate levels may cause to the Postal Service's position as a competitor in the market in which Priority Mail competes. The Commission rejects the suggestion of United Parcel Service that this is an impermissible or negligible consideration in formulating pricing recommendations.⁷⁶

e. Proposed Classification Changes

(1) Introduction of One-Pound Rate

[5318] Under the current rate schedule for Priority Mail, the minimum weight interval for which a rate is available is set at two pounds. In this proceeding, the Postal Service proposes introduction of an unzoned one-pound rate for Priority Mail, to be set at \$3.45. USPS-T-34 at 9.

[5319] Witness Robinson explains that the proposed one-pound rate is intended as a long-term solution for bridging the rate differential, or “gap,” between the maximum rate for First-Class Mail and the minimum Priority Mail rate. She notes that the Commission addressed this concern in Docket No .R97-1 by recommending an increase from 11 to 13 ounces in the maximum weight increment for First-Class Mail. While this change directly addressed the discontinuity between First-Class and Priority rates in R97-1, witness Robinson submits that the specific cause of the problem—the current 19-ounce

⁷⁶ “As to § 3622(b)(5), the Commission has consistently, and reasonably, held that it authorizes a reduction in rates to maintain the position of the Postal Service as a competitor in the mail delivery industry.” *United Parcel Service v. U.S. Postal Service*, 184 F.3d 827, 845 (D.C.Cir. 1999).

weight step between the subclasses—requires a different solution. For this reason, she develops proposed Priority Mail rates that include a new one-pound rate. *Id.* at 15-16.

[5320] Obviously, witness Robinson notes, adding a one-pound element to the current rate design does not change the relative costs associated with a heavyweight First-Class piece and a lightweight Priority Mail piece. However, she testifies that appropriate rate design can select a rate transition between the two subclasses that will produce a smooth transition between their respective cost structures. Her proposed one-pound rate of \$3.45 is 40 cents lower than the two-pound Priority Mail rate of \$3.85 she develops, and 35 cents greater than the maximum First-Class Mail rate of \$3.10 proposed by witness Fronk. *Id.* at 16.

[5321] For the additional 35cents, she submits, a postal customer receives considerable additional service: the ability to mail an additional three ounces, the expedited handling and transportation performed for Priority Mail, and the opportunity to purchase delivery confirmation. Additionally, she states, the one-pound rate provides an attractive alternative for customers mailing documents, and affords a lower-price alternative for First-Class mailers who wish to “buy up” to Priority Mail service. *Id.* at 16-17.

[5322] No participant in this proceeding presented testimony or argument on brief opposing the introduction of a one-pound rate. APMU witness Haldi testifies in support of this change, stating that the proposal “seems sensible” because it reduces the weight step between First Class and Priority Mail, and mirrors the structure of rates charged by major competitors for their services that compete directly with Priority Mail. Tr. 25/11558. However, he also observes that the resulting rate structure “creates something of an anomaly” because the rate increment between one pound and two pounds would be 40 cents, but for the third and additional pounds up to five pounds would be \$1.25. According to witness Haldi, any mailer could rightfully ask why the rate increment for an additional pound increases so precipitously. *Ibid.* He also testifies that Priority Mail users, seeing the “unbundling” of the current two-pound rate, would expect the 20

percent increase in the latter to be accompanied by a reduction in the one-pound rate. *Ibid.*

[5323] In light of these considerations, witness Haldi states that introduction of the one-pound rate for Priority Mail makes it necessary to consider: (1) reducing the maximum weight of First-Class Mail, and (2) reducing the one-pound rate itself. Over time, he surmises, if the Postal Service is able to reduce Priority Mail costs, it should be possible to evolve to an unzoned rate structure that will feature four equal rate increments from one to five pounds. *Id.* at 11559. To implement his second recommendation, witness Haldi proposes a one-pound rate of \$3.00. *Id.* at 11566.

[5324] *Commission analysis.* The Commission recommends the introduction of a one-pound rate as a useful rate design innovation for “bridging the gap” between First Class and Priority Mail rates, and thereby enhancing the fairness and equity of these components of the mail classification schedule in accordance with § 3623(c)(1) and § 3622(b)(2). The potential utility of this new rate element also establishes its desirability and justification under § 3623(c)(2).

[5325] As noted above, no party has objected to the Service’s proposed change, and the only controversy involves the appropriate rate to recommend in this proceeding. This issue will be addressed in the discussion of Priority Mail rate design below.

(2) Lowering Subclass Threshold to 11 Ounces

[5326] As noted in the preceding section, APMU witness Haldi proposes a reduction in the First-Class/Priority Mail breakpoint to 11 ounces. Tr. 25/11559-60. This change would reverse the two-ounce elevation in the breakpoint in Docket No .R97-1, which he proposed in that case to address the rate gap between the maximum First-Class rate and the minimum Priority Mail rate.

[5327] Witness Haldi explains that, with the Postal Service’s proposed introduction of a one-pound rate, the “fundamental problem” with the rate gap has been solved, and alternatives to the current limit on the weight of First Class should be considered. *Ibid.*

More importantly, given his proposal of a \$3.00 one-pound rate, both the Service's proposed First-Class rates and the current rate structure establish "too high a floor" at a 13-ounce maximum. APMU Brief at 24. At current rates, a 13-ounce First-Class piece is charged \$2.97; at the Postal Service's proposed rates, the corresponding charge would increase to \$3.10.

[5328] On brief, the Postal Service opposes APMU's proposed return to the 11-ounce breakpoint. While it agrees with witness Haldi's premise that there should be a rational relationship between the highest First-Class rate and the lowest Priority Mail rate, the Service asserts that its proposed rates—which incorporate a 35-cent rate step—agree closely with the 36-cent step provided under the witness Haldi's proposal. Moreover, the Service argues that the proposal fails to satisfy the criteria witness Haldi articulated in his R97-1 testimony because it would result in an artificially low first-increment rate for Priority Mail. Postal Service Brief at VII-100-101.

[5329] *Commission analysis.* In the context of his proposed schedule of Priority Mail rates, witness Haldi's proposal to roll back the First-Class/Priority breakpoint to 11 ounces is a rational adjunct to his other recommendations. However, at the rate levels the Commission recommends for First-Class mail, it is unnecessary to lower the "floor" for the first-increment Priority Mail rate from the current 13-ounce breakpoint. Under the Commission's recommended First-Class rate schedule, a 13-ounce piece would pay \$2.86. Inasmuch as the one-pound Priority Mail rate the Commission recommends is 64 cents above this maximum First-Class rate, there is no need to adjust the current breakpoint between the two subclasses. Consequently, the Commission declines to recommend APMU's proposed change.

(3) SCF-Destinating Discount Category

[5330] APMU also proposes the introduction of a discounted rate category for zone-rated Priority Mail pieces mailed to a destination Sectional Center Facility (SCF) for

processing and delivery of their contents. Qualifying pieces would receive discounts ranging from \$1.50 to \$3.35, based on their weight. Tr. 25/11571, Table 11.

[5331] APMU witness Haldi testifies that some mailers (such as through-the-mail photofinishers) who wish to expedite delivery of smaller items of a different class (such as Standard A pieces) currently combine them in a Priority Mail piece for delivery at a Destination Sectional Center Facility (DSCF), where it is opened and the enclosed mail pieces are processed for delivery. This type of mailing is typically referred to as “Priority Mail dropship,” and the practice is codified in the Domestic Mail Manual as follows:

Priority Mail drop shipment expedites movement of any other class or subclass of mail (except Express Mail) between domestic postal facilities. The drop shipment receives Priority Mail service from the origin post office to the destination post office of the shipment, where the enclosed mail is processed and provided the appropriate service from that post office to its destination.

DMM § D071.2.1.

[5332] Under the current practice, witness Haldi notes, the illustrative Standard A mailpieces contained in the Priority Mail piece pay a destination entry rate, inasmuch as the dropshipment avoids transportation and handling costs that otherwise would have been incurred. However, the Priority Mail piece itself pays the full applicable rate, notwithstanding the fact that it terminates at the DSCF, and thereby avoids the costs of handling and transportation beyond the SCF, as well as the cost of delivery to a business or residence.

[5333] To promote fairness and equity in the rate schedule, witness Haldi testifies that a discount should be established to recognize these cost savings. Tr. 25/11568-69. He also observes that these heavier, zone rated Priority Mail pieces produce relatively high unit profits for the Postal Service, and submits that this profitable segment should be cultivated by the adoption of a discount. *Id.* at 11560-61. Moreover, he states, a discount would help prevent loss of such SCF-destinating Priority Mail volume to alternative carriers, which are better able to compete with Priority Mail because of the

availability of consolidated national payment options that did not previously exist. *Id.* at 11570.

[5334] Because Priority Mail delivery cost data are unavailable, witness Haldi develops his proposed discounts from cost data underlying the Postal Service's proposed rates for the DSCF category of Parcel Select service. He derives estimates of the costs of delivering parcels of different weights by dividing a smoothed set of the proposed Parcel Select SCF rates by 113 percent, which witness Plunkett has identified as the coverage implicit in his proposed rates. Applying a passthrough of 75 percent of the cost estimates, he produces a schedule of discounts for each pound up to 70 pounds; averages the discounts over ten-pound weight ranges; and rounds the proposed discount for each weight interval down to the nearest five cents. *Id.* at 11569-70.

[5335] Witness Haldi testifies that the volume of destination entry SCF Priority Mail used to dropship smaller items is not known, but is reckoned to be as much as 10 percent of all Priority Mail pieces over five pounds. Projecting this level of usage at APMU rates, he estimates that his proposed rates would result in a revenue reduction of \$9.95 million. Offsetting this reduction, he states, would be revenues from any increase in Priority Mail volume stimulated by the discounts, as well as additional revenue from the enclosed pieces. *Id.* at 11570.

[5336] The Postal Service opposes APMU's discount proposal on brief. The Service concedes that witness Haldi has proposed "a novel discount that may merit further study," but argues that it should be rejected because of its "analytic shortcomings[.]" Postal Service Brief at VII-102.

[5337] First, the Service challenges witness Haldi's use of information used by witness Plunkett in designing Parcel Post rates, arguing that Haldi improperly applied Plunkett's 113 percent implicit coverage to DSCF volumes, and failed to remove the effects of rate constraints Plunkett imposed in designing DSCF rates. *Id.* at VII-102-03. Second, the Service argues that witness Haldi's discount proposal ignores several kinds of potential additional processing costs that DSCF parcel post shipments do not incur but Priority Mail shipments may incur. *Id.* at VII-103-07. Finally, the Service asserts that

witness Haldi could not provide specific information on the number or characteristics of the Priority Mail pieces potentially eligible for the discount, and that his assessment of demand for a DSCF category is only anecdotal. *Id.* at VII-107. In view of the numerous unanswered questions concerning key aspects of the proposed discount, the Service urges the Commission to reject the proposal in the absence of adequate supporting cost studies and market research. *Id.* at VII-108.

[5338] *Commission analysis.* Witness Haldi has identified a segment of Priority Mail volume that may merit recognition in the form of a rate category to which discounts would apply. In qualitative terms, the “Priority Mail dropship” segment already identified in the DMM would appear to offer the potential for such recognition. However, as the Postal Service has argued, significant uncertainties remain unaddressed, primarily for lack of cost and demand data specific to this portion of Priority Mail volumes. While the Commission commends witness Haldi for focusing attention on this type of Priority Mail, his discount proposal lacks sufficient support to warrant recommendation at this time. However, the Commission strongly encourages the Postal Service to investigate the bases of such a discount in its ongoing review of the Priority Mail subclass.

(4) Application of One-Pound Rate to Flat Rate Envelope

[5339] As noted earlier, under the Postal Service’s proposal in this docket the Priority Mail flat-rate envelope would continue to be charged the two-pound rate, notwithstanding the proposed introduction of a lower, one-pound rate element. Two participants object to this proposal, arguing that the new one-pound rate should apply.

[5340] Intervenors Douglas F. Carlson and David B. Popkin present several arguments on brief in opposition to the Postal Service’s proposed retention of the two-pound rate for the flat-rate envelope. Both claim that application of the two-pound rate would produce an anomaly, inasmuch as 77 percent of flat-rate envelopes currently weigh one pound or less, and this majority volume would be charged 40 cents more than the one-pound rate proposed by the Service. Carlson Brief at 1-2; Popkin Brief at 12-13.

Mr. Popkin illustrates the potentially absurd results of this rate application, observing that, “[m]ailers would save money by placing the flat-rate envelope [weighing less than a pound] into another container such as the available Tyvek envelope or crossing out the flat-rate designation.” Popkin Brief at 13.⁷⁷

[5341] Mr. Carlson also challenges what he views as the Postal Service’s “only plausible argument” for retaining the two-pound rate, namely that, “over time there would be upward pressure on the one-pound rate as price-sensitive customers mail heavier pieces using the flat-rate envelope to take advantage of the lower rate.”⁷⁸ Carlson Brief at 2. He asserts that the size and capacity of the flat-rate envelope impose an upper limit on the weight they can contain, probably near the 22.89-ounce average weight of those pieces that weigh more than one pound; that potential migration to the flat-rate envelope is limited to a small proportion of Priority Mail volume that weighs, on average, only ounces more than a pound; and that the limited potential pressure of these pieces’ migration to the flat-rate envelope at the one-pound rate is not cause for alarm. Even if some upward pressure on the one-pound rate occurs and the rate is raised in a subsequent rate case, he argues, customers would still be better off than if they were charged the two-pound rate. *Id.* at 2-6.

[5342] Both Mr. Carlson and Mr. Popkin also oppose application of the two-pound rate on the ground that it is likely to cause confusion among Priority Mail users, and has the potential for overcharging them. Mr. Popkin observes that it will require considerable publicity and training of postal employees to make the public aware of the potential savings resulting from *not* using the flat-rate envelope they are accustomed to, and that those users not savvy enough to change their mailing habits will be victims of “a 40-cent

⁷⁷ In a sealed brief, Mr. Popkin further argues that most knowledgeable mailers would select the non-flat-rate Tyvek envelope provided by the Postal Service—which costs more than twice as much as the cardboard flat-rate envelope—to save the 40-cent difference in postage, thereby imposing additional costs on the Service for retaining the two-pound flat rate. Popkin Initial Brief Filed Under Protective Conditions, September 12, 2000, at 1.

⁷⁸ Responses of the United States Postal Service to Presiding Officer’s Information Request No. 5 (Questions 3 through 10), March 24, 2000, Question 7, p. 1 of 2, Tr. 46D/21792.

fraud.” Popkin Brief at 13. Mr. Carlson discusses the Postal Service’s options—including the possible introduction of a new, non-flat-rate envelope—at length, but concludes that, “[t]he clear solution to eliminate confusion and inefficient consumer behavior is to apply the one-pound rate to flat-rate envelopes.” Carlson Brief at 8. Mr. Popkin concurs. Popkin Brief at 13.

[5343] Mr. Carlson further claims that, at the two-pound rate, the flat-rate envelope provides little value to Postal Service customers. Contrary to witness Robinson’s justification that customers derive value from the absence of the need to weigh their flat-rate envelopes,⁷⁹ Mr. Carlson notes that customers are required to take Priority Mail pieces weighing over 16 ounces to a retail window because of security concerns. See DMM § D100.2.6. If customers have any doubt about whether their mailing is under this threshold, they must weigh their envelopes—during which process they could as easily determine the applicable postage rate. Because security restrictions on the deposit of mail in collection boxes have eliminated most of the value formerly associated with the flat-rate aspect of such envelopes, Mr. Carlson argues that the Commission should reject the Service’s suggestion that customers should pay a higher rate for their purported convenience. Carlson Brief at 7-8.

[5344] Finally, Mr. Carlson asserts that the one-pound rate for the flat-rate envelope is more consistent with applicable statutory pricing criteria because it is fair and equitable; is more consistent with the diminished value of the flat rate; reflects a better alignment with actual cost; would have a more moderate impact on users; and would better reflect simplicity in rates. *Id.* at 10.

[5345] In response, the Postal Service states that the assertions made by Mr. Carlson and Mr. Popkin on brief were not examined on the record as testimony; that no party has had an opportunity to present responsive testimony; and that “[t]hese procedural inadequacies militate strongly against serious consideration of the classification change sought.” Postal Service Reply Brief at VI-39.

⁷⁹ Tr. 46D/ 21793 (Response to POIR No. 5, Question 7.)

[5346] Beyond these alleged procedural defects, the Service challenges the factual bases of the analyses on which Mr. Carlson bases his assertions. Contrary to Mr. Carlson's position, the Service argues that the potential for "push up" on the one-pound rate caused by setting the flat rate at that level cannot be ignored. While recognizing that the record does contain sufficient information to quantify how the adoption of a one-pound flat rate would increase the average weight of (and the costs allocated to) the resulting one-pound/flat-rate envelope rate cell, the Service asserts that the former could increase by 0.41 pounds, or 63 percent above the 0.64 pound figure underlying witness Robinson's proposed one-pound Priority Mail Rate. *Id.* at VI-40 through VI-42. The Service also notes that neither Mr. Carlson nor Mr. Popkin have addressed the resulting decrease in Priority Mail revenue, which would have to be made up if the revenue target for the subclass is to be met. *Id.* at VI-43.

[5347] The Service also disputes Mr. Carlson's assertions regarding the limited utility and value of the flat-rate envelope. According to the Service, there is no empirical record support for the assertions that flat-rate envelopes are useful only for documents and other matter not requiring padded protection, or that the envelopes do not hold more than the average of 22.89 ounces. *Ibid.* On the matter of value, the Service observes that mailers who apply stamps to Priority Mail pieces over one pound may tender them to a letter carrier at their residence or place of business; for mailers with postage meters, the Service submits the value of the flat-rate envelope may be even greater because the prohibition against deposit in a street collection box does not apply. *Id.* at VI-44 through VI-45. The Service also argues that Mr. Popkin's argument regarding customers' use of more expensive Postal Service-provided packaging material is similarly unsupported by record evidence, and cites the Service's announced intention to design a "non-flat-rate" envelope for weight-rated Priority Mail pieces that will have characteristics similar to the current flat-rate envelope. *Id.* at VI-45, citing Tr. 7/2872.

[5348] *Commission analysis.* The Commission agrees with intervenors Carlson and Popkin that the introduction of a one-pound Priority Mail rate, while maintaining the rate for the flat-rate envelope at the two-pound level, would create the potential for

confusion among consumers and possible overcharging for the many lightweight mailings currently sent in flat-rate envelopes. Messrs. Carlson and Popkin also raise questions regarding the continuing utility of the flat rate envelope when security restrictions have limited access to mailings of one pound or more, but these concerns seem overstated in light of the extensive use currently made of this mailing option.

[5349] The Commission agrees with the intervenors that the fairness and equity both of the Priority Mail rate schedule under § 3622(b)(1), and of the Domestic Mail Classification Schedule under § 3623(c)(1), are better served by setting the rate for the flat-rate envelope at the new one-pound level.

[5350] When the Postal Service proposed introduction of the flat-rate envelope in Docket No. R90-1, it also proposed application of the minimum rate for Priority Mail, then the two-pound rate. The Postal Service witness presenting the proposal characterized two pounds as being about “the effective maximum weight the envelope will hold[,]”, but also recognized the possibility that a three-pound item might be sent in it. Docket No. R90-1, Direct Testimony of Ashley Lyons on Behalf of United States Postal Service, USPS-T-18 at 125. To the degree that pieces weighing more than two pounds might cause the Postal Service to incur additional transportation costs, he anticipated that there would be compensating benefits from reductions in window transaction costs. *Id.* at 125-26.

[5351] The record in this proceeding reveals that 77 percent of flat-rate envelope Priority Mail pieces would be expected to weigh less than one pound in the test year, prior to introduction of the proposed one-pound rate. USPS-T-34, Attachment C, page 1. Lightweight pieces so dominate flat-rate envelope volumes that the average weight per piece is estimated to be 10.3 ounces. *Ibid.*

[5352] However, with the introduction of the one-pound rate, witness Robinson’s estimate of flat-rate envelope volume undergoes a reduction of nearly 79 percent, from 156,451,596 pieces to 33,148,328 pieces. *Id.*, Attachment B, page 3 of 7; Attachment D, page 1 of 5. This analysis assumes that all Priority Mail pieces of one pound or less—including mailings that would otherwise make use of the flat-rate envelope—would divert

to mailing at the one-pound rate. As such, the analysis is premised on an assumption that potential flat-rate envelope users would make the economically rational decision to mail under the one-pound rate using some other type of container, and thereby avoid paying the higher two-pound rate.

[5353] Given the extensive degree to which flat-rate envelopes are used for mailing lightweight Priority Mail shipments,⁸⁰ the Commission is skeptical of the assumed response, which would require that 100 percent of potential users make a perfectly informed choice between that familiar medium and a different container eligible for the one-pound rate. It appears more likely that many Priority Mail users would continue the ingrained habit of using the flat-rate envelope, and unjustifiably be charged the two-pound rate for mailings of less than one pound. Further, since the security restriction on deposit in collection boxes becomes applicable only when a mailpiece exceeds one pound, the users whose mailings are most likely to overpay at the two-pound rate are also coincidentally those least likely to interact with a window clerk or other potential source of consumer information regarding the availability of the one-pound rate.

[5354] In light of the pre-existing pattern of use of the flat-envelope for mailings predominantly less than one pound, the Commission cannot ignore the potential for widespread overcharging of Priority Mail users if the two-pound rate remains applicable. In the Commission's opinion, the potential detrimental impact on consumers establishes the desirability of a mail classification change under § 3623(c)(2) and (5). See *also* § 3622(b)(7). Accordingly, the Commission recommends that §223.5 of the Domestic Mail Classification Schedule be changed to state that Priority Mail sent in a flat-rate envelope is charged the one-pound rate.

[5355] The Commission recognizes that the "desirability of special classifications" must be considered "from the point of view of both the user and of the Postal Service[.]" 39 U.S.C. § 3623(c)(5), and that the Service's opportunity to be heard on the latter point has been limited to arguments on brief, which do not favor the recommended change. It

⁸⁰ On a before-rates basis, some 11.5 percent of all Priority Mail test year pieces are expected to consist of mailings in flat-rate envelopes. *Id.*, Attachment B, page 3 of 7.

must also be acknowledged that application of the one-pound rate to the flat-rate envelope leads to the development of recommended one-pound and two-pound rates that are slightly higher than they might be if the two-pound rate were retained. Nevertheless, the Commission is sufficiently concerned about the fairness and equity of retaining the two-pound flat-envelope rate while recommending adoption of a new one-pound rate interval that it finds it must recommend a change in rate application in this proceeding.

f. Rate Design

[5356] With the exception of the new one-pound rate element, the rates the Commission recommends in this docket retain the structural features of current Priority Mail rates. However, because the Commission recommends a larger average rate increase for Priority Mail than the Postal Service proposed, the rates are generally somewhat higher.

[5357] In designing Priority Mail rates, the Commission retains the “Emery adjustment” used by witness Robinson to distribute the costs of the PMPC contract to the piece rate elements and the poundage rate elements. While the allocation factor used to distribute contract costs cannot be traced to any identifiable pattern of cost causation because of the lack of data, the Commission agrees with the Postal Service that this approach is preferable to recovering 100 percent of PMPC system costs from the piece rate element alone.

[5358] The Commission recommends a one-pound rate of \$3.50. At the 34-cent first-ounce and 21-cent additional ounce rates recommended for First-Class Mail, this first-increment Priority Mail rate provides a smooth transition between the two subclasses.

[5359] The Commission recommends a two-pound rate of \$3.95. The three-pound, four-pound and five-pound rates increase in uniform increments of \$1.20 from the two-pound rate.

[5360] For the heavier, zoned portion of the rate schedule, the Commission develops rates using the same cost distribution described in witness Robinson's testimony. However, to produce a more cost-based schedule, the Commission did not constrain rates as witness Robinson did with a five-percent band around the average rate increase of 15 percent. Instead, the Commission imposed an absolute rate increase constraint of 25 percent on all Priority Mail rates. Some rate elements in zones 7 and 8 were also adjusted to provide smoother transitions in rate progression.

g. Consistency with Statutory Criteria

[5361] The Commission finds the schedule of rates it recommends for Priority Mail to be consistent with the statutory considerations prescribed in the § 3622(b) factors. As in the last omnibus rate proceeding, a significant increase in estimated test year attributable costs dictates an above-average increase to satisfy the requirement of § 3622(b)(3). Considerations of impact on users under § 3622(b)(4) and of the Postal Service's status as a competitor under § 3622(b)(5) suggest moderating Priority Mail's contribution to institutional costs. Value of service considerations under § 3622(b)(2) also justify moderation in assigning institutional costs to Priority Mail, as previously discussed. Nevertheless, at the Commission's recommended rates Priority Mail will make an above-average contribution to institutional costs.

[5362] Inasmuch as there is no presorted or other worksharing-based category of Priority Mail at present, the "degree of preparation" consideration in § 3622(b)(6) is not applicable in this case.⁸¹ The Commission finds the introduction of the one-pound rate element proposed by the Postal Service to be compatible with the § 3622(b)(7) factor; while it represents a slight additional complication of the pre-existing rate schedule, its redeeming feature is the improved transition it provides between the First Class and Priority Mail rate schedules. Finally, the Commission finds resetting the flat envelope

⁸¹ This finding does not address the merits of APMU's proposed DSCF category, which the Commission declines to recommend on other grounds, as discussed earlier in this section.

rate to match the new one-pound rate to be consistent with fairness and equity, in accordance with § 3622(b)(1).

C. Standard A Mail

1. Introduction and Summary

[5363] The main focus of the Service's proposal for Standard A Mail is on several important internal cost and rate design concerns. One is the cost support for the commercial pound rates. Another is the statutory preferred rate markup formula. Others involve cost coverage considerations, especially in terms of the effect of the proposal on mailers and competition, and the choices entailed in balancing numerous—and often competing—rate design objectives. The latter are often most evident in the level of worksharing-related savings the Service passes through to mailers and the extent to which shape-related cost differences are recognized.

[5364] The proposal, as filed, reflects a system average increase of 6.4 percent for all mail classes and services. USPS-T-32 at 36. For individual subclasses, the increases are 9.4 percent for Regular; 4.9 percent for Enhanced Carrier Route (ECR); 5.6 percent for Nonprofit; and 14.8 percent for Nonprofit Enhanced Carrier Route (Nonprofit ECR).⁸² USPS-T-35 at 36.

[5365] In response to persistent questions about the support for the pound rate, the Service presents a new cost approach. Based on this analysis and related considerations, it proposes reducing the Regular pound rate by 1.6 cents (from 67.7 cents to 66.1 cents), and reducing the ECR pound rate by 7.9 cents (from 66.3 cents to 58.4 cents). Based largely on other considerations, the Service proposes increasing the Nonprofit pound rate by 3 cents (from 55 cents to 58 cents), and increasing the Nonprofit ECR pound rate by 8.0 cents (from 29 cents to 37 cents). The proposed Nonprofit ECR rates are also based on an anticipated amendment to the Revenue Forgone Reform Act of 1993 (RFRA).⁸³

⁸² These increases reflect revenue per piece; they do not include the effect of the increases in the residual shape surcharge.

⁸³ P.L. 103-123, 107 Stat. 1267, 39 U.S.C. § 3626(a)(4).

[5366] Piece rates, which are assessed on all Standard A mail, increase by varying amounts for mail above and below the breakpoint. For other rate elements, the Service generally relies on updated cost studies and employs traditional rate design objectives. The proposal maintains letter/nonletter differentials at their current levels. Proposed discounts for established worksharing discounts are generally smaller, in absolute terms, than current discounts. In the automation flats category, discounts reflect about 75 percent of their current value, due to reduced cost savings and changes in the automation processing environment.

[5367] The Service proposes to increase the residual shape surcharge (which is assessed primarily on parcels⁸⁴), and to apply it on a subclass-specific basis. The latter approach is designed, in part, to accommodate the proposed introduction of a 3-cent discount for prebarcoded pieces subject to the surcharge. Thus, the surcharge would increase from a now-uniform 10 cents to 15 cents in the commercial and preferred Enhanced Carrier Route subclasses and to 18 cents in Regular and Nonprofit. In addition to the parcel barcode discount, the proposal includes two other classification changes. Both have limited impact. One extends the automation letter weight limit to 3.5 ounces, thereby allowing pieces between 3.3 ounces and 3.5 ounces to qualify for lower rates. The other applies a pre-selected, rounded breakpoint of 3.3 ounces in the Standard A rate schedules. Proposals in the Special Services area extend eligibility for Delivery Confirmation, Return Receipt for Merchandise and Bulk Insurance Service to Standard A parcels.

[5368] *Financial summary.* Table 5-8 summarizes the financial impact of the Service's Standard A proposal, based on data in the Service's original filing. Subsequent errata (related to delivery costs) changed some of these figures, but the Service did not revise its proposed rates; instead, it indicates that the implied passthroughs (all within three percentage points of the originals) are consistent with its Standard A rate design objectives and the criteria of the Postal Reorganization Act. USPS-T-35 at 42 (revised).

⁸⁴ For convenience and readability, the term "parcels" is generally used to refer to all types of pieces that do not meet the dimensions of a letter or flat or are prepared in accordance with parcel requirements.

Table 5-8
Standard A Test Year After Rates Financial Summary
 (as originally filed by the Postal Service)
 (in millions)

	Revenue	Cost	Contribution	Coverage
<i>Commercial Subclasses:</i>				
Regular	\$9070.437	\$6823.933	\$2246.504	132.9%
ECR	5162.025	2471.864	2690.160	208.8%
<i>Preferred Subclasses:</i>				
Nonprofit	\$1543.086	1320.611	222.475	116.9%
Nonprofit ECR	264.218	208.577	55.641	126.7%

Source: Adapted from USPS-T-35 at 41.

[5369] *Discussion.* The record developed in response to the Service's Standard A proposals has been dominated by debate over the ECR pound rate reduction and ECR cost coverage. Participants' views cover a broad spectrum. They range from support for the Service's proposal as the minimum acceptable outcome on this record, to arguments that the pound rate should be kept at the current level or even increased. Reaction to the cost study varies. Some say it is adequate, especially considering the results of statistical tests on related supporting data. Others say it is seriously flawed, and that a different analysis (such as an engineering study) is required. Still others say no study is needed, on grounds that logic and common sense justify a reduction. Assessments of the impact of the reduction on mailers, their customers, and various competitors also diverge.

[5370] There is limited, but pointed, criticism of other aspects of the Service's Standard A proposal. Mailers of parcels vigorously oppose the increase in the residual shape surcharge. There is also opposition to the Service's proposal to pass through less than 100 percent of the savings associated with destination entry discounts; an assertion that the automation flats cost model understates savings; criticism of the ECR letter/flat passthrough; and comment on "address quality" issues. In addition to the cost coverage implications of the ECR pound rate, relative Standard A and First-Class Mail coverages

have been questioned. However, the new prebarcoding discount is unopposed. The anticipated RFRA amendment, the 3.3 ounce prescribed breakpoint, and the automation letter rate eligibility proposal have generated little or no comment.

[5371] *Commission recommendations.* Recommended piece rates are shown in the accompanying rate charts. The Commission concludes that the appropriate level of the commercial pound rates is an issue requiring substantial additional analysis notwithstanding the extensive efforts of participants to explore the issue in this case. The Commission includes in this Opinion a discussion of factors relevant to designing more efficient, cost based pound rates. In the interim, it recommends more moderate changes than the Service has requested.

[5372] Specifically, the Commission recommends a Regular pound rate of 66.8 cents and an ECR pound rate of 63.8 cents. It recommends the changes in the residual shape surcharge the Service has proposed. It also recommends the proposed 3-cent discount for prebarcoded parcels. Recommended destination entry discounts are higher than the Service proposed. The Commission's recommended treatment of the letter/flat differentials varies from retaining the current percentage passthroughs to passthroughs greater than 100 percent to avoid rate shock in adversely affected rate categories. Finally, the Commission's rates reflect the following cost coverages: Regular subclass, 137.47 percent; ECR subclass, 199.45 percent; Nonprofit subclass, 107.51 percent; and Nonprofit ECR, 136.17 percent.

[5373] Although the ECR proposal has garnered most of the attention on this record, all participants have contributed substantially to the Commission's understanding and appreciation of the impact of a number of rate design decisions on users and competitors. To the extent possible, the Commission has attempted to reflect these insights in accommodating various rate design objectives.

[5374] *Organization of remaining discussion.* A summary of current, proposed and recommended rates follows. The discussion addresses several preliminary considerations, such as post-filing adjustments and the Commission decisions on other aspects of the Service's filing. It then reviews specific aspects of the Standard A

proposal; addresses intervenors' alternatives, and presents the Commission's recommendations. Several broad issues that affect Standard A, such as the Service's proposed revenue requirement (especially the 2.5 contingency), cost methodology and cost adjustments, are addressed in other sections of this Opinion.

Table 5-9
Regular Subclass Rate Chart

	Rates (cents)		
	Current	Proposed	Recommended
Schedule 321A - Presort Categories			
Letter Size			
Piece Rate			
Basic	23.5	24.2	25.0
3/5-Digit	20.7	22.5	23.0
Destination Entry Discount per Piece			
BMC	1.6	1.7	1.9
SCF	2.1	2.2	2.4
Nonletter Size*			
Minimum per Piece			
Basic	30.4	31.1	31.9
3/5-Digit	24.0	25.8	26.3
Destination Entry Discount per Piece			
BMC	1.6	1.7	1.9
SCF	2.1	2.2	2.4
Pound Rate	67.7	66.1	66.8
Plus per Piece Rate			
Basic	16.4	17.5	18.1
3/5-Digit	10.0	12.2	12.5
Destination Entry Discount per Pound			
BMC	7.9	8.3	9.3
SCF	10.0	10.8	11.4
Schedule 321B - Automation Categories			
Letter Size			
Piece Rate			
Basic Letter	18.3	20.0	19.7
3-Digit Letter	17.6	19.3	18.7
5-Digit Letter	16.0	17.2	17.4
Destination Entry Discount per Piece			
BMC	1.6	1.7	1.9
SCF	2.1	2.2	2.4
Flat Size			
Minimum per Piece			
Basic	24.5	26.7	27.5
3/5-Digit	20.3	23.1	23.6
Destination Entry Discount per Piece			
BMC	1.6	1.7	1.9
SCF	2.1	2.2	2.4
Pound Rate	67.7	66.1	66.8
Plus per Piece Rate			
Basic	10.5	13.1	13.7
3/5-Digit	6.3	9.5	9.8
Destination Entry Discount per Pound			
BMC	7.9	8.3	9.3
SCF	10.0	10.8	11.4
Residual Shape Surcharge	10.0	18.0	18.0
Parcel Barcode Discount	N/A	3.0	3.0

Table 5-10
Enhanced Carrier Route Subclass Rate Chart

	Rates (cents)		
	Current	Proposed	Recommended
Schedule 324			
Letter Size			
Piece Rate			
Basic	16.2	17.5	17.6
Basic Automated Letter	15.6	16.3	15.5
High Density	13.9	15.2	15.1
Saturation	13.0	14.3	14.3
Destination Entry Discount per Piece			
BMC	1.3	1.5	1.9
SCF	1.8	1.8	2.4
DDU	2.3	2.3	2.9
Nonletter Size			
Piece Rate			
Minimum per Piece			
Basic	16.2	17.5	17.6
High Density	15.1	15.4	15.4
Saturation	14.0	14.8	14.7
Destination Entry Discount per Piece			
BMC	1.3	1.5	1.9
SCF	1.8	1.8	2.4
DDU	2.3	2.3	2.9
Pound Rate	66.3	58.4	63.8
Plus Per Piece Rate			
Basic	2.5	5.5	4.4
High Density	1.4	3.4	2.2
Saturation	0.3	2.8	1.5
Destination Entry Discount per Pound			
BMC	6.4	7.2	9.3
SCF	8.5	8.8	11.4
DDU	11.1	11.0	14.0
Residual Shape Surcharge	10.0	15.0	15.0

Table 5-11
Nonprofit Subclass Rate Chart

	Rates (cents)		
	Current	Proposed	Recommended
Schedule 321A - Presort Categories			
Letter Size			
Piece Rate			
Basic	16.9	15.9	15.5
3/5-Digit	14.2	15.0	14.3
Destination Entry Discount per Piece			
BMC	1.6	1.7	1.9
SCF	2.1	2.2	2.4
Nonletter Size*			
Minimum per Piece			
Basic	23.3	21.9	21.7
3/5-Digit	16.5	17.5	16.8
Destination Entry Discount per Piece			
BMC	1.6	1.7	1.9
SCF	2.1	2.2	2.4
Pound Rate	55.0	58.0	55.0
Plus per Piece Rate			
Basic	12.0	9.9	10.4
3/5-Digit	5.2	5.5	5.5
Destination Entry Discount per Pound			
BMC	7.9	8.3	9.3
SCF	10.0	10.8	11.4
Schedule 321B - Automation Categories			
Letter Size			
Piece Rate			
Basic Letter	11.9	12.9	13.0
3-Digit Letter	11.4	12.2	12.0
5-Digit Letter	9.3	10.1	10.5
Destination Entry Discount per Piece			
BMC	1.6	1.7	1.9
SCF	2.1	2.2	2.4
Flat Size			
Minimum per Piece			
Basic	18.2	17.8	17.6
3/5-Digit	14.4	15.8	15.1
Destination Entry Discount per Piece			
BMC	1.6	1.7	1.9
SCF	2.1	2.2	2.4
Pound Rate	55.0	58.0	55.0
Plus per Piece Rate			
Basic	6.9	5.8	6.3
3/5-Digit	3.1	3.8	3.8
Destination Entry Discount per Pound			
BMC	7.9	8.3	9.3
SCF	10.0	10.8	11.4
Residual Shape Surcharge	10.0	18.0	18.0
Parcel Barcode Discount	N/A	3.0	3.0

Table 5-12
Enhanced Carrier Route Subclass Rate Chart

	Rates (cents)		
	Current	Proposed	Recommended
Schedule 324			
Letter Size			
Piece Rate			
Basic	9.9	11.3	11.6
Basic Automated Letter	9.2	10.0	10.3
High Density	7.8	9.0	9.3
Saturation	7.2	8.4	8.7
Destination Entry Discount per Piece			
BMC	1.3	1.5	1.9
SCF	1.8	1.8	2.4
DDU	2.3	2.3	2.9
Nonletter Size			
Piece Rate			
Minimum per Piece			
Basic	9.9	11.3	11.6
High Density	9.2	9.7	10.0
Saturation	8.4	9.2	9.5
Destination Entry Discount per Piece			
BMC	1.3	1.5	1.9
SCF	1.8	1.8	2.4
DDU	2.3	2.3	2.9
Pound Rate	29.0	37.0	37.0
Plus Per Piece Rate			
Basic	3.9	3.7	4.0
High Density	3.2	2.1	2.4
Saturation	2.4	1.6	1.9
Destination Entry Discount per Pound			
BMC	6.4	7.2	9.3
SCF	8.5	8.8	11.4
DDU	11.1	11.0	14.0
Residual Shape Surcharge	10.0	15.0	15.0

2. Preliminary Considerations

a. Background

[5375] Standard A—formerly referred to as third-class mail—consists primarily of advertising circulars, catalogs and product samples.⁸⁵ Basic eligibility provisions require that each mailing consist of at least 200 pieces or weigh at least 50 pounds. Each piece

must weigh less than a pound, meet size and aspect ratio restrictions, and be submitted as part of a mailing that complies with various presentation and preparation requirements. Senders of Standard A must pay an annual bulk mail permit fee.

[5376] *Recent volume and revenue figures.* In fiscal year 1999, total Standard A volume amounted to 85.2 billion pieces, or more than 40 percent of all domestic mail, and generated \$14.4 billion in revenue. USPS-T-6 at 107, and FY 1999 RPW Report. These results establish Standard A as the second-largest class in the U.S. postal system; only First-Class Mail generates more volume and revenue.

[5377] *Subclass composition and rate structure.* As a result of major restructuring in the mid-1990s, Standard A is comprised of four bulk subclasses. Two—Regular and ECR—are often referred to as the commercial subclasses. The two others—Nonprofit and Nonprofit ECR—are known as preferred subclasses, based on a longstanding statutory rate preference. This preference has changed over time in form and benefit, but is generally understood as an expression of Congressional interest in more favorable rates for mail in the preferred subclasses, relative to their commercial counterparts. While this case was pending, legislation was passed that changes the method of developing rates for the preferred subclasses.

[5378] Each Standard A subclass has the same type of rate structure. This entails a flat rate, referred to as the “minimum per piece,” through a certain weight or breakpoint (now 3.3 ounces, rounded). Pieces above the breakpoint (through the 15.99-ounce weight limit for the class) are assessed at both per-piece and per-pound rates.⁸⁶ There are two formal shape distinctions. One is the letter/nonletter differential (referred to as the letter/flat differential below the breakpoint), which reflects cost differences between letters and all other shapes in the class, such as flats and parcels. The residual shape

⁸⁵ The term “Standard A” is used to distinguish the component of Standard Mail that represents former third-class mail.

⁸⁶ This will be referred to as a “minimum per piece/piece-pound structure.” Mail below the breakpoint is often referred to as piece-rated mail, while mail above the breakpoint is referred to as pound-rated mail. However, a piece rate (which varies by subclass) also applies to “pound rated” mail.

surcharge reflects a portion of the cost differences within the nonletter grouping, as between flats and all other shapes (generally parcels).

[5379] The established worksharing categories recognize presorting to several ZIP Code levels, certain density levels (High Density and Carrier Route) and prebarcoding of letters and flats. The Service proposes extending a prebarcoding discount to parcels in this case. Destination entry discounts (also referred to as dropshipping discounts) recognize entry at three points: bulk mail centers (BMCs), sectional center facilities (SCFs), and destination delivery units (DDUs).

b. Docket No. R2000-1 Rate Design Approach

[5380] *Service's approach.* The Service's proposal for Standard A, presented by witness Moeller, is based on the rate structure and rate design methodology that underlie current (Docket No. R97-1) rates. In general, Moeller's approach to rate design entails judgmental assessments of the statutory cost and non-cost criteria; reliance on cost and pricing support from other Postal Service witnesses; reference to a schematic commonly referred to as the presort tree; and application of a rate formula.⁸⁷ For specific rates, Moeller generally begins with the passthroughs underlying current rates, with modifications made to meet the Service's rate design objectives within each subclass. USPS-T-35 at 4-5; Tr. 10/3867. These objectives include recognizing worksharing efforts through discounts; limiting the percentage increases for individual rate cells to about 10 percent; monitoring the cells that are "pushed up" to finance these limits; and limiting the reduction in the level of the established discounts, given that they have led to significant mailer investment. Additional objectives include creating (or maintaining) appropriate rate relationships, such as ensuring that the 5-digit automation letter rate is lower than the basic ECR letter rate, but higher than the basic ECR automation letter

⁸⁷ The formula includes an algebraic equation that solves for the two piece-rate elements in the underlying structure. The inputs to the formula include discounts; a breakpoint; a target subclass cost coverage; the pound rate (for a piece that is not entered at a destination facility by a mailer); and passthroughs for various discounts. USPS-T-35 at 3-4.

rate; avoiding rate anomalies; providing for more cost-based rates; and achieving results that are reasonable, in terms of an overall perspective. Tr.10/3868 and 3871.

[5381] *Discussion.* Witness Moeller's rate design approach essentially follows the approach that has been developed and found acceptable over the past several rate cases. The Commission accepts it in most respects. In the area of worksharing discounts, the Commission shares the Service's interest in ensuring that certain important rate relationships are maintained. Thus, the recommendation includes a rate for 5-digit automation letters in the Regular subclass that meets two key considerations: it is lower than the basic letter rate in ECR, but higher than the ECR automation letter rate. This relationship, according to Moeller, has led to significant, beneficial changes in mail preparation, because mailers no longer have an incentive to prepare 10-piece packages of carrier route presorted mail; instead, those with the density for ECR basic can instead choose to prepare their mail for the 5-digit automation letter category rate. Another important relationship is the "zero" passthrough of shape-related cost differences for letters and flats in ECR. The Commission's rate design incorporates this rate relationship in both the commercial and preferred subclasses. Also, Moeller states that in designing rates, he pays particular attention to maintaining or increasing the incremental differences in the dropshipping discounts (between the destination bulk mail center and destination sectional center facility), in response to concern about the relationship that was expressed in the last rate case. The Commission's recommended dropshipping discounts also reflect this interest.

[5382] The Commission's approach differs in the following respects. First, the Commission's lower average rate increases generally obviate the need for the 10 percent cap that witness Moeller employs. Second, with respect to the letter/nonletter differential, the Commission believes it is appropriate to recognize more of the reported cost difference, where this can be achieved without undue impact. Third, the Commission believes that greater recognition of destination entry savings is appropriate, and therefore recommends a higher passthrough level than the Service has proposed.

c. Pricing and Cost Support

[5383] Witness Moeller relies, in part, on the cost trends in witness Daniel's weight-cost study to support his proposed pound rate reductions. This study (presented in USPS-T-28) is based on witness McGrane's Docket No. R97-1 In-Office Cost System (IOCS) analysis, but includes changes witness Daniel says are designed to address the Commission's criticisms of the earlier effort. In brief, Daniel analyzes subclass costs in the mail processing, window service, delivery, transportation, vehicle service and "other" cost components individually by shape and, in total, over all shapes. She asserts, in general, that the results show that increasing weight results in higher total unit cost of handling mail, especially since the proportion of flats and parcels increase in heavier weight increments. She says that although the cost of handling letters tends to increase as weight increases, the costs of handling flats and parcels do not appear to increase as weight increases in the lighter weight increments, but do tend to increase in heavier weight increments. USPS-T-28 at 3.

[5384] Daniel says her cost estimates by weight increment are designed to provide a general indication of how costs are influenced by weight. *Id.* at 1. She cautions that they "are not necessarily intended to be an *exact* quantification of costs for every individual weight increment." *Id.* at 3. (emphasis in the original). Daniel notes that she is dealing in a complex area of causation, and has not been able to control for all variables; thus, she concludes: ". . . while it is possible to analyze the data for guidance in rate design, it is difficult, if not impossible, to isolate precisely the impact of weight on cost or identify the exact unit cost of each ounce increment for three of the major classes of mail." *Id.* at 4.

[5385] *Worksharing discounts.* Proposed presort discounts for Regular and Nonprofit are based on mail processing and delivery cost studies by witnesses Miller (USPS-T-24) and Daniel (USPS-T-28). In general, Moeller says these studies show that presorting continues to reduce costs for the Postal Service, and therefore warrants recognition in the rate schedule. These studies also provide support for the proposed

letter/nonletter differential. USPS-T-35 at 5. See also USPS-LR-I-95 and USPS-LR-I-96. Witness Daniel provides separate cost estimates for ECR.

[5386] The automation discounts for letters and flats are based, respectively, on studies by Miller (USPS-T-24) and Yacobucci (USPS-T-25). Moeller says a changing automation environment for flats (discussed by witness Kingsley) and the difference in characteristics between automation and non-automation flats make estimation of the savings associated with mailer-applied barcodes more difficult in this case. Moreover, he says that Yacobucci's study finds that there is "very little benefit to the barcode alone, and illustrates that flat-shaped mail preparation and rate application may need to be reviewed as the flat processing environment evolves." USPS-T-35 at 13. Moeller says the Service is not proposing a significant change in the rate relationships between automation and non-automation flats in this proceeding, but cautions that Yacobucci's testimony "clearly indicates that the automation discounts are too large, so a reduction is warranted." *Ibid.* The new automation discount for prebarcoded pieces subject to the residual shape surcharge (primarily parcels) is based on witness Eggleston's updated study (in USPS-T-26) for a similar discount for Package Services.

[5387] Witness Crum (USPS-T-27) supplies cost data for the residual shape surcharge and destination entry discounts. Moeller says Crum's dropshipping study shows that savings associated with this activity have grown by 78 percent since Docket No. MC95-1. *Id.* at 10.

[5388] Witness Mayes provides cost coverage analysis for both commercial subclasses. USPS-T-32 at 35-36 and 38-39. Her approach, in line with past practice, assesses the Service's proposals for Regular and ECR in terms of the nine pricing criteria in 39 U.S.C. § 3622(b).

[5389] *Commission reliance on underlying cost studies.* The most thoroughly contested study is Daniel's weight analysis, which provides general guidance for the proposed pound rate reductions. Witness Miller's study has not been challenged. Several other analyses (such as witness Crum's studies and Daniel's ECR letter/flat differential) have been contested only in limited respects. The Commission has

reviewed these studies, and finds that they are generally updates and refinements of the analyses that form the cost support for the current Standard A rate schedule. It accepts them with the following changes: use of 1999 CRA cost updates; substitution of Commission variabilities; and the Postal-Service filed errata associated with witness Daniel's delivery costs.

[5390] In related testimony, PostCom witness Glick and Time Warner witness Stralberg propose adjustments to the Yacobucci model. These are discussed in more detail in the Periodicals section of this Opinion. In brief, witness Glick identifies four errors in the Yacobucci model, and PostCom contends that these show that the Service has understated the test year cost savings for processing Standard A automation flats. Correcting for these errors (and applying them to Stralberg's revised model) yields a net reduction of 1.6 cents per piece for basic and .8 cents for the combined 3/5 digit automation pieces. Postcom does not argue that the revised costs should be substituted, but says they show the Service's proposed discounts are conservative. With the exception of Glick's assumption that the incoming secondary factor should be 70 percent, the Commission has incorporated the Glick/Stralberg adjustments in its measurement of automation flats cost savings.⁸⁸

3. The Service's Classification Proposals

a. Automation-related Discount for Certain Prebarcoded Parcels

[5391] The major classification change in the Service's Standard A proposal is a new automation-related discount. This entails a 3-cent discount for prebarcoded machinable Regular and Nonprofit Standard A pieces that are subject to the residual shape surcharge.⁸⁹ Pieces subject to the surcharge are those that are not letter- or

⁸⁸ The Commission view the 70 percent assumption as overly optimistic for this purpose.

⁸⁹ ECR and Nonprofit ECR avoid processing on the equipment that reads barcodes, so discounts for barcoding are not appropriate for these subclasses.

flat-shaped, or pieces prepared as parcels. Witness Moeller says the proposal responds to the interest Standard A mailers expressed, in Docket No. R97-1, in a discount similar to the 3-cent barcoded parcel discount the Service proposed for Standard B in that docket. At that time, the Service objected to extending the discount to Standard A on grounds that another rate element—the residual shape surcharge—was being introduced, and the impact of a parcel barcode discount had not been taken into consideration in deciding on the amount of the proposed surcharge. Since the residual shape surcharge is now an established rate element, and since mailer-applied barcodes are expected to have some processing value, Moeller says the Service now considers it appropriate to offer this discount. USPS-T-35 at 1-2.

[5392] *Cost and volume estimates.* The Standard A prebarcoded parcel discount is based on the discount proposed for Standard B in this case, which reflects full passthrough of Postal Service witness Eggleston’s modeled cost savings of 2.9 cents. *Ibid.*, see also response to P.O. Information Request No. 3, Question 11 at Tr .21/8546. The Service estimates that slightly more than one-half billion Standard A parcels will qualify for the discount (approximately 490 million in the Regular subclass and 12 million in Nonprofit). Tr. 10/3852.

[5393] *Consistency with statutory classification criteria.* Section 3623(c) of title 39, U.S. Code, identifies six classification criteria. Moeller reviews the proposal’s consistency with these criteria, and finds that all applicable factors are satisfied. In particular, he asserts that the proposed discount enhances fairness and equity by extending to mailers of Standard A parcels pricing incentives currently offered to similarly processed Standard B parcels. USPS-T-35 at 2. He also says Postal Service processing and efficiency benefit to the extent that additional parcels become barcoded. *Ibid.* In connection with simplicity, Moeller notes that because there is a separate rate distinction for parcels in Standard A (the residual shape surcharge), administration of an additional rate element applying to these pieces will not be particularly complex. *Ibid.*

[5394] *Discussion.* No participant expresses opposition to this proposal, and PSA witness Zimmerman specifically includes this change among those in the Service’s

proposals that “make some sense” with respect to Standard A parcels. Tr. 29/14137. However, PSA takes issue with what it views as the Service’s characterization of the proposal as a means of mitigating the proposed increase in the residual shape surcharge. It states: “The two have nothing to do with each other; the discount is earned and the surcharge is unwarranted.” PSA Brief at 37.

[5395] The Commission agrees that a prebarcoding discount should be extended to Standard A mailers on the terms identified in the Service’s proposal. It adopts witness Eggleston’s study, which (as revised for Commission adjustments and updates) indicates savings of 3.0 cents per piece. The recommended discount of 3 cents reflects 100 percent passthrough. The Commission adopts witness Moeller’s assessment of the proposal’s consistency with the statutory criteria.

b. Eligibility of Automation Letters for Minimum Per Piece Rates

[5396] *Proposal.* Witness Moeller notes that the Standard A rate design is predicated on the assumption that there will be no effect on costs or revenues if the Postal Service increases the maximum weight for Standard A automation letters to 3.5 ounces.⁹⁰ He expects a *de minimis* effect on costs and revenues, as the weight increase is relatively small; however, he says the Service will revisit this assumption after these heavier weight pieces are introduced into the mail processing environment. USPS-T-35 at 12-13. Presumably, the Service would then present its findings and any related data in a future rate case.

[5397] No witnesses, other than Moeller, have specifically addressed this matter. Although this proposal may seem minor, it touches on two significant points: the appropriate Standard A breakpoint and the changing automation environment. In reviewing this issue it must be recognized that the breakpoint is not the result of a cost analysis. Rather it is an arbitrary rate design feature. There is no reason to believe

⁹⁰ Moeller says that corresponding changes to the maximum weight of *non-automation* letters are not contemplated. USPS-T-35 at 12-13.

letters or flats slightly above the breakpoint have significantly different characteristics than letters or flats slightly below the breakpoint. While the breakpoint is arbitrary, a single recognized dividing line is fair.

[5398] A change in the breakpoint may be appropriate. An entirely new rate design for Standard Mail may be called for. This issue has not been explored since R80-1, and in subsection 4.(d.) (6) of this chapter the Commission explains that other aspects of the Standard Mail rate design also warrant study. Before allowing this de facto increase in the breakpoint for certain Standard A mailers (and thereby reducing their rates), the Commission believes a more comprehensive assessment is needed. Therefore, the Commission does not recommend the requested extension of eligibility for minimum per piece rates to automation letters between 3.3 ounces and 3.5 ounces.

c. The 3.3 Ounce Breakpoint

[5399] The Standard A rate structure gives rise to a transitional weight, referred to as “the breakpoint,” which marks the crossover from the minimum-per-piece portion of the structure to the piece-pound portion. Moeller explains that current practice, in line with the traditional approach, is to calculate a breakpoint weight to the ten-thousandths place to create a perfectly smooth transition from the minimum-per-piece rates to pound-rated rates.⁹¹ *Id.* at 9. He says that prior to the introduction of destination entry discounts (in 1991), this approach worked well, because there was only one transitional pound rate for all pound-rated pieces. With dropshipping discounts now established elements of the rate structure, however, Moeller notes that there are effectively as many as four pound rates in a given subclass, and 14 different pound rates in Standard A. *Ibid.* Thus, although the non-destination entry pound rate has continued to be used as the reference point to calculate the precise breakpoint that allows for a perfectly smooth transition, Moeller says it does not provide for a smooth transition for all destination entry pound rates.

⁹¹ This weight is currently 3.3087 ounces in the Regular subclass.

[5400] Given this development, Moeller says the Service anticipates that a rounded breakpoint of 3.3 ounces will be used in the rate schedules when new rates are implemented. In support of this approach, he observes that “we are not sacrificing much precision, if any, by merely using the selected breakpoint of 3.3 ounces as the prescribed breakpoint; [given that] its precision has long been confined exclusively to non-destination entry categories.” *Id.* at 9-10 (footnote omitted). Moeller also says this approach offers the advantages of practicality and simplicity. For example, he says the Service generally chooses the highest of the four breakpoint weights to use for the maximum weight of automation letters in other classes of mail, so using 3.3 ounces for all breakpoints will avoid changes in the weight limit with every rate case. In addition, he says it will eliminate expression of the breakpoint with a cumbersome figure carried to a ten-thousands of an ounce decimal place. *Ibid.*

[5401] *Commission recommendation.* As witness Moeller indicates, the introduction of destination entry discounts has effectively eliminated the application of a single breakpoint to the entire Standard A subclass. Therefore, the use of a breakpoint with four decimal places, which was adopted in the interest of providing a smooth transition, has lost essentially all of its original significance. Simplicity and practicality are also valid considerations in rate administration.

[5402] The Commission finds that the proposed change is well-supported, and recommends it. To clarify this change and its application in the rate schedule, the Commission adds the following language in the footnotes to the Standard A rate schedules: “The transitional weight between the minimum per piece rate and the pound rate in Standard Mail is 3.3 ounces.”

[5403] The Commission does not endorse 3.3 ounces as a permanent breakpoint for Standard A. This question—the appropriate transitional weight—should be addressed in the broad rate design inquiry the Commission believes is needed.

4. Rate Design for the Commercial Subclasses (Regular and ECR)

a. Introduction

[5404] The Regular and ECR subclasses, which were established as a result of the Docket No. MC95-1 reclassification case, are successors to the former third-class mail Regular-Rate subclass. Moeller says mailings in the Regular subclass are sometimes viewed as demographically targeted, while those in ECR are often seen as geographically targeted. USPS-T-35 at 18. In fiscal year 1999, the combined volume of the commercial subclasses amounted to more than 71.3 billion of the 85.2 billion pieces in Standard A as a whole. The Regular subclass, with 38.5 billion pieces, generated slightly more than half of the commercial volume; ECR, with 32.8 billion pieces, generated slightly less than half. USPS-T-6 at 107. This volume (without fees) produced revenue of \$12.8 billion. FY 1999 RPW Report.

b. Regular Subclass Proposal

[5405] The Postal Service proposes rates that reflect, on average, revenue increases of 9.4 percent for the Regular subclass. USPS-T-35 at 2. The proposal is based on the prevailing rate structure; assumes a 3.3 ounce breakpoint; applies the rate formula underlying current rates; reflects an 18-cent residual shape surcharge; and a 3-cent prebarcoding discount for machinable pieces subject to the residual surcharge. *Id.* at 6-7 and 9.

[5406] *Rates.* For mail below the breakpoint, the Service proposes the changes identified in Table 5-9. For mail above the breakpoint, Moeller proposes reducing the pound rate from 67.7 cents to 66.1 cents. *Id.* at 8. In support of this change, which he characterizes as a “modest reduction” of 1.6 cents, Moeller notes that the pound rate traditionally has been considered a proxy for a surcharge on parcels. However, he notes that the introduction of the residual shape surcharge—and the increase proposed in this case—reduce the need for the pound rate to act as a proxy for a parcel surcharge.

Moeller also asserts that the proposed decrease is not inconsistent with Postal Service witness Daniel's study of the effect of weight on costs. *Ibid.* Corresponding piece rates for mail above the breakpoint are shown in the Table 5-9.

[5407] *Letter/nonletter differential.* The proposed letter/nonletter differentials in the Regular subclass are identical to those in existing rates; however, Moeller says this reflects an interest in moderating rate increases for individual rate categories, rather than a preference for a specific degree of shape recognition. He considers the resulting passthroughs (of 77 percent in basic and 64 percent in the combined 3/5 digit tier)⁹² reasonable, as they not only recognize a significant portion of the cost differential, but also reflect the Commission's previously expressed intentions to increase them. He also notes that if the passthroughs were larger, the percentage increase for the category receiving the highest increase in the Service's overall proposal—the minimum-per-piece rate for 3/5 digit presorted automation flats—would likely be even higher. *Id.* at 5-6.⁹³

[5408] *Presorting.* Moeller notes that once the letter/nonletter passthroughs have been established, selection of a presort passthrough for letters is the pivotal rate design decision, because it dictates the effective passthrough for nonletters and several other tiers. *Id.* at 10. Relying on witness Miller's cost avoidances, Moeller attempts to justify a variety of passthroughs.

[5409] *Automation letters.* In the automation letters category, current rates reflect full passthrough of the measured cost avoidance. Moeller departs from this approach (in the direction of passthroughs greater than 100 percent) in all three tiers. Passthrough in basic is 110 percent (which preserves 80 percent of the existing discount); 106 percent in the 3-digit tier; and 160 percent in the 5-digit automation tier. *Id.* at 11. Moeller cites three reasons for proposing unconventional passthroughs. First, the Regular automation letter discounts were reduced as a result of Docket No. R97-1, and would be further

⁹² Moeller notes that the relative passthroughs differ, in part because of changes in cost methodology. Moreover, in current rates, 50 percent of the cost difference between letters and flats is recognized at the basic presort tier, and 40 percent of the difference at the 3/5 tier. USPS-T-35 at 5.

⁹³ The R97-1 and R2000-1 passthroughs are not directly comparable because of differences in calculating underlying costs and in measuring the cost difference between letters and flats. *Id.* at 5.

reduced if passthrough of cost avoidance estimates is limited to 100percent. Second, this approach moderates the percentage increase for the 3-digit category which, at 9.7 percent, is above the average for the subclass and the highest increase for automation letters. Third, the proposed 3-digit tier passthrough helps achieve the desired 5-digit automation rate relationship with ECR basic. *Id.* at 11-12.

[5410] *Automation flats.* Moeller asserts that decreased savings, due to a changing automation environment and higher reported costs, would warrant a substantial reduction in the current discounts for automation flats. To mitigate the impact on mailers, he proposes maintaining them at about 75 percent of the current level. *Id.* at 13. This results in unconventional passthroughs of 230 percent for basic automation flats and of 500 percent for 3/5-digit automation flats. USPS-T-35, Workpaper 1.

[5411] *Destination entry discounts.* Moeller proposes an increase in the absolute level of the discounts, consistent with the increase in savings, but a slight reduction in the percentage passthrough relative to current rates. However, he says passthroughs—ranging from 73 to 78 percent—continue to encourage dropshipping and allow him to maintain or increase the incremental discounts. USPS-T-35 at 14-15. The proposed passthroughs are 73 percent for DBMC and 77 percent for DSCF. Moeller says that if 75 percent were used for both, the incremental differences could not be maintained. He also says a greater passthrough would result in a larger increase in the basic rates, which conflicts with the general guideline of tempering individual rate increases. *Id.* at 15.

[5412] *Commission rate design.* No participant opposes the Service's proposed minimum-per-piece and piece-pound rates in the Regular subclass. The Commission's rate design for Regular follows witness Moeller's in many respects. However, using updated costs and the Commission's costing methodology generally produces slightly larger cost differentials. This allows the Commission to adhere to a cost based methodology for presort and automation letters by using 100 percent passthroughs. To avoid undue rate increases for automation flats, and to recognize that the value of these flats will likely be higher in the test year than the Postal Service anticipates in its filing,

the Commission recommends the Postal Service's proposed letter/flat passthrough and passthroughs greater than 100 percent for automation flats. This is consistent with the Service's proposal.

[5413] The Commission also recommends slightly higher passthroughs for destination entry discounts, but this is based on updated costs and the Commission's costing methodology. This recognizes more of the cost differences, and prevents the incremental differences between the dropshipping tiers from shrinking. Shrinking these differences would adversely affect mailers who dropship.

[5414] Witnesses Glick and Schick, testifying on behalf of the Association for Postal Commerce and Mail Advertising Service Association, Inc., support full passthroughs in destination entry discounts. Tr. 32/15716-18 and 15703-07. As witness Glick's testimony indicates, the Commission's stated preference is for full passthrough. However, the Commission finds—as does witness Moeller—that this interest cannot be accommodated in its entirety, due to the impact on other rates. However, the Commission does recognize more of the savings than the Service's rate design, passing through 84 percent of the savings (determined on the Commission's costs) for BMC entry, 84 percent for SCF entry, and 82 percent for DDU entry.

[5415] *Cost coverage.* Moeller notes that Postal Service witness Mayes proposes a cost coverage of 132.9 percent for Standard A Regular, which results in an average rate increase of 9.4 percent. In support of the proposed coverage, Mayes says that Regular, like the other Standard subclasses, has a relatively low intrinsic value of service (criterion 2), due to its deferability, use of ground transportation, lack of access to the collection system, and absence of free forwarding. USPS-T-32 at 35. She states that although the Service may attempt to satisfy mailer requests for delivery within a specific time frame, these typically involve advance planning and coordination by the mailer to facilitate the achievement of these requests. *Ibid.*

[5416] With respect to the cost floor requirement of criterion 3, Mayes notes that at projected test year after rates volumes, the \$9,070 million revenue from the subclass easily exceeds its estimated incremental cost of \$6,938 million. *Id.* at 37. She says the

price elasticity for Regular (at -0.570) is higher than estimated in Docket No. R97-1, and higher than that of First-Class Letters. *Ibid.* However, she states that it is lower than that of ECR, and concludes that this suggests “an intermediate economic value of service.” *Id.* at 36. She also indicates that the Service hopes that the availability of new ancillary services (Delivery Confirmation, Return Receipt, and Bulk Insurance) will slightly increase the value of service for some Standard A mailers.

[5417] With respect to criterion 4, Mayes posits that the 9.4 percent increase is above the rate of inflation, and higher than the system average of 6.4 percent. She says this results “in a noticeable, but reasonable, impact” on the users of Regular mail but, considering the 132.9 percent cost coverage over volume variable costs, also “suggests that competitors are not unfairly targeted by this increase.” *Ibid.*

[5418] With respect to criterion 5, Mayes notes the availability of alternatives for demographically targeted advertising including special-interest magazines, cable television, and internet websites. *Ibid.*

[5419] Mayes states that mail within the Regular subclass has a substantial degree of mailer preparation, which must be considered by virtue of criterion 6. *Id.* at 36-37. With respect to criterion 7, Mayes says the rate schedule for Standard A is designed to offer a range of rates to reflect the varying ways that the mailers may choose to perform worksharing, which means that the rate schedule is not particularly simple. *Id.* at 37. However, she states that as the rates for Standard A only apply to bulk-entered mail, senders tend to be sophisticated users of the postal system or utilize the services of those more expert in postal matters, permitting criterion 7 considerations (generally expressed in terms of simplicity) to be manifested more in terms of creating reasonable and identifiable rate relationships, rather than a limited number of rates. Based on the foregoing evaluation, Mayes concludes that the proposed rate level is fair and equitable (criterion 1).

[5420] *Relative First-Class Mail/Standard A cost coverages.* No Standard A witness has specifically addressed witness Mayes’ analysis; however, to finance his rate proposals for First-Class Mail, ABA/NAPM witness Clifton proposes an increase in

Standard A cost coverages. Specifically, he would increase cost coverages for Standard A Regular by 9.3 percentage points (from 132.9 to 142.2) and for Standard A ECR mail by 5.6 percentage points (from 208.8 to 214.4 percent). Clifton's rationale for these adjustments draws on a review of relative cost coverages of presorted First Class Mail and Standard A since 1994 and on assertions regarding First-Class Mail's contribution to institutional costs since 1990. Tr .26/12458-60.

[5421] Witness Prescott says Clifton's proposal is not supported. He asserts that, by definition, cost coverage for a given subclass of mail is the ratio of revenues to volume variable costs for that subclass of mail. He observes that increases in cost coverages, therefore, can occur either through an increase in revenues, a decrease in costs, or a combination of both. Prescott says the increase in First Class Mail cost coverage comes about in large part from lower costs; he says a cost coverage increase in First-Class Mail does not, as witness Clifton asserts, mean that it is being singled out for discriminatory rate increases. Tr. 44/19316. The Commission is not accepting witness Clifton's First-Class Mail proposals, so his interest in adjusting Standard A coverage is generally moot. However, the Commission notes its agreement with Prescott's observation that an increase in cost coverage can result simply from the mechanics of the ratio, and is not, in itself, indicative of discriminatory treatment.

[5422] *Commission cost coverage.* The Commission finds witness Mayes' analysis well reasoned. The Commission recommends rates that provide a cost coverage of 137.4 percent, on a cost basis updated for FY 1999 CRA costs and calculated according to Commission methodology.

c. Proposed Changes Affecting the Residual Shape Surcharge

[5423] *Background.* In Docket No. R97-1, the Postal Service proposed—and the Commission recommended—a uniform 10-cent surcharge for pieces that were not letter- or flat-shaped, or were prepared as parcels. The impetus for a surcharge on these “residual shape” pieces was the Commission's concern, expressed in PRC Op. MC95-1,

that they were not covering their costs.⁹⁴ This concern was borne out in Postal Service witness Crum's Docket No. R97-1 study, which showed an estimated cost difference of 35.2 cents (using Postal Service costs). Based on several considerations (including impact on affected mailers and fairness), the Commission agreed with the Service's proposal to pass through a fairly low percentage of the cost difference, and recommended a 10-cent surcharge. PRC Op. R97-1, paras. 5476-5489.

[5424] In this case, Moeller says witness Crum's update of his original study conclusively demonstrates that "there continues to be a measurable difference [now 65.5 cents] between the costs for flat-shaped pieces and the costs for the remaining pieces in the non-letter categories of Regular and [ECR] mail." USPS-T-35 at6. Based on this cost finding, Moeller says the Service proposes increasing the current 10-cent surcharge to 15 cents in ECR and to 18 cents in Regular. He says the increase furthers the goal of greater recognition of the cost difference, and its application on a subclass-specific basis takes into consideration the proposed 3-cent discount for prebarcoded parcels. *Ibid.*

[5425] Moeller says the surcharge reflects a passthrough that equates to 27.5 percent, based on the methodology the Commission used in Docket No. R97-1. He notes that this is similar to the 24 percent passthrough that underlies the current surcharge, but results in an increase because it is applied to the higher cost base that witness Crum has calculated. Moreover, he says: "Ideally, a greater passthrough would be proposed; however, in order to moderate the impact on mailers, an even greater per-piece increase ... is not proposed at this time." *Id.* at 7.

[5426] Moeller also notes that mailers in the Regular and Nonprofit subclasses can now partially offset the 8-cent increase in the surcharge by tendering parcels that qualify for the 3-cent prebarcoding discount the Service has proposed for parcels that meet automation eligibility requirements. *Id.* at 6. With respect to ECR, Moeller says witness Crum demonstrates that the cost differential greatly exceeds the proposed surcharge

⁹⁴ PRC Op. MC95-1, para. 5559.

and, unlike Regular, the pound rate does little or nothing to generate much revenue from ECR parcels relative to flats. *Id.* at 23-24. He also notes that parcel-shaped pieces are excluded from ECR unless they are merchandise samples, so the only surchargeable pieces in this subclass are merchandise samples. *Id.* at 24.

[5427] Moeller observes that the Commission's Opinion in Docket No. R97-1 acknowledged that an alternative way of considering this issue is to examine the revenue/cost relationship. He does not endorse this alternative, but says this comparison not only results in a revenue shortfall, but also fails to consider the offsetting effects of the lower pound rate and the proposed parcel barcode discount in the Regular subclass. *Id.* at 7. Moeller offers the further observation that even if the proposed surcharge resulted in an implicit cost coverage on surcharged pieces that slightly exceeds 100 percent, the Service does not think it undesirable for Standard A parcels to make some contribution to institutional costs, especially given the proposed extension of several Special Services, such as Delivery Confirmation, to pieces subject to the residual shape surcharge, but not to "other, less contribution-challenged pieces." *Id.* at 7-8. Moreover, Moeller says: "[F]uture prospects for a larger residual shape surcharge seem probable even if the cost differential does *not* increase. The proposed passthrough was suppressed to 27.5 percent in order to moderate the rate increase on parcel mailers. A higher passthrough applied to the same cost differential in the next rate case would, by itself, result in a higher requested surcharge." T r.10/3845 (emphasis in original).

[5428] *Volume and costs.* Moeller says he does not expect the incremental increase in the surcharge to have much effect on parcel volume. *Id.* at 3849. With respect to costs, witness Crum identifies two major occurrences that have had opposing impacts on his results. First, an implementation decision has allowed parcels less than 1.25 inches thick to qualify for the flat automation rate if they meet all other criteria for that rate and are properly prepared. Thus, Crum says that the surcharge is not applicable to some unknown number of parcels between .75 inches and 1.25 inches thick that are prepared as automated flats. USPS-T-27 at 7-8. He says: "The logical conclusion, then, is that the pieces still subject to the surcharge will have a higher cost

than those presented in this analysis and my estimate of the cost difference is conservative.” *Id.* at 8. The other consideration is a difference between Docket No. R97-1 and this case in the way mail processing costs are calculated. Explicit econometric-based volume variability factors were part of the Service’s mail processing cost presentation in that case, and Crum notes that this is not the case in this docket for effectively all of the parcel operations and some portion of the flats operations. He says this expands the cost difference between flats and parcels beyond the level that resulted under the R97-1 volume variability proposal. *Ibid.*

[5429] *Discussion.* District Photo, Inc., Mystic Color Lab and Cox Sampling (appearing jointly as DMC), MOAA, PSA, PostCom and RIAA strongly oppose the Service’s residual shape surcharge proposal. DMC questions the costs that underlie the increase. DMC Brief at 12-15. RIAA contends that the Commission should recommend a surcharge for Regular mailers that does not exceed 13 cents before application of the proposed discount for prebarcoded parcels. RIAA Brief at 2. PSA contends that there is no justification for surcharge treatment, in the first instance, and that the Service’s attempt to impose an 80 percent increase in this case contravenes criterion 4 of the Postal Reorganization Act (effect of increases on mailers). PSA Brief at 34-36.

[5430] PSA witness Zimmerman objects to the size of the increase and reiterates several points that were raised when the surcharge was first proposed. Among other things, he objects to the Service’s “blending” into one category, both for surcharge purposes and for cost purposes, four separate subclasses of mail. T r.29/14137. He also says the PRA does not require that each piece of mail within a rate category fully cover attributable costs. *Id.* at 14164. Zimmerman further questions 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.” *Id.* at 14139. He notes that to the extent a shortfall exists, the “difference is small and the remedy . . . is large.” He also contends that there is some question as to the “fragility of Service’s cost estimates.” *Id.* at 14140. In particular, he says the Postal Service cannot reconcile what he refers to

as “the absurd finding” that a nonprofit ECR parcel costs three times as much as a Regular parcel to process. *Ibid.*

[5431] RIAA, through witness Glick, presents a theoretical basis for using the revenue differences between flats and parcels in determining the residual shape surcharge. Glick notes that Moeller has used a “traditional passthrough” approach in setting the residual shape surcharge in this case. He contends that “an exact piece” comparison is a more appropriate analogy. Tr .23/10392. Glick further states that while Crum’s general analytical approach seems reasonable, he did not adjust for differences in weight. *Id.* at 10392-93. He says this may be reasonable for comparisons of mail of approximately the same weight, but is inappropriate here because the average Standard A commercial parcel weighs 2.5 times as much as the average Standard A flat. He contends that this amounts to double-charging parcels for weight-related costs. *Id.* at 10393. In the absence of reliable cost data by shape and weight increment, Glick asserts that the appropriate approach for this adjustment is to use the weight-related revenue difference between flats and parcels as a proxy. He identifies this as 20 cents per piece, based on current rates. *Ibid.*

[5432] With respect to revenue, RIAA says the “entirety of the revenue effect analysis performed by Postal Service witness Moeller is based on FY 1998 data.” RIAA Trial Brief at 5. It says that since the surcharge did not take effect until after the conclusion of that fiscal year, these data are of little probative value. *Ibid.* However, it says there is nothing in the FY 1999 data that either calls into question witness Glick’s explanation of why revenue differentials must be taken into account in setting the surcharge or cures the infirmities in the Service’s showing. *Id.* at 5-6.

[5433] *Postal Service’s response.* The Service dismisses witness Zimmerman’s criticism regarding the “blending” of subclass costs, stating that the approach in the Service’s proposal is consistent with the current Commission-accepted methodology for establishing a cost basis for surcharge. It further argues that witness Zimmerman offers no record basis for an alternative approach. Postal Service Brief at VII-189-190. Also, it states that witness Crum shows that even if the four subclasses were viewed

independently, the proposed surcharge is still less the FY 1998 cost-revenue differential. Thus, it says attempting to tailor the surcharge for each subclass “would appear to be a fruitless exercise, since in all instances, the surcharge would not provide adequate revenue to cover the costs of residual shapes.” *Id.* at VII-190.

[5434] The Service also rejects Zimmerman’s contention that there is no requirement that all pieces within a subclass cover their own costs. It takes the position that this is not only inconsistent with the Commission’s previous legal conclusions regarding the fairness and equity criterion, but also “defies logic and common sense.” *Ibid.* The Service also says Zimmerman’s criticisms fail to acknowledge the balanced nature of the Service’s presentation in this docket.

[5435] With respect to witness Glick’s testimony, the Service acknowledges that Glick’s “exact piece” comparison may warrant further consideration, but says he has simply provided a theoretical basis for using revenue differences to determine the rate differential. Therefore, the Service says there is no record basis for adopting this approach in this case. However, it takes issue with Glick’s criticism that Crum’s cost study does not consider the impact of weight. In particular, the Service says that Crum’s study in this proceeding reconfirms the finding in his Docket No. R97-1 analysis that in ECR, where the weight is nearly identical between parcels and flats, costs for flats and parcels differ greatly. Therefore, it argues that the Commission’s findings in Docket No. R97-1 regarding the suitability of witness Crum’s original study should apply with equal force in this docket. *Id.* at VII-193.

[5436] *Commission recommendation.* Several objections raised on this record were also presented and resolved in Docket No. R97-1. In essence, these include arguments that there is no cost coverage requirement below the subclass level; that costs should not be “blended”; and that other mailers have not objected to “averaged” costs. The Commission has once again considered the validity of these arguments, but finds no sound reasons to depart from its previous conclusions. In general, the Commission continues to believe that overall considerations of fairness and equity and an interest in cost-based rates overcome opponents’ objections.

[5437] Given the conclusion that a residual shape surcharge is an appropriate element of the Standard A rate structure, the main question on this record is whether the amount of the increase the Service has proposed is appropriate. The Commission agrees with opponents that the increase seems large, but finds that witness Crum's results, which reflect improvements in the original analyses, appear to be generally reliable. In this regard, the Commission notes that the cost volatility DMC has pointed out is considerably muted when the costs of the individual subclasses are aggregated, as they are here. The Commission has considered whether an even lower passthrough would be appropriate, but finds that this would conflict with appropriate interests in recognizing cost differences.

[5438] The Commission also has considered opponents' arguments that the revenue generated by parcels should be considered. However, as the Service points out, even by this measure these parcels fail to cover cost by a considerable margin. Accordingly, this argument does little to advance parcel mailers' position. The Commission also agrees that witness Glick's "exact piece" comparison may warrant further consideration, but there is no basis for adopting that approach on this record.

[5439] The remaining question relates to the Postal Service's proposal to apply the surcharge on a subclass specific basis, in recognition of the proposed introduction of the parcel barcode discount. The Commission is recommending the proposed 3-cent parcel barcode discount; therefore, the recommended residual surcharges are 15 cents in both ECR subclasses and 18 cents in Regular and Nonprofit. The Commission considers this approach an improvement over the existing single surcharge.

d. Standard A Enhanced Carrier Route Subclass

[5440] The Postal Service proposes Standard A ECR rates that reflect, on average, revenue increases of 4.9 percent, with a cost coverage of 209 percent. USPS-T-32 at 38. Moeller's proposed rate design assumes retention of the ECR subclass and the established rate structure. It also reflects the Service's cost and pricing assumptions;

employs the rate formula underlying current rates; includes a 3.3 breakpoint; and includes the proposed residual shape surcharge of 15 cents. *Id.* at 9.

[5441] *Minimum per piece rates for mail below the breakpoint.* Current and proposed minimum per piece rates are shown in the rate chart appearing at Table 5-10.

[5442] *Piece and pound rates for mail above the breakpoint.* Moeller's rate design produces increases in the piece rates for ECR mail above the breakpoint as shown in the rate chart at Table 5-10.

[5443] Moeller proposes a corresponding pound rate of 58.4 cents, which is a reduction of 7.9 cents from the current 66.3 cent rate. *Id.* at 10 and 19. Moeller says this proposal, which he characterizes as a "moderate reduction," addresses the Commission's prior concerns about competition and should also address objections raised by enterprises in the private sector that offer alternatives. *Id.* at 19-20. Specifically, he says: "The moderate reduction in the pound rate is designed to allay concerns for those that contend they may be disadvantaged by a significant reduction in the pound rate. Yet the moderate reduction acknowledges the needs of small businesses who rely on the mail, or wish to use the mail, for affordable advertising." *Id.* at 23.

[5444] As discussed within, the Commission agrees that a reduction in the pound rate is appropriate, but does not recommend as large a reduction as the Service proposes. Instead, it proposes 63.8 cents.

[5445] *Letter/flat differential.* In line with the Commission's recommendation in Docket No. R97-1, Moeller's proposed ECR design has no rate differential between basic letters and flats. *Id.* at 18-19. Moeller says this approach (a "zero" passthrough, in effect), coupled with rate distinctions at the other tiers, balances recognition of cost differences with the Service's interest in fostering its letter automation program. *Id.* at 24-25. At the other levels, Moeller proposes passthroughs of 65 percent at high density and 95 percent at saturation. *Id.* at 25.

[5446] Witness Haldi, sponsored by Val-Pak Direct Marketing Systems, Inc., Val-Pak Dealers' Associations, Inc., and Carol Wright Promotions, Inc., appearing jointly

as Val-Pak, *et al.*, contends that the Service's proposed ECR letter/flat differential is understated. The Commission addresses his position below. In brief, it finds that the error Haldi has identified would have a *de minimis* effect; therefore, it does not impact the Commission's recommendation.

[5447] *Worksharing discounts.* For the basic automation letter discount in ECR, Moeller proposes full passthrough of the reported cost differential in the underlying cost study. He proposes passing through 125 percent between the basic and high density tiers, and 100 percent between high density and saturation. Given the presort tree and shape passthroughs, the corresponding passthroughs for nonletters are 63 percent between basic and high density and 84 percent between high density and saturation. *Id.* at 25.

[5448] Moeller says these passthroughs are consistent with those underlying current rates, with the exception of the 125 percent passthrough between basic and high density letters. *Id.* at 25-26. He attributes the exception to the Service's interest in mitigating the effect of the "zero" shape passthrough at the basic tier; in maintaining the current per-piece rate differential between basic and high density letters; and in tempering the percentage change for the high density and saturation tiers. Moeller says that if 100 percent were used, the increase for saturation letters would be 12.3 percent, or more than double the subclass average. He says the proposed approach also allows for greater recognition of the cost difference between basic and high density flats. *Id.* at 26.

[5449] *Destination entry.* Moeller passes through 73 percent of reported savings for DMBC entry, 77 percent for DSCF entry, and 77.5 for DDU entry, for the reasons identified in the Regular subclass discussion. *Id.* at 26-27.

[5450] *Commission rate design.* The Commission accepts the basic rate design methodology that underlies the Service's ECR proposal, and recommends the proposed 15 cent residual surcharge. With respect to worksharing elements, the Commission finds that adhering to 100 percent cost passthroughs is problematic for ECR letter

categories because the cost differentials have increased dramatically between FY 1998 and FY 1999, as Table 5-13 shows.

Table 5-13
Test Year Cost Differentials

ECR Letter Category	USPS Based on BY 1998	PRC Based on BY 1999	Percent Growth
Basic	-	-	-
Basic Automation	1.2¢	2.8¢	135%
High Density	1.8¢	3.3¢	78%

Source: USPS-LR-I-166 and PRC-LR-I-15

[5451] Some of the growth in these differentials is due to the difference between the Postal Service's and the Commission's costing methodologies, but this only accounts for a small portion. Growth of these magnitudes in cost differentials makes rate design difficult, since it is generally desirable to have minimally disruptive rate changes. The Commission must also consider the possibility that the cost differences obtained in FY 1999 might shrink in the future if FY 1999 ECR letter data are anomalous, or there are operating conditions in FY 1999 that will not exist in the future or the test year. For this reason, the Commission is recommending rates based on 75 percent passthrough of the cost differences between ECR Basic letters and ECR Basic Automation letters and between ECR Basic letters and ECR High Density letters. In the future, if these costs show abrupt year-to-year changes, the Postal Service should consider using a three- to five-year moving average to smooth changes in affected rates.

[5452] In other categories, the Commission's recommended rate reflects a 100 percent passthrough for saturation letters, and for the letter/flat differential at the high density and saturation density levels. To support the Postal service's letter automation program, the Commission continues the policy of adopting a zero percent

passthrough of the letter/flat cost differential for the basic density tier. By virtue of the presort tree, these passthroughs produce a 56 percent passthrough for high density flats and a 100 percent passthrough for saturation flats. The Commission's recommended rates are as cost based as possible given the underlying costs and the considerations outline above.

e. ECR Pound Rate Discussion

[5453] The most controversial issue in Standard A is the Postal Service's proposal to reduce the ECR pound rate from 66.3 cents to 58.4 cents. According to Moeller, the rationale for this reduction draws on "general guidance" from witness Daniel's cost study and several other considerations. These include: (a) an implicit coverage comparison, which shows that the reduction does not distort relative coverages for piece-rated mail and pound-rated mail; (b) alleviation of an "illogical" result under the current pound rate, where postage for two 4-ounce pieces is only three-tenths of a cent more than an 8-ounce piece; (c) recognition that the pound rate is no longer needed to act as a proxy for a parcel surcharge; and (d) the conclusion that the moderate nature of the decrease addresses concerns about the impact of the proposal on mailers, their customers, and competition.

[5454] AAPS, NAA and Val-Pak, *et al.* oppose the proposed ECR pound rate reduction. Their opposition, expressed on brief and through the testimony of AAPS witness White, NAA witnesses Tye and Wilson, and Val-Pak, *et al.* witness Haldi, focuses on four main arguments. These include: Daniel's cost-weight study is unreliable or inadequate; Daniel's regression analysis is not useful, and others presented on this record add confusion to the record; Moeller's implicit cost coverage comparison is not reliable and proves little, since the Service does not use it elsewhere; and the proposal interferes with competitors, in contravention of 39 U.S.C. §3623(b)(4) and other considerations.⁹⁵

[5455] Supporters of the Service's ECR proposal include the Association of Independent Store Owners and Professionals (AISOP); the Saturation Mail Coalition (SMC); Mail Order Association of America (MOAA), the Association for Postal Commerce (PostCom) and the Direct Marketing Association, appearing jointly as MOAA, *et al.* Witness Crowder, on behalf of Advo, and witness Prescott, on behalf of MOAA, *et al.*, address technical aspects of the Service's proposal and of opponents' criticisms. AISOP and SMC sponsor industry witnesses who address impact arguments.

[5456] The Postal Service sponsors witness Bozzo (USPS-RT-18) in further support of the use witness Moeller makes of Daniel's cost findings, and sponsors witness O'Hara (USPS-RT-19) regarding the Service's motivations for proposing a reduction in the pound rate and competition issues.

[5457] The debate over the Service's ECR pound rate proposal has consumed considerable time and effort, and has covered numerous complex, and often inter-related, topics. The Commission believes this effort has been extremely worthwhile, regardless of the position one takes on the merits of the Service's proposal or the Commission's recommendation.⁹⁵ In particular, there is now a much clearer picture of the type of data and information that would materially advance the understanding of pound-rate cost causation. In the interest of obtaining and evaluating that type of data and information, the Commission calls on the Service to conduct a new analysis addressing the matters described at the conclusion of this section. This will provide the Commission and all interested participants with a sounder basis for addressing key matters left untouched in the Daniel study and witness Moeller's rate design testimony.

[5458] The broad sweep of written and oral testimony, discovery responses, library references, and other material forecloses summarizing every argument or position that has been raised. Therefore, the discussion attempts to identify basic positions and

⁹⁵ This will generally be referred to in this discussion as part of the competitive impact or effect argument.

⁹⁶ Given the operation of the rate formula, corresponding ECR piece rate elements increase.

address the points most pertinent to the Commission's analysis. In the discussion of competitive impact, the SAI report—and some arguments on brief—were filed under seal. The Commission has considered this material, and finds that it can address relevant issues in this Opinion, on the public record, without interfering with the interests that prompted confidential treatment.

[5459] In essence, the following discussion indicates that the Commission finds that the Daniel study is not dispositive on the question of the appropriate pound rate. The Commission directs the Service to conduct a study to obtain the data and information needed to reach firm conclusions on this important point. At the same time, the Daniel study (as supplemented by later-filed data) has addressed some of the Commission's reservations about earlier studies. Tally thinness, for example, has been explored, and placed in proper perspective. In brief, minor technical criticisms lodged against study have not withstood scrutiny.

[5460] The Commission finds the study does not point to a clear measure of the impact of weight on the cost of ECR mail, but it does allow the Commission to have a degree of confidence that the pound rate it is recommending is not out of line with apparent cost trends. Given that the Service and the parties are urged to explore additional cost and policy issues, the Commission is not yet able to form a permanent position on the appropriate pound rate.

[5461] The Commission finds that several considerations, not directly related to the study, point to the appropriateness of a modest reduction in the ECR pound rate.⁹⁷ These include (1) the demonstration that the current pound rate produces an illogical postage result, inconsistent with notions of fairness and equity and efficient postal operations; (2) the recognition that reclassification has reduced the need for the pound rate to act as a proxy; and (3) the demonstration that the pound rate “over recovers” due to shape. The first two points are largely self-evident; with the respect to the latter point, the Commission notes that witness Crowder's contention that the ECR letter/flat cost

⁹⁷ No one consideration is necessarily more influential than another; each contributes to the impression that the current rate is too high.

differential reflects differences due to shape and weight has merit. Unlike the Regular subclass rate differentials, which are based on special mail processing cost studies, ECR cost differentials are based directly on costs from the CRA. The mail processing costs are thus from IOCS. When comparing one CRA unit cost to another, the difference may be due to several factors related to the characteristics of the mail. By developing unit costs for each density level, the Service eliminates differences due to density level. Using the results of its destination entry cost study, the Service also eliminates differences due to dropship patterns that may differ by density level and shape. However, because the weight of letters and flats varies, the letter/flat cost differential by density level likely reflects differences in both weight and shape. As the pound rate is supposed to reflect the effect of weight on cost, passing through a substantial portion of the ECR letter/flat differential amounts to a double counting of the effect of weight. Thus, in part because the Commission is adopting a 100 percent passthrough of the letter/flat cost difference, a reduction in the pound rate for ECR is justified. The recommended reduction—of 2.5 cents—is intended to offset double counting inadvertently captured in the letter/flat rate differential.

[5462] It should also be noted that Val-Pak, et al. enhanced the record by emphasizing that the cost per pound should be marked up when it is used as an input to the rate design formula. They noted that pound costs in other subclasses are marked up in the rate design process, including First-Class, Priority, Periodicals, and Standard B. Val-Pak, *et al.* Brief at 23. Prior to the Val-Pak, *et al.* Brief, the participants were focused on only the cost per pound, either through a bounding analysis or through regression analysis. Including a markup in the pound rate is logical since all the rates should recover attributable cost plus markup. Thus, when the Postal Service proposes a pound rate and when the Commission recommends a pound rate, there is an implicit cost coverage attached to both the piece rate and pound rate for mail above the breakpoint. The importance of implicit cost coverage is discussed further below.

[5463] The Commission has evaluated the arguments participants have presented on the impact of the Service's proposal. Importantly, notwithstanding the concerns

posed by the late production of a confidential internal market analysis, there is no evidence that the pound rate reduction was motivated by an improper Postal Service interest in harming competition. Instead, quite apart from the cost study itself—which was clearly a consideration for the Service—there are legitimate reasons that support the Service’s interest in seeking approval of a postage rate it views as more fair. Based on the descriptions of industry practice provided on this record, the pound rate the Commission has recommended should foster competition.

(1) The Postal Service’s Rationale for a Reduction in the ECR Pound Rate

[5464] *Cost support.* Witness Moeller acknowledges the criticisms of witness McGrane’s study the Commission articulated in PRC Op. R97-1, and asserts that Daniel’s new weight-cost study responds to these concerns in two ways: by improving the distribution of mail processing costs by weight increment, and by using weight, rather than pieces, as a distribution key for the elemental load time component of carrier street delivery time. Moeller observes that in the previous study, the costs of tallies where the weight of the piece is not known were distributed using the aggregate distribution of the tallies with known weight increment. He says that in the current study, Daniel performs this distribution within cost pool and IOCS activity code using the information for tallies with known weight increment. USPS-T-35 at 20, citing USPS-T-28 at 5 and 8.

[5465] *The implicit cost coverage comparison.* Moeller notes that cost coverages are not required below the subclass level, but says he finds them illuminating in this instance. USPS-T-35 at 20. His implicit cost coverage comparison relies on costs from Daniel’s weight-cost study. *Ibid.* He uses Daniel’s total unit attributable cost, calculated separately for piece-rated and for pound-rated ECR mail. However, he cannot use 3.3 ounces—the Standard A breakpoint—because the IOCS records weight in half-ounce increments for lightweight mail; therefore, he focuses on the unit attributable cost for ECR mail above and below two points: 3.0 ounces and 3.5 ounces. Then, to develop an implicit cost coverage, he calculates unit revenue using the breakpoint as the dividing

line. *Ibid.* His results show that, after rates, the implicit cost coverages for piece rated and pound rated mail using 3.0 ounces as the breakpoint for costs are 215.6 percent and 216.1 percent, respectively. Similarly, using 3.5 ounces as the breakpoint for costs, the implicit cost coverage for piece rated mail is 211.5 percent and 212.6 percent for pound rated mail. *Id.* at 21. Given that the after-rates cost coverages for piece-rated and pound-rated ECR converge, Moeller concludes that lowering the pound rate does not distort the relative cost coverages of the two groupings. *Ibid.*

[5466] *Illogical postage for heavyweight mail.* Moeller also notes that under current rates, the per-piece rate for pound-rated mail is only 0.3 cent (\$0.003) for pound-rated saturation nonletters. Thus, the rate for this mail nearly doubles as weight doubles. As an example, he notes that two 4-ounce ECR saturation pieces provide almost the same revenue as one 8-ounce ECR saturation piece. He observes that in both cases, the revenue is virtually the same, but says it seems illogical that the Postal Service would be that indifferent between processing and delivering two 4-ounce ECR pieces and one 8-ounce ECR piece. *Id.* at 21-22.

[5467] *Reclassification obviates ECR pound rate's role as a proxy.* Moeller further explains that the pound rate traditionally has served as a proxy for the change in shape between flats and parcels as weight per piece increases, *i.e.*, the proportion of parcels increases and the proportion of flats decreases as weight increases. Under this approach, parcels—being heavier than flats—generate higher revenue per piece. Moeller contends that this situation was appropriate when there was one only commercial subclass because parcels in the then-combined subclass were heavier than flats. However, with the advent of separate subclasses, ECR and Regular can now be evaluated separately. His comparison of the average weight of flats to the average weight of parcels shows that they weigh about the same. Accordingly, he argues that the pound rate can be lowered, as it no longer needs to act as proxy for the change in shape mix. *Id.* at 22.

[5468] *Moderate nature of the proposal, and moderate effects.* Moeller states that witness Daniel's cost trend indicates the Service could have selected a lower pound rate

but, given concerns about competition, chose a more moderate path. However, he acknowledges that regardless of the degree of the reduction, the fact that there is a reduction may lead, intuitively, to the assumption that the average revenue for pound-rated mail should, likewise, decrease. However, he emphasizes that this is not the case, because the proposed reduction in the pound rate is accompanied by a proposed *increase* in the corresponding per-piece rate for mail above the breakpoint. *Id.* at 22-23. At current rates, Moeller calculates the revenue per piece for pound-rate mail at 19.412 cents per piece. The corresponding amount under the Service's proposal is 19.472 cents per piece, a 0.26 percent increase. *Id.* at 23. Moreover, Moeller says that at the basic level, only pieces weighing more than 6 ounces would experience a rate decrease, and he notes that these pieces represent only 4.6 percent of volume. He concludes that the impact of the proposal is limited, and therefore moderate. *Ibid.*

[5469] Moeller says the moderate reduction in the pound rate is designed to allay the concerns of those that contend they may be disadvantaged by a significant reduction, yet acknowledges the needs of small businesses who rely on the mail, or wish to use the mail, for affordable advertising. *Ibid.*

(2) Commentary on Daniel's Cost Study

[5470] *Introduction.* Contrary to witness Moeller's position, AAPS, NAA and Val-Pak, *et al.* contend that Daniel's cost-weight study does not provide a sufficient support for a reduction in the pound rate. Their arguments are summarized as follows: (a) witness Daniel has discredited her own study; (b) the underlying tallies are too thin, and certain data points produce anomalous results or allow other inferences that undermine the study; (c) the study is, in fact, generally unresponsive to the Commission's criticisms in Docket No. R97-1; (d) the study does not control for important variables; and (e) the use of direct tallies to evaluate the effect of weight on mail processing cost is inappropriate.

[5471] *Alleged discrediting.* The first argument—that Daniel has discredited her own study—is based on NAA witness Tye’s reading of Daniel’s testimony that “. . . while it is possible to analyze the data for guidance in rate design, it is difficult, if not impossible, to isolate precisely the impact of weight on costs or identify the exact unit cost of each ounce increment.” Tr. 30/14699-14700, citing USPS-T-28 at 4. However, it seems clear, as MOA A *et al.* witness Prescott observes, that Daniel is referring to the precision of her results, not to their reliability. Prescott further emphasizes—as does witness Daniel—that Moeller does not rely on specific weight interval cost estimates in Daniel’s study or the related regression results to support lowering the pound rate; instead, he uses them as general guidance in selecting an appropriate rate. Tr. 44/19291-92.

[5472] *Tally thinness and assertions about certain data points.* Assertions that “thin tallies” and seemingly anomalous results at certain data points undermine the study have also been shown to lack merit. For example, Tye contends that the tallies underlying the cost-weight study are too thin, and a pervasive problem. In particular, he notes that only 16 mail processing tallies were recorded for the 11-13 ounces increment, and that less than 200 mail processing tallies were recorded for increments above 7 ounces. Tr. 30/14700. He contends that the thinness problem results in anomalous costs, noting that the study shows ECR parcels cost only one-third as much as Nonprofit ECR parcels, but that lightweight Nonprofit parcels cost four to seven times as much as corresponding ECR parcels. *Id.* at 14703.

[5473] At the same time, Tye asserts that the high unit cost for the 15-16 ounce increment is *not* anomalous, but the logical result of a discontinuity between Standard A and Standard B rates. Specifically, he contends that given that Standard A rates for a 15-16 ounce piece are cheaper than the corresponding Standard B rates for pieces weighing slightly more than 16 ounces, mailers of packages slightly heavier than 16 ounces have an incentive to lighten the package to qualify for Standard A rather than Standard B. Moreover, he asserts that this data point provides the only reliable unit cost,

and that the costs for the other heavyweight intervals are unreliable. Tr. 30/14700, Tr. 44/19293.

[5474] In response to these assertions, Crowder characterizes Tye's criticisms as nit-picks because they focus on the upper weight brackets that constitute only a small portion of total ECR volume. She notes that nonletter volume above 8 ounces is only 1.4 percent of total volume, and that the 15-16 ounce interval represents only 0.14 percent. Moreover, she says that the tallies for ECR should be thin, as this mail does not incur much in-office processing. Tr. 44/19401. In addition, witness Prescott says that his regression analysis (discussed below) overcomes the problems Tye has identified. *Id.* at 44/19298.

[5475] Bozzo asserts that small volume categories should generate relatively few tallies, *i.e.*, the tallies should be thin given the overall sample size. He says that if there is a cost measurement problem, it relates to the relative standard error of some narrowly defined weight increments, not data thinness. *Id.* at 19471. Bozzo asserts that when increasing the overall sample size is not practical, the solution is to "limit the reliance on individual point estimates that are subject to large sampling variation." *Ibid.* He notes that Moeller, consistent with this solution, uses large weight groupings for cost purposes. *Id.* at 19471-72. Bozzo then calculates the coefficient of variation (CV) for Moeller's cost groups, using the generalized variance formula (GVF) approach.⁹⁸ *Id.* at 19472. The results are shown in Table 5-14

[5476] Bozzo characterizes these CVs as relatively small, noting that with the exception of Nonprofit ECR (which exceeds ten percent), the other categories have CVs of less than five percent. He says this indicates relatively small sampling error. He therefore concludes that thinness is not a problem for the current Standard A rate design. *Id.* at 19473-74.

⁹⁸ To distinguish between piece-rated mail and pound-rated mail, Bozzo's calculations use the costs for 0 to 3.0 ounces as a proxy for piece-rated mail and costs above 3.0 ounces as a proxy for pound-rated mail. USPS-T-35 at 1 and Tr. 44/19473, Table 2.

Table 5-14
Coefficients of Variation

Subclass/Category	Coefficient of Variation
Enhanced Carrier Route	
Piece Rate	1.7%
Pound Rate	2.8%
Regular	
Piece Rate	0.9%
Pound Rate	1.3%
Nonprofit Enhanced Carrier Route	
Piece Rate	4.5%
Pound Rate	11.3%
Nonprofit	
Piece Rate	1.7%
Pound Rate	4.1%

Source: Tr. 44/19473, Table 2

[5477] Witness Prescott says that his regression analysis (discussed below) overcomes the problems Tye has identified. Tr.44/19298.

[5478] The American Bankers Association and National Association of Presort Mailers (ABA/NAPM) jointly criticize Bozzo's use of the GVF method, saying that using this measure is not valid in the presence of bad data. ABA/NAPM Brief at 2. The Postal Service asserts that ABA/NAPM offer no citation to the record to support this claim, and says it does not withstand scrutiny. Postal Service Reply Brief at VI-71-72. The Commission agrees with the Service.

[5479] *Haldi's argument regarding anomalies.* Haldi states that where weight affects cost, it is reasonable to expect that the relationship would be smooth and monotonically increasing as weight per piece increases. Tr.32 /15846. To test this expectation, he computes the percentage change in unit cost from ounce increment to ounce increment. *Id.* at 15845. The percentage changes range from -14.4 to 805.5.

Haldi believes these percentage changes are unstable showing dramatic jumps and drops and even a negative change. *Id.* at 15846-47. Bozzo observes that the first anomaly occurs in the 4 to 5 ounce weight increment. He adds that the 0 to 4-ounce range accounts for 99.8 percent of the letter piece volume and 99.4 percent of volume variable costs. The remaining 0.2 percent of the letter piece volume should show large sampling variation, according to Bozzo. He concludes that the problem here is not with the IOCS, but with slicing the data too thinly. Tr .44/19469-70. On brief, Val-Pak asserts that Bozzo ignores the anomaly between the 2.5 and 3.0 ounce increments, VP-CW Brief at 50, but the Postal Service, on Reply, contends that there was a transcription error in Dr. Haldi's Table. Postal Service Reply Brief at VI-77. When corrected the anomaly disappears. After reviewing the calculations, the Commission agrees with the Service. The revised numbers do not show the anomaly.

[5480] On brief, SMC says the Commission should not be misled by looking at individual data points when assessing the Daniel's study. Rather, it says the Commission should observe the overall pattern of costs embodied in the study. SMC Brief at 25. SMC adds that if thinness were a problem, the results from study to study submitted over the years would show wildly fluctuating results. SMC notes, however, that the same pattern of cost distribution emerges from every cost-weight study. *Id.* at 26-27.

[5481] *Whether Daniel controls for important variables.* Witness Haldi cites two reasons to support his argument that Daniel has not accounted for important variables. One is that she has not controlled for certain factors that unquestionably affect cost, such as presort level and average haul. Tr .32/15828-29. The other is that in the circumstance where she does provide an adjustment for destination entry differences, the effect is to increase weight-related costs. *Ibid.* In response to this assertion, witness Prescott contends that Haldi has misstated the effect of Daniel's destination entry adjustment. Rather than increasing the weight-related costs, Prescott shows that her adjustment does, in fact, decrease them. Using Daniel's data, Prescott shows that the

cost per ounce is 1.55 cents before the adjustment, and 1.42 cents after the adjustment, or a .13-cent decrease. Tr. 44/19293.

[5482] On brief, SMC argues that by virtue of the supplemental data Daniel provided in response to various interrogatories, interested participants could adjust for the factors Haldi cites. These data, according to SMC, include separate costs for letters and flats; separate costs for basic versus high density and saturation combined; and costs normalized for destination entry differences by weight increment. SMC Brief at 14.

[5483] *Distribution methodology: use of direct tallies for measuring the effect of weight on cost.* Haldi contends that the direct tallies Daniel relies on tend to reflect individual piece handlings, and that heavyweight pieces can be handled at the same cost as lightweight pieces. Tr. 32/15832. In furtherance of this point, he explains that direct tallies are used to distribute the cost of not-handling tallies. Thus, in cases where weight is the cost driving factor, as in the instance where a mailhandler is moving empty equipment, he says that using direct tallies as the basis for distributing the cost of not-handling tallies to ounce increment will miss the causal connection between weight and cost. *Id.* at 15833. Haldi asserts that as the weight of individual mail pieces increases, the amount of equipment needed to move mail between processing operations increases and, accordingly, the amount of empty equipment moving between operations also increases. *Id.* at 15831-32. He contends this problem also extends to mixed-mail tallies. *Id.* at 15836. Haldi concludes that because of these deficiencies in the IOCS, the Postal Service should conduct some other type of study, such as an engineering study. *Id.* at 15844, 15848.

[5484] Witness Prescott asserts that Haldi assumes that equipment and personnel are already fully utilized and that all not-handling costs are driven by weight. Prescott, on the other hand, contends that if equipment and personnel are not fully utilized, more work can be performed *without* adding cost. He also believes that the costs of not-handling tallies are correctly distributed to weight increment, based on Postal Service witness Van-Ty-Smith's testimony that there are instances between handlings where employees are performing duties not affected by weight. These include monitoring the operation of

equipment, going to pick up equipment, performing an incidental administrative task, or taking a break. Tr .44/19300-301, citing USPS-T-17 at 13.

[5485] Crowder also believes that Haldi has overstated the effect of weight on mail processing costs, based on her contention that there is excess capacity in the system. She states that most Standard A mail does not fill the containers, which leaves excess capacity that can handle additional weight. She also contends that larger mailings are generally put in larger containers. Both of these factors, according to Crowder, contribute to scale economies in bulk handling. She concludes that this explains why Daniel's study shows that costs increase at a lesser rate than weight. *Id.* at 19391.

[5486] Crowder adds that this also addresses Haldi's suggestion that not-handling tallies and mixed-mail tallies should be distributed to ounce increment on the basis of weight. She contends that bulk handling scale economies mean that bulk costs do not increase in a one-to-one correspondence with piece weight or total weight. According to Crowder, these economies can be related to the direct handling tallies. For ECR, she suggests that the majority of bulk handlings reflect identical items or containers. *Id.* at 19394-95. Because the piece weight is identified for these handlings, the direct tallies associated with them form an appropriate distribution basis for mixed and not-handling tallies. Crowder also speculates that for ECR, the use of direct tallies for items/containers as a distribution key may overstate the effect of heavier mailings on mixed mail costs. For these reasons, Crowder believes that Daniel's distribution methodology is reasonable. *Id.* at 19395.

[5487] In witness Bozzo's opinion, Haldi's concerns about the distribution of not-handling and mixed-mail tallies reflect a variety of potential shortcomings that have been overcome by using MODS-based costing. *Id.* at 19469. He explains that the IOCS provides estimates of the proportion of labor time by activity. For example, if activity A requires more time than activity B, then there will be more tallies for activity A. Thus, if heavier mail requires more handling time than lighter mail, Bozzo says there will be more tallies for heavier mail. *Id.* at 19466-67. He states that mixed mail tallies contain ample information on shape (and sometimes on class) to inform cost distribution. The Postal

Service's distribution keys are stratified by MODS-based cost pools and item/container type. Only direct tallies associated with each cost pool and item/container type are used for the distribution of mixed-mail cost. *Id.* at 19467-68. For not-handling tallies, Bozzo explains that their costs are generally distributed within the cost pool in which they reside, except for allied activities which are based the distribution of costs in the cost pools with which they are associated. *Id.* at 19468.

[5488] With respect to Haldi's call for an engineering study, Prescott and Crowder also agree with Daniel that the IOCS covers the broad spectrum of costs over an extended period of time. For this reason, they both conclude that IOCS data should be superior to data from an engineering study. *Id.* at 19290-91, 19393.

[5489] *Responsiveness to previous criticisms.* The question of whether Daniel's study responds to the Commission's PRC Op. R97-1 criticisms is a more complex question. On this point, witnesses Tye, White, and Haldi contend—again contrary to witness Moeller's assertions—the Daniel study does not fully respond to the Commission's criticisms. Tye says she addresses only one of the criticisms and, even then, has simply modified the distribution of elemental load cost, while ignoring the Commission's criticism concerning tally thinness. Tr .30/14698. In response to this assertion, witness Prescott contends that Daniel has made significant improvements. In particular, he says she changed the distribution of elemental load cost from a piece basis to a weight basis. He adds that Daniel also improved the distribution of the cost associated with IOCS data observations where weight is not known by using the distribution of tallies with known weight within cost pool, activity, and subclass, rather than using the aggregate distribution of all direct tally costs with known weight. Tr. 44/19287-88. Postal Service rebuttal witness Bozzo agrees with Prescott, emphasizing that he considers Daniel's study an improvement over the previous one because, by virtue of using MODS-based costing, it recognizes the differences in the composition of handlings between direct and mixed-mail tallies. *Id.* at 19470.

[5490] Witness White contends that the Commission asked for a formal study of the effect of weight on carrier street time cost, and this has not been provided. Instead, he

asserts that Daniel simply assumes that route and access costs vary with pieces. He also says that Daniel admits that route cost might vary with the weight of a piece. He contends that support costs, which are distributed to weight category on the basis of the distribution of all other carrier costs, are also affected by this oversight. Tr.22/9959. White says he does not know the exact effect of weight on costs, but concludes that it is substantial, based on his experience in the delivery business. *Id.* at 9961. He believes this is evidenced by his recent experience with a total market coverage (TMC) product his company delivers. Its weight per piece increased by a half ounce, thereby adding 26 pounds to each carrier's weekly load and one-half to one mile of walking distance to each route. White adds that the increased weight led to an increase in the delivery charge to cover the additional costs. *Id.* at 9960. Because witness White believes weight has a substantial effect on delivery costs and the Service has not studied that effect, he contends that the Commission should reject the Daniel's study. *Id.* at 9959.

[5491] Advo witness Crowder observes that on cross-examination, witness White concedes that, on average, his carriers carry about 15 pounds per walking loop, which amounts to about 50 percent of the available satchel capacity. According to Crowder, this undermines White's position, because the increased weight from the TMC product could be accommodated by the excess satchel capacity with minimal or no impact on cost. Tr. 44/19387-88. Using data from Docket No. 97-1, Crowder calculates that Postal Service city carriers average about 20 pounds per loop in a satchel, with a maximum allowable limit of 35 pounds. She says the Engineered Standards data base provided by Postal Service witness Raymond shows that the actual average weight in a city carrier satchel is 11.3 pounds. *Id.* at 19397. Crowder therefore argues that the substantial "excess satchel/weight capacity means that a marginal increase in piece weight should have no effect on the number of loops or any other activities which depend on the number of loops." *Id.* at 19397-8.

[5492] Val-Pak, *et al.* witness Haldi contends that Daniel simply assumes that elemental load cost varies with weight, rather than basing her distribution on a study showing how cost varies with weight and pieces. He also claims that using weight as a

distribution key is inconsistent with CRA methodology. Tr.32 /15848-49 and Tr. 44/19475.

[5493] Witness Bozzo responds to the criticisms lodged against Daniel's distribution of access and route costs and to the contention that her weight-based keys are not consistent with the CRA methodology by computing upper and lower bounds on the costs Moeller uses in his implicit cost coverage comparison. He recomputes total attributable costs for Moeller's two weight groupings on two bases: (1) he assumes access and route costs are entirely related to *pieces* (which produces a lower bound, as these costs are assumed not to be pound related), and (2) he assumes these costs are entirely related to *weight* (for an upper bound). Bozzo concludes that the lower bound cost estimate for ECR increases Moeller's implicit cost coverages, and thereby strengthens the cost justification for reducing the pound rate. Tr .44/19475-79.

[5494] *Discussion.* It is true that the Service has not provided the type of carrier study the Commission referred to in the last rate case, and the Commission continues to believe that a more comprehensive study of the cost support for the pound rate is needed. However, Daniel's analysis, especially as supplemented by material Daniel provided in response to interrogatories, is an improvement over previous efforts. It is not dispositive on the question of the appropriate pound rate, but provides a general indication of cost trends. Moreover, it helps advance the Commission's understanding of the direction a more definitive study must take.

(3) Commentary on Regression Analyses

[5495] Several regression analyses have been presented on this record. One is witness Daniel's, which was provided in a library reference accompanying testimony filed at the outset of the case. USPS-LR-I-92. In brief, she regresses weight per piece on cost per piece. Others include those performed by witnesses Prescott and Crowder.

[5496] Witness Tye acknowledges that Daniel does not endorse her regressions, but nevertheless offers several criticisms. One is that Daniel's regressions are not useful

because she has included piece-rated pieces to measure the incremental cost per ounce of pound rated mail. Tr. 30/14705. Another is that her grouping of the data is not grounded in statistical theory. Based on his belief that ECR costs are not linear, Tye argues that grouping the heaviest weight increments obscures the curvature of the trend line. *Ibid.* Third, as noted earlier, he believes the data are too thin, which creates outliers and other anomalous results. Tr. 44/19279 and Tr. 30/14699-704. Fourth, he suggests that the regressions are not weighted to account for variation in pieces and weight from interval to interval. Tr. 30/14706.

[5497] *Prescott's regression analysis.* Witness Prescott contends that his revision to Daniel's regressions cures the tally thinness and the outlier problems Tye has raised. Whereas Daniel regressed weight per piece on cost per piece, Prescott regresses pieces per pound on cost per pound.⁹⁹ He performs one regression for Regular and one regression for ECR. For Regular, his results show a per piece cost of 11.1 cents and a per pound cost of 52.5 cents. For ECR, his results show a per piece cost of 5.6 cents and a per pound cost of 17.6 cents. Prescott notes that the cost per pound for Regular is much larger than for ECR. Tr. 44/19281.

[5498] In evaluating these results, Prescott asserts that his data set contains no statistical outliers and that the 15-16 ounce data point is now within the normative range of the entire data set. *Id.* at 19283. He states that the R-squared values for Regular and ECR are 95.9 percent and 96.5 percent, respectively, and indicate the proportion of variation explained by changes in pieces per pound. He concludes that this shows "a strong relationship between changes in unit costs and changes in weight." *Id.* at 19282.

⁹⁹ The basic equation is $\text{cost} = \text{cost per piece} \times \text{pieces} + \text{cost per pound} \times \text{pounds}$. This formulation exactly matches the ECR rate structure for mail above the breakpoint weight. Daniel divided both sides of the equation by pieces, so that her regression equation is $\text{cost per piece} = \text{a fixed cost per piece} + \text{a constant} \times \text{pounds per piece}$. Multiplying each side of the resulting regression equation result by pieces produces regression results for the original basic equation. In contrast, Prescott divides both sides of the basic equation by pounds, so that his regression equation is $\text{cost per pound} = \text{a fixed cost per pound} + \text{a constant} \times \text{pieces per pound}$. As in the case of Daniel's formulation, multiplying each side of the Prescott's resulting regression equation result by pieces produces regression results for the original basic equation.

[5499] As noted in the discussion on tally thinness, Tye argues that the 15-16 ounce interval is more reliable than the other heavyweight intervals because it contains more tallies. Prescott agrees with Tye. He performs a regression on Daniel's data *without* the 15-16 ounce data point and compares the results to Daniel's regression *with* that data point. His results show that the variation per pound and the variation per piece are much larger when the 15-16 ounce interval is included. Prescott asserts, however, that his regressions overcome this problem. *Id.* at 19294-95.

[5500] Prescott also agrees with Tye that Daniel's regressions are unweighted. He notes that there is a wide variance in volume, and that this can affect the results of a regression analysis. *Id.* at 19295-96. However, he contends that his regressions are implicitly weighted by pounds within intervals, which substantially reduces the variance and produces results much closer to reflecting equal statistical weighting for each interval. *Id.* at 19297.

[5501] *Crowder's regression analysis.* Witness Crowder also performs regressions on Daniel's ECR data, but adjusts the costs by removing differences due to transportation and mail processing expenses avoided because of dropshipping. The data to make these adjustments was provided by witness Daniel in response to interrogatories. Crowder also adjusts the costs to reflect Haldi's heavyweight letter adjustment; to equalize the carrier in-office unit costs for high density/saturation letters and flats; and to correct rural carrier costs to reflect the figures in USPS-LR-I-95. *Id.* at 19378 and 19375-76, fn. 8. Her regression results show a per pound cost of 22.2 cents for basic flats and 16.5 cents for high density/saturation flats. *Id.* at 19378. She contends that this shows the proposed pound rate recovers much more than the corresponding cost. *Id.* at 19375.

[5502] Val-Pak, *et al.* characterize Daniel's regressions as ambiguous, limited, and confusing. VP-CW Brief at 21. In support of this characterization, Val-Pak, *et al.* gathers the various pound rates that can be derived from her regressions. The basis is the cost for a 16-ounce piece, which Val-Pak, *et al.* believe should be comparable to the pound rate. Val-Pak, *et al.* develop a rate for the 16-ounce piece by multiplying the cost by the

Postal Service's proposed cost coverage of 132.9 percent for Regular subclass and 208.8 percent for ECR. *Id.* at 22-25. The results are shown in tables presented in *Id.* at 24 and 26. Based on this comparison, Val-Pak *et al.* contend that Daniel's regressions support rates (*i.e.*, cost times cost coverage) ranging from \$0.45 to \$1.51 per pound for Regular Subclass. It says comparable rates for ECR range from \$0.52 to \$0.93 per pound. *Id.* at 23. According to Val-Pak, *et al.* the latter range does not include the Service's proposed pound rate for a DDU saturation flat (\$0.484). *Id.* at 25 and 26.

[5503] Val-Pak, *et al.* further assert that Crowder and Prescott add to the confusion by performing additional regressions on Daniel's data. *Id.* at 32-33, 38-40.

Val-Pak, *et al.* adjust both witnesses' costs for cost coverage, and contend that this produces a rate for 16-ounce pieces outside the range of ECR rates developed from Daniel's regressions shown above. *Id.* at 32 and 39. SMC strongly contests the introduction of this material at the briefing stage. Among other things, it says Val-Pak, *et al.* have introduced major misunderstandings by using Daniel's unweighted regressions.

[5504] While witness Daniel's regressions were relatively basic presentations, those presented by witnesses Prescott and Crowder clearly have helped inform the record. The Commission rejects Val-Pak, *et al.*'s contrary assertions.

(4) Commentary on Other Arguments in Support of the Proposal

[5505] *Utility of the implicit cost coverage comparison.* Witness Tye attacks Moeller's implicit cost coverage argument as unreliable because Moeller does not apply the test to Regular subclass or the Nonprofit subclasses, and the Postal Service does not use it in First-Class. Tye contends that equalizing the cost coverage for piece-rated and pound-rated mail in Regular would require a decrease in the current pound rate.¹⁰⁰ Tr. 30/14708. He also asserts that the comparison is inconsistent with the Postal Service's proposal in First-Class. Treating First-Class one-ounce mail as piece-rated

¹⁰⁰ Tye does not calculate implicit cost coverages for Nonprofit and Nonprofit ECR.

and mail weighing more than one ounce as pound-rated, Tye calculates the implicit cost coverages at test year before rates as 164.7 percent and 185 percent, respectively. To equalize cost coverages, Tye says the additional ounce rate would have to decrease. He observes, however, that the Postal Service proposes to increase the additional ounce rate. *Id.* at 14710.

[5506] *Crowder's observations.* Witness Crowder notes that no witness on this record has claimed that current pound rate accurately reflects the effects of weight. She also notes that no witness has refuted Moeller's contention that it produces illogical postage. Elaborating on this position, she comments that to support the existing rate, one would have to believe that the piece-related handling cost for a saturation flat is three-tenths of a cent, with all the remaining cost solely related to weight. She says: "The notion that it costs the Postal Service only 0.3 cents more to handle two 4-ounce pieces than one 8-ounce piece is simply inconceivable." Tr. 44/19371.

[5507] Crowder adds that Haldi acknowledges that heavier weight saturation pieces pay too much in weight-related charges because the presort (density) discounts do not reflect weight-relating savings. *Id.* at 19372. She also notes that Haldi stated on cross-examination that if the letter-flat differential contained both shape-related and weight related cost differences, which Crowder contends it does, then full passthrough would overcharge nonletters. *Id.* at 19373.

[5508] Using Daniel's costs, adjusted to remove differences due to dropshipping, Crowder calculates weight related costs per pound for two cases. In the first case, she uses the total attributable costs for flats (above and below the breakpoint). She subtracts from total attributable costs, the costs of transportation, vehicle service drivers, and dropship-related mail processing, so that the remaining costs should reflect ECR mail dropshipped at the DDU. *Id.* at 19376. She then assumes that the costs are all weight-related and divides by pounds. In the second case, Crowder uses only the cost for flats above the breakpoint. The results are shown in Table 5-15.

[5509] Crowder contends the extreme assumption shows a cost of 33.4 cents, but she argues that all the case 1 costs are excessive because some of the costs must be

Table 5-15
Per Pound Costs for ECR Flats Dropshipped to the DDU

Case	Basic Flats	High Density/ Saturation Flats	All Flats
1	38.8¢	25.9¢	33.4¢
2	26.8¢	19.9¢	24.3¢

Source: Tr. 44/19377 (Note: these reflect Postal Service costs).

piece related. She believes the case 2 costs are also excessive, but she contends that they represent “the absolute upper limit on the amount of weight-related cost that should be used to develop rates” for pound-rate pieces. *Ibid.* Crowder provides the comparable numbers for flats not dropshipped.

Table 5-16
Per Pound Costs for ECR Flats Not Dropshipped

Case	High Density/ Saturation Flats	Flats	All Flats
1	56.1¢	43.2¢	50.7¢
2	44.1¢	37.2¢	41.6¢

Source: Tr. 44/19377 and ADVO-RT-1, W/P UnitCost1, Sheet: Per Pound Costs, L15..L56, as applicable. (Note: these figures reflect Postal Service costs.)

[5510] Crowder further states that her regressions, discussed earlier, also show that the current pound rate is excessive. She adds that the average cost per piece taken from the costs used to calculate the numbers in her tables show that costs do not rise as sharply as postage for pound-rated mail. Tr. 44/19379. In her final demonstration that the current pound rate is too high, Crowder assumes that the letter-flat cost differential for ECR is *entirely* weight related and divides the cost difference by pounds.¹⁰¹ The results are shown below.

Table 5-17
Per Pound Cost Estimates
Based on Letter-Nonletter Cost Differences

Category	Per Pound Cost
Basic – Non-Dropship	21.42¢
Basic – DDU	4.14¢
Saturation – Non-Dropship	17.41¢
Saturation – DDU	0.13¢

Source: Tr .44/19382.

[5511] According to Crowder, the costs above “are only a fraction of the USPS proposed pound rates.” *Ibid.* She also argues that because the ECR letter-flat cost differential reflects weight- and shape-related differences, the high pound rate leads to a double counting of weight-related costs. *Id.* at 19382-83. She also says the substantial letter-flat passthrough also results in a higher per piece contribution for nonletters than letters. *Id.* at 19383.

[5512] Val-Pak, *et al.*, respond that if Crowder’s case 1 costs per pound are adjusted to reflect the Postal Service’s proposed cost coverage for ECR and adjusted to reflect non-dropshipped mail, the resulting pound rates are higher than current rates.

(5) Commentary on the Proposal’s Impact

[5513] There has been considerable testimony on witness Moeller’s contention—essentially a subsection 3622(b)(4) argument—that the proposed reduction in the pound rate, given its moderate nature, does not interfere with competition. Supporters of the Service’s proposal sponsor AISOP witness Smith, PostCom witness Harding, and SMC witnesses Buckel, Merriman, Guiliano, and Bradpiece. Opponents sponsor NAA witness

¹⁰¹ Crowder uses Daniel’s ECR costs that already exclude differences due to dropshipping. However, she adds transportation costs to develop costs for non-dropshipped basic and saturation mail. Tr. 44/19381.

Table 5-18
Val-Pak, et al.'s Adjustment of Crowder's ECR Case 1 DDU Costs
to Reflect Cost Coverage and Entry Cost at the Origin

	Case 1 Costs - DDU Entry	Cost x 208.8%	Plus 17.3¢ for Origin Entry
	(1)	(2)	(3)
1) Basic Flats	38.8¢	80.7¢	98.0¢
2) High Density/Saturation Flats	25.9¢	53.9¢	71.2¢
3) All Flats	33.4¢	69.5¢	86.6¢

Source: VP-CW Brief at 30

Tye, AAPS witness White and NAA witness Wilson. The Service also sponsors witness O'Hara's rebuttal testimony on this issue.

[5514] The Commission prefaces the following discussion with two observations. One is that the SAI report, an update of a previous analysis prepared for the Postal Service's marketing department, once again became the subject of controversy in an omnibus rate proceeding. The report was eventually produced and examined under seal, and participants have discussed its import in portions of their briefs filed under seal. The Commission has been able to reach conclusions on arguments related that the report without placing any portion of this Opinion under seal.

[5515] The other point is that the testimony of the industry witnesses (on both sides of the issue), considered as a whole, provides an extensive—and sometimes frank—assessment of the current state of competition in the marketplace. Much of the testimony, in fact, addresses conditions much more recent in time than the SAI report. The testimony also provides a summary of significant developments over time, in reaction to postal rate changes and reclassification. This provides a useful context for decisionmaking.

[5516] *Opponents' claims.* Witness Tye raises several impact issues. One is that the reduced pound rate will "continue to divert" delivery volumes from private carriers to

the Postal Service. He says this is evidenced by the prospective percentage decrease in rates for pound-rate mail (with some reductions as large as 12.2 percent) and by the Postal Service's alleged "targeting" of heavier mail for rate decreases. Tr. 30/14733-34. Tye also contends that the Postal Service's success at competing with alternate delivery is indicated by Postal Service witness Tolley's estimate that 16.43 percent of the increase in ECR volume is the result of the decline in the pound rate in real terms. Further, Tye observes that the Postal Service's cross elasticity estimate of ECR with newspapers (.812) in conjunction with the Service's own-price elasticity estimate for ECR (.802) indicates that a one percent increase in the price of newspaper advertising would have roughly the same effect on ECR volume as a one percent decrease in the price of ECR. *Id.* at 14735. He therefore concludes that Moeller has not sufficiently considered the effect on competition. *Id.* at 14736.

[5517] Tye also criticizes, among other things, the fact that the proposed average rate increase is less for ECR than for Regular or Nonprofit ECR; and he observes that the pound rate has decreased in real terms because it has remained fixed since the beginning of the ECR subclass. *Id.* at 14736-37.

[5518] AAPS witness White argues that the reduction in Periodicals rates that resulted from the 1995 reclassification hurt the alternate delivery industry. He says his company delivered 175,000 periodicals monthly prior to reclassification, but lost this business afterwards. Tr. 22/9938-39. In his opinion, "[t]he key competitive rate when it comes to saturation advertising and our membership is the pound rate, because the shopping guides and the free publications that make up the backbone of the business for most of our members make their delivery choices with reliance almost exclusively on the pound rate, not the piece rate." *Id.* at 9944. He believes that lowering the pound rate will further damage his industry's ability to compete. *Id.* at 9940. He also speculates that although the Postal Service denies having a competitive motive, it is proposing a lower pound rate to divert delivery volumes from alternate delivery carriers to the Postal Service. *Id.* at 9947-48.

[5519] NAA witness Wilson suggests that newspapers compete with companies that distribute local retail advertising, rather than the Postal Service. Tr .44/19137. He also says that since the 1995 reclassification, AAPS membership has declined from 300 in 1995 to 100. *Id.* at 19146. He urges the Commission to recognize that newspapers are the prime conduit for disseminating information, and that loss of advertising revenue reduces the distribution of the news. *Id.* at 19137. In an argument similar to witness Tye's, he contends that the Postal Service's proposal is aimed at shifting advertising from newspapers to saturation mail products. *Id.* at 19137-38. On brief, AAPS adds that "there is a sense of equilibrium in the market" and that lowering the pound rate will give the Postal Service an advantage. AAPS Brief at 10-11.

[5520] *Supporters' views on impact.* SMC witness Buckel, a consultant with a long career in the publishing field, characterizes the pound rate "as artificially contrived and excessive." Tr. 22/9915. He claims it has resulted in private delivery dominating the preprint advertising market in the New York area. Buckel states that the cost of postage for a 12 ounce piece at current rates is \$406 per thousand pieces and at proposed rates is \$366 per thousand pieces, compared to private delivery cost of \$125 per thousand pieces. He contends that this price disparity has resulted in shared mail not being competitive in this market, and has confined shared mailers to lightweight advertising preprints. *Id.* at 9927. Buckel observes that this is causing shared mailers to consider shifting to private delivery. *Id.* at 9916.

[5521] SMC witness Bradpiece publishes a weekly mailed saturation free paper (a "Pennysaver" publication) with a circulation of 1.3 million in Maryland and northern Virginia. He also owns the Metro Community News, a weekly saturation free paper with a circulation of 290,000 that is distributed, via private carrier, in Erie and portions of Niagara counties in New York state. Tr. 44/18910. Bradpiece testifies that, in New York, lower private carrier costs warrant greater attention to the private delivery option. *Id.* at 18928. He also asserts that the high pound rate prevents him from competing effectively for preprint inserts. He further asserts that the pound rate effectively places a

cap on his business, since he tries to avoid exceeding the breakpoint. *Id.* at 18918, 18941.

[5522] SMC witness Merriman publishes the *Farmer and Rancher Exchange*, a free distribution advertising publication with a weekly circulation of 42,000 copies.

Tr. 32/15658. He claims that alternative delivery is not a viable option for his rural publication given low density (his rule of thumb is that a private carrier will not deliver on a route with four or less homes per mile). *Id.* at 15663, 15677. Witness Merriman states that small saturation mailers like his advertising shopper will benefit from a lower pound rate. *Id.* at 15664. He contends that the major advertisers who use his publication are sensitive to weight-related charges because they do not face rates that are as weight sensitive from nonpostal carriers. *Id.* at 15664-65. He therefore believes that the Postal Service's proposal would benefit his customers and other rural advertising publications. *Id.* at 15664.

[5523] AISOP witness Baro is director of sales for *The Flyer*, a Hart-Hanks free shopper publication in South Florida. He addresses, among other things, the price sensitivity of saturation mail. He emphasizes that postage increases cause medium to large mailers to consider alternative media, while many small businesses conclude that they have to stop advertising, or reduce the size of their advertisement. Tr. 30/14377-78.

[5524] AISOP witness Smith operates the Buttercup Dairy, a full-service neighborhood grocery in Terryville (Long Island), NY. He testifies that mail advertising is essential to small businesses. *Id.* at 14529. He explains that he can only afford a half-page ad, while his large competitors can afford 6-to-8 ad pages. He urges the Commission consider the needs of small mailers who depend on affordable postage rates to stay in business. *Id.* at 14533. He believes that with the Postal Service's proposed rates he can compete with larger businesses that have more advertising choices. *Id.* at 14531.

[5525] PostCom, *et al.* witness Harding, who advises print advertisers on placement, contends that over 90 percent of his clients' print advertisements are placed in newspapers. Tr. 45/19581-82. He further states that there has been no shift from

newspapers to mail over the last five years. *Id.* at 19585. Harding adds that the high pound rate has hurt saturation mailers' ability to compete for heavier preprints. *Ibid.*; SMC Brief at 42.

[5526] SMC witness Giuliano is a senior executive with Advo who has focused on postal matters since 1983. He adds that Advo began a shared mail program in the Oklahoma City market in 1991, but this initiative was affected by the Docket No. R87-1 rate increase (which he describes as a 25 percent increase), and later discontinued after Distribution Systems of Oklahoma was created as the *Daily Oklahoman's* private delivery arm. Tr. 44/18996. On brief, SMC contends that the newspaper industry is the dominant competitor in the print advertising market. SMC Brief at 41.

[5527] SMC argues that neither AAPS witness White nor NAA witness Tye has presented factual evidence to substantiate their claims of the adverse competitive effects of Postal Service pricing on their members. MOAA, *et al.* Brief at 25. AISOP agrees that AAPS and NAA have not provided any evidence of harm. AISOP Brief at 14.

[5528] MOAA, *et al.* contend that in the fact of the opponents' failure to produce information on the rates private alternatives charge, the Commission should invoke the adverse inference rule. It says: "[T]he rule provides that when a party has relevant evidence within his control which he fails to produce, that failure gives rise to an inference that the evidence is unfavorable to him." MOAA, *et al.* Brief at 24, citing *International Union (UAW) v. N.L.R.B.*, 459 F. 2d 1329, 1336 (D. C. Cir. 1972).

[5529] Postal Service witness O'Hara contends that the Service's ECR subclass proposal—both in terms of proposed cost coverages and reduced pound rate—is manifestly reasonable. He notes that both NAA and AAPS contend that the proposal is motivated in large part by a desire to divert business from newspapers and alternative delivery carriers. Tr. 46E/21935. He notes that they also represent that if the pound rate is reduced as proposed by the Postal Service, their organizations' members will suffer economic harm due to diversion of advertising from alternative media, such as newspapers, to Standard A ECR. *Ibid.* O'Hara says, however, that witness Tye admits that he did not review rates charged by newspapers for inserts, and claims he offers no

other quantitative data to support his conclusion that volumes will shift as his testimony portends. *Id.* at 21936.

[5530] O'Hara notes that AAPS witness White's testimony cites ongoing commissioning of SAI research, as well as the Service's stated intent with regard to the proposed ECR pound rate reductions in earlier docket. O'Hara's assessment is that:

In effect, NAA and AAPS would have the Commission maintain ECR rates for heavier weight pieces at levels far in excess of the relationship suggested by their costs. This necessarily implies that a more affordable alternative, in the form of a more attractive rate for heavier weight ECR mail, would be denied to mailers for the sake of the protectionist self-interest of NAA's and AAPS's members, thereby restricting choice and *reducing* competition. Simply put, the 3622(b)(4) requirement that the Commission consider the effect on competition weighs in favor of the Postal Service's proposal, for it will enable competition to flourish in the market for high circulation advertising, to the benefit of advertisers.

[5531] *Id.* at 21937 (emphasis in original).

[5532] *Discussion.* The Commission finds no persuasive evidence on this record that a reduction in the pound rate, at the Commission's recommended level, will unduly interfere with competition. Given intense competition in the saturation market, any reduction may require competitors to adjust their practices to some degree. However, there is no evidence that a pound rate reduction will impair competitors' ability to attract or retain advertisers; in fact, there are representations on the record indicating that at least some competitors simply price below the Service's rate. The Commission's recommendation must also consider the impact on mailers (and their customers) who pay the pound rate. The Commission finds that although the reduction it is recommending is not as low as the Service proposed, it also fairly takes into consideration the interests of these participants.

(6) Determining Appropriate Revenue From The Pound Rate Using Implicit Markups

[5533] Rate design for a subclass can be thought of as setting the implicit percentage markups for each rate category. The weighted average implicit markup for a subclass (weighted by cost) equals the predetermined subclass markup. Thus, rate design is a zero sum game requiring below average implicit markups to be offset by above average implicit markups. The Commission begins the rate design process assuming equal implicit markups. This is a neutral starting position which seems to be implied by § 3622(b)(1), a fair and equitable schedule. It is consistent with the Commissions general policies that the rates for each rate category be above cost; that rates reflect the costs developed in the record; and that rate design results in identifiable relationships between rate categories. Equal implicit markups, however, are only a starting place, and often may not be practicable or appropriate. The Commission frequently has good reason to depart from them in actual practice.

[5534] The Commission bases worksharing discounts on avoided costs. Basing discounts on avoided costs does not result in equal implicit markups, rather it results in equal per-piece markups. It also results in worksharing mail having higher implicit markups than mail which is not workshared and the most heavily workshared pieces (*i.e.* those with the largest discount) having the highest implicit markups.

[5535] This approach to worksharing discounts is called “efficient component pricing” (ECP) in the economic literature. The theory requires the discount to be 100 percent of the cost savings. The Commission tries to achieve 100 percent passthrough of the worksharing savings, but again it frequently may depart from this standard for a variety of reasons. An important virtue of ECP is that the mailer will perform the workshared activity (*e.g.* presort) when he can do so at a lower cost than the Postal Service. This leads to productive efficiency (*i.e.* the most efficient provider does the work resulting in the lowest cost to society). Because ECP also lowers the real cost of mailing, volume should increase in response to lower effective prices.

[5536] Under ECP, workshared mail makes the same unit overhead contribution as nonworkshared mail. Consequently, the Postal Service is financially indifferent to worksharing because it collects the same overhead contribution from workshared and nonworkshared mail. ECP is Pareto optimum in that some mailers are made better off, but no mailer is made worse off. In some circumstances the introduction of a workshare discount may result in deaveraging if some mailers are already doing the worksharing without a discount. If the volume of already workshared mail is small, it will have a very small impact on mailers who will not workshare. If existing worksharing is widespread, the impact will be greater. The Commission generally mitigates any impact by setting initial passthroughs at less than 100 percent. This explains why worksharing discounts are generally not opposed by mailers who don't workshare. It is largely because of ECP rate design that an extensive range of worksharing discounts has been put in place by the Postal Service over a 25-year period with relatively little opposition from mailers.

[5537] Rate design involves recognizing attributes that cause cost differences among the rate categories (*i.e.* distance, weight, shape or machinability). If a subclass does not have worksharing, then recognition of the cost differences would result in passing through the marked up cost differences to obtain equal implicit markups for each rate cell (*i.e.*, the neutral starting position). When the Commission does not passthrough 100 percent of the marked up cost differences the implicit markups are not equal, and similarly when the passthrough of worksharing savings is not 100 percent then the unit markups will not be equal.

[5538] Subclass rate designs proposed by the Postal Service and recommended by the Commission frequently depart from the principle of equal implicit markups and from ECP in order to mitigate the effect of large changes in cost on affected rate payers. The Commission also departs from 100 percent passthroughs to accommodate Postal Service's policies concerning how it wants mail prepared. In addition, the Commission departs from strict cost based rates in order to avoid or mitigate anomalous relationships between subclasses.

[5539] Witness Moeller has advanced the Commission's understanding of the pound rate issue by providing us with estimates of the implicit markups for the totality of pieces above and the totality of pieces below the break point. The estimates are based on attributable costs including in-office, transportation and delivery costs. While the estimates of IOCS costs for pieces above and below the break point are statistically reliable, the Commission has not closely examined the basis upon which transportation and delivery costs are distributed. If the Commission is to make proper further use of the implicit markups in setting the pound rate, the basis for distributing transportation and delivery costs must be subject to more scrutiny.

[5540] The Commission hopes that reliable information on implicit markups may make it possible to calculate the total amount of revenue that should be obtained from pieces above and from pieces below the break point. This would be an important contribution to ensuring that intra subclass rate relationships for Standard Mail are fair and equitable. The separate issue of the best way to design rates for the pieces above and below the break point might also be addressed by studying implicit markups.

[5541] Witness Moeller's implicit markups reflect the mix of mail on either side of the break point. However, pieces above and below the break point have different worksharing profiles and different shape profiles. The Commission believes that implicit markups comparison should be adjusted for these differences.

[5542] This Commission hopes that the Postal Service and the parties can develop this information to allow the appropriate comparison of the implicit markups for pieces above and below the breakpoint. These should reflect the degree and type of worksharing in each category and the distribution of shapes within each category as well as Commission recommended passthroughs. The Commission could use this information to recommend rates that produce the appropriate amount of revenue from pieces above and below the break point.

[5543] While it is important to collect the appropriate revenue from each broad category, there is also the problem of the degree to which the current rate structure is cost based. The Commission would like to learn if statistically reliable implicit markups

for subgroups of pound rated pieces can be obtained. If so, it may be possible examine alternate ways (linear and non-linear) to design rates for pound rated pieces and perhaps, for all pieces in each Standard Mail subclass.

f. Witness Haldi's "Heavy Letter" Letter Adjustment in ECR

[5544] *Haldi's approach.* Haldi contends that the cost of ECR letters is overstated, while the cost of ECR nonletters is understated.¹⁰² Tr. 32/15765. He explains that the problem occurs because the IOCS and RPW use different definitions of flat-shaped mail. Specifically, IOCS uses a dimensional (length, width, thickness) definition, while RPW uses the rate paid by the mailer. According to Haldi, this produces a mismatch of data by shape for costs and volumes because the IOCS letter costs include the cost of letter-shaped mail above the breakpoint, while the RPW letter revenues exclude the revenues of letter-shaped mail above the breakpoint. He notes that RPW records the revenue correctly because all Standard A mail above the breakpoint, regardless of shape, must pay the nonletter rate. *Id.* at 15766.

[5545] *Haldi believes the IOCS costs should be adjusted to properly align shape costs and volumes.* *Ibid.* Using Daniel's cost data, witness Ramage's information on IOCS tallies, and the assumption that the tally cost for letters between 3.0 ounce and 3.5 ounces is evenly distributed by ounce increments of 0.1, he estimates that 2.6 percent of all ECR letter tallies are assignable to the cost of nonletters. By shifting 2.6 percent of letter cost to nonletter cost, he recalculates the cost of letter and nonletters. His approach adds .29 cents to the letter-nonletter differential. *Id.* at 15813-19.

[5546] *Opposing views.* Both Prescott and Crowder point out that there is no mismatch of costs and volumes in Daniel's data because the volumes for letters and nonletters reflect the IOCS shape definitions. Tr. 44/19306, 19311 and 19405. Both also explain that any adjustment would, therefore, require both the costs and volumes of heavyweight letters to be shifted to the nonletter category. *Id.* at 19306 and 19405.

¹⁰² Haldi also explains that the problem infects the other subclasses of Standard A mail. *Ibid.*

They further testify that Haldi shifts a portion of total attributable costs, rather than only mail processing and delivery costs, which both the Commission and the Postal Service use to calculate the letter-flat differential. *Id.* at 19305 and 19405. Crowder recalculates the letter and nonletter costs using Haldi's tally assumptions, but only mail processing and delivery cost. She shifts both the cost and volume of heavy letters from the letter category to the nonletter category. She estimates that the letter-nonletter differential would increase by .077 cents per piece. *Id.* at 19405.

[5547] *Commission analysis.* The Commission agrees with Haldi that there is a mismatch between IOCS costs and RPW volumes related to letters and nonletters. However, it also agrees with witnesses Prescott and Crowder that (1) Daniel's volumes, which are not RPW volumes, are based on the same definition of shape as used in the IOCS; (2) both the cost and volume of heavyweight letters should be shifted to the nonletter category; and, (3) only the costs of mail processing and delivery should be used in the calculation of the letter-nonletter differential.

[5548] Crowder calculates the average difference between ECR letter and nonletters in accordance with the three items above. By Crowder's calculation, the average difference would increase by only .077 cents. Rounded, this would add one-tenth of a cent to the average difference. However, for ECR rate design, Moeller uses letter-nonletter costs by density level (basic, high density, saturation), not the average difference. Thus, the add-on does not exactly align with the density levels. Further, it seems that this adjustment should apply only to IOCS data, as the problem involves the shape definition used in IOCS, but Crowder includes street time from cost segment 7 and all of rural carrier costs from cost segment 10. *Ibid.* Neither of these costs are developed from IOCS. Since excluding these costs from Crowder's calculation would further reduce the add-on, the Commission believes the impact on the letter-nonletter differential would be *de minimis*. For this reason, it is not used in the cost differential supporting the ECR letter-nonletter rates.

[5549] This does not mean that the Postal Service can ignore the problem. It extends to all four subclasses in StandardA, and directly affects rate design, which

requires costs to be as accurate as possible. These mismatched costs enter the letter/nonletter differential for the Regular subclass through the CRA adjustment factor and, as described above, CRA costs by shape and density level are used for ECR rate differentials. For this reason, the Postal Service should change its IOCS recording procedures to identify Standard A mail above and below the breakpoint. Although the breakpoints currently vary across subclass from 3.2873 ounces for Nonprofit subclass to 3.3103 ounces for Nonprofit ECR, using 3.3 ounces as the reference weight in IOCS would appear to be sufficient for this purpose.

g. Witness Lubenow's Rate Design Suggestions

[5550] Witness Lubenow, testifying on behalf of PostCom, *et al.*, asks the Commission to increase the automation discounts, based on mailers' extensive address quality efforts; suggests consideration of a discount for 5-digit mixed carrier route packages; and offers several other observations on rate design improvements.

Tr. 29/14105-07. Lubenow's support for larger automation discounts is based on the assertion that mailers incur costs in attaining high address quality and maintaining it through regular certifications. *Id.* at 14105. He does not offer an economic analysis, but asserts that the relevant standard of comparison should be the depth of these discounts in the current rates. He says that other things being equal, the behavior of mailers in considering investments in address hygiene will be driven by the relative magnitude of the discounts over time. *Ibid.* Lubenow says the Commission should either lower the automation rates, or raise the rates used by mail with defective addresses.

Id. at 14105-06.

[5551] Lubenow describes his 5-digit mixed carrier route proposal as a smaller discount than the basic carrier discount, but worth more than current 5-digit packages, as only pieces with addresses of sufficient quality to allow the carrier route code to be identified would be included. *Id.* at 14105.

[5552] Witness Lubenow's testimony offers an important industry perspective on the Service's automation program, and significant insights into several rate design improvements that could encourage attention to address quality. The Commission is not recommending the 5-digit mixed carrier route, as important cost, operational, and other rate design considerations have not been explored on this record. Overall, however, witness Lubenow's testimony has contributed useful information on the role of address quality in postal operations. The Commission encourages the Service and the mailing industry to consider his observations as they explore possibilities for rate design improvements.

5. Impact of Legislation on Preferred Subclasses (Nonprofit and Nonprofit ECR)

a. Background

[5553] In this proceeding, the Service applies the RFRA markup formula in developing proposed Standard A Nonprofit rates, but bases proposed Nonprofit ECR rates on an anticipated amendment to the law. In areas other than markup, Moeller generally follows, for both preferred subclasses, rate design approaches that mirror those proposed for their commercial counterparts.¹⁰³ USPS-T-35 at 30-33 and 37-39. The proposed pound rate for Nonprofit is 58 cents, a 3-cent increase over the current pound rate of 55 cents. Moeller says this is consistent with the overall increase for the subclass, and avoids upward pressure on the piece rates. *Id.* at 30-31. The proposed Nonprofit ECR pound rate is 37 cents, 8 cents more than the current rate of 29 cents. Moeller acknowledges that this is a large increase but, like the increase for Regular, avoids upward pressure on piece rates. He also says that it is "still well below what is was prior to the implementation of Docket No. R87-1 rates. *Id.* at 37.

¹⁰³ Witness Tolley's testimony indicates the two preferred subclasses accounted for approximately 10.9 billion pieces. The Nonprofit subclass contributed 8.0 pieces; 2.9 billion pieces were Nonprofit ECR. USPS-T-6 at 107-108.

[5554] *Markup considerations.* Moeller notes that, as of the Service's filing, controlling provisions in RFRA set the markup for the preferred subclasses at one-half of the commercial markup. *Id.* at 29. He observes that the Service was able to apply this formula without undue impact in developing rates for the Nonprofit subclass, but found that adhering to the RFRA formula in Nonprofit ECR resulted in a rate increase of more than 30 percent. *Id.* at 36. He attributes this, in part, to the fact that recent classification reform (Docket No. MC96-2) replaced the former unitary bulk nonprofit subclass with two subclasses, which necessitates separate markups under RFRA.¹⁰⁴ *Id.* at 29-30, 36.

[5555] *The Postal Service's anticipated markup alternative for Nonprofit ECR.* Given these results for Nonprofit ECR, Moeller says the Service's markup approach reflects an anticipated amendment to RFRA which would limit the extent to which rate increases for preferred subclasses could exceed the commercial counterpart. Specifically, it provides the option of setting the markup at less than one-half the commercial markup if necessary to keep the percentage increase within 10 percentage points of the commercial increase. *Ibid.*

[5556] The legislation eventually enacted (S. 2686) provides that Standard A Nonprofit rates, overall, are to be set so that the estimated average revenue per piece from each subclass is equal, as nearly as practicable, to 60 percent of the estimated average revenue per piece from the corresponding regular-rate category.¹⁰⁵ In pertinent part, Section 1(d) adds a new 39 U.S.C. 3626(a)(6). The report accompanying S. 2686 notes: "The legislation is designed to address technical problems in the nonprofit ratesetting structure by locking in the current rate relationship between nonprofit and commercial mail." Report 106-468 at 1. The report also discusses a transitional provision in S. 2686. It says this provision is intended to mitigate the impact of these

¹⁰⁴ Moeller notes that application of RFRA in the reclassification case had led to significant declines for almost all rate categories of nonprofit mail. In Docket No. R97-1, Nonprofit increased 9.6 percent, and Nonprofit ECR decreased again, by 10.6 percent. USPS-T-35-29-30.

¹⁰⁵ S. 2686 was signed into law on October 27, 2000. Section 1(a) addresses regular rates. It amends RFRA by providing that regular rates are to be established by applying specified policies to the attributable costs of both the commercial and preferred subclasses.

changes on regular-rate mailers in the pending rate proceeding at the Commission. *Id.* at 4. The report says that under this provision, the estimated reduction in revenue from Nonprofit Standard A mail caused by the enactment of the new ratemaking rules, if any, is to be treated as a reasonably assignable cost of the Postal Service to be apportioned among the various classes of mail and types of postal service in accordance with section 3622(b)(3). *Id.* at 4.

b. Commission's Rate Design

[5557] The new law affects the revenue requirement, but not rate design. The new law expects the Commission to recommend rate differentials consistent with the policies of the Act. Generally, this is the province of rate design. Consistent with previous Commission decisions, the Commission is relying on special cost studies that identify avoidable cost differences between rate categories as the basis for recommending discounts.

[5558] Given the timing of this amendment to RFRA, there has been essentially no opportunity for participants to discuss implementation. The Postal Service states that although the provisions of this legislation are not identical to those it had anticipated, "it is expected, if enacted, the general outcome in terms of the relationship between commercial and nonprofit rates would not differ significantly from that anticipated in the filing." Postal Service Brief at VII-205. The Service also says that nothing in the legislation should preclude the use of the special studies used to determine rate differentials, such as discounts, although depending on the final language of the bills, there could be adjustments to the overall level of the rates. *Ibid.*

[5559] The Commission recommends retaining the pound rate of 55 cents for Nonprofit. As discussed in some detail in the section on Standard ECR, the proper level of the pound rate is an issue that requires additional analysis. The recommended pound rates for Nonprofit ECR is 37 cents, the rate suggested by witness Moeller. Nonprofit ECR rates must increase substantially to comply with the new legislation, and it is

appropriate to spread this burden among all Nonprofit ECR mailers. Therefore, pound rates are increased to the level suggested by the Service. The recommended residual shape surcharges and the prebarcoding discounts are identical to those recommended for commercial mailers as proposed by the Postal Service.

[5560] *Nonprofit rate design.* The Commission attempts to have rate designs as cost based as possible, so in three of the four letter categories, the Commission recommends full passthrough of cost savings. In the other category—5-digit automation letters—the Commission passes through 115 percent of cost savings. This is done to support the Service’s automation program by providing a 5-digit automation rate that is between basic ECR and basic ECR automation. The Commission recommends Nonprofit flats discounts that are the same as those the Service proposed. Letter/flat differentials are also essentially similar to what the Service proposed. Thus, the passthrough patterns for both Nonprofit and Nonprofit ECR rates are similar to those in the Postal Service’s proposal.

[5561] The Commission anticipates that the next proceeding will provide an opportunity for all interested participants to offer comments on rate design options under the new law.

[5562] *Nonprofit ECR rate design.* The Commission has adopted the discounts proposed by the Postal Service. Given the updated Nonprofit ECR costs, the Commission’s passthrough percentages reflect a pattern similar to the Postal Service’s, with the exception of the letter/flat passthroughs. The Postal Service’s response to P.O. Information Request No. 4 shows Nonprofit ECR shape unit costs display volatility from year to year. For the years 1989 through 1991 and for 1993, 1997, and 1999, the unit mail processing cost for letters unexpectedly exceeds the unit mail processing cost for flats. For the other years in the 1989-1999 period, the unit mail processing cost for flats exceeds the corresponding unit cost for letters, as expected. Since these costs are IOCS based, the counterintuitive results for some years, including the 1999 base year used by the Commission, likely occur because Nonprofit ECR is a small-volume subclass for IOCS purposes. Thus, one might expect these volatile results over time.

But these kinds of cost changes can disrupt rate design if they result only from statistical variation. Since this is likely the case for FY1999, the Commission is passing through more than 100 percent of the letter/flat cost differentials at the high density and saturation tiers. This approach adopts the Postal Service's proposed letter/flat rate differentials and does not produce unduly burdensome rate changes.

[5563] *Flats*. Because the Commission is using the Postal Service's presort tree methodology, the passthroughs for letters and the letter/flat differential result in a passthrough of 44 percent for high density flats and 118 percent for saturation flats. This also results in discounts for flats equal to Postal Service's proposed discounts.

D. Periodicals

1. Introduction and Summary

[5564] The Postal Service's proposal for Periodicals, which entailed an overall increase of 13.5 percent,¹⁰⁶ has been marked by two significant developments. One is the impressive effort, spearheaded by the Periodicals Mailers, to identify appropriate post-filing adjustments to Periodicals costs and revenues, and thereby restrain the proposed increase.¹⁰⁷ The other is enactment of legislation amending the Revenue Forgone Reform Act of 1993 (RFRA).¹⁰⁸ This alters the development of all Periodicals rates. It also allows the Commission to give effect to the Service's proposed merger of the Nonprofit, Classroom and Regular subclasses into a combined "Outside County" subclass.¹⁰⁹

[5565] Mailers' interest in the possibility of post-filing adjustments (mainly in the cost area) was fueled not only by the unexpected size of the proposed increase, but also by the alleged cause: persistent—and unexplained—increases in mail processing costs. Other factors—such as cost attribution changes and Periodicals' share of a 2.5 percent contingency request—also contributed to an unprecedented effort to address possible errors, omissions, cost reduction programs and other alternatives.

[5566] This initiative dominated the record on Periodicals, spilled over into other classes, and culminated in the Service's agreement, prior to close of the record, to a variety of post-filing adjustments. The Commission has accepted nearly all of the

¹⁰⁶ This figure is an average for all Periodicals, including Within County, and is based on mail-mix information filed late in the case. The proposed increase for Outside County is 13.7 percent.

¹⁰⁷ The Periodicals Mailers include Magazine Publishers of America, Inc., Alliance of Nonprofit Mailers, American Business Media (formerly American Business Press), the Coalition of Religious Press Associations, Dow Jones & Co., Inc., The McGraw-Hill Companies, Inc., National Newspaper Association, and Time Warner Inc. These parties also participated in other joint efforts discussed on this record.

¹⁰⁸ P.L. 103-123, 107 Stat. 1267, 39 U.S.C. § 3626(a)(4).

¹⁰⁹ Within County remains an independent subclass.

agreed-upon items as appropriate adjustments. Along with adjustments in other areas, this allows the Commission to reduce the recommended increase for Periodicals to 9.4 percent.¹¹⁰

[5567] The mid-October enactment of an amendment to RFRA, which the Service had anticipated in its filing, changes Periodicals rate development in two significant ways. First, commercial rates are to be developed by applying the ratemaking criteria in 39 U.S.C. § 3622(b) to the combined attributable costs of Regular, Nonprofit and Classroom mail, instead of to the attributable costs of Regular alone. Second, rates for Nonprofit and Classroom are to be 5 percent lower than the rates for Regular, as developed on “combined cost” basis.¹¹¹ The development of Within County rates is affected by the new legislation only in that the benchmark subclass becomes Outside County.

[5568] This legislative change is part of a broader initiative to resolve what many view as anomalous outcomes under the original RFRA rate formula, which set the markup on preferred subclasses at one-half the level of their commercial counterpart. The reasons why anomalies occur differ somewhat from class to class, but in Periodicals, higher-than-expected costs and relatively low markups for the benchmark subclass are generally cited as the causes.

[5569] Given the attention to post-filing adjustments, discussion of other matters, such as rate design, has been limited. The Commission makes several rate design adjustments that are essentially technical in nature. It supports the Service’s proposed solution to the question of extending eligibility for destination delivery unit (DDU) discounts to publications entered under exceptional dispatch arrangements. It does not recommend an intervenor-proposed pallet discount.

¹¹⁰ The recommended increase for Outside County is 9.5 percent.

¹¹¹ This is subject to an exception which provides that the 5 percent discount will not apply to the advertising pound portion of a preferred rate mailing if the advertising portion exceeds 10 percent. This exception is consistent with the previous direction of Congress (in the Revenue Forgone Reform Act), which provides that equal rates are to be applied to the advertising portion of commercial and preferred Periodicals publications. 39 U.S.C. § 3626(a)(4).

[5570] The Commission compliments the Service and the Periodicals Mailers on their initiative and cooperation in reaching substantial agreement on most of the post-filing adjustments affecting Periodicals in this case. Continued efforts will be needed to ensure that desired outcomes are achieved. The Commission also appreciates the Service's efforts to devise an effective solution to the DDU rate eligibility matter.

[5571] A comparison of proposed and recommended rates follows. The rates recommended for Within County represent an average increase for Within County of 6.8 percent. The remaining discussion addresses several preliminary considerations; addresses each of the post-filing adjustments suggested by intervenors; reviews details of the merger and resulting rate design; discusses Within County rates; and resolves remaining issues.

Table 5-19
Outside County

Rate Element	Proposed Rate	Recommended Rate
<i>Pound Rates (cents per pound)</i>		
Destination Delivery Office Entry	18.0	14.8
Destination SCF Entry	21.0	18.8
Zone 1 & 2	24.7	23.0
Zone 3	26.3	24.5
Zone 4	30.2	28.3
Zone 5	36.1	34.1
Zone 6	42.3	40.1
Zone 7	49.9	47.4
Zone 8	56.3	53.7
Editorial pound rate	18.6	17.3
<i>Piece Rates (cents per piece)</i>		
Basic Presort	31.8	32.5
Barcode discount for letters	5.6	6.5
Barcode discount for flats	3.2	4.1
3-digit Presort	27.4	27.6
Barcode discount for letters	4.5	5.1
Barcode discount for flats	2.7	3.4
5-digit Presort	22.2	21.4
Barcode discount for letters	4.8	4.0
Barcode discount for flats	2.8	2.4
Carrier Route Presort	14.1	13.6
High density discount	2.5	2.5
Saturation discount	4.3	4.3
Per-piece editorial discount	6.6	6.5
Per-piece DDU entry discount	2.1	1.7
Per-piece DSCF entry discount	1.2	0.8

Table 5-20
Within County

Rate Element	Proposed Rate	Recommended Rate
<i>Pound Rates (cents per pound)</i>		
Destination Delivery Office Entry	11.8	11.3
General Entry	14.5	14.4
<i>Piece Rates (cents per piece)</i>		
Basic Presort	9.9	10.0
Barcode discount for letters	5.0	5.1
Barcode discount for flats	2.7	2.7
3-digit Presort	9.2	9.2
Barcode discount for letters	4.4	4.5
Barcode discount for flats	2.3	2.4
5-digit Presort	8.4	8.3
Barcode discount for letters	3.9	3.9
Barcode discount for flats	2.0	2.1
Carrier Route Presort	4.8	4.7
High density discount	1.6	1.5
Saturation discount	2.1	2.1
Per-piece destination delivery unit discount	0.5	0.5

2. Preliminary Considerations

a. Background

[5572] Periodicals is currently comprised of four subclasses: Regular, Nonprofit, Classroom, and Within County. The latter three are known as preferred subclasses because they receive special (*i.e.*, reduced) rate treatment under the Postal Reorganization Act.¹¹² One category in Regular—Science of Agriculture—also receives

¹¹² The Classroom Publishers Association provides a concise review of the preferred rate treatment traditionally afforded the Classroom subclass in its brief. See CPA Brief at 2-6.

special treatment in the form of reduced pound rates on advertising content within zones 1 and 2.

[5573] Eligibility for the Periodicals class is conditioned, among other things, on a minimum amount of nonadvertising—or editorial—content.¹¹³ The presence of this type of content entitles all Periodicals mail to special consideration, given explicit statutory recognition of educational, cultural, scientific and informational value as a ratemaking criterion. *See 39 U.S.C. § 3622(b)(8). Additional consideration for the preferred subclasses and the Science of Agriculture rate category is codified in 39 U.S.C. § 3626.*

[5574] The four Periodicals subclasses have similar rate structures, which are based on per-piece and per-pound charges. The piece charges reflect several worksharing options (presorting, prebarcoding, and dropshipping) and, with the exception of Within County, recognize the proportion of editorial content. The per-pound charges (except for Within County) are tied to advertising and editorial content. The advertising pound charge varies by postal zone and entry point. The editorial pound charge is held to a reduced level, and does not vary by zone or entry point; thus, it is often referred to as the “flat editorial rate.” Within County pound rates do not vary depending on the proportion of editorial content, and are not zoned.

[5575] The Service’s Periodicals proposal assumes a merger of three of the four Periodicals subclasses, based on anticipated legislation. (Legislation along the lines the discussed by Postal Service witness Taufique was later introduced and enacted prior to issuance of the Commission’s recommendation.) The merger combines the Regular, Nonprofit and Classroom subclasses into a single subclass referred to as “Outside County.” Proposed Domestic Mail Classification Schedule provisions identify Nonprofit and Classroom as “preferred qualification” rate categories, rather than as subclasses. Postal Service Request, Attachment A at 33. The Service proposes one rate schedule for the new subclass, which includes a footnote indicating that Nonprofit and Classroom

¹¹³ Periodicals mailers must pay a one-time application (original entry) fee. There are three other types of application fees: for additional entry; re-entry and news agent registration. The Service proposes increasing the original entry fee from \$305 to \$350; maintaining the additional entry fee at \$50; and reducing the additional entry and news agency registration fees from \$50 to \$40. USPS-T-39 at 92.

mailings are eligible for the specified 5 percent discount. Postal Service Request, Attachment B at 27 (Rate Schedule 421.)

[5576] *Volume and revenue.* In FY 1999, Periodicals volume amounted to 10.3 billion pieces and revenue was \$2.1 billion. The Regular subclass accounted for the largest share, with 7.2 billion pieces and \$1.7 billion in volume. Nonprofit generated 2.1 billion pieces and \$331 million in revenue; Classroom generated 59.6 million pieces and \$13.2 million in revenue pieces. In the Within County subclass, there were 893.5 million pieces and \$77.1 million in revenue.¹¹⁴

b. Mail Processing Cost Trends

[5577] Sharply increasing mail processing costs are a major cause for the Service again proposing above-average rate increases for Periodicals. Therefore, the Commission pressed the Service to assist in identifying definitive reasons for the historical pattern of above-average mail processing cost increases.¹¹⁵ Initially, an Information Request presented a table showing Cost Segment 3 unit mail processing costs for Regular Periodicals for FY 1989 through FY 1998, adjusted for wage inflation and for material costing method differences. P.O. Information Request No. 4 (February 25, 2000), Attachment 1. The POIR observed that “the basic trend is up,” and requested the Service to provide shape-related cost data for other classes “to help ascertain if this upward trend in flat-shaped mail costs occurs for other mail categories and shapes as well.”¹¹⁶ *Id.* at 1. It also asked the Service to discuss the adequacy of the costs for analytical purposes. *Id.* at 2.

¹¹⁴ The National Newspaper Association’s observations on the accuracy of reported Within-County volume are addressed in a later portion of this section.

¹¹⁵ This concern had been pursued in the early 1990s and expressed in other omnibus cases. See Order No. 1002 (January 14, 1994) terminating Docket No. RM92-2.

¹¹⁶ The subclasses for which data were requested include First-Class Letters and Sealed Parcels; Regular Periodicals; and all four Standard A subclasses (Regular, ECR, Nonprofit and Nonprofit ECR). P.O. Information Request No. 4 (February 25, 2000) at 2.

[5578] The Postal Service supplied the requested data, but Postal Service witness Smith, who had coordinated its production, expressed doubt about its analytical utility. He agreed that overall trends may be obtainable, but said that it is likely that “the true magnitude of changes over time will not be accurately captured by these costs,” given discontinuities in the underlying data and inadequacies of the LIOCATT-based costs. Postal Service Response to P.O. Information Request No. 4. Tr .46D/21812.

[5579] After considering the response to P.O. Information Request No. 4, the Commission issued Order No. 1289, which set out several graphs based on data the Service had provided. It observed:

Two trends in particular stand out, one of which warrants further study. The inflation-adjusted costs of processing letters are steadily declining, which has alleviated the pressure for rate increases. The other pronounced trend is the increase in the inflation-adjusted costs of processing Periodicals since 1993. This is a negative trend that should be analyzed so that if possible, rates and classifications can be designed that will assist the Service in changing it.

PRC Order No. 1289 (March 28, 2000) at 1.

[5580] The Commission directed the Service to present detailed evidence explaining the causes of the trend in the costs of processing Periodicals from a witness qualified to respond to participants’ questions, noting that one “with high-level managerial responsibility over flat handling operations would appear to be best suited to this need.” *Id.* at 2. It also asked for an explanation of why First-Class Mail and Standard A Regular (which have large volumes of flat mail) had exhibited a sharp increase in unit flats processing costs in FY 1998. *Ibid.* A supplemental ruling asked for an analysis of the productivity of flats processing on the flat sorting machine (FSM) 881. P.O. Ruling No. R2000-1/31 (April 7, 2000).

[5581] In response to the Commission’s directive, the Postal Service sponsored the testimony of witnesses O’Tormey and Unger. Witness O’Tormey is the manager of Processing Operations, Operations Planning and Processing, and has extensive

responsibility for letter, flat and package processing operations.¹¹⁷ USPS-ST-42 at 2. Witness Unger is the manager of Operations Support for the Southeast Area. USPS-ST-43 at 2.

[5582] With respect to the graphs in Order 1289, witness O'Tormey says the trend lines show that the experience with all types of flats is mixed, but acknowledges that Periodicals represents "a special case." USPS-ST-42 at 7. He asserts that a full understanding of why the cost trends for Periodicals flats have been different from other flats costs lies in differences between classes. In particular, he notes that Periodical mail piece and preparation characteristics make processing Periodicals even more of a challenge than processing First-Class Mail and Standard A flats. These characteristics include differences in makeup requirements for packaging, in typical volumes in a mailing, in densities of destinations, in presort levels, in whether they are sequenced by line of travel (LOT), and in whether they are in skin sacks. *Id.* at 13.

[5583] O'Tormey also cites other factors, such as the effects of the recent reorganizations, which reduced the number of experienced supervisors, and a change in the treatment of workhours. He says the latter resulted in a significant number of hours associated with prepping and dispatching mail for FSM operations being shifted from indirect to direct workhour costs. *Id.* at 17.

[5584] Witness Unger provides a field operations perspective; addresses the increase in flats costs in FY 1998; and reviews FSM 881 performance. Among other things, he describes the introduction and evolution of the Service's flat mail automation program; identifies the challenges this program has – and continues – to pose; discusses distinguishing characteristics of letter mail and flat mail; and discusses differences between Periodicals flats and Standard A flats. USPS-ST-43 at 3 *et. seq.*

[5585] Unger offers three general explanations for the overall Periodicals cost trend. These are essentially the same as those identified by witness O'Tormey. They include the characteristics of Periodicals mail; measures taken to improve service for

¹¹⁷ Witness O'Tormey also works in other functional groups on issues related to automation, equipment deployment, labor negotiations, facilities, transportation and delivery. USPS-ST-42 at 2.

Periodicals, but not for mail in other classes; and operational considerations. As examples of the latter, Unger cites the use of polywrap and the fact that smaller-volume Periodicals' mailings generally are not as suited to long-run machine operations as Standard A mailings. *Id.* at 3 and 14.

[5586] *The FY 1998 cost spike for flat-shaped mail.* Witness Unger points to two factors that might account for the higher reported costs for all flat mail in FY 1998: the after-effects of the United Parcel Service strike, as the pent-up volume from mailers of flats was introduced into a stressed system, and expenses incurred in preparing for the Fall 1998 mailing season, so that service levels would be acceptable. *Id.* at 11-13. He explains: "Fiscal Year 1998 had opened in September 1997 with overloaded processing systems, high use of overtime, and extra transportation. It closed with the impact of more costs that were being incurred to ensure that a different fall mailing season would occur in 1998." *Id.* at 12. As it turned out, Unger says, there was less volume than mailers had predicted, but he contends that "[a]s planned, service benefited from the extra complement, transportation, and processing capacity; but additional expenses were incurred to ensure that service." *Ibid.*

[5587] *Declining FSM 881 productivity.* Witness Unger also acknowledges that FSM 881 productivity has declined. For the machines in operation during 1995-1999 in his area, he states: "The combined productivity (keying and BCR/OCR read) has declined from 711 total pieces handled per workhour to 545 total pieces handled per workhour." *Id.* at 13. However, his assessment is that this "indicates that while some operational inefficiencies have occurred, beneficial operational changes have had a very significant impact, but have also contributed to the impression of a loss in productivity." *Ibid.*

[5588] In addition, Unger cautions against using machine productivity as a performance indicator. *Id.* at 14. In his view, the considerations relevant to assessing performance are the type of sortation; whether automation assets are fully utilized within the available operating window; the extent to which related operations are costed with the sortation operation; the cost of the workhours involved; and the impact on

downstream operations. Unger says these considerations come together in the operating budget, so he contends that using dollars as the common denominator is the most valid approach to assessing performance. *Id.* at 15.

[5589] *Cross-examination.* On cross-examination, witness Unger agrees that an evaluation of his testimony should consider not only the cost increases the Service has incurred, but also cost savings that mailers achieve on behalf of the Service.

[5590] Tr. 21/8221. He then acknowledges that over the period in question, numerous practices that should have tended to offset cost increases, at least in part, have been introduced or expanded. For example, he agrees that dropshipping (undertaken at mailers' expense) reduces the Service's costs, and is a practice that has grown since 1993. *Id.* at 8239. He also agrees that the volume of automated Periodicals mail has increased since 1993 and that, all other things being equal, this should tend to reduce the Service's mail processing costs. *Id.* Moreover, he agrees that the Service has installed more automated flat processing capacity over the period in question, and states that this should—and does—reduce the costs of mail processing. *Id.* at 8240. He also acknowledges that more Periodicals mail is entered on pallets in 1999 than in 1993; that the percentage of Periodicals mail presorted to the carrier route level has grown, and that some newspapers are now barcoded, while none were in 1993. *Id.* at 8246-47.

[5591] Similarly, cross-examination of witness O'Tormey also elicited agreement that the advent of various automated functions should have reduced total unit mail processing costs, at least for the distribution function. Moreover, as to the effect of supervisors' retirements, O'Tormey acknowledges that the bulk of the "unusual bulge" was over by the end of FY 1993, and that "average" attrition has occurred since then. *Id.* at 8336.

[5592] *Conclusion.* Notwithstanding its attempt to address the disturbing Periodicals cost trend, the Commission's inquiry found no definitive reasons why Periodicals mail processing costs have increased. Certainly, as one witness for the Periodicals Mailers concludes, there is no "smoking gun." Postal Service witnesses O'Tormey and Unger discuss numerous and varied factors that, at first impression, may

appear to be contributing factors; however, on cross-examination, both witnesses agree that a stream of mechanization and technological improvements should have generated cost reduction benefits.¹¹⁸ Further, they acknowledge that increases in mailer worksharing—such as presorting, barcoding and dropshipping—plus widespread use of pallets—should have had a downward influence on costs. They also concede that some events, such as supervisors’ retirements and the United Parcel Service strike, were essentially one-time occurrences.

[5593] The only conclusion is not comfortable: there are many reasons for believing that costs should have decreased; only a few factors that could be associated with increases; and a persistent net upward trend. It is clear that mailers and the Service must aggressively pursue the cost reduction opportunities identified on this record, and explore other aspects of the “operational realities” they face.

c. Post-filing Adjustments

[5594] The Periodicals Mailers developed extensive testimony identifying potential post-filing adjustments that could be recognized on this record. This effort addressed not only mail preparation and processing changes, but also the contingency, an additional revenue source, and costing methods.¹¹⁹ With the Postal Service’s support, their effort has produced concrete results: namely, the identification of nearly \$100 million in post-filing projected test year adjustments. Along with other changes the Commission recommends, this allows the Commission to recommend a single-digit increase for Periodicals. The Service does not oppose an increase at this level.

[5595] In the Commission’s view, the favorable outcome achieved on this record can be traced to the creation and sustained efforts of the joint USPS-Periodicals Industry Operations Review Team¹²⁰ and to ongoing work of the Mailers’ Technical Advisory

¹¹⁸ Witness Stralberg correctly points out that some of the largest increases in Periodicals costs occurred prior to FY 1989, starting in FY 1986. Tr .24/11356.

¹¹⁹ Tr. 24/11262 *et seq.*

Committee (MTAC). The Review Team, established following Docket No. R97-1, visited more than a dozen postal facilities, related delivery post offices, and two mailer plants, in the final quarter of calendar 1998. The purpose of the visits was to investigate the causes of, and seek solutions to, continuing cost increases. USPS-LR-193 (Item 2—March 15, 1999 Team Report) at 2-3. An MTAC Package Integrity Work Group has pursued many issues related to bundle breakage.

[5596] Significantly, the Review Team’s report stated that it had “identified actions that should be taken by industry, local postal managers, and national postal management to improve Periodicals processing and drive costs from the system.” *Id.* at 3. The related recommendations were grouped into 15 broad issues, as follows: mail make-up; mail containerization; address quality; enforcement and enhancement of entry/acceptance requirements; flats operation plan; combination and separation of mail classes in the incoming mail stream; bundle preparation and handling; operations management; transportation; mail processing annexes; flats automation; inter-class cost impact; the relationship between low costs and good service (specifically, that these are not mutually exclusive propositions); allied operations and cost attribution methods; and rate design. *Id.* at 4-6.

[5597] In its report, the Review Team expressed its hope that the results of a number of specific initiatives could be reflected in this rate case. *Id.* at 7. As filed, the Service’s Request did not include any recognition of the cost savings associated with initiatives that were underway; however, over the course of this case, the Service has expressed its support for many proposed adjustments related to mail preparation and mail processing changes. As discussed below, the Commission finds that most of these adjustments should be reflected in its recommendation.

[5598] This result would not have been possible without the joint efforts that preceded the filing of this case, that have been put forth on this record, and that are

¹²⁰ This team consisted of eight representatives from the Postal Service and its contractors; two representatives of Magazine Publishers of America; one representative of American Business Media (formerly American Business Press); two representatives of Time, Inc.; one representative of Meredith Corporation; and one representative of The McGraw-Hill Companies. Tr. 24/11312.

expected to follow. The Commission compliments the Review Team and applauds the industry support behind its formation and ongoing work. It recognizes the longstanding contributions that MTAC has made to improving the mailing environment and, in particular, compliments the work of the MTAC Package Integrity Work Group. The Commission also acknowledges the Service's cooperation in addressing this difficult, but important, matter. It urges individual members of the Periodicals industry, their suppliers, and postal management to accept the clear import of the Review Team's recommendations: without effective change, costs cannot be constrained, nor can rate increases be moderated.

[5599] *Note on post-filing adjustments.* In virtually every omnibus filing, the Commission finds it appropriate—and often necessary—to reflect post-filing adjustments. These adjustments can range from the purely technical (such as the correction of an obvious error or omission) to the highly controversial (such as those associated with methodological differences). There is no single standard for making such adjustments, but threshold considerations are the extent to which they materially assist in the development of an appropriate base for the Commission's rate and classification recommendations and the extent to which they have record support.

[5600] Historically, these adjustments have had a comparatively limited impact on any particular class of mail in terms of percentage rate increase. The adjustments proposed by the Periodicals Mailers in this case, considered as a whole, reduce the originally proposed Periodicals rate increase by almost one-third. Some of these are typical rate case adjustments (making a correction or a conforming change), but others rely to a great extent on substantial prospective (test-year) changes in mailer behavior and Postal Service operations.

[5601] The Commission generally concludes that the record supports a finding that all of the items identified in the jointly proposed changes reflecting improvements in mail processing and mail preparation constitute appropriate post-filing adjustments. Moreover, the Commission is cautiously optimistic that associated savings (and savings

from additional changes) can be increased in the period beyond the test year, assuming continued attention from the industry and postal management to critical issues.

(1) Test Year Cost Reductions Associated with Mail Preparation and Mail Processing Initiatives

[5602] The Periodicals Mailers and the Postal Service jointly identify several cost reductions arising from changes in mail preparation and mail processing expected to be in place for all or part of the test year. Some of these require mailers to undertake changes in the way they prepare their mail for acceptance; others require the Service to adjust processing operations in a variety of ways.

[5603] The Periodicals Mailers represent that their trade associations are working in three areas to ensure that the proposed makeup requirement changes are publicized to all Periodicals mailers. These efforts include publicizing the changes to their own members, discussions at association postal committee meetings, and anticipated notification to their entire membership when final rules are promulgated. They also include participation in panel discussions on mail preparation changes and preparation of updates to educational materials. The Periodicals Mailers also note that the Postal Service is undertaking its own educational efforts.

[5604] *Reduction in bundle breakage.* There is no clear agreement on the extent to which increased bundle breakage has contributed to higher mail processing costs, but the Review Team concluded that bundle breakage appears to add significantly to Periodicals costs. Based on changes being made in the preparation and processing of bundles, MPA witness Glick projects that there will be a 50 percent reduction in breakage, and that this will produce test-year cost savings of approximately \$21 million for Periodicals. Tr. 24/11236 (Table 3). This estimate is based on witness Stralberg's revision of witness Yacobucci's mail flow model, discussed further below. The Service, on the other hand, contends that a reduction of no more than 25 percent is feasible, and that this will yield savings of \$15 million. Postal Service Brief at VII-141. The Postal Service estimate is based on the Yacobucci model as filed.

[5605] This is one of the few areas where the Service and the mailers have not reached complete agreement. The Commission agrees that some savings from improved bundle preparation and processing will occur. Both witnesses O'Tormey and Unger state their belief that bundle breakage reduction measures will work. USPS-ST-42 at 22-23; Tr. 21/ 8169. Precise quantification on this record is not possible, but the Commission believes that it is appropriate to adopt witness Glick's reduction of 50 percent, given the extensive attention being given to this issue by the mailers and the Postal Service. Following the Postal Service's use of the Yacobucci's model as filed, updated to FY 1999 and for Commission costing results, the savings are found to be \$27.6 million for Periodicals, before the application of piggyback factors.¹²¹

[5606] *Preparation of presorted carrier route Periodicals in LOT sequence.* LOT sequencing generally approximates carriers' actual sequence of delivery. USPS-ST-43 at 4. Postal Service witness Unger says preparing mailings in this manner results in significant savings because carriers spend less time casing the mail, as the next piece to be sorted is usually very close in the line of travel to the compartment for the piece just sorted. *Ibid.*

[5607] Under the terms of a new mailing requirement that will take effect upon implementation of Docket No. R2000-1 recommendations, Periodicals mailers will be required to prepare their carrier route presorted mail using up-to-date Postal Service line-of-travel information.¹²² 65 FR 46363-64. Both the Periodicals Mailers and the Postal Service propose recognition of \$23 million in associated cost savings. Tr. 24/11275; Periodicals Mailers Brief at 7; and USPS-LR-I-307.

[5608] This proposal seeks a substantial adjustment based on prospective compliance with a new mail preparation rule. The Commission finds that recognizing estimated savings of \$23 million is appropriate, assuming widespread compliance with, and enforcement of, this now-optional mail preparation method. A significant factor

¹²¹ For Standard A Mail, the savings are \$24.2 million.

¹²² As an alternative, the rule allows mailers to prepare mail in actual walk sequence to qualify for basic carrier route rates. 65 FR 31507.

influencing the Commission's decision to recognize savings at the proposed level is that the record shows extensive education efforts that have been underway. Moreover, printers may already be familiar with this requirement, as it currently exists in Standard A.

[5609] *Preparation of mail is a manner compatible with the Service's use of a 5-digit sort scheme—the "L-001" requirement.* The Periodicals Mailers also propose recognition of \$4.972 million associated with a new regulation requiring mailers to combine mail from 5-digit sacks or pallets destinating at the same station, which allows creation of a five-digit scheme container. 65 FR 46361-63. According to witness O'Tormey, this preparation method takes its name from the label used for pallets and sacks prepared this way, and has been an option since July 1999. He asserts that this practice has had a positive impact. USPS-ST-42 at 25.

[5610] The Commission concludes that the record shows that this practice allows greater densities (because there are more direct containers) at locations where piece distribution takes place. The Commission has recognized these savings.

[5611] *Elimination of skin sacks for carrier route mailings in sacks.* Witness O'Tormey notes that "skin sacks" are often prepared by the Periodicals industry to improve or protect service. He says the theory is that pieces in direct sacks (those that do not have to be opened until they reach the carrier) are less likely to be delayed during interim processing steps (sack sorting, opening, dumping, distributing bundles, etc.). O'Tormey states that eliminating this sacking option for carrier route mailings would reduce the number of sack handlings in the system without jeopardizing service, since those sacks would not be opened until they were at the delivery unit.¹²³ *Id.* at 24.

[5612] In a final rule published in the *Federal Register* (65 Fed Reg 46361-63), the Service has adopted a change that effectively eliminates skin sacks by increasing sack minimums from 6 to 24 pieces. Both the Periodicals Mailers and the Postal Service

¹²³ Mailers will still be allowed to prepare "skin sacks" at the 5-digit level.

support recognition of \$1.587 million associated with this rule. Periodicals Mailers Brief (ANM, *et al*) at 8; Postal Service Brief at VII-140.

[5613] The Commission agrees with the recognition of this change, in the amount proposed by the Periodicals Mailers and the Postal Service.

[5614] *Combined automation and presort mailings.* The Periodicals Mailers and the Postal Service also support recognition of \$7.924 million associated with another rule change, which would allow mailers to combine barcoded and non-barcoded bundles in the same sack (but not the same package). 65 FR 50054-89; Tr. 46-D/21512-14; USPS-LR-I-332; Postal Service Brief at VII-141. The Commission also agrees that savings in the amount proposed on this record should be recognized.

[5615] *Implementation of vertical flat casing.* The Periodicals Mailers and the Service point to savings of \$7 million from implementation of a work method change, pursuant to a Memorandum of Understanding with the National Association of Letter Carriers. This entails converting routes in a delivery point sequencing (DPS) environment that use the composite bundle work method to the DPS vertical flat casing method, and generates a cost reduction in carrier operations. Tr. 46-C/20958-59. USPS-ST-42 at 23. Witness O'Tormey says the agreement gives management the authority to implement the vertical flats casing method for those routes not currently using it. Under this method, flats are sequenced in the order of delivery in one handling by the carrier rather than in two handlings, as occurs under the more traditional flats sorting method. USPS-ST-42 at 23-24. The Service has included \$7 million for this item in its July 7 update. Tr. 46C/20874.

[5616] The Commission agrees with the recognition of this change. As responsibility for ensuring that the projected savings are realized lies primarily with the Postal Service, the Commission expects management to foster a smooth transition on affected routes.

[5617] *Productivity improvements and postal equipment enhancements.* The Periodicals Mailers and the Postal Service also support recognizing cost reductions associated with several mail processing changes. These include \$2 million in savings for

increased manual productivity (Tr. 46-C/20961-62); \$4 million in savings for improved AFSM 100 performance; and \$250,000 associated with retrofitting FSM 1000s with an optical character reader and an automatic feeder.

[5618] Witness O'Tormey says one area where the Service has already realized improvement is in manual flats distribution operations, where the Service is achieving increased productivity levels. USPS-ST-42 at 22. The Service confirms that its July 7 update includes \$6.266 million associated with these improvements and enhancements. Tr. 46C/20874.

(2) Additional Periodicals Revenue Source

[5619] *"Ride-along" revenue.* Both the Periodicals Mailers and the Postal Service support the recognition of \$10 million dollars in "ride-along" revenue associated with certain attachments and enclosures. This is based on the expectation that at least this much revenue will be generated by a recently-approved experimental classification change (in Docket No. MC2000-1) that allows Standard A material to be included in (or "ride along" with) Periodicals publications for a fee of 10 cents.¹²⁴ Tr. 24/11296 and Tr. 38/17077.

[5620] The Commission agrees that this revenue should be recognized. It not only accepted witness Taufique's representations in the recent experimental case that estimated ride-along revenue would amount to at least \$10 million, but specifically noted that Taufique said the revenue would thereafter be associated with Periodicals. PRC Op. MC2000-1 at 5. Neither the Service's Request nor the hybrid billing determinants recognize this revenue.

[5621] As to the amount that should be recognized, the Postal Service states that data show approximately 42 million pieces mailed at the "ride-along" rate as of August 3, 2000, or \$4.2 million in revenue. Given the time lag between the filing of mailing statements and tabulation, the Service indicates that this figure could be somewhat

¹²⁴ Docket No. MC2000-1 was pending at the time the Service was preparing its filing.

understated. It also suggests that seasonal effects and “ramping up” might lead to increased usage later in the year. Tr. 46C/20871 (response to MPA/USPS-69).

(3) Test Year Savings from Deployment of the Automated FSM (AFSM) 100

[5622] *Projected AFSM savings.* MPA witness Cohen says witness Buc’s correction to the Service’s estimate of test year cost savings related to the installation of AFSM 100s increases savings by approximately \$200 million for all mail classes. Tr. 24/11316. She determines Periodicals’ share by using mail processing cost distribution keys in Postal Service witness Van Ty Smith’s testimony. Consistent with Buc’s analysis, which estimates that half of the savings is from replacing manual sorts and the other half is from replacing machine sorts, Cohen distributes half of the savings using the key for manual flat sorting and half using the FSM distribution key. *Ibid.* Her estimate for Periodicals adds \$28 million to the savings projected by the Service. *Id.* at 11278.

[5623] In response to Order No. 1294, the Postal Service increases its estimate of savings from installation of AFSM 100s from the original \$169.4 million to \$226.4 million. Using available information on sorting productivities for FY 1999, witness Buc revised his correction to the Service’s estimates, leading to a net amount of \$176 million. Tr. 38/17191 (Table 2). Cohen estimates that \$24 million of this should accrue to Periodicals. *Id.* at 17076.

[5624] On rebuttal, Postal Service witness Patelunas raises a number of questions about the data and assumptions used by witness Buc, and argues that Buc’s figures are out of line with the amounts the Postal Service has set in its field budgets. Tr. 38/17145; see *also* Postal Service Brief at II-26-28, and Reply Brief at VI-51; Periodicals Mailers Brief at 14, and Reply Brief at 7; DMA et. al. Brief at 22, and Reply Brief at 9.

[5625] The Commission agrees that some caution is needed in projecting operating savings. It appears witness Buc’s assumptions are overly optimistic. Accordingly, the

Commission accepts the amount the Service estimates in its response to Order No. 1294.

(4) Final Adjustment for Hybrid Test Year Worksharing

[5626] Billing determinants play an important role in this case due to mailers' worksharing patterns and changes in the structure of presort discounts as a result of Docket No. R97-1.¹²⁵ To create a set of billing determinants for FY 1998 that accurately reflects the discount structure of Docket No. R97-1, witness Taufique uses data from postal quarter three of FY 1999 to adjust the billing determinants for FY 1998. USPS-T-38 at 5. When cost information for FY 1999 became available, the Commission asked the Postal Service to submit an appropriate set of billing determinants for FY 1999. P.O. Information Request No. 16 (July 14, 2000). In response, the Postal Service asserted that because two different rate structures were in effect for FY 1999, it would be better to use the billing determinants for the postal fiscal year consisting of the last two quarters of FY 1999 and the first two quarters of FY 2000. The Postal Service prepared these "hybrid" billing determinants and submitted them as part of USPS-LR-I-435.

[5627] To provide a reference point for assessing these determinants, witness Cohen develops an adjusted set of FY 1999 determinants, using a process that is analytically similar to the process Taufique used to adjust the FY 1998 determinants. She then observes that there was more mailer worksharing in the hybrid billing determinants than in her adjusted FY 1999 determinants. As increased worksharing should lower the Service's costs, Cohen proposes to adjust the FY 1999 costs downward to align the costs with the hybrid billing determinants. T r.38/17077-78 and MPA-LR-13.

[5628] Witness Cohen observes that the Postal Service made final adjustments to test year after rates (TYAR) cost estimates for all major classes except Periodicals.

¹²⁵ Specifically, the presort tiers of basic, 3/5-digit, and carrier route were expanded to basic, 3-digit, 5-digit, and carrier route. This change took effect upon implementation of Docket No. R97-1 rates on January 10, 1999. Therefore, important F Y1999 has one presort structure prior to January10, 1999, and a revised one after that date.

Tr. 38/17078. To correct for the increased worksharing, the adjustments Cohen proposes are \$31 million for Periodicals Regular and \$8 million for Nonprofit. *Ibid.*, citing MPA-LR-13, Exhs. 7.1 and 8.1. She says her method follows Postal Service precedent: she uses the Periodicals Mailers' mail processing cost avoidance model (MPA-LR-2), witness Stralberg's DDU cost avoidance estimate, and the Service's unit delivery and transportation costs for Periodicals. *Id.* at 17078.

[5629] The Service agrees that some adjustment is in order, but indicates it might not make the adjustment in exactly the same way as Cohen proposes. Postal Service Brief at I-23-24; Postal Service Reply Brief at VI-48. Given the Commission's decision to use a hybrid test year, an adjustment is warranted. Based on models updated for FY 1999 and Commission costing, the amount is \$39.1 million.¹²⁶

(5) Rail Transportation

[5630] In direct testimony, witness Cohen estimates \$22 million in test year cost savings associated with Periodicals rail and highway transportation. Tr. 24/11279-80. This estimate is based on MPA witness Nelson's analysis. In supplemental testimony, Cohen asserts that the Service has acknowledged highway transportation savings, but has not incorporated "easily achievable" efficiencies in rail transportation. She says this portion represents \$16 million in additional savings. Tr. 38/17076.

[5631] The estimates of witness Nelson for savings in rail transportation are related to shifting mail off Amtrak, and to the potential benefits of negotiating more favorable contracts as a result of increased competition in the rail industry. His estimates were discussed extensively by Postal Service witnesses Pickett, (USPS-RT-9) and Young (USPS-RT-10). See also Postal Service Brief at V-147-48. The Commission concludes, following review of these materials, that it would be speculative to project that these savings will occur in the test year even though the Postal Service will surely continue to seek lower transportation costs across all modes, consistent with its needs.

¹²⁶ Of this amount, \$30.1 million is associated with Regular and \$8.9 million with Nonprofit.

(6) Air Transportation

[5632] Witness Cohen notes the existence of air transportation dollars for Periodicals. She says the Periodicals Industry Operations Review Team noted these as well and concluded that such “extraordinary transportation was inappropriate.” Tr. 24/11276. Cohen indicates that the Postal Service generally agrees. She then points to the fact that air transportation costs for Periodicals were \$11 million lower in FY1999 than in FY 1998, and argues that this is evidence that the Service already has reduced this type of air transportation usage. Cohen believes test year costs should be reduced by this amount.

[5633] This suggestion was effectively overtaken by later developments, which led to the Commission’s use of actual FY 1999 costs to estimate test year costs. If the Commission were developing test year costs using FY 1998 as a base, Cohen’s suggestion appears to have merit. As it stands, however, the issue is moot on this record.

(7) Costing Methodology Changes

[5634] *Costing theory: volume variability and the ES study.* Two issues receiving considerable attention in this case are Postal Service witness Bozzo’s volume variability analysis and Postal Service witness Raymond’s use of an Engineering Standards (ES) study to analyze city carrier costs. As summarized in the testimony of witness Cohen, the Periodicals Mailers support the Bozzo analysis, but oppose the use of the ES study. Assuming the Bozzo analysis is used, the Periodicals Mailers support its extension to non-MODS offices and to bulk mail centers (BMCs). According to witness Cohen, this extension reduces Periodicals costs by \$106 million dollars; rejecting the ES study reduces them by another \$50 million.¹²⁷

¹²⁷ Both of these issues have significant implications for other subclasses as well.

[5635] As explained in detail in the costing sections of this Opinion, the Commission is not accepting the Bozzo analysis or the ES study. The sections that follow provide a brief discussion of a number of other proposals of the Periodicals Mailers. Most are discussed in more detail in other sections.

[5636] *Distribution of mixed-mail and not-handling costs.* The Periodicals Mailers propose a \$17 million decrease in base year Periodicals costs related to a change in the distribution of allied mixed mail costs. This entails extending the broader mixed mail procedures used by the Service for the MODS and BMC Platform cost pools to the allied mixed mail pools. The Postal Service agrees with this change. As discussed in the costing section, the Commission adopts it. In a related matter, the Periodicals Mailers support a broader distribution of not-handling tallies than the Service proposed, specifically using the response to In-Office Cost System question 19. Tr. 24/11288 and 11378. The Postal Service does not support this broader distribution. Postal Service Brief at V-61-69 and Postal Service Reply Brief at VI-54. The Commission agrees with the Service on this issue.

[5637] *Use of annual volume data from rural carrier cost system.* The Periodicals Mailers and the Service jointly support a \$17 million decrease in Periodicals base year costs based on a change in the rural carrier mail shape adjustment using a full year of volume data from the rural carrier cost system. Tr. 46-C/20840 and USPS-LR-I-335. Postal Service witness Kay endorses this change, which was presented by MPA witness Glick. Postal Service Brief at I-21. The Commission accepts this adjustment.

[5638] *New regression analysis for load time variability.* The Periodicals Mailers propose use of a new regression analysis for the variability of load time. This change produces a \$50 million reduction for Periodicals. The Postal Service says the proposed change produces more accurate and more reliable results. Tr. 43/18695-96. USPS-LR-I-402 and 450. The Commission adopts this change.

[5639] *Zero variability for loop/dismount costs.* The Periodicals Mailers propose recognizing \$46 million from a costing method change related to setting the variability for loop/dismount costs on city park-and-loop routes at zero. Tr. 43/18723-28. The Postal

Service agrees with this position, on grounds that witness Baron has demonstrated the appropriateness of this change. *Ibid.*, and Postal Service Brief at I-21. The Commission's variability adopts this change.

[5640] *Roadrailleurs costs.* "Roadrailleurs" refers to a hybrid service that combines operational aspects of freight rail with the service responsiveness of direct long-haul transport. Tr. 46-C/20851. Both the Periodicals Mailers and the Postal Service propose an adjustment in the distribution of some of these costs, but disagree on the amount. MPA witness Nelson contends \$3.1 million should be recognized. The Service supports a \$2.3 million redistribution, based on a special study witness Pickett presented in rebuttal testimony. Tr. 43/18531 and USPS-L-1-432 and 433; Postal Service Brief at I-20. The Commission adopts the Service's proposed \$2.3 million redistribution.

[5641] *Distribution of empty equipment rail costs.* The Periodicals Mailers also propose a revised distribution key for empty rail equipment costs, based on MPA witness Nelson's testimony. Tr. 28/13414. This has the effect of lowering Periodicals costs by \$5 million. Witness Degen indicates that the Postal Service does not challenge this change. Tr. 38/17332. On brief, the Service confirms this position. Postal Service Brief at VII-144. The Commission adopts this change.

(8) Contingency

[5642] Several participants not only seek a reduction in the contingency, but also urge the Commission to eliminate any portion relative to Periodicals. MPA witness Cohen proposes that the Commission recommend one-quarter of 1 percent, rather than the 2.5 percent the Service requested, and further proposes that none of the reduced contingency be applied to Periodicals. Tr. 38/17078-79. ABM witness Morrow also proposes the elimination of any contingency burden on Periodicals. Tr. 29/13543-60.

[5643] The Service opposes both the overall reduction in the contingency and the elimination as to Periodicals. Postal Service Brief at II-2-8; Postal Service Reply Brief at II-38.

[5644] The overall level of the contingency is discussed in the Revenue Requirement section of this Opinion. The Commission rejects the suggestion that the contingency should be applied selectively among subclasses.

d. Cost Support

[5645] Witness Taufique, who presents the Service's rate proposals for Periodicals, relies on costs from witness Kashani (USPS-T-14); volumes from witnesses Tolley and Thress (USPS-T-6 and T-7); distance-related transportation cost proportions developed by witness Pickett (USPS-T-19), and fee estimates from witness Mayes (USPS-T-32).

[5646] In the worksharing area, witness Crum (USPS-T-27) provides cost savings estimates for the proposed destination entry discounts. Witnesses Yacobucci, Daniel, and Miller provide cost savings estimates for the presort, barcode, high density and saturation discounts (USPS-T-25, T-28, and T-24, respectively.) Proposed changes to Yacobucci's flats flow model (which applies to Periodicals, First-Class Mail and Standard A) are discussed in this section of the Opinion. The Daniel study of carrier delivery costs for letters, flats and parcels in First-Class Mail and Standard A, is also relied on by the Service, in part, to identify delivery costs for flats in Periodicals. This study and witness Crum's estimates are also discussed. There is no controversy on the use of the Daniel study of the costs for high density and saturation mail in Standard A which is used for those low volume categories in Periodicals. Similarly, Miller's letter presort cost study, which analyzes First-Class Mail and Standard A, is applied by the Service to the small number of letters in Periodicals.

[5647] *The Yacobucci model.* Witness Yacobucci's model (USPS-LR-I-90) focuses on the flow of flats and bundles of flats through mail processing facilities. It recognizes types of containers, machinability, and automation compatibility. It develops costs by presort level for barcoded and non-barcoded pieces. An underlying assumption – critical to all cost levels – is that the bundle breakage rate is 10 percent for bundles both on

pallets and in sacks each time they are sorted. This assumption is based on a survey of postal managers.

[5648] Witness Stralberg, on behalf of the Publishing Mailers, proposes several adjustments to Yacobucci's model. First, in place of the common bundle breakage assumption for pallet and sacks, he uses separate bundle breakage rates for each type of container. He derives these alternative rates from an MTAC Package Integrity Work Group study, which provides separate breakage rates for Periodicals and for Standard A, and further separates these into rates for bundles in sacks and for bundles on pallets.

[5649] The MTAC study also divided problem bundles into those that were broken when observed and those that were not broken, but were "suspect" because of damage that had already occurred. Stralberg assumes the MTAC breakage rates on the first sort, assumes that the "suspect" bundles broke on the second sort, and then assumes no more breakage.

[5650] Stralberg also introduces a variable to control the number of pieces from broken bundles that are sorted on small parcel and bundle sorters (SPBSs) instead of on flat sorting machines (FSMs). In response to Order No. 1294, Stralberg updates the model for FY 1999 costs. MPA-LR-14.

[5651] *Extent of Commission reliance on cost studies.* The Postal Service has not sponsored testimony on any aspect of the changes, technical or otherwise, that Stralberg makes to the Yacobucci model. On brief, it points favorably toward the model as originally filed, and does not mention Stralberg. Postal Service Brief at VII-155. In its reply brief, it argues that the average bundle breakage rates in the MTAC study relied on by Stralberg are roughly the same as the 10 percent rates assumed by witness Yacobucci, and that the use of the average "does not 'introduce new non-presortation-related bias into cost differences between rate categories'." Postal Service Reply Brief at VI-56, citing Tr. 5/1441. A bias was suggested by witness Stralberg. Tr. 24/11391.

[5652] The Commission has reviewed both models. It accepts the modified version presented by witness Stralberg for purposes of estimating test year cost avoidances.¹²⁸²

Since there are significant differences in the proportion of sacks to pallets in Periodicals and Standard A, using average rates is not adequate. Also, Stralberg's recognition of suspect bundles is an improvement, as is his model's ability to control the proportion of pieces from broken bundles sorted on flat sorters instead of SPBSs. Both refinements appear to be a better reflection of operational realities.

[5653] Witness Yacobucci's observation about non-presortation bias was included in a response to an interrogatory asking about the effect on presort discounts of recognizing that, according to the MTAC study, the breakage rates for bundles in sacks is as much as 15 to 31 times the breakage rate for bundles on pallets. Neither the nature nor the size of the bias is explained on the record. The Commission's preference for Stralberg's modifications is not based on any conclusion regarding bias in cost differences in the original model.

[5654] In supplemental testimony, witness Stralberg updated his model to accommodate FY 1999 costing results, although his update was limited to the costs for Periodicals. Tr .38/17066. The Commission has further updated the model to reflect FY 1999 costs for all classes, and for Commission costing.¹²⁹

[5655] *The Daniel carrier delivery cost model.* There is no opposition or discussion on the record concerning witness Daniel's carrier cost model; however, certain features of the model and its use were clarified in response to several P.O. Information Requests.¹³⁰ The Commission has reviewed Daniel's carrier model, and finds that it is an

¹²⁸ The Commission notes that either model can be used to estimate the savings from a reduction in bundle breakage rates. This is done by running the models under different breakage assumptions and multiplying the difference in the cost outputs by the test year after rates volume levels. The total dollars of test year costs avoided due to reductions in bundle breakage will be smaller using the original Yacobucci model instead of the model as modified by Stralberg. The Commission will use the more conservative (smaller) reductions in bundle breakage estimates produced by the original Yacobucci model, updated to FY 1999 and to Commission costing results.

¹²⁹ In Commission Library Reference 14, the model is labeled PRC-Flat-Yac.xls. The 'Data' sheet has been updated for the labor rate, the premium pay factors, and the piggyback factors. The 'CRA Cost Pools' sheet has been updated with all Commission costs. The volume variability factors on the 'Productivities' sheet have also been updated. Note that in order to obtain the desired costing results, this model must be run separately for each subclass.

improvement over previous models.¹³¹ The Commission has updated it for F Y1999 costs and for Commission costing.

[5656] *Witness Crum's dropship study.* Studies supporting the sectional center facility (SCF) and destination delivery unit (DDU) dropship savings for Periodicals were performed by witness Crum, who analyzes Regular and Nonprofit separately. Witness Stralberg proposes an improvement to these models to account for the operational practice that mail delivered to DDUs is unloaded by mailers rather than the Postal Service. Tr. 24/11403-05. The Service does not oppose this change. Postal Service Brief at VI-146.

[5657] The Commission accepts the dropship models, with Stralberg's revisions. They have been updated for Commission costing. This entails updates to the test year hourly wage rate, premium pay, and piggyback factors. It also entails using the density (in pieces per pound) from the hybrid billing determinants and the Commission's variability factors.

3. Outside County Subclass

a. Merger Implementing New Legislation

[5658] The Service's proposal anticipates passage of a statutory amendment that would allow merger of the Nonprofit and Classroom subclasses with Regular, thereby forming a combined "Outside County" subclass. The new subclass would have one set of rates, with the preferred nature of Nonprofit and Classroom recognized through a "bottom-line discount" of 5 percent on total postage, excluding postage for advertising pounds. USPS-T-38 at 3-4.

¹³⁰ See responses to P.O. Information Request No. 6, question 4 at Tr. 46D21126; P.O. Information Request No. 7, questions 3 and 4 at Tr. 46D21128-29; P.O. Information Request No. 11, questions 1 and 2 at Tr. 46D21130-32; and P.O. Information Request No. 13, questions 3-5 at Tr. 46D21133-38.

¹³¹ Daniel's agreement that certain of her findings do not apply to Periodicals has no bearing on the Commission's assessment of her model, but assists in developing appropriate cost avoidances.

[5659] *Rationale for the merger.* Under the RFRA, the markup for the Regular subclass is determined on the basis of the cost coverage criteria in 39 U.S.C. § 3622(b). This then serves as the benchmark coverage for the three preferred subclasses (Nonprofit, Classroom, and Within County), which are given markups set at one-half this amount. Taufique indicates that one apparent goal of this approach is to keep preferred rates lower than Regular, while providing some contribution to institutional costs. However, he says:

This goal was not entirely met by the recommended rates resulting from Docket No. R97-1 These rates, in some instances, provided lower postage for preferred publications when the Regular rate schedule was used While no Nonprofit or Classroom rate cells were higher than the corresponding rate cell in the Regular schedule, a combination of rate cells with certain discounts produced this anomaly. Only in some instances when Regular rates are combined with some relatively large Regular discounts, a preferred mailer may pay lower postage using the Regular schedule rather than the preferred rate schedule.

Id. at 2.

[5660] Taufique says this led to the filing of the Periodicals Classification Change case (Docket No. MC99-3) and an ensuing Commission recommendation that provides Nonprofit and Classroom mailers with the option of using the Regular rate schedule, if these rates are lower. *Id.* at 2-3. He states that the Service had hoped to be able to propose Nonprofit and Classroom rates uniformly lower than Regular rates in this case, but application of the statutory formula will not keep preferred postage below Regular in all instances, especially given the low markup for Periodicals. *Ibid.* He suggests that this may not have been envisioned when RFRA was enacted, given that the benchmark markups prior to its passage ranged from 23 to 25 percent, and thus provided a “buffer.” *Id.* at 3. Taufique points out that circumstances have changed substantially, as evidenced in the Docket No. R97-1 outcome and in this case.

[5661] Thus, Taufique says cost trends and the proposed low markup for Periodicals—proposed to be 1.45 percent in this case—will keep the rate anomaly issue

alive, barring a change in RFRA. *Ibid.* He asserts that legislative change is the only certain way to avoid rate anomalies in current and future proceedings. He notes that under the terms the Service has proposed, postage for Nonprofit and Classroom, by definition, would be lower than Regular. He says this is appropriate, given they are preferred classifications. He also says that Nonprofit and Classroom are not believed to have different cost causing characteristics compared to Regular mail of the same profile.

[5662] Taufique contends the combined subclass as a whole will cover its costs and provide a contribution “deemed reasonable” for Periodicals based on the pricing criteria. The proposed combination, which results in two subclasses rather than four, would simplify, consolidate, and provide stability in Periodicals volume and cost estimates. He indicates that for ratemaking purposes, the Service intends to combine data for Regular, Nonprofit and Classroom for the subclass. Thus the statistical systems will become more reliable under the merger, with volumes and costs for the new subclass attaining greater stability. *Id.* at 4.

[5663] *Consistency with classification criteria.* Section 3623(c) of title 39, U.S. Code sets out the criteria for classification changes. Taufique reviews the Service’s proposed merger in terms of these criteria, and concludes that it is consistent with them. With respect to fairness and equity, he notes that Nonprofit and Classroom rate categories pay the same rates as their Regular counterpart for worksharing activities, but receive a discount in recognition of their preferred status. *Id.* at 15. He indicates that discovery of a rate anomaly following Docket No. R97-1 and the expectation that such anomalies would persist point to the desirability and justification for the type of change proposed here. Taufique further notes that the combined subclass permits more stable cost data to be used, a desirable result from the point of view of both Periodicals mailers and the Postal Service, thereby fulfilling the requirements of criteria 2 and 5. *Id.* at 15-16. Taufique says the Service makes no distinction between Regular, Nonprofit and Classroom Periodicals in terms of degree of reliability and speed of delivery, which are relevant considerations under criteria 3 and 4. *Id.* at 16.

[5664] *Participants' positions.* The Alliance of Nonprofit Mailers (ANM), American Business Media (ABM), Magazine Publishers Association, as well as Consumers Union, specifically express their support for merger legislation. Tr .24/11036 (Milani). The Periodicals Mailers express vehement opposition to the size of the rate increase proposed by the Service, but not to the merger. The Classroom Publishers Association (CPA) and the Coalition of Religious Press Associations (CRPA) take issue with various aspects of the legislation.

[5665] CPA contends that a 5 percent discount is inadequate, given that Congress established the statutory "classroom" rate at 60 percent of the Regular Rate in 1962, and that this differential was maintained until 1996. CPA Brief at 4. It asserts that a 25 percent discount is more reasonable, and notes that it proposed an amendment to S. 2686 that reflects this amount. *Id.* at 5 and 9. CPA also contends that the proposed merger would introduce structural and legal problems, and may be counterproductive. *Id.* at 7. It sees no logic in the combination, except for using the joint sampling data "as an expedient financial cost measurement tool until a better and more accurate sampling system or approach can be implemented." *Id.* at 8.

[5666] Further, CPA says classroom publications are usually bundled, palletized or sacked to 5-digit ZIP Codes or carrier routes going directly to their destinations. *Id.* at 8. It says most classroom publishers exercise all possible worksharing opportunities, which produces considerable savings for the Postal Service, and differentiates them from the typical Nonprofit Periodical mailing.

[5667] CRPA asserts that the rate anomaly situation that the Service uses as a rationale for the merger has occurred "because USPS has an irrational costing system for periodicals which produces irrational results . . ." CRPA Brief at 8. It contends that if the alleged flaw in attributable costs were corrected, the anomaly would no longer exist, and there would be no reason not to maintain separate subclasses. *Ibid.* CRPA also says that Nonprofit publications "would pay exorbitant and inequitable rates under either a unitary Periodicals Class rate schedule, with a 5 percent discount for nonprofit

publications, or under a schedule which maintains separate regular and nonprofit subclasses . . .” *Ibid.*

[5668] If the proposed revision to RFRA is enacted and if the Commission makes substantial reductions in Periodicals costs, CRPA asks the Commission to “seriously consider whether or not it is in the public interest” to merge Nonprofit and Classroom with Regular Periodicals. *Id.* at 9.

[5669] *Commission recommendation.* The Commission finds that the Service’s proposed merger of the Regular, Nonprofit, and Classroom into a new subclass identified as “Outside County” is consistent with the newly-enacted legislation.¹³² It acknowledges the concerns CRPA and CPA have raised regarding a merger. To the extent these concerns are directed at the inadequacy of a 5 percent discount, the Commission has no flexibility under the terms of the legislation. To the extent they run to other concerns, the Commission believes the merger poses no material legal or structural problems. Moreover, it notes that the conference report accompanying S. 2686 indicates that the Service is to continue to monitor Classroom rates. In addition, the report states: “The Postal Service is urged to examine available options to help ensure that postal rates for classroom periodicals and teacher guides remain at a price that ensures their availability and affordability to all classrooms.” Report of the Senate Committee on Governmental Affairs, to Accompany S. 2686 at 3 (S. Rep. No. 106-468) (2000). In general, the Commission adopts Taufique’s assessment of the proposal’s consistency with the classification criteria.

b. Rate Design

[5670] *Introduction.* Rate design questions often arise when subclasses are merged. In this case, which involves the merger of Regular, Nonprofit, and Classroom Periodicals, several difficult issues must be faced. What proportion of the revenue of the

¹³² Notwithstanding its name, the new subclass will contain some mail whose office of original entry, office of direct entry, and location of final delivery are in the same county.

joint subclass should come from the piece rates, as opposed to the pound rates? On what basis should the pound rate differences between the zones be developed?¹³³ How should the worksharing discounts for the joint subclass be determined? How should the per-piece editorial discount of the joint subclass be determined?

[5671] Taufique says the proposed rate design for the new subclass remains “essentially unchanged” from the Commission’s recommended methodology in Docket No. R97-1. USPS-T-38 at 7. The only difference is that the rates are designed for the combined subclass using combined billing determinants, and a cost coverage 101.45 percent is applied to combined costs. It is the Service’s position that rates for the combined subclass should be developed using the cost avoidances and the rate design conventions of the existing Regular subclass. This approach seeks to neutralize the effect of the merger on Regular mailers. Differences from past practice relate to the development of the dropshipping discounts and to the level of the per-piece editorial discount. No participant challenges the rate design incorporated in the Service’s proposed rates.

[5672] The Commission agrees that Regular subclass mailers should not be harmed by the merger; thus, the Service’s rate development, in many respects, is an appropriate response to several of the questions posed by the merger. However, because separate cost results will not be available in future cases and because of an interest in basing rates on actual costs incurred, the Commission finds it preferable to base the discounts on weighted averages of the merged subclasses.

[5673] *Proportion of revenue generated from pound and piece rates.* An initial question relates to the proportions of revenue to be generated from the subclass’s two basic structural elements. Under the proposed design, the pound-piece split is 40 percent-60 percent, as in current rates for the Regular subclass. Based on this split, the Service’s pound rate development follows the traditional approach, with the editorial

¹³³ Except to outline the procedures used, witness Taufique does not address these issues in his testimony. In response to P.O. Information Request No. 1, question 7 (February 4, 2000), however, he makes the Service’s position clear. Tr. 46D/21829.

pound rate set at 75 percent of the zone 1 and 2 rate. Science of Agriculture DDU, DSCF, and zone 1 and 2 rates are set at 75 percent of corresponding rates for advertising pounds, as required by RFRA. *Id.* at 7-9.

[5674] *Discussion.* As indicated, witness Taufique proposes to apply the 40-percent figure (from Regular) to the joint subclass, which has a per-piece weight of 7.3 ounces. The per-piece weights of the formerly independent components, however, are quite different. Specifically, the per-piece weight in Regular is 8.2 ounces and in Nonprofit is 4.5 ounces.

[5675] For any cost based set of rates, the proportion of the revenue obtained from the pound rate increases as the weight per piece increases. If rates for Regular mailers are to be cost based, the proportion of revenue from the pound rates for the joint subclass should be a weighted average of the current 40-percent proportions for Regular and the current 30-percent proportion for Nonprofit and Classroom. This moves the proportion of revenue from the pound rates in the direction of the findings of the weight study witness Daniel presents in USPS-LR-I-93.

[5676] There is a further consideration, though, that needs to be recognized. The weight per piece of the Regular subclass in Docket No. R97-1 was 7.4 ounces. The 8.2-ounce figure in this case, then, represents an increase of 19 percent. Ordinarily, an increase in the weight per piece should lead to an increase in the proportion of the revenue from the pound rates. As one would expect then, using a weighted average of the 40-percent and the 30-percent proportions results in significantly lower increases in the pound rates than in the piece rates. Therefore, in order to move toward costs, and to balance the sizes of the rate increases, the Commission is obtaining 40 percent of the joint revenue from the pound rates and 60 percent from the piece rates.

[5677] *Editorial per-piece benefit.* The current editorial benefit for Regular is 5.9 cents per piece. As explained in response to P.O. Information Request No.2, question 3, Taufique proposes increasing this by an amount equal to two percentage points below the average percentage increase for the joint subclass, before the 5 percent

discount to the preferred categories, to balance the rate increases experienced by various mailers. Tr. 46D/21839.

[5678] *Discussion.* Unless this method is used to modify an imbalance caused by another factor, the Commission does not consider the two-percentage-point reduction appropriate. Absent other influences, this reduction will tend to cause higher rate increases for editorial material than for advertising. Therefore, the Commission recommends rates developed by increasing the current figure of 5.9 cents by the percentage increase experienced by the Regular mailers as a result of the jointly developed rates. This results in a per-piece discount of 6.5 cents.

[5679] In connection with the decision to base the per-piece editorial discount on the current discount for Regular, a weighting effect occurs. The Regular subclass has 36.3 percent advertising (weighted on a per-piece basis), while Nonprofit has 16.3 percent. Regular, therefore, has more advertising over which to spread the per-piece editorial discount. This means that for a given discount, only a moderate elevation in the advertising rates is needed to absorb the editorial discount. In Nonprofit, on the other hand, much less advertising is available and the rates for the advertising must be increased by a greater amount in order to finance the same editorial discount.

[5680] When the subclasses are combined, there is less advertising, proportionately, than Regular considered alone. Therefore, the joint advertising rate will be higher than for Regular alone, resulting in a slight elevation in all rates (assuming the same editorial per-piece discount).

[5681] *Dropshipping discounts.* Dropshipping discounts (for DDU and DSCF entry) are based on transportation costs and on the non-transportation savings identified in witness Crum's study. Taufique proposes allocating transportation cost savings on the same basis as now, but changes the allocation of non-transportation cost savings from the current 50/50 split to 70 percent piece related and 30 percent pound related. USPS-T-38 at 9 (revised).

[5682] The rationale for this change is that the new split will provide a more meaningful discount to mailers who provide their own transportation. *Id.* at 9-10 (citing

Docket No. MC95-1). Taufique notes that on the pound side, the value of this discount diminishes because less than half of all pounds actually pay the zoned advertising rates. Therefore, he contends that the piece discount provides a more efficient vehicle for providing dropship incentives because the value of the discount applies to every piece, regardless of the editorial and advertising proportions. *Id.* at 10.

[5683] *Discussion.* Witness Crum's cost study shows that the savings per pound are almost the same for Regular and Nonprofit, even though the weight per piece of Regular is 8.2 ounces and of Nonprofit is only 4.5 ounces. In response to a Presiding Officer's Information Request asking whether this means the savings tend to be pound oriented, as the Service had argued in Docket No. R90-1, Taufique explained that the savings are per container and that the near equality of savings could mean that Nonprofit and Regular containers weigh approximately the same. P.O. Information Request No. 2, question 2. Tr. 46D/21836-37.

[5684] It would seem, however, that if the savings are the same for a container with many light-weight pieces as for a container holding fewer heavy-weight pieces, then the savings are, in fact, pound oriented. If, under these conditions, the discount is given on a per-piece basis, the container with many lightweight pieces will receive a discount larger than the Postal Service's savings and the container with fewer heavy-weight pieces will receive a discount smaller than the savings. The incentive thus provided would be for mailers of lightweight pieces to dropship and receive an excessive discount.

[5685] The Commission appreciates that the effective passthrough of a discount on the pound rates is reduced by the unzoned editorial pound rate, but this is a necessary outcome of the decision not to zone editorial rates. It is not appropriate to try to overcome this effect by providing a discount that is not cost based, and gives inappropriate incentives. Therefore, the Commission recommends rates that continue to give 50 percent of the non-transportation discount on a piece basis. For the joint subclass, the dropship savings of Regular are recognized on a savings per-pound basis (which are only 0.17 cents per pound higher than the savings for Nonprofit). The savings per pound are converted to a piece basis using the joint density.

[5686] *Piece rates.* The Service's proposed piece rates are based on the Yacobucci, Daniel and Miller studies. Specifically, the presort discounts and the automation discounts for flats are developed based on mail processing costs for Periodicals flats, and delivery costs drawn from Daniel's estimates for Standard A. USPS-T-38 at 11, citing USPS-T-25 at 4 (Table II-2); USPS-T-28 at 26 (Table 5). The Carrier Route High Density and Saturation rates are developed using Daniel's estimates for the Standard A ECR subclass. *Ibid.*, citing USPS-T-28 at 29 (Table 7). Miller's cost estimates for Standard A letters are used to set discounts for automated letters based on both shape differential and barcode. *Ibid.*, citing USPS-T-24 at 18 (Table 1).

[5687] *Presort tiers.* Taufique proposes passing through 100 percent of the estimated costs at both the 3- and 5-digit tiers, which are required presort levels in Periodicals. The 3-digit rate increases from 25.3 to 27.4 cents, for an 8.3 percent increase; the 5-digit rate goes up from 19.7 to 22.2 cents, a 12.7 percent increase. *Ibid.*

[5688] For carrier route presort, Taufique proposes to pass through 129 percent of the savings, relative to the 5-digit level. Taufique argues that this passthrough holds the increase in the carrier route piece rate, proposed to be 14.1 cents, to 15.6 percent. This is approximately 2 percentage points above the 13.4 percent overall increase for the new subclass, prior to reductions for the two preferred subclasses. *Id.* at 12. He says limiting the passthrough to 100 percent would result in an even larger increase, and he believes this should be avoided. Taufique further notes that approximately 40 percent of the mail volume of the Outside County subclass is carrier route sorted, and says the 2 point limit was designed to mitigate the combined impact on mailers affected by both the general increase for Periodicals and carrier route pieces in particular.

[5689] *Discussion.* Based on weighted average costs (which are somewhat higher than the Postal Service's costs given changes explained elsewhere in this Opinion), the Commission recommends a uniform passthrough of 95 percent of the costs at the 3-digit, the 5-digit, and the carrier route tiers. Relative to the next higher tier, the resulting discounts are 4.9 cents for 3-digit presort, 6.2 cents for 5-digit presort, and 7.8 cents for carrier route. The first two of these discounts are higher than those proposed; the carrier

route discount is somewhat smaller. These discounts preserve reasonable worksharing incentives and do not unduly alter current rate relationships.

[5690] *Automation flat (barcode) discounts.* Based on a significant decline in the value of a barcode relative to current discounts, the changing environment for flats processing, and the high rate increase faced by Periodicals mailers, Taufique applies a restriction to the barcode discounts similar to that in carrier route. He notes that this results in unconventional passthroughs. The basic automation rate for flats would increase from 24.8 cents to 28.6 cents (based on a passthrough of 109 percent); the 3-digit automation rate would increase from 21.4 to 24.7 cents (119 percent passthrough) and the 5-digit automation rate would increase from 16.8 cents to 19.4 cents (284 percent passthrough). *Id.* at 12-13. The respective discounts are 3.2, 2.7 and 2.8 cents, compared to current discounts of 4.6, 3.9 and 2.9 cents.¹³⁴ These increases are approximately 15.4 percent, or 2 percentage points above the overall 13.4 percent increase for the combined subclass. *Ibid.*

[5691] The Commission agrees with the Service that maintenance of automation incentives is important and that substantial reductions in discounts from current levels should be avoided. Also, it is important to maintain reasonable rate relationships and to recognize costs. The cost avoidance for barcoded 5-digit pieces (2.98 cents in R97-1 versus 0.65 cents in this case, at Commission costing) seems anomalous, and this has led Taufique to propose the passthrough of 284 percent.

[5692] The recommended passthroughs, applied to weighted average costs at the basic, 3-digit, and 5-digit levels are 120 percent, 112 percent, and 375 percent, respectively. This allows the barcode discount at the basic level, now 4.6 cents, to decrease only to 4.1 cents, instead of to the proposed level of 3.2 cents. Similarly, the discount at the 3-digit level decreases from 3.9 cents down only to 3.4 cents, instead of to 2.7 cents. At the 5-digit level, the recommended barcode discount is 2.4 cents. This

¹³⁴ As proposed, the barcode discount for 5-digit pieces is larger than the one for 3-digit pieces. This is counterintuitive, as 3-digit pieces receive more processing and therefore can benefit more from the automated processing allowed by the barcode.

is lower than both the current level of 2.9 cents and the proposed level of 2.8 cents. Comparing the basic level, the 3-digit level, and the 5-digit level, the discounts decline from 4.1 cents, to 3.4 cents, to 2.4 cents. This relationship is better aligned with operational realities than the proposed pattern of 3.2 cents, 2.7 cents, and 2.8 cents, as cost savings due to automation should be higher for pieces that must undergo more processing. Passthroughs of over 100 percent are recommended under exceptional circumstances, and will be revisited in future cases.

[5693] *Discussion: barcode discounts for letter-size Periodicals.* The Service takes the position in this case, as it has in the past, that the barcode discounts for letter-size Periodicals pieces (which are few in number) should be based on the savings for the barcode *plus* the difference in costs between a letter and a flat. Developed this way, letter-size pieces with barcodes effectively receive a discount for being a letter, while letter-size pieces without a barcode do not. The Commission commented on this procedure in Docket No. R97-1 and suggested that it should receive attention. PRC Op. R97-1, para. 5826. There is no indication on this record, however, that attention has been given to this problem. The difference in cost between a letter and a flat is developed in two separate cost studies, one for flats and the other on letters. It seems possible that differences in costs between cells within a given study might be more meaningful than differences in specific cells between studies. The cost difference between letters and flats in Regular is 14.2 cents; the corresponding difference in Nonprofit is only 10.7 cents. Whatever the correct level is, it is difficult to understand why there is such a large difference between the two subclasses.

[5694] Witness Taufique does not address specifically the proposed barcode discounts for letter-size pieces. At the basic, 3-digit, and 5-digit levels, current discounts, respectively, are 6.2 cents, 4.7 cents, and 3.5 cents. The corresponding proposed discounts are 5.6 cents, 4.5 cents, and 4.8 cents. The resulting pattern provides a larger discount for barcoded letter-size pieces at the 5-digit level than at the 3-digit level. As discussed above, this is counterintuitive. Taufique's passthrough at the three levels, in order, are 30 percent, 25 percent, and 25 percent. These are low because the costs

include the letter/flat cost differential. They are also consistent with the Commission's passthroughs in R97-1 of 25 percent at each level.

[5695] The Commission continues to recognize the letter/flat cost differential and supports the continued application of low passthroughs. Based on weighted average costs, the Commission recommends passthroughs of 37 percent, 32 percent, and 25 percent, at the basic, 3-digit, and 5-digit levels. These provide discounts of 6.5 cents, 5.1 cents, and 4.0 cents. The Commission's discounts are increases from current levels and maintain reasonable relationships; in addition, they continue to support the Postal Service's automation program.

[5696] Watchtower Bible and Tract Society of New York, Inc. (Watchtower), a mailer of letter-shaped Periodicals publications, objects to the Service's proposed increases for automation-compatible letter-shaped mail. It asks the Commission to retain current rates for letter-shaped Periodicals or to implement modest increases commensurate with the proposed First-Class Mail increase. Watchtower Brief at 8. Watchtower's rationale for this approach is that the physical characteristics and preparation standards of Periodicals letter-shaped mail allow it to be processed on the same automation equipment as First-Class and Standard A letter-shaped mail. *Id.* at 3-4. Therefore, it asserts that rates for Periodicals letter-shaped mail should not increase due to increased costs for processing flat-size mail, since letters are handled using entirely different mail processing equipment and processes than are flats. *Id.* at 3. It contends: "It logically follows that the same percentage of increase should apply to Periodicals letter mail as applies to First-Class and Standard A letter mail." *Id.* at 4.

[5697] The Commission's recommended rates and discounts for letter-size automation pieces provide a more favorable result than those proposed by the Postal Service. Therefore, Watchtower obtains some relief. Its interest in parity with other subclasses, however, requires consideration of factors beyond those addressed in its brief, such as service standards, average weight, and other distinctions among the subclasses.

[5698] *Other discounts.* There are several other per-piece discounts. Specifically, there are high-density discounts, saturation discounts, and discounts for DDU entry and destination SCF entry. Witness Taufique does not discuss them in detail. The destination entry discounts, however, are influenced substantially by Taufique's proposal to provide 70 percent of the savings on a per-piece basis. As discussed above, the Commission does not recommend this proportion.

[5699] The current high-density discount is 1.9 cents per piece. The Service's proposal is to increase this to 2.5 cents, which is an increase of 31.6 percent. On a passthrough of 65 percent (which was 50 percent in R97-1), the Commission recommends the 2.5-cent discount. Taufique suggests the current saturation discount of 3.7 cents, be increased to 4.3 cents. Based on a passthrough of 95 percent (which was 90 percent in R97-1), the Commission recommends the 4.3-cent discount. This is an increase of 16.2 percent.

[5700] For the per-piece discounts for DDU entry and destination SCF entry, respectively, which are currently 1.3 cents and 0.7 cents, Taufique proposes discounts of 2.1 cents and 1.2 cents, increases respectively of 61.5 percent and 71.4 percent. These are high because of the proposal to shift the discount to 70 percent on a per-piece basis. Based on a 100 percent passthrough of costs, with 50 percent being recognized on a per-piece basis, the Commission recommends discounts, in the same order, of 1.7 cents and 0.8 cents. These are increases of 30.8 percent and 14.3 percent. In Docket No. R97-1, the same passthroughs were 70 percent and 100 percent.

[5701] *Pound rate zone differences.* In the Service's proposal and in the Commission's recommendation, the transportation costs and the billing determinants are combined before the pound-rate differences among zones are developed. Under the assumption that the transportation costs on a dollars-per-pound-mile basis are the same for Regular and Nonprofit, the pound rate differences among the zones should not be affected by the merger. These differences are designed to be directly equal to the cost per pound-mile of transporting the mail from one zone to another, without a markup. The

absolute levels of the zone rates, however, will be affected somewhat, due to differences in the amount of advertising in each subclass.

[5702] While most of the zoned pound rates “fall out” from the transportation analysis and the decision to obtain 60 percent of the revenue from the pound rates, a decision must be made on the pound rate discounts for DDU and destination SCF entry. In going from zones 1 and 2 down to the destination SCF and then down to the DDU levels, the Service proposes reductions of 3.7 and 3.0 cents per pound. Based on 100 percent passthrough of the cost differences, the Commission recommends reductions, in the same order, of 4.2 cents and 4.0 cents. These discounts are, again, affected by the decision to apply 50 percent of the dropship discounts on a per-pound basis, and they provide support for mailer worksharing.

[5703] *Billing determinant issues: cost adjustment (related to worksharing) and correction.* The Commission’s acceptance of MPA witness Cohen’s proposal regarding a final cost adjustment to reflect worksharing changes identified by utilizing adjusted FY 1999 billing determinants was discussed earlier. The Commission has made the adjustments, based on the hybrid billing determinants, as suggested.

c. Cost coverage

[5704] The Service’s proposed cost coverage for the new subclass is 101.45 percent, based on witness Mayes’ assessment of the statutory pricing criteria. USPS-T-38 at 1, citing USPS-T-32. The main issue that has emerged with respect to her analysis is the likely impact on business mail users (39U.S.C. §3622(b)(4)), as nearly every Periodicals participant strongly objects that the Service’s proposal is far more severe than the Service realizes. Another issue, related to the value of service factor embodied in 39 U.S.C. § 3622(b)(2), is Professional Football Publications Association (PFPA) witness Jones’s testimony on delayed and inconsistent service experienced by PFPA members’ publications.

[5705] *Impact*. Periodicals mailers testify that the Service's proposal, in terms of individual publications, imposes double-digit increases on top of the substantial increases already incurred as a result of reclassification and Docket No. R97-1. Witness Morrow, an executive of Crain Communications Inc. appearing for participants collectively referred to as the Periodicals Mailers, says the average increase for his company's publications would be 14.76 percent, and that Cahner's would be nearly 15 percent. He also describes the impact of the proposed increase in Periodicals rates on the type of small-circulation Periodicals published by Crain, by other members of ABM, and by smaller-circulation Periodicals publishers in general. Tr.29/13545-46. He states that the increase would not be financially ruinous, but would have a significant impact, and could stifle development of new Periodical products. *Id.* at 13547.

[5706] Witness Milani, on behalf of ANM, MPA and American Business Media, describes the impact of the Service's proposed increases on Consumers Union.¹³⁵ He describes the organization's efforts to perform additional worksharing, but says despite the size and sophistication of its mailing operations, postage expenses have continually outpaced inflation in recent years. Tr. 24/11034.

[5707] In the nonprofit area, CRPA witness Stapert suggests that the increase could be as high as 21.8 percent for a high-editorial, lightweight Nonprofit publication under the proposed merger, and even higher (26.8 percent) if the merger is not effected. Tr. 30/14438. For classroom publications, CPA points to higher-than-average increases, estimating that classroom publication rates will increase by 15 percent. CPABrief at 1. Moreover, it says that this increase represents an increase of 65 to 76 percent (depending on mail characteristics) over 1996 rates. *Ibid.*

[5708] Witness Navasky, testifying on behalf of The Nation, L.P.,¹³⁶ describes The Nation's status as a journal of opinion. He notes that the most recent audit statement

¹³⁵ Consumers Union Periodical publications include *Consumer Reports* (published 13 times a year), *Zillions* (a bimonthly periodical for children) and two newsletters (*Consumer Reports on Health* and *Consumer Reports Travel Letter*. Tr. 24/11033. Milani notes that none of Consumers Union's publications accept advertising. *Ibid.* He also identifies *Consumer Reports Online* as an online edition with 421,000 paid subscribers. *Id.* at 11034.

shows 94,176 mailed subscriber copies, and 3,037 single copy newsstand sales. He says the publication uses two entry points, with copies destined for the Northeast trucked to New York City, and the rest entered into the mail stream in Harrisburg, PA, near the printer's location. He says copies are barcoded and presorted to carrier-route where possible. He notes that 11 percent of a recent representative issue was sorted to carrier route. Tr .28/13360. Witness Navasky states:

. . . we were shocked when we asked the mailing specialist at our printer for a preliminary analysis of our circulation file and the impact of the proposed rate increase. He has informed us that the new rates would mean an increase of 18.6% to The Nation, or approximately \$140,000 annually.

Id. at 13361.

[5709] Witness Navasky claims it is essentially infeasible to pass the increased postal costs on to readers and/or raise advertising rates. *Ibid.* He also says he has explored co-mailing, but has not been able to find another publisher working “with compatible deadlines or complementary business imperatives.” He summarizes: “For advertising-heavy periodicals, with circulation in the millions, the proposed new rates will cut into their profits; for journals of opinion, there are no profits to cut into. The proposed new rates could put a number of them out of business.” *Id.* at 13363.

[5710] *Cost coverage reflected in Commission's recommendation.* The Commission's recommended rates for the merged subclass reflect a cost coverage of 100.6 percent for the new Outside County subclass.¹³⁷ As with the Service's proposal, this reflects a constrained coverage to moderate the impact of the sustained, substantial underlying cost increases in this class. Additionally, this low coverage will serve to moderate disparate impacts on individual publications that might result from the

¹³⁶ Witness Navasky notes that he also appears informally on behalf of the Independent Press Association, which he describes as a community of small circulation periodicals. Tr .28/13359.

¹³⁷ After the 5 percent discount is recognized for the preferred categories, the resulting coverage for the Outside County subclass is 100.1 percent.

legislation. In general, the Commission believes that it is preferable for the class to make more than a nominal contribution to institutional costs; therefore, this coverage is not necessarily a benchmark for future cases. It does, however, allow the Commission's recommendation for the newly-combined subclass to be consistent with the requirement, in 39 U.S.C. § 3622(b)(3), that rates cover attributable costs.

[5711] The Commission's recommended rates increase significantly less than those proposed by the Postal Service, so the impact is less severe than it might otherwise have been. As to PFPA witness Jones's testimony, the Commission has considered whether service problems warrants some adjustment in cost coverage. Even if the narrow margin above the cost floor were not a consideration, the Commission does not find that the service inconsistencies apparently experienced by PFPA members justifies a cost coverage change. At the same time, the Commission is sympathetic to the concerns witness Jones raises. A more effective forum for achieving better service for individual PFPA member publications may be assistance from postal headquarters, rather than at the local level. The Commission encourages the Service to address PFPA's concerns, should these be pursued outside this rate case.

4. Within County

a. Proposal and Recommendation

[5712] The Within County subclass consists of publications that meet certain circulation restrictions and are addressed for delivery within the county (or parish) where published and entered.¹³⁸ DMCS § 423.21. The proposed increase for Within County is 8.5 percent.

¹³⁸ The total paid circulation of the issue must be less than 10,000 copies, or the number of paid copies distributed within the county of publication must be at least one more than one-half of the total paid circulation of the issue. USPS-T-38 at 13, citing DMCS § 423.21.

[5713] The Service's proposal for Within County is unaffected by the legislation. Taufique says the rates are designed to cover volume variable costs and to provide a contribution to institutional costs. Rate development is based on essentially the same inputs as for Outside County. In particular, the presort and barcode discounts are based on Nonprofit Periodicals mail processing cost savings developed by witness Yacobucci. USPS-T-38 at 13, citing USPS-T-25, at 8 Table II-3.

[5714] Taufique says the passthroughs for Within County "are by necessity" much smaller than other classes, because the cost studies for Nonprofit are not in all cases directly applicable. He also says that mitigation of a relatively large increase for Periodicals affects the choice of passthroughs in this subclass. *Id.* at 14.

[5715] *Discussion.* Several observations on distinctions between Within County and Outside County rate development are important. First, Within County rates do not recognize any difference between advertising and non-advertising matter. Second, there are no zones in the subclass, based on the presumption that nearly all of the mail is entered at the destination SCF or at a facility associated with that SCF. In other words, very little, if any, of this mail would be entered at one SCF and then transported to another for further processing and delivery. Third, as noted above, no separate cost studies are available for Within County.

[5716] Witness Taufique's workpapers show that his reliance on the Nonprofit cost studies differs in one regard from the procedure used by the Commission in Docket No. R97-1. The cost basis for the destination delivery unit (DDU) discount has traditionally had a non-transportation portion and a transportation portion. Witness Taufique does not recognize the transportation portion, which is taken as the transportation cost difference between DDU mail and SCF mail in Nonprofit. The Commission reinstates this difference in its recommended rates.

[5717] Also, witness Taufique builds the non-transportation portion of the DDU discount off the per-piece savings for Nonprofit for DDU mail relative to zones 1 and 2 mail. This raises two issues. First, the savings should be for DDU mail relative to SCF mail since, as described above, very little Within County mail is handled at two SCFs.

Second, as discussed above for Outside County Periodicals, the reliance should be on the per-pound savings measured for Nonprofit, rather than on the per-piece savings. The Commission relies on the per-pound savings for Nonprofit, focusing specifically on the difference between the DDU savings and the SCF savings. The per-piece savings are calculated by multiplying the per-pound savings by the density (in pounds per piece) of Within County mail.

[5718] In a procedure that differs from the way he handles the corresponding Outside County discount, witness Taufique recognizes all of the savings on a per-pound basis, with 46 percent passthrough, and all of the savings on a per-piece basis, with 30 percent passthrough. For the reasons that apply to Outside County Periodicals above, plus the lack of separate recognition of advertising and non-advertising in Within County, the Commission continues to recognize one-half of the savings on each basis and to select the passthroughs as a separate step.

[5719] *Rate design.* In line with the Commission's recommendation in Docket No. R97-1, witness Taufique proposes to obtain 60 percent of the Within County revenue from the piece rates and 40 percent from the pound rates. No questions concerning these proportions have been raised on the record. Also, in part to provide continuity over time and in part because the cost studies for Nonprofit do not apply directly to Within county, witness Taufique proposes that passthrough decisions for the discounts be based on recognizing costs, while tempering the effect on mailers. The Commission agrees with this approach.

[5720] The Commission's recommended Within County rates were developed by considering the cost avoidances associated with each discount, the current rates, the specific rates proposed by the Service, and the effect on mailers. In general, the Commission favors passing through worksharing savings to mailers, but this is not always possible, given other important considerations. For example, the Postal Service proposes to include the cost difference between letters and flats in the cost avoidance for barcoded letter-size pieces. This avoidance, at the 5-digit level, is 14.3 cents. Using this as a discount could easily lead to negative rates, which would be an unacceptable result.

Partly for this reason, the Commission agrees with Taufique's proposal to keep the passthrough very low for automation letters.

[5721] *Presorting and density discounts.* For the 3-digit, 5-digit, and carrier route discounts, the Commission recommends passthroughs of 20 percent, 17 percent, and 50 percent respectively. The passthroughs for high density and saturation are 42 and 52 percent, respectively. These proportions provide 3-digit, 5-digit and carrier route discounts (of 0.8 cents, 0.9 cents and 3.6 cents) that are equal to or slightly larger than those proposed. At 1.5 cents, the high density discount is one-tenth of a cent smaller than proposed. The saturation discount, at 2.1 cents, is the same as proposed. These discounts are equal to or slightly higher than the current discounts.

[5722] *Destination entry and barcode discounts.* For the DDU discount, the passthrough is 70 percent on the pound rate portion and 100 percent on the piece rate portion. The resulting discounts support worksharing activities and are larger than the current discounts. At the basic, 3-digit, and 5-digit levels, the passthroughs for barcoded letters are 39 percent, 35percent, and 27 percent. The discounts thus provided (5.1 cents, 4.5 cents, and 3.9 cents, respectively) are each larger than the avoidance without the letter/flat cost differential. For barcoded flats, passthroughs are 100 percent, 100 percent, and 325 percent. These provide discounts that decline as the presort level increases, and bear a reasonable relationship to current rates and to the proposed rates. They also support the automation program. The passthrough of 325percent for barcoded flats at the 5-digit level is equal to that proposed by the Postal Service. It is necessary to support the automation program, to provide reasonable rates, and to account for a cost result that is inexplicably low.

[5723] *Cost and volume issues.* As in past proceedings, NNA (through witnesses Heath and Elliott) raises questions about reported costs and volumes for the Within County subclass. In Docket No. R97-1, the Commission adjusted Within County volumes, citing the fact that the subclass is small, which tends to cause fluctuations over time in estimates of both costs and volumes.

[5724] In this case, NNA witness Elliott submits a survey to show that there is little support for a finding that the Within County volumes have been declining. Tr. 24/11043. The survey is a stratified random sample of newspapers drawn from a database supplied by NNA. One thousand sixteen surveys were sent out and 340 responses were received. Of these responses, only 161 provided data for both 1992 and 1998. According to Elliott, “the survey results show an increase of 3 percent in in-county volume over this 6-year period.” *Id.* at 11045.

[5725] NNA witness Heath provides additional reasons for believing that volume may not have declined. First, he notes that he has been active in NNA’s postal affairs since 1986, and has never seen another organized group appearing to defend Within County mail, nor has he encountered any other type of publication that claims to be a heavy user of this subclass. *Id.* at 10907. He believes that if there is another industry group with a strong usage pattern, another voice would have been heard. Therefore, he contends that is reasonable to assume that newspapers—particularly weekly newspapers—drive the Within County subclass. *Id.* at 10907-08.

[5726] Heath also states that, as a non-statistician, he is skeptical about the accuracy of the Revenue, Pieces and Weight (RPW) system. He points in particular to RPW’s reliance on only 25 post offices out of more 26,000 to obtain the volume data that is “blown up” to produce totals, and to the possibility that this panel is “infrequently refreshed.” *Id.* at 10908. Heath also states that he believes there is substantial reason to question the manner in which rural post office data is collected, given the results shown by NNA’s data. *Ibid.*

[5727] Heath also contends that the accuracy of certain costs cited in Postal Service witness Patelunas’s supplemental testimony (providing F Y1999 updates) should be treated with skepticism, and that adjustments should be considered before using them to develop Within County rates. Tr. 43/18508. Heath’s focus is cost segments 3.1 and 6.1, but he says much of his concern could be applied to other segments as well. *Id.* at 18509. With respect to cost segment 3.1, which represents

clerk and mail handler costs, Heath notes that NNA has questioned the accuracy of these costs in the past.

[5728] *Discussion.* NNA's effort to provide sound statistical data from a professional survey is commendable, but certain aspects of the survey's design and execution mar its usefulness as an analytical tool. For example, the survey has a number of very wide confidence intervals and a coefficient of variation of nearly 300 percent. Tr. 24/11088. Certain other weaknesses are summarized in the Postal Service Brief at III-15.

[5729] In addition, the record shows that the Postal Service's data systems have been improved since NNA initially raised doubts about their validity. *Id.* at III-14. Thus, the Commission finds less reason to believe that there are significant problems with reported Within County volumes. However, the reported volume for this subclass remain unstable. To allow for the possibility that there is still some failure to capture Within County volume in its entirety, the Commission is continuing the approach it employed in Docket No. R97-1: namely, using a four-year average of volumes.

b. Eligibility for Destination Delivery Unit Discount

[5730] NNA witness Heath presents a revised version of a proposal raised in previous dockets pertaining to Within County Periodicals delivered by the mailer to the destination delivery unit (DDU) under the Exceptional Dispatch arrangements. He again contends that such copies should be eligible for the DDU discount. Tr.24 /10914-18. See *also* Docket No. R97-1, paras. 5870-5873 and Docket No. MC95-1, para.5308. Previously, the Service has objected to allowing the discount based on concerns relating to acceptance, verification, and payment arrangements. In Docket No. R97-1, however, the Service explained that these mailers could achieve the DDU discount by entering their mail through Plant Verified Drop Ship (PVDS) procedures. The Commission noted this possibility and strongly encouraged use of this alternative. PRC Op. R97-1, paras. 5877-5881.

[5731] In this proceeding, witness Heath explains a number of reasons why the PVDS procedures are not working well for Within County mailers. Tr. 24/10917. He also identifies the new conditions NNA proposes attaching to eligibility. These include postmaster authorization to meet time-sensitivity needs; a 100-mile limit on length of haul from the entry office to destination office or zones 1 and 2 short hauls; and a 2 percent limit on volume fluctuation from issue to issue. *Id.* at 10916-17. NNA witness Elliott proposes applying Postal Service witness Crum's DDU cost study to Exceptional Dispatch mailings.¹³⁹ *Id.* at 11048.

[5732] In witness Taufique's rebuttal testimony, (USPS-RT-25) the Service agrees in principle with the Heath proposal, but suggests several revisions. It also suggests that the proposal be implemented without a formal classification change, through changes in the Domestic Mail Manual (DMM), following publication of a *Federal Register* notice. The Service-proposed changes to NNA's proposal include extension of the arrangement to all Periodicals mailers, not just Within County mailers; limitation on use of the option to zones 1 and 2 mail; and a restriction on eligibility to mailers with circulations of 25,000 and under, unless specifically approved as an exception by the Postmaster. All existing restrictions on DDU entry would have to be satisfied as well.

[5733] The Service says these changes reduce the risk of existing PVDS customers increasing operational difficulties by bypassing routine verification and shifting to exceptional dispatch. Witness Taufique suggests that the amount of mail using this discount would likely be small, and thus that the revenue loss would be negligible. This expectation is supported further by the fact that the discount itself is not large.

[5734] *Discussion.* The Commission compliments the parties on proposing revisions to the original concept that appear to meet publishers' interest in recognition of worksharing efforts and the Service's legitimate concerns about impact on operations and finances. The Commission finds that the Service's proposed terms represent a fair

¹³⁹ The Commission notes that no questions have been raised in the past about the applicability of the Crum study to Exceptional Dispatch entry, at least with regard to mail processing and transportation operations. The questions raised by the Service related to administrative and control issues.

and equitable set of conditions. It also agrees that implementing the changes via the DMM appears to be an acceptable means of adopting the change.

[5735] The Commission views this as a further step in the worksharing area, which is in line with the rate setting and classification guidance in the Postal Reorganization Act. It should lead to be increased overall effectiveness of the mail service received by the mailers and the ultimate recipients. In a future proceeding, the Service and the mailers will be welcome to report on their experience with the arrangements.

5. Other Matters

a. Rate Grid Concept (MPA witness O'Brien)

[5736] Witness O'Brien, on behalf of many of the Periodicals Intervenors, presents an alternative structure, referred to as a rate grid concept, which he contends would provide incentives for more efficient mailer behavior.¹⁴⁰ He acknowledges that the detailed cost data and information needed to "cost out" the grid do not currently exist, but suggests that his approach nevertheless provides the right model for "future development of correct postal prices that will give mailers incentives to change their behavior in order to minimize combined mailer and Postal Service costs."

Tr. 24/11190.¹⁴¹

[5737] The cells in the grid reflect a spectrum ranging from what O'Brien identifies as "the least costly mail" in Periodicals—carrier route bundles on a five-digit pallet entered at the DDU—to those that would be the most costly. The latter are non-barcoded pieces in a mixed ADC bundle, in a mixed ADC sack, entered at a printing plant distant from the ultimate destination. *Ibid.*

¹⁴⁰ The grid appears at Tr. 24/11193.

¹⁴¹ O'Brien notes that ABM, CRPA and McGraw-Hill, who are identified as Periodicals Intervenors, take no position on the rate grid concept discussed in his testimony.

[5738] O'Brien says the grid has two goals. One is to reflect "the true cost" of each required processing operation. The other is to allow the Service and the Commission to send "very clear" pricing signals, based on operational efficiencies (or lack thereof), consistent with the statutory ratemaking criteria. *Ibid.*

[5739] O'Brien acknowledges three potential problems: rate complexity, relative impact, and costing. He dismisses complexity as a substantial barrier, given his belief that the vast majority of Periodicals mailers use a computer to calculate their postage. *Id.* at 11190-91. He notes that the impact issue harkens back to the "thorny issue" dealt with in Docket No. MC95-1, and acknowledges that the grid shifts rates in ways that help or hurt, depending upon level of mail preparation. In terms of costing, O'Brien says concerted efforts would be needed to refine and make more accurate the distribution of in-office costs and the mail flow models used in rate design. *Ibid.*

[5740] O'Brien asserts that the costs of more and less efficient mail need to be passed along to mailers in a manner that causes them to react and, where necessary, improve mailing practices. *Ibid.* He asserts that with the costing grid and a proper rate structure, a number of desirable industry changes would occur, such as a significant increase in DDU deliveries, co-mailing, co-palletization and dropshipping. To verify this prediction, he says "one simply needs to look at Standard A." *Ibid.* In that class, he says correct rate incentives have produced a substantial increase in dropshipping, and equipment manufacturers are now providing flat sorting machines that perform the merging needed for co-mailing. *Id.* at 11191-92.

[5741] Overall, O'Brien observes that very little change takes place without the proper financial incentives, and suggests that the rate grid approach could provide the type of rate structure that would cause desirable changes in mailing practices. *Id.* at 11192.

[5742] *Discussion.* Although adoption of the rate grid is not a formal proposal on this record, it clearly identifies specific activities in the current operating environment that affect costs. It is likely that it also offers some insight to service considerations, which are necessarily important to mailers of time-sensitive material. The grid also

demonstrates the vast changes that have occurred since the class was established. Interestingly, although not apparent from the grid itself, many of these structural changes have occurred relatively recently, with most having been introduced in the past decade.

[5743] Of the three potential problems witness O'Brien raises, two—complexity and costing—are legitimate concerns, but would appear to pose no significant barriers. Relative impact, on the other hand, is a far more challenging issue. This played a major role in reclassification decisions, as witness O'Brien acknowledges, and undoubtedly would do so again, given the logical rate implications of extensive de-averaging. This is not an insurmountable obstacle, but raises policy questions that are quite different from the more pragmatic issues associated with rate complexity and costing. The postal community's attention to the grid's policy implications may foster approaches acceptable to all stakeholders. In any case, the ramifications of specific proposals will have to be thoroughly aired before formal Commission action is possible.

b. Proposed Pallet Discount (TW witness Stralberg)

[5744] Witness Stralberg proposes a discount for Periodicals entered at sectional center facilities (SCFs) or destination delivery units (DDUs) on 5-digit pallets. Stralberg indicates that the number of 5-digit pallets at the present time is low, but contends that mail on such pallets is very low-cost, and should be encouraged. He argues that with an incentive more mailers might prepare them, and that there could be some movement toward co-palletization. Given the low number of current 5-digit pallets, Stralberg indicates that the revenue loss from the discount would be very small. *See generally* Tr. 24/11405-09.

[5745] The Postal Service argues on brief that it is premature to offer such a discount, especially since witness O'Brien has suggested a grid of other discounts that might be offered. Postal Service Brief at V-146.

[5746] *Discussion.* The Commission agrees with the Service's position that a 5-digit pallet discount should not be recommended at this time. This discount would be

useful only to a small group of the largest mailers, and there is little evidence that it would cause meaningful changes in mailer behavior. If further discounts are to be given, an assessment should be made of where potential cost savings are the largest, and of which discounts are most likely to bring about mailer response that enhances Postal Service efficiency.

E. Package Services Mail (Standard Mail (B))

[5747] The Postal Service proposes to rename Standard B Mail, which consists of Parcel Post, Bound Printed Matter, Special, and Library Mail, as Package Services mail. USPS-T-36 at 9. In addition, the Postal Service proposes to rename Special Standard Mail as Media Mail. USPS-T-37 at 1. The Postal Service requests that the Commission recommend conforming changes to the DMCS. USPS-T-36 at 10 and USPS-T-37 at 1. The Commission recommends that the DMCS be amended to reflect the proposed name changes.

1. Parcel Post Subclass

a. Introduction

[5748] Currently, Parcel Post is defined as Standard Mail weighing 16 ounces or more that is not mailed as Bound Printed Matter, Special, or Library Mail. Standard Mail is mailable matter that is neither mailed nor required to be mailed as First-Class Mail nor entered as Periodicals. In addition, Parcel Post, which is generally used to ship merchandise, may not exceed 70 pounds or 130 inches in length and girth combined. Finally, Parcel Post is the only subclass available for mailing eligible matter measuring over 108 inches but not over 130 inches in combined length and girth. Such mail is subject to the prevailing oversized rate.

[5749] The current Parcel Post rate structure, which was revised extensively in Docket No. R97-1, is based on weight, distance from origin to destination, mail preparation requirements, and machinability. The revisions, which became effective in January 1999, included: establishing three new rate categories for parcels entered at Sectional Center Facilities (SCF), Destination Delivery Units (DDU), and Origin Bulk Mail Center (OBMC), reestablishing a balloon rate for pieces weighing less than 15 pounds that exceed 84 inches, but not 108 inches, in combined length and girth, expanding

eligibility and adding a separate surcharge for oversized pieces, and establishing a discount for prebarcoded parcels. Additional, preexisting rate categories include Inter-BMC,¹⁴² Intra-BMC,¹⁴³ and Destination Bulk Mail Center (DBMC). Nonmachinable Inter-BMC mail is subject to a surcharge, currently \$1.65 per piece. Pickup service is available for Parcel Post mail.

b. RPW Parcel Post Estimates

[5750] *Background.* A preliminary, but significant issue concerning Parcel Post is the sufficiency of the Postal Service's systems for estimating revenue, pieces, and weight. For these estimates, the Postal Service relies on the Revenue, Pieces, and Weight System (RPW), which includes, among other things, the Bulk RPW (BRPW) and the Domestic RPW (DRPW) subsystems. See USPS-T-5 at 2-5, USPS-T-4 at 3-7, and Tr. 31/15021 *et seq.* The remaining RPW subsystems are the International RPW and the Miscellaneous/OMAS RPW. Tr. 31/15021; see *also* USPS-LR-I-30 at 1.

[5751] Briefly, the BRPW system provides total revenue and volume estimates for various bulk mail categories, including permit imprint Parcel Post. See USPS-T-5 at 2-3. The bulk mail categories also include presort First-Class Mail, permit imprint Priority Mail, Periodicals, Standard Mail (A), and permit imprint Bound Printed Matter. The BRPW utilizes postage statements collected from an ongoing panel of post offices consisting of all of the automated bulk mail entry offices under the PERMIT System, supplemented by a stratified random sample of non-automated offices. *Id.* at 3; see *also* Tr. 2/810-11.

[5752] The DRPW system, a continuous probability sample of single-piece mail exiting the postal system, including Parcel Post, provides estimated revenue, pieces, and weight for mail categories not corresponding exactly with the Postal Service's

¹⁴² Inter-BMC rates apply to parcels, not eligible for destination entry rates, that originate in the service area of a BMC/ASF or in Alaska, Hawaii, or Puerto Rico and that destinate outside that area.

¹⁴³ Intra-BMC rates apply to Parcel Post originating and destinating (a) in the service area of the same BMC or Associate Service Facility (ASF), (b) in the same state for Alaska and Hawaii, and (c) in the same territory for Puerto Rico.

revenue accounting system and for which data are not available from postage statements. USPS-T-4 at 4. Among the other mail categories for which DRPW estimates are available are single-piece First-Class Mail, non-permit imprint Priority Mail, non-bulk Library and Special Mail, and most Special Services. Revenue, volume, and weight estimates from the RPW subsystems are fed into the RPW Adjustment System “to develop the official U.S. Postal Service RPW data by mail class, subclass and rate class for each Accounting Period, Postal Quarter, and Government Fiscal Year.” USPS-LR-I-30 at 1; see *also* Tr. 2/759-60 and Tr. 31/15021. In other words, as indicated by witness Pafford, the RPW Adjustment System combines estimates from the BRPW and DRPW along with Alaska Bypass mail and official mail estimates to produce revenues, pieces, and weight for all categories of mail. Tr. 2/710.

[5753] Prior to FY 1999, the Postal Service’s Parcel Post revenue and volume estimates were derived exclusively from the DRPW. In FY 1999, the Postal Service changed this approach and began utilizing both the BRPW and the DRPW to develop Parcel Post estimates. The Postal Service restated FY 1998 Parcel Post revenue and volume totals based on the combined BRPW and DRPW estimates. According to Postal Service witness Prescott, the restatement was needed to facilitate comparisons to the prior year and to provide more accurate data in this proceeding. Tr. 43/18790. As compared to the FY 1998 DRPW-only Parcel Post estimates, the combined estimates increased Parcel Post volumes to approximately 316 million parcels (from approximately 266 million) and increased revenues to approximately \$948 million (from approximately \$824 million). Tr. 46-D/21543-44.

[5754] UPS, through witness Sellick’s testimony, broadly challenges the Postal Service’s restated FY 1998 Parcel Post estimates. Among his criticisms are that the Postal Service’s restated BY 1998 estimates are not adequately documented, that the BRPW process cannot be replicated, and that the BRPW Parcel Post estimates are untested and unreliable. Tr. 31/15017 *et seq.* In support of the latter point, Sellick argues, *inter alia*, that the Postal Service failed to apply a trial balance account adjustment to its 1998 Parcel Post BRPW estimates, that Parcel Post volumes are

overstated, and that the BRPW system provides insufficient weight data. Witness Sellick recommends that the Commission reject the Postal Service's combined F Y1998 BRPW/DRPW Parcel Post estimates and instead adopt the FY 1998 DRPW-only estimates for base year purposes. See UPS Brief at 66-78.

[5755] In rejoinder, the Postal Service submitted the rebuttal testimony of witness Prescott, who addresses the discrepancy in BY 1998 Parcel Post estimates and argues that Sellick's various criticisms are speculative and unsupported. See Tr. 43/18782 *et seq.* and 18800 *et seq.* PSA witness Glick also submitted rebuttal testimony criticizing Sellick's analysis of BRPW data as unpersuasive. Tr. 41/18062-69; see *also* Postal Service Reply Brief at III-13-22.

[5756] *Analysis.* Witness Sellick's testimony is commendable on several levels, including, for example, its useful review of the RPW system and its attention to the discrepancy in BY 1998 Parcel Post estimates. However, the Postal Service used FY 1999 volumes to project test year revenues, and there is no DRPW-only estimate available for FY 1999. See Tr. 46-D/21542. In response to P.O. Information Request No. 17 questions 2, 3, and 8, the Postal Service provided only the portions of the FY 1999 BRPW/DRPW Parcel Post estimates generated by the various RPW subsystems, including the DRPW. See *id.* at 21535, 21225, and 21234. Hence, as a practical matter, the Commission could not, even if so persuaded, adopt Sellick's proposal.¹⁴⁴ Nonetheless, while the Commission ultimately has not adopted his recommendation, Sellick has raised fundamental questions about the Postal Service's Parcel Post estimates, which, in the end, have led to a thorough examination of the RPW system.

¹⁴⁴ Witness Luciani's attempt to forecast FY 1999 DRPW-only estimates based on an extrapolation of the combined BRPW and DRPW data is not convincing. His forecast of FY 1999 DRPW-only quarterly Parcel Post estimates relies on the BRPW/DRPW growth rates from FY 1998 to FY 1999 as applied to FY 1998 DRPW-only estimates. Witness Luciani then substitutes his forecast estimates for the actual FY 1999 BRPW/DRPW estimates used by witness Tolley to derive his forecast test year volumes. The propriety of using the BRPW/DRPW quarterly growth rates in connection with an attempt to forecast DRPW-only estimates has not been demonstrated. In any event, given its conclusion regarding the sufficiency of the BRPW Parcel Post estimates, the Commission finds UPS's DRPW-only estimates are unnecessary.

[5757] That process began by exploring the reasons for the discrepancy. When asked why the DRPW was undercounting Parcel Post volume, the Postal Service indicated that data collection, as opposed to sample design, data processing, or data estimation, was the cause of the problem. Tr. 46-C/21031. In support, the Postal Service stated that data collectors were incorrectly treating all permit imprint Standard Mail (B) as non-countable in the DRPW system. *Ibid.* Other factors cited by the Postal Service included data collectors' failure to sample certain Parcel Post, e.g., volumes endorsed "Bulk," or pieces weighing less than one pound that might be misidentified as Standard Mail (A). *Ibid.*

[5758] The Postal Service explored the discrepancy in greater depth in the rebuttal testimony of Prescott. See Tr. 43/18782 *et seq.* and 18800 *et seq.* Responding to Sellick's contentions, Prescott outlined the steps the Postal Service pursued to validate the BRPW data and to identify the reasons for the discrepancy. *Id.* at 18792-94. Noting that the discrepancy surfaced late in FY 1997, the Postal Service considered two possible causes: (a) whether DBMC parcels were being properly endorsed, and (b) whether the DRPW panel reflected the PQ 1 FY 1998 update to include all CAG C offices. In addition, the Postal Service reviewed whether the PERMIT System data were being summarized correctly in the Corporate Business Customer Information System (CBCIS). To address these concerns, the Postal Service conducted various analyses or studies, which, as outlined by Prescott, concluded that: (a) DBMC volumes were being properly endorsed, (b) PQ 1 FY 1998 sampling improvements did not significantly affect DRPW parcel Post data, (c) the roll-up of PERMIT transaction level data through CBCIS to the BRPW input file revealed no material errors, and (d) comparisons with the Origin Destination Information System (ODIS) correlated well with the PERMIT system data. *Id.* at 18793. Finally, conferences with Statistical Program managers and data collectors corroborated the belief that data collection was the root cause of the discrepancy. *Id.*

[5759] Simultaneously, the Postal Service designed and tested a BRPW module for permit imprint Parcel Post. The Postal Service also measured the volume of permit imprint Parcel Post entered at non-PERMIT System offices, enabling it to assess the

need for a supplemental BRPW panel. Only thereafter, beginning in PQ 1 FY 1999, did the Postal Service use PERMIT System data to generate Parcel Post permit imprint estimates. *Id.* at 18793-94.

[5760] The Commission's concern with the discrepancy is simple – the Postal Service's estimation systems, which underlay the ratemaking process, must produce accurate, reliable estimates if the rates the Commission recommends are to be fair and equitable.¹⁴⁵ The Commission concludes that the Postal Service's explanation of the cause of the discrepancy in BY 1998 Parcel Post data is plausible. Based on the record, the discrepancy is not due to a systemic problem with either the BRPW or DRPW, but rather, as indicated by the Postal Service, to data collection errors in the DRPW. See Postal Service Reply Brief at III-15-16; see *also* PSA Brief at 19-21. Furthermore, as discussed below, the record supports the conclusion that the BRPW/DRPW estimation methodology represents an improvement over the DRPW-only procedures.

[5761] UPS advances several arguments that the Postal Service's Parcel Post volume estimates are overstated. Each is flawed. First, UPS argues that the PERMIT System incorrectly counts some Standard Mail (A) parcels as Parcel Post. Tr. 37/16957-58; see *also* UPS Brief at 67-70. In support, UPS notes that Single-Piece Standard Mail (A) rates were, for certain ounce increments, higher than those for Parcel Post during FY 1998 and part of FY1999. As a consequence, citing the volume of Single-Piece Standard Mail (A) in those years, UPS contends that BRPW Parcel Post estimates are inflated. UPS Brief at 67-68. While unable to quantify the overstatement, UPS suggests that it may be substantial. This conclusion is not adequately supported.

[5762] As PSA points out, single-piece parcels are generally not permit imprint and thus would generally be counted by DRPW, not BRPW. PSA Brief at 17. Moreover, the issue became moot following the elimination of single-piece Standard Mail (A) in January 1999. *Ibid.*; see *also* Postal Service Reply Brief at III-16-17. Furthermore, the Postal

¹⁴⁵ PSA complains that inaccurate data in Docket No. R97-1 caused the Commission to recommend higher Parcel Post rates than it otherwise would have. The Commission declines to speculate on what might have been. In every proceeding, however, the Commission's recommendations are based on the underlying record.

Service required Standard Mail (A) paid at Standard Mail (B) rates to be marked as Standard Mail (B). *Ibid.*; see also Tr. 43/18804.

[5763] Second, UPS argues that DRPW data collectors fail to accurately distinguish between permit imprint and other indicia mail, thereby causing permit imprint volumes to be double counted. See UPS Brief at 77. While this conclusion may have superficial appeal, it, too, fails for lack of support. As witness Glick notes, if witness Sellick's premise is accurate, then the reverse would also be possible, *i.e.*, that metered mail would be incorrectly categorized as permit imprint pieces, and thus not be counted by DRPW or BRPW. Tr. 41/18067-68; PSA Brief at 18-19; Postal Service Reply Brief at III-22.

[5764] Further, characterizing witness Sellick's testimony as speculative and without evidentiary support, Postal Service witness Prescott suggests that "there is no reason to conclude DRPW data collectors cannot distinguish between a permit imprint and a stamp or meter." Tr.43/18796. PSA gives some credence to this position, noting that the task of distinguishing between a permit imprint and meter mail is relatively easy. PSA Brief at 18-19. While the acknowledged data collection errors associated with DRPW-only FY 1998 estimates cast some doubt on data collectors' abilities, Prescott is correct in this respect -- the record fails to demonstrate that double counting is a problem, let alone the extent of the problem, if any.

[5765] Third, although apparently not addressed by UPS on brief, witness Sellick contends that volumes reported in the Carrier Cost System, comprised of the City Carrier Cost System and the Rural Carrier Cost System, corroborate the DRPW-only results. However, as pointed out in rebuttal and on cross-examination, this contention rests on an incomplete analysis. Witness Sellick failed to include mail delivered to firm holdouts and box sections. See Tr. 43/18805-06 and Tr. 37/16977-85; see also PSA Brief at 21. Thus, far from demonstrating the reasonableness of the DRPW-only estimates, the omission lends support to the Postal Service's estimates.

[5766] Fourth, on brief, UPS contends that the PERMIT System data are inaccurate. UPS Brief at 70-75. For example, UPS argues that the Postal Service failed

to apply a trial balance account adjustment to its 1998 Parcel Post BRPW estimates. Although this is true, it does not necessarily follow that DRPW-only estimates are more accurate. Nor has UPS shown them to be. Again, the use of 1999 data effectively moots this criticism.

[5767] The Postal Service implemented a unique trial balance for FY 1999. Witness Sellick criticizes the Postal Service's use of an "interim" factor for PQs 1 and 2 as inappropriate. Tr.37/16960. The unique trial balance adjustment factors for PQs 3 and 4 were substantially higher than the interim factor used for the earlier quarters. Tr. 46-C/21232. While a unique trial balance adjustment factor is always preferable, the use of the interim factor, under the circumstances, is acceptable since, among other things, witness Sellick was unable to suggest what the factor should be for the two quarters in question. Tr .37/16976. Moreover, use of the interim factor yields lower estimates than, for example, annualizing the unique trial balances. See Postal Service Reply Brief at III-17-19; PSA Brief at 13-15.¹⁴⁶

[5768] Fifth, citing witness Sellick's testimony, UPS argues that the BRPW error-checking process is flawed. UPS Brief at 71-72, citing Tr.1/ 15039-45. For example, UPS asserts that "Standard Mail (A) pieces could easily be mistakenly entered into the PERMIT System as Parcel Post and not be detected." UPS Brief at 71 (citation omitted). Again, without quantification, it is difficult to accept UPS's conclusion as much more than speculation. As the Postal Service points out, USPS-LR-I-279, a study undertaken by an independent accounting firm, found "no instances of error in capturing and reporting of the PERMIT System postage statement revenue and volume used in the BRPW." Postal Service Reply Brief at III-20.¹⁴⁷ In a similar vein, UPS contends that information on Form 8125 may be recorded inaccurately. UPS Brief at 73.¹⁴⁸ While this may occur, absent a demonstration of a pervasive problem, it is, as the Postal Service

¹⁴⁶ PSA urges the Commission to substitute the average of the trial adjustment factors for FY 1999 PQs 3 and 4 for the interim adjustment factor used by the Postal Service. PSA Brief at 15. The Commission declines to do so.

argues, largely “irrelevant since PERMIT System data are entered from mailing statements, not [Form] 8125s.” Postal Service Reply Brief at III-22.

[5769] Additional criticisms by witness Sellick merit brief comment. He argues that, as compared to the DRPW system, the BRPW system provides insufficient weight data, thus rendering billing determinants less accurate. Tr. 31/15041. While witness Prescott concedes the point that the PERMIT System provides less weight distribution detail, he argues that this does not mean that applying DRPW-based distribution keys to the PERMIT System-derived estimates produce inaccurate weight distributions. Tr. 43/18795-96. The Commission concurs. Moreover, BRPW, which provides near census estimates, is markedly superior to DRPW in generating volume and revenue estimates. *Ibid.*

[5770] Witness Sellick’s final criticism is that “[t]he Postal Service’s RPW results assume that BRPW provides accurate weight estimates by rate category and zone.” Tr. 37/16961-65. This criticism is essentially meaningless because, as witness Prescott notes, PERMIT System data are not used to distribute weight to rate category and zone. Tr. 43/18806-07. The PERMIT System provides total weight as a billing determinant input. *Id.* at 18807. However, base year RPW total estimates are not dependent on BRPW weight estimates by rate category and zone. Such estimates rely on BRPW

¹⁴⁷ Witness Sellick makes a related claim, apparently not pursued by UPS on brief, that disaggregated BRPW data, provided in library reference USPS-LR-I-401, cannot be reconciled with aggregated data, provided in library reference USPS-LR-I-194. Tr. 37/16955. In addition, he cites the existence of certain nonsensical records. *Id.* at 16956. The assertion that the data cannot be reconciled does not withstand scrutiny. The record demonstrates that the data in LR-I-401 closely replicate the CBCIS extract file used for the BRPW, with revenue matching to 0.000017%, volume to –0.000343%, and weight to 4.1%. Tr. 43/18802-03. While weight does not replicate as well, such data are not as critical (as revenue and volume) in the RPW Report, and, in any event, that discrepancy appears to be due largely to keystroking errors. *Id.* at 18803. In sum, the discrepancies do not materially affect the Postal Service’s permit imprint Parcel Post volume estimates contained in the RPW Report for FY 1998 or FY 1999. Similarly, the data do not support Sellick’s assertions concerning the presence of nonsensical records. Tr. 46-B/20652-53; PSA Brief at 12.

¹⁴⁸ UPS’s argument concerning Form 3605-PR is unclear, since it notes that errors are less likely with that form. UPS Brief at 72-73. Regardless, the Postal Service adequately addresses the issue of “keystroking errors.” Postal Service Reply Brief at III-21, fn. 4.

estimates for total revenue, volume, and weight, but not for the distribution of these items to rate categories and zone. *Id.* 18806.

[5771] In sum, the Postal Service's defense of its estimation systems, including its explanation of the discrepancy in base year estimates, provides sufficient confidence in the BRPW Parcel Post estimates to allay, for purposes of this proceeding, the Commission's concerns regarding the adequacy of the base year Parcel Post estimates. That conclusion is also influenced by the demonstrable superiority of PERMIT System derived Parcel Post estimates as compared to DRPW-only derived estimates. This is perhaps best illustrated by examining the reasons behind the Postal Service's decision to use the PERMIT System, beginning P Q1 FY 1999, to develop permit imprint Parcel Post estimates in the RPW.

[5772] The decision to expand the PERMIT System to include Parcel Post data was driven by three factors. First, the PERMIT System provides census or near-census estimates as compared to sample based estimates. Consequently, as compared to the DRPW, statistical variance is minimized. Second, for various reasons, *e.g.*, endorsement requirements and mail acceptance policies, DRPW data collectors are unable to record with certainty the actual revenue per piece for some categories of bulk entered mail. Indeed, the data collection errors manifest this problem. In contrast, this is not a problem under the PERMIT System, which utilizes postage statements to provide accurate per piece revenue estimates. Third, the introduction of new dropship discounts in January 1999 accelerated the need to use the PERMIT System for Parcel Post. Given the lack of a specific endorsement for each rate category, DRPW data collectors would have been unable, as a practical matter, to distinguish among the three new rate categories. Again, that problem does not arise under the PERMIT System since such data are readily available from postage statements. Thus, the Commission adopts the Postal Service's FY1999 Parcel Post estimates.¹⁴⁹

c. Postal Service Proposal

[5773] On behalf of the Postal Service, Plunkett proposes to increase Parcel Post rates, on average, by 1.3 percent. USPS-T-32 at 40; see *also* USPS-T-36 at 9 *et seq.* This increase reflects a cost coverage of 115.1 percent, which is sponsored by witness Mayes. See USPS-T-32 at 40-43. Witness Plunkett developed his proposed rates in two phases. First, the transportation costs identified by witness Eggleston were distributed to weight and zone separately for Intra-BMC, Inter-BMC, and DBMC. Witness Plunkett also proposes to continue the existing convention of including an add-on of two cents per pound to recover weight-related non-transportation costs. Estimated revenues associated with this add-on are subtracted from the non-transportation costs. The remaining costs are recovered via proposed per piece rates. USPS-T-36 at 13. Witness Plunkett indicated that his preliminary rates were designed “to establish the cost basis for rates within a given category, and to provide a preliminary estimate of the magnitude of price changes to which underlying cost data give rise prior to application of the other statutory ratemaking criteria.” Tr.13/4980. The first phase produced rate increases that, in Plunkett’s opinion, were generally excessive, although the rates for certain zones and categories would have declined. To rectify this, Plunkett imposed rate constraints in phase two. More specifically, no rate was allowed to increase more than 10 percent, and for the DSCF and DDU rate categories, no rate could change by more than two percent. USPS-T-36 at 13-14. In certain instances, narrower constraints were imposed to smooth rate relationships. *Id.* at 14.

[5774] Witness Plunkett proposes to maintain the existing rate design, except for the following changes. He proposes to eliminate the one pound minimum weight requirement for Parcel Post. In lieu of a separate rate for pieces weighing less than one

¹⁴⁹ UPS also contends that the Postal Service has overstated Parcel Post revenues because it projects an increase in OMAS and Alaska revenues while indicating that the volumes will decrease. UPS Brief at 79; see *also* Tr. 25/11787, and Tr. 38/17242. While this result appears illogical, the point is moot since the Commission’s test year revenue estimate for OMAS and Alaska is based on actual revenue in the RPW report.

pound, Plunkett proposes that the up to two-pound rate be charged. Witness Plunkett also proposes extending the non-machinability surcharge, which currently applies to Inter-BMC parcels, to parcels mailed at intra-BMC and DBMC rates. He suggests that there be three separate non-machinability surcharges. In addition, Plunkett proposes the pickup fee be increased from \$8.25 to 10.25.

d. Cost Coverage

[5775] Two witnesses propose cost coverages for Parcel Post. A third witness addresses cost coverage and, while not proposing a specific coverage, proposes that, at a minimum, Parcel Post destination entry rate categories not be increased. Postal Service witness Mayes recommends a cost coverage of 115.1 percent over volume-variable costs as estimated by the Service.¹⁵⁰ In support of her proposal, Mayes discusses how the various ratemaking criteria of the Act influenced her decision. For example, she argues that Parcel Post exhibits a low value of service (criterion 2) as demonstrated by its low intrinsic value, e.g., low delivery priority, and its low economic value of service as reflected in its relatively high own-price elasticity of above 1.0 in absolute value (-1.23). Witness Mayes asserts that the proposed increase, 1.3 percent, will neither materially effect mailers, nor preclude competitors from continuing to compete successfully (criterion 4). She also contends that the degree of mail preparation (criterion 6) is adequately recognized through the rate structure revisions adopted in Docket No. R97-1. In addition, she argues that criterion 3 is satisfied because estimated revenues, \$1,211 million, exceed estimated incremental costs, \$1,052 million. Exhibit USPS-32B at 1, revised April 21, 2000. Finally, she contends that the proposed rate level (criterion 1) is fair and equitable. USPS-T-32 at 40-43.

[5776] UPS witness Sappington recommends a 24.9 percent increase in Parcel Post rates, reflecting a cost coverage of 111 percent over attributable costs as estimated

¹⁵⁰ Exhibit USPS-32B, revised April 21, 2000, at 1; see also Tr. 11/4559-60 and Exhibit USPS-36K, revised April 17, 2000. In her prepared testimony, witness Mayes supported a cost coverage of 114.1 percent. USPS-T-32 at 40.

by UPS. Tr. 31/15260. As revised by the Supplemental Testimony of witness Luciani, UPS apparently is proposing an increase of 38 percent. Tr.38/17249; *see also* Amazon.com Reply Brief at 1-2. Witness Sappington cites five factors in support of his proposal. First, he argues that attributable costs have increased substantially, comparing test year Docket No. R97-1 estimates with his test year estimates in this proceeding. Tr. 31/15261. Second, citing data for the 1990s, he claims Parcel Post volumes and revenues “have grown substantially in recent years,” thus suggesting that Parcel Post can sustain a healthier margin than that adopted in Docket No. R97-1. *Id.* at 15261-62. Third, he contends that in FY1998 and in prior years “Parcel Post revenue seems to have failed to cover its attributable costs.” *Id.* at 15264. Fourth, he claims that features like DDU, coupled with service by a consolidator and delivery confirmation service, markedly increase the value of service of Parcel Post. Finally, he argues that if the Postal Service’s new methodology for measuring volumes is accurate, it would support a more robust cost coverage since any concerns that “a sizeable increase in rates would reduce Parcel Post volumes to unacceptably low levels” are lessened. *Id.* at 15266-67.

[5777] As noted, initially, witness Sappington proposes a rate increase of 24.9 percent, incorporating a cost coverage of 111 percent. Tr. 31/15260. Subsequently, UPS revises its suggested rate increase up to 38 percent. Tr. 38/17249. UPS continues to propose a cost coverage of 111 percent, a result that, under the circumstances, is not tenable. See UPS Brief at 57-59. To be sure, cost coverage is a matter of judgment influenced by sometimes-conflicting considerations. Nonetheless, to maintain a 111 percent cost coverage, notwithstanding that the revised rate increase is more than 50 percent greater than UPS’s original proposal, suggests a result driven more by expediency than circumstances.

[5778] On brief, UPS asserts that Parcel Post cost coverage should be increased from the Docket No. R97-1 level to 111 percent. *Ibid.* Conspicuous by its absence, however, is any mention of the specific increase proposed (38 percent) or that its coverage initially reflected a lower rate increase. UPS’s goal of increasing the cost

coverage for Parcel Post cannot be so easily divorced from the rate increase it seeks to impose. Coverage may be influenced by the rate increase proposed, and it is incumbent on the proponent to adequately support both. The Commission concludes, based on an analysis of UPS's proposal as a whole, that it has not justified its proposed rate increase. This does not mean, however, that Parcel Post cost coverage should not be increased. While, as a general matter, the Commission has rejected UPS's attempts to attribute additional costs to Parcel Post, the Commission has, nonetheless, increased Parcel Post's attributable costs above the levels proposed by the Postal Service, and based on consideration of the statutory criteria increased Parcel Post's cost coverage above recent levels and the level suggested by UPS.

[5779] The Commission's recommended rates are tempered by two additional considerations. First, in Docket No. R97-1, Parcel Post rates increased substantially more than the system average and reflected a cost coverage of 108 percent. In this proceeding, Parcel Post costs have not increased to an extent that would require an above average rate increase. Second, designing fair and equitable Parcel Post rates involves practical considerations, including intra- and inter-subclass rate relationships, which, on balance, make further adjustment to the Parcel Post cost coverage unwarranted. Attempts to increase coverage were hindered by inter-subclass rate relationships and the need to avoid illogical and unacceptable rate anomalies, e.g., Parcel Post rates above those for Priority Mail. On the other hand, the current record does not support maintaining the current coverage.

[5780] PSA witness Zimmermann contends that the Postal Service's proposed Parcel Post cost coverage is excessive. Tr. 29/14143, 14146-49. The predicate for this position is his belief that the Postal Service would not have proposed that coverage but for its error in Docket R97-1 "underestimating both revenues and volumes for Parcel Post, producing a rate increase that was five times the system-wide average increase." Tr. 29/14147. Comparing the sum of the systemwide average increase from Docket No. R97-1, 2.5 percent, and that proposed by the Postal Service in this proceeding, 6.0 percent, with the 12.3 percent recommended by the Commission in Docket No. R97-1 for

Parcel Post, Zimmermann asserts that a 4 percent decrease in Parcel Post rates would be justified. *Ibid.* see also PSA Brief at 5-6. Witness Zimmermann does not propose a specific cost coverage for Parcel Post. He does, however, conclude that the Commission should recommend no increase in Parcel Post rates and “increased discounts for Drop Ship rate categories.” *Id.* at 14149. Regarding the “Drop Ship rate categories,” elsewhere in his testimony Zimmermann recommends that the Commission “reject all increases for DBMC, and recommend larger increases in the DSCF and DDU discounts.” *Id.* at 14143.

[5781] On brief, PSA argues that the cost coverage for Parcel Post should remain at its Docket No. R97-1 level, 108 percent. PSA Brief at 7. It notes that witness Mayes adjusted her coverage from 114 percent to 115.1 percent, and concludes, therefore, that “the Postal Service has no justification for its increased coverage...” *Ibid.* This argument is not convincing. Witness Mayes explained her rationale for increasing the cost coverage, even if not the slightly higher figure. See USPS-T-32 at 40-43. PSA ignores this testimony entirely, except to note her comments concerning criterion 2. PSA Brief at 8. Consideration of one criterion is rarely dispositive of cost coverage. PSA also suggests that but for the DRPW estimation error in Docket No. R97-1 current Parcel Post rates “would be much lower,” a result that “argues in favor of a small rate increase and a low cost coverage in this proceeding.” *Id.* at 7. This claim is more about rates than cost coverage. In any event, the Commission declines to speculate what it might have done if the record in that proceeding had been different.

[5782] Upon a thorough review of the record, the Commission recommends Parcel Post rates that increase, on average, by 2.7 percent, reflecting a cost coverage of approximately 115 percent. This represents an increase over the current coverage and yields a markup index of .253, which is also above recent indices for Parcel Post. The modest but meaningful increase reflects a careful consideration of competing factors.

[5783] Parcel Post has a low value of service, reflecting its non-preferential processing, surface transportation, and lack of access to collection boxes. In addition, its estimated own-price elasticity is above 1.0 in absolute value (-1.23), second highest

among all subclasses. USPS-T-32 at 6. Delivery confirmation, an option that may add value for certain customers, is available only upon payment of a separate fee. On the other hand, Parcel Post lacks standard features offered by competitors, *e.g.*, free insurance and tracking. See Postal Service Brief at VI-24.

[5784] UPS also cites the availability of the DDU rate category as evidence of improved Parcel Post value of service. UPS Brief at 58. Workshare activities cut across several criteria. The Commission must consider them under criterion 6, and they have cost and rate structure implications under criteria 3 and 7, respectively. As a general matter, worksharing rate categories reduce the Postal Service's costs, while affording mailers opportunities to achieve efficiencies through their own efforts or in coordination with consolidators.

[5785] The recommended Parcel Post rates satisfy criterion 3. They recover attributable costs and, given the increased cost coverage, make a reasonable contribution to institutional costs. In addition, the increased cost coverage provides further assurance that the recommended rates will be fully compensatory in the test year.

[5786] Generally, criterion 4 requires the Commission to consider the effect of rate increases on the public, business mailers, and private carriers. A related consideration is criterion 5, alternative delivery options. Parties representing mailer and private carrier interests participated actively in this proceeding. PSA urges the Commission to recommend lower Parcel Post rates than proposed by the Postal Service. AMZ endorses the Postal Service's proposal. UPS proposes that Parcel Post rates be increased. While there was testimony about parcel markets and estimates of relative market shares, no testimony claimed any specific adverse impact due to the Postal Service's Parcel Post proposal. Along with whatever relevant, record information is available, the absence of specific allegations of harm bears on the Commission's consideration of the effects of rate increases. Based on the "imperfect information at its disposal," (Tr. 31/15462, Tr. 44/19537) the Commission concludes its recommended rates will not burden users unfairly.

[5787] Shipper interests cite reliance on the Postal Service and the competitive role the Service plays. Tr .29/14131-35, Tr .41/18127-34. UPS cites advantages inherent to the Postal Service, e.g., its statutory monopoly and exemption from certain taxes and fees. UPS Brief at 52.¹⁵¹ UPS, however, has not asserted that the Postal Service's proposed rates will cause it competitive injury. See, e.g., P.O. Ruling R2000-1/112. In the absence of such testimony, the Commission finds no basis to conclude that the recommended rates will occasion competitive injury.

[5788] Plainly, the parcels market, however defined, is competitive. There is some evidence that UPS is the dominant carrier. See, e.g., USPS-T-6 at 158, PSA Brief at 9-11, and Tr. 44/19525-29. On the other hand, UPS makes the case that the Postal Service carries more parcels. UPS Brief at 60-61. For purposes of this proceeding, it is immaterial which, if either, position is more accurate. That alternatives exist does not require the Commission to recommend rates causing the Postal Service to cede markets to competitors. See *United Parcel Service, Inc. v. United States Postal Service*, 184 F.3d 827, 845 (D.C. Cir. 1999) (“[t]he Commission has consistently, and reasonably, held that [criterion 5] authorizes a reduction in rates to maintain the position of the Postal Service as a competitor in the mail delivery industry.”) Nor is it the Commission's role to assure market share for the Postal Service. The Commission's role is to protect competition, not competitors. *Direct Marketing Association, Inc. v. United States Postal Service*, 778 F.2d 96, 106 (2nd Cir. 1985). The recommended rates are designed with that goal in mind.

[5789] Criterion 6 is reflected in the rate schedule in the form of workshared rate categories. While these mailing options may be attractive to certain mailers, they cannot be exercised without cost. See Amazon.com Brief at 30-31. Consistent with criterion 7, the various Parcel Post rate categories, including the relatively new destination entry categories, are reasonably simple, familiar to mailers, and bear a direct relationship to the costs and the service provided. In sum, considering all the statutory criteria, the Commission concludes that its recommended Parcel Post rates are fair and equitable.

¹⁵¹ By the same token, the Postal Service, as a governmental agency, may incur costs, e.g., universal service, which disadvantage it compared to competitors.

e. Rate Design

[5790] In Docket No. R97-1, the Commission recommended significant rate design revisions to Parcel Post, including, as noted above, establishment of DSCF and DDU rate categories. Those revisions became effective January 10, 1999. In this proceeding the Postal Service has proposed a few rate design changes, which, while relatively minor, nonetheless merit close attention.

[5791] As might be expected with a zoned rate structure designed for pieces weighing up to 70 pounds, Parcel Post rates are complicated by a number of practical considerations. Rates within the various rate categories should bear a reasonable relationship to one another. This is largely accounted for by basing discounts on cost savings, which yields lower rates for greater worksharing. Care must be taken however to avoid anomalies if at all practicable. Similarly, conflicts with Priority Mail are to be avoided. These practicalities necessitate using interim constraints to smooth rate relationships, and to develop fair and equitable Parcel Post rates. Longer term, continued use of constraints imposes rate design difficulties, particularly for zoned parcels, which may be rectified best through classification reform. *See, e.g.,* Tr. 13/4998. The Postal Service is encouraged to study the issue.

[5792] The Commission's discussion of rate design is organized by topic as follows: weight-related non-transportation costs, rate categories (inter-BMC, intra-BMC, Parcel Select DBMC, DSCF, and DDU), discounts (BMC presort discount, OBMC discount, and barcode discount), separate, parcel-specific charges (oversize parcel, balloon rate, and nonmachinable surcharge, including the Postal Service's proposal to expand the nonmachinable surcharge to intra-BMC and DBMC parcels), and additional services (pickup service and delivery confirmation). The final rate design issue addressed is the Postal Service's proposal to eliminate the minimum weight requirement for Parcel Post.

(1) Weight-related non-transportation costs

[5793] The Postal Service proposes Parcel Post rates that reflect the use of the existing convention of including an add-on of two cents per pound to recover weight-related non-transportation costs. This two cents per pound charge has been employed in designing Parcel Post rates “from as far back as Docket No. R84-1.” Tr. 13/4987. According to witness Plunkett, who could provide no data supporting the charge, it “provides a means through which rates may reflect sortation and mailhandling and delivery costs that are presumed to be caused by weight.” *See Ibid.*

[5794] Florida Gift Fruit Shippers Association (FGFSA) witness Ball notes, *inter alia*, that there is no evidentiary support for the charge. In the absence of data demonstrating the affect of weight on non-transportation costs, *i.e.*, handling costs, he argues that the charge discriminates against heavier parcels, “charging [them] with a greater portion of the costs than can be justified.” Tr. 30/14306. In lieu of the charge, he proposes that the imputed cost, approximately \$39 million, be assigned on a per piece basis using the cube/weight relationship on which transportation costs are distributed. *Id.* at 14305-06; *see also* USPS-LR-I-62, Attachment H, Cell 09. He cites Exhibit USPS-T-26, Attachment K, which is attached to his direct testimony as Table B, as setting forth an appropriate cube/weight relationship. Alternatively, Ball proposes that the add-on be reduced from two cents to one cent per pound. In its brief, FGFSA emphasizes that no cost data support inclusion of the two cents per pound add-on. FGFSA Brief at 11-12.

[5795] The Postal Service did not address this issue in rebuttal testimony or on brief. Nor did any other participant.

[5796] The Commission has repeatedly suggested that this issue be studied. *See* PRC Op. R97-1, para. 5662; *see also* PRC Op. R90-1, para. 6409, and PRC Op. R87-1, para. 5908. That suggestion has fallen on deaf ears. In Docket No. R97-1, in response to FGFSA's general suggestion the curvilinear relationship for transportation costs be used to distribute weight-related handling costs, the Commission concluded that “no

alternative has been well developed.” PRC Op. R97-1, para. 5662. In this proceeding, FGFSa has refined its proposal by tying it to USPS Exhibit -T-26.

[5797] FGFSa’s proposal represents an improvement over the status quo. It is reasonable because parcel handling costs would appear to be related to both weight and cube. FGFSa’s proposal is that non-transportation costs be distributed based on an established cube/weight relationship, albeit for transportation. In that regard, witness Plunkett was “not aware of any reason why there would be a difference between the weight/cube relationship” of parcels being processed as opposed to those being transported. Tr. 13/5036. While not holding himself out to be an expert on either transportation costs or processing operations, Plunkett did provide examples of the influence of weight on costs. *Id.* at 5042, 5031-32, and 5045-46. Similarly, the rationale behind the balloon rate gives credence to the influence of cube on costs even if its relationship with weight is not measured precisely. *Id.* at 5037. Absent a more quantitative analysis, FGFSa’s proposal represents a more rational distribution of the imputed costs, one more compatible with the Commission’s goal of cost based rates, particularly as compared to the status quo.

(2) Rate Categories

[5798] *Inter-BMC and Intra-BMC.* In designing rates for Inter- and Intra-BMC the Postal Service followed the established methodology described briefly in section c. above. The Commission’s rate design for inter- and intra-BMC Parcel Post is similar to the Postal Service’s design with one exception. The Commission distributes the weight-related, non-transportation handling costs as proposed by witness Ball.

[5799] An apparent anomaly exists in the rate design of the Intra-BMC rate schedule. This schedule consists of five separate zones despite there being only two distinct transportation costs, one for the ‘local’ zone and one for all the other zones. But for the fact that rates were forced upward by imposing constraints, the rates for zones 1 & 2, 3, 4, and 5 would be the same. Maintaining this artificial five zone Intra-BMC

structure puts downward pressure on the DBMC rates in zones 3, 4, and 5 because these rates must be lower than the comparable Intra-BMC rates to avoid an illogical rate structure. The Service is advised to study this issue.

[5800] *Parcel Select*. The Postal Service has employed the term Parcel Select to refer to destination entry discounts. The Commission recommends that the DMCS be modified accordingly. Destination entry rate categories include DBMC, DSCF, and DDU. Prior to considering proposals specific to each rate category, the Commission will address an issue common to each, namely passthroughs.¹⁵²

[5801] Witness Plunkett proposes to pass through approximately 100 percent of the cost savings arising from the various Parcel Post worksharing programs. Attachment H to USPS-T-36, revised April 17, 2000. The passthroughs range from 99 percent for the BMC presort discount to 102 percent for the prebarcoded discount. *Ibid*. Postal Service witness Eggleston presents the cost savings. See USPS-T-26 at 11-17. Witness Plunkett suggests that because, during the rate design process, he constrained rates for certain discounted rate categories, e.g., DDU, so as not to decrease by more than 2 percent, the passthroughs could be viewed as less than 100 percent. Tr. 13/4996, 5009; see Postal Service Reply Brief at VI-100. In other words, the constraints result in higher rates, an effect akin to limiting passthroughs.

[5802] Witness Luciani proposes a 63 percent markup on the attributable cost of DDU-entered Parcel Post, which he suggests is appropriate based on a comparison with Priority Mail. Tr. 25/11805. The predicate for this markup is that, in Luciani's view, Priority Mail and Parcel Post receive "a comparable level of service once they reach the DDU." *Id.* at 11959; see also *Id.* at 11805. Using that markup and the Postal Service's costs, Luciani calculates the DDU passthrough at approximately 50 percent. *Id.* at 11805-06 and 11821; see also *Id.* at 11821. He recommends that the Commission follow a similar method to derive the DDU passthrough utilizing his DDU-entry costs. He

¹⁵² Passthroughs also effect BMC, OBMC, and barcode discounts. No participant has opposed the Postal Service's proposals with respect to those discounts. The proposed nonmachinable surcharge also depends on a passthrough.

acknowledges that his DDU-entry costs are significantly higher than the Postal Service's due to the costing changes he proposes. *Id.* at 11805, fn. 15. At a minimum, he recommends that the DDU passthrough not exceed 80 percent, a level he claims results from Plunkett's rate constraints. *Id.* at 11806. See also UPS Brief at 84-86.

[5803] Two witnesses criticize Luciani's proposal as flawed. First, Amazon.com, Inc. witness Haldi argues that the use of what he characterizes as an explicit markup for a rate category is inappropriate.¹⁵³ He contends that under Luciani's approach rates for workshared rate categories would not be determined in a consistent fashion. Stated otherwise, he argues that Luciani inappropriately employs both a top-down and bottom-up approach to ratemaking. Tr. 44/19544. Witness Haldi contends that Luciani's approach is problematic and, if adopted, would cause "confusion and irrational rates." *Ibid.*; see also Amazon.com Brief at 17-19.

[5804] Second, PSA witness Glick argues that Luciani's implicit markup method is essentially unworkable. It would, according to Glick, lead to "rate anomalies," contrary to the principle of cost based rates. Tr. 41/18083. Moreover, he asserts that assigning a rate category an implicit markup based on the characteristics of a separate subclass confounds the ratemaking process since, unlike Luciani's implicit markup, explicit markups are not based solely on value of service. *Id.* at 18084. Witness Glick also takes issue with Luciani's suggestion that the passthrough should in no event exceed 80 percent. Based on his proposed DBMC cost avoidance, which is smaller than that developed by Eggleston, Glick argues that rate mitigation is less of a concern, thus justifying a passthrough "significantly more than 80 percent of the DDU cost avoidance" *Id.* at 18084-85. Witness Glick urges the Commission to follow its recommendation from Docket No. R97-1, which set the DDU passthrough at approximately 100 percent. *Id.* at 18082-83; see also PSA Brief at 30-31.

[5805] The Commission finds that use of an implicit markup to derive a passthrough is neither justified nor consistent with efficient component pricing ratemaking. As Luciani

¹⁵³ Witness Luciani characterizes the markup, which he uses "to back into" his proposed passthrough, as implicit. Tr. 25/11933.

testified, he backs into a passthrough he thinks is appropriate in pursuit of another objective, namely, to increase the institutional cost contribution of DDU-entered Parcel Post mail. See Tr. 25/11933, 11595; see *also id.* at 11805-06, 11932. It represents a “backdoor” attempt to do indirectly what more appropriately should be addressed directly in the design of rates for the Parcel Post subclass. Furthermore, the result of Luciani’s approach is contrary to the principle of cost based rates reflected in the Commission’s practice to recommend passthroughs at or near 100 percent of cost avoidance whenever feasible. This is not to suggest that under certain circumstances, *e.g.*, implementing a new rate category, a lower passthrough may not be appropriate. In this instance, however, Luciani’s proposal is not justified by such circumstances.

[5806] As both witnesses Haldi and Glick testify, rates based on an implicit markup may defy rational development and lead to inconsistent and unreasonable results. See, *e.g.*, Amazon.com Brief at 17-18, PSA Brief at 30-31. The Commission develops markups for subclasses by balancing numerous conflicting considerations. It then attempts to use efficient component pricing to obtain reasonable contributions from each segment of each subclass. It would be contrary to sound economic and pricing principles to ascribe a unique markup to individual rate cells. Accordingly, the Commission rejects Luciani’s passthrough proposal.

[5807] The Commission recommends passthrough levels of 100 percent for DBMC and a somewhat lower percent for DSCF and DDU, in order to achieve a rate design that is more consistent with efficient component pricing.

[5808] Specifically, the Parcel Select rates are not constrained to a particular percentage change.¹⁵⁴ Rates are set by distributing transportation costs and weight-related non-transportation handling costs to weight increments on the basis of the cube/weight relationship developed by the Postal Service. The per piece portion of the rate is calculated by subtracting the unit cost savings of each successive workshared category from the previous per piece rate. By removing constraints and passing through

¹⁵⁴ Due to the intra-BMC rate structure, it was necessary to constrain individual rate cells in zones 3, 4, and 5.

close to 100 percent of the mail processing cost savings these rates reflect the Commission's preference for cost based rate setting. Thus, to achieve efficient component pricing, subclasses that become heavily workshared will generally bear increasing cost coverages over time. This recommendation is consistent with that general pricing principle.

[5809] *DBMC cost savings.* The Postal Service develops its estimate of the cost savings achieved by DBMC-entry parcels through use of a cost avoidance model that includes both window service cost savings of 10.5 cents, and outgoing mail processing savings of 59.3 cents, subsequently revised to 57.4 cents and further revised to 55.7 cents. USPS-T-26, Attachment C. Witness Plunkett proposed to pass through 100 percent of this cost savings although his rate constraints lowered the effective passthrough to approximately 80 percent. Tr. 13/4996, 5009.

[5810] UPS witness Luciani contends that the cost savings calculated by the Postal Service for the workshared categories are overstated. For DBMC, he claims that the Service uses an "outdated 'top-down' estimation technique." Tr. 25/11795. According to Luciani, this approach is flawed because it uses LIOCATT costs, stale volume estimates, and an erroneous presumption that DBMC-entry parcels cannot incur non-BMC outgoing mail processing costs. *Id.* He proposes an alternative calculation that begins with witness Eggleston's model costs for Parcel Post. He then adjusts these models to remove the non-machinable parcels, claiming that the savings should be based on machinable differences only because the proposed non-machinable surcharge for DBMC mail reflects any cost difference between DBMC and Intra-BMC related to machinability. Finally, he adds the DBMC mail processing costs avoided at origin AOs that are not reflected in the models. This results in a unit cost savings for DBMC of 35.8 cents. *Id.* at 11796-800.

[5811] PSA witness Glick agrees with Luciani's argument that some DBMC parcels incur outgoing non-BMC costs but criticizes his alternative method. Glick claims that Luciani's alternative is flawed for three reasons. First, he agrees with witness Eggleston's assessment that the Parcel Post models are insufficient to estimate the

DBMC cost avoidance. Second, Luciani's technique excludes some customer service facility costs that should be included. Third, Luciani conducted no independent checks of his alternative to ensure accuracy. Witness Glick proposes a third method which "assumes that DBMC parcels incur a smaller amount of outgoing, non-BMC mail processing cost than do non-DBMC parcels" and results in a cost savings of 42.4 cents. Tr. 41/18072-74.

[5812] On brief, the Postal Service dismisses witness Luciani's assertion that the DBMC cost avoidance uses LIOCATT costs, claiming that the LIOCATT data are used only as a breakdown of basic functions. It also reiterates witness Eggleston's assessment that her models would have to be substantially altered in order to be used to estimate DBMC cost avoidance. Finally, it accuses witnesses Luciani of using a model that is "at least as 'outdated' as witness Eggleston's" because of the method he used to incorporate the AO costs avoided. Postal Service Brief at VII-115. The Service does not address witness Glick's alternative.

[5813] While the Commission employs worksharing models in estimating cost savings for rate categories where actual unit costs are not available, in this instance that would be inappropriate. Witness Eggleston says her models "were not developed for the purpose of estimating DBMC cost savings." Tr. 13/5167. Extensive changes would need to be made to these models to use them for this purpose and those changes have not been made on this record. Therefore, the Commission finds the original DBMC cost savings model more appropriate. It does, however, find that some DBMC parcels incur outgoing non-BMC mail processing costs and modifies the model to reflect these costs. The Commission calculates a window service costs savings of 11.1 cents and an outgoing mail processing savings of 56.2 cents.

[5814] *DSCF and DDU cost savings.* The Postal Service proposes DSCF and DDU cost savings of 42.8 cents and 73 cents respectively. PSA witness Zimmerman contends that these cost savings estimates are understated because the Service fails to apply the 'CRA adjustment' to its modeled costs. The CRA adjustment is used to reflect non-modeled costs and make the results of the models conform to the estimated CRA

unit cost. It is used extensively with other worksharing mail categories. Applying the CRA adjustment would increase the modeled costs and therefore the cost savings. Zimmerman claims that the resulting understatement is compounded by the fact that Postal Service witness Plunkett effectively passed through only 80% of the cost savings when designing his Parcel Post rates.

[5815] During oral cross examination witness Eggleston justifies her omission of the CRA adjustment by explaining that the DDU and DSCF categories are new and the uncertainty of the costs requires conservatism:

For the DDU and DSCF I am estimating cost savings, so I am estimating what we think is happening. Since we do not have a lot of data on what is happening we want to be cautious that we don't overstate those savings and give mailers the wrong price incentive because my costing goes into pricing, so we are very cautious by not applying a CRA adjustment factor in the first few years it is introduced. Tr.13/5252.

[5816] On brief, the Service also points out that the fixed CRA adjustment factor is the same for both DSCF and DDU so the only effect of applying the factor would be to multiply the difference. Postal Service Brief at VII-117.

[5817] The Commission agrees with the Service that not applying the CRA adjustment in this case is justified. Because the DDU and DSCF rate categories were introduced in Docket No. R97-1 and the rates did not go into effect until January 1999 reliable cost data are not yet available. It is unclear what costs, if any, are absent from the cost models. In this proceeding, the Commission accepts the Postal Service's cost savings estimation method as presented by witness Eggleston.

[5818] Witness Luciani claims that the transportation costs for DSCF and DDU are underestimated because Alaska air costs have not been allocated to them. Tr. 25/11803. He proposes to allocate the costs of one intermediate transportation leg to those rate categories. *Ibid.* On brief, the Postal Service asserts that, because the transportation costs were extrapolated from a base year that did not include the DDU and DSCF rate categories, DBMC was used as a proxy. DBMC does not incur Alaska air costs. The

Postal Service argues that Luciani's proposal is irrational since those rate categories did not exist in the base year. Postal Service Brief at VII-117; see Postal Service Reply Brief at VI-103-04. In USPS-LR-I-470, which updates transportation costs to reflect FY 1999 data, the Service allocates local transportation costs to DSCF and DDU. The Commission's cost analysis incorporates these data. It is not apparent that distribution based on an intermediate transportation leg is appropriate for service in Alaska. However, since these rate categories were introduced relatively recently, data should be available in the next proceeding to analyze the issue. *Cf.* Tr. 25/11962.

[5819] In contrast to PSA's view that DSCF and DDU cost savings are understated UPS argues that the cost saving estimate for DDU is overstated because it includes cost avoidance related to sack shakeout. Witness Luciani bases this conclusion in part on the Commission's decision in Docket No. R97-1 to exclude these costs from consideration of the cost savings. He also bases his opinion on the minutes from a Mailer's Technical Advisory Committee Meeting that he claims "make clear that Postal Service employees at the DDU will assist in unloading DDU-entry mail when they are available." *Id.* at 11800.

[5820] PSA witness Wittnebel supports the Service's contention that these costs are avoided by DDU parcels. Wittnebel is the Vice President of Delivery Services at CTC, which uses the DDU discount. He states that CTC's drivers are responsible for unloading the trucks and the Service incurs no sack shakeout costs because none of the DDU mail is entered in sacks. He also explains that the minutes from the meeting were taken out of context and that he has never seen Postal Service employees assisting drivers unload the trucks. Tr. 41/18044-46. Based on this testimony, the Commission finds that including the sack shakeout costs in the avoidance model is appropriate. The Commission's cost savings for DSCF and DDU are 41.1 cents and 69 cents, respectively.

[5821] Finally, in the Postal Service's roll-forward model the final transportation costs for Parcel Post are adjusted downward to account for a change in mail mix due to the DSCF and DDU discounts introduced in Docket No. R97-1. UPS witness Luciani claims that this final adjustment is overstated because of a double-count in DSCF

volume. He argues that 7.11 percent of DBMC parcels were entered at the DSCF even before the DSCF discount was available. Therefore, no cost savings accrue from these parcels and they should be excluded from the mail mix adjustment. He contends that fixing this 'error' results in an increase in transportation costs for Parcel Post of \$7.7 million in the test year. Tr. 25/11798-99. On brief, UPS argues that "some parcels were clearly entered at DSCFs in 1998." UPS Brief at 42. It does not address the Service's contention that there is no evidence of double-counting.

[5822] In rebuttal testimony, witness Eggleston asserts that Luciani's correction assumes that 7.11 percent of DBMC volume is dropped at the DSCF in the pre-mix volume but not the post-mix volume. She claims that this assumption is not rational and that the correct assumption under witness Luciani's argument is to assume the portion of DBMC dropped at DSCF is zero percent in both the pre-mix and post-mix volume. The effect of this change is to decrease Parcel Post costs by \$1.9 million in the test year. Tr. 41/18161-62; see Postal Service Brief at VII-113-14.

[5823] Witness Luciani's assumption that 7.11 percent of the pre-mix DBMC parcels dropped at the DSCF become DSCF parcels in the post-mix environment is questionable, as even he appears to acknowledge. See Tr. 25/11927; see also Tr. 41/18161. Moreover, as witness Eggleston notes, this assumption suggests that the percentage of DBMC parcels dropped at the DSCF should be zero for both pre-mix and post-mix volumes. *Id.* at 18161. Based on the evidence, the Commission concludes that this approach is preferable. Thus, the Commission's final adjustment is consistent with Eggleston's rebuttal testimony.

(3) Discounts

[5824] *BMC Discount.* The BMC discount is available for inter-BMC mailings of at least 50 pieces, separated into machinable and nonmachinable pieces and presorted to the destination BMC or secondary sort operation. The Service proposes increasing this

discount from the current 22 cents to 23 cents. This proposal is unopposed and accepted by the Commission.

[5825] *OBMC Discount.* The OBMC discount is available to inter-BMC mail that is entered at a BMC other than the destination BMC. The pieces must be presorted. The current discount is 57 cents and the Postal Service proposes an increase to 93 cents. The proposal is unopposed. The Commission recommends a discount of 90 cents based on its costing methodology.

[5826] *Barcode Discount.* The parcel sorting machine (PSM) is the only mailhandling operation affected by the presence of a barcode. Witness Eggleston modeled the cost of this operation to develop an estimate of prebarcode cost savings. USPS-T-26 at 10. Her estimated test year per piece cost savings is 2.9 cents. USPS-T-26, Attachment B. Based on this analysis, Plunkett proposes a barcode discount of 3 cents, which is the same as the current discount. The Postal Service's proposal is unopposed and, accordingly, the Commission recommends it be implemented.

(4) Parcel-Specific Rates

[5827] *Oversize Parcel Post.* Pieces that measure more than 108 inches, but not more than 130 inches, in combined length and girth are subject to the applicable Parcel Post oversized rate, regardless of weight. The oversized rate was implemented pursuant to the Commission's recommendation in Docket No. R97-1. See PRC Op. R97-1, para. 5702. Witness Eggleston develops modeled costs for inter-BMC, intra-BMC, and DBMC oversized NMOs. USPS-T-26 at 9-10, revised March 22, 2000. For each of these rate categories, she calculates the cost differences between the adjusted modeled cost of NMOs and oversize NMOs. See USPS-T-26, AttachmentA at 1. Witness Plunkett employs these estimated cost differences to develop proposed oversize Parcel Post rates.

[5828] The principal cost driver behind the proposed oversize rates is the average cube of the oversize parcel. Witness Eggleston used 8.04 cubic feet, based on a sample of oversize parcels in PQ 3 FY 1999. Tr. 13/5156. PSA witness Karls contends that the Postal Service's sample is too small to be reliable. Tr. 23/10811; see *also* PSA Brief at 34. Based on a survey of two mailers' experience with oversize parcels, Karls suggests that reducing the average cube to 6 feet would be appropriate. Tr. 23/10813. He indicates that his employer, Fingerhut Companies, Inc., which ships three times as many oversize parcels as the Postal Service's estimated test year volumes, makes little use of the oversize rate "because the cost is prohibitive." *Ibid.* see *also* PSA Reply Brief at 6.

[5829] On brief, the Postal Service opposes PSA's proposal, contesting both the theoretical mathematical sample used to derive the estimated average cube as well as the reliability of the data from two shippers concerning oversized parcels. Postal Service Brief at VII-112-113. In reply, PSA contends that the Postal Service distorts the record, and that Karls' analysis, based on a large volume of oversized parcels, provides a better estimate of average cube than the Postal Service's estimate that was based a statistically insignificant sample. PSA Reply Brief at 4-7.

[5830] The evidence developed on the average cube of oversized parcels is flawed. While it may properly be characterized as random, the Postal Service's sample is so small, representing only .0004 of total oversized volumes, as to raise doubts about its reliability. The sample size, however, may simply be a reflection of the relatively small universe of oversized parcels. See Tr. 13/5160-61. On the other hand, notwithstanding that greater volumes were measured, Karls' analysis relied on selected data from only two shippers. Karls candidly acknowledges that the experience of two shippers may not be representative. Tr. 23/10813. Moreover, as the Postal Service notes, Karls' attempt to buttress his estimate by reference to the 95 percent confidence interval of the sample, 6.55 to 9.53, is unavailing. Postal Service Brief at VII-113.

[5831] Upon careful evaluation of the testimony and arguments on brief, the Commission recommends adoption of the Postal Service's proposal. Although PSA

criticizes the Postal Service's sample as "so small as to be statistically insignificant," (PSA Reply Brief at 6) it proffered no testimony to support this contention. The Postal Service's sample reflects, at least to some degree, oversized pieces in its mailstream. In contrast, none of the oversized parcels for one of the shippers for which PSA provided data shipped those parcels via the Postal Service. Certainly, price is an important consideration, but, in some circumstances, other factors may be overriding. The Commission appreciates PSA's effort to develop an alternative to the Postal Service's average cubic feet. On this record, however, that alternative is not adequately supported to warrant its adoption. Given shipper interest in the oversized rate plus a market for such parcels, the Commission urges the Postal Service to provide a more thorough analysis of cube in the next rate proceeding.

[5832] *Balloon Rate*. In Docket No. R97-1, the Postal Service proposed and the Commission recommended the reestablishment of the "stop-loss" or "balloon" rate applicable to Parcel Post items weighing less than 15 pounds which exceed 84 inches, but not 108 inches, in length and girth combined. Such mail is charged the 15-pound rate for the applicable zone. Witness Plunkett proposes to continue the balloon rate. See USPS-T-36 at 12; see also USPS-T-36 Attachment D and Attachment K, revised April 17, 2000. Eggleston sponsors volume and cube data concerning balloon-rate parcels. See USPS-T-26 at 2 and USPS-LR-I-105.

[5833] The Postal Service's proposal is unopposed. The Commission recommends that it be adopted.

[5834] *Proposed Nonmachinable Surcharge*. Generally, the nonmachinable surcharge applies to parcels weighing more than 35 pounds or measuring more than 34 inches long, 17 inches wide, or 17 inches high. USPS-T-26 at 8. Other criteria, as specified by the Postal Service, are applicable to nonmachinable parcels. See DMM §630.1.4. Currently, the surcharge applies only to items mailed at inter-BMC rates. The surcharge does not apply to items mailed at the oversized rates. Witness Plunkett proposes to extend the surcharge to the intra-BMC and DBMC rate categories. His

rationale is that such mail “can be assumed to receive a BMC handling.” USPS-T-36 at 14, revised April 17, 2000; see *also* Postal Service Brief at VII-111.

[5835] Witness Eggleston develops the estimated cost of processing inter-BMC, intra-BMC, and DBMC non-machinable outsides (NMOs). USPS-T-26 at 8-9. For each rate category, the adjusted modeled cost of NMOs is compared to the adjusted modeled cost of machinable parcels. The cost differences, inter-BMC \$1.79, intra-BMC \$1.173, and DBMC \$1.277, form the basis for Plunkett’s proposed non-machinable surcharges. Witness Plunkett proposes to pass through 100 percent of the processing cost difference for inter-BMC Parcel Post, increasing the non-machinable surcharge to \$1.79, or by 8.5 percent. In contrast, he proposes to pass through only 35 percent of the cost differences for intra-BMC and DBMC, yielding surcharges of \$.40 and \$.45, respectively. This decision rests on his belief that “passing through 100 percent of the costs would result in rate changes that are excessive given the magnitude of the rate changes I propose for these categories generally.” USPS-T-36 at 14, revised April 17, 2000; see *also* Postal Service Brief at VII-111.

[5836] No participant opposes the proposed surcharges. The Commission recommends that the proposed non-machinable surcharge be adopted with modifications. First, based on its costs, the Commission recommends a surcharge of \$2.00 for inter-BMC NMOs. Second, the Commission finds that Plunkett’s rationale for limiting the passthrough on intra-BMC and DBMC NMOs is not persuasive. At the Postal Service’s proposed Parcel Post rates, exclusive of the surcharge, the increase to intra-BMC and DBMC mail subject to the surcharge is approximately 8 percent. Including the surcharge, the increase averages about 17 percent. Percentage increases, however, are but one factor that the Commission must consider. The surcharge is designed to recover the processing cost differences associated with NMOs. This purpose is thwarted if, as the Postal Service has proposed, the passthrough is inadequate. As proposed by Plunkett, substantially more than half of the processing cost differences attributable to NMOs would not be borne by such mail. Stated otherwise, the proposed passthrough is inadequate, inappropriately burdening non-NMO-mail with

NMO-related costs. Consistent with its policy of setting passthroughs at or near 100 percent, where feasible, the Commission recommends the following surcharges for NMOs: intra-BMC \$1.35, and DBMC \$1.45. The recommended surcharges coupled with the Commission's rate design for Intra-BMC and DBMC strike a reasonable balance among affected mailers, while, at the same time, better reflecting the Commission's preference for cost based rates. In addition, the recommended surcharges better serve as an incentive to mailers to mail, where practical, machinable items. To the extent the incentive works, the Postal Service's costs will decline. On the other hand, to the extent that mailers continue, for whatever reason, to mail NMOs, such mail will bear its share of the costs incurred.

(5) Additional Services

[5837] *Pickup Fee.* Pickup service is available on a scheduled or on-call basis. The current pickup fee is \$8.25. Based on witness Campbell's estimated average cost per stop, witness Robinson develops a weighted average cost of \$10.01, based on the TY estimated number of stops for Express Mail, Priority Mail, and Parcel Post. See USPS-LR-I-160, section I at 1 and USPS-T-34, Attachment I. Witness Eggleston proposes a fee of \$10.25. The Postal Service's proposal is unopposed and the Commission recommends that it be adopted.

[5838] *Delivery Confirmation.* PSA witness Zimmermann proposes that delivery confirmation be free for Parcel Select mailers using an electronic manifest. Tr. 29/14141-42. In response to that proposal, Postal Service witness Davis reexamined the assumptions underlying the initial delivery confirmation cost estimates. Tr. 39/17422-31. Witness Davis estimates that the total, unit volume variable cost for the Standard Mail electronic option is \$0.079. *Id.* at 17431. On brief, the Postal Service indicates that the revised unit cost of Standard Mail (B) manual (retail) option is \$0.425. Postal Service Brief at VIII-31. As discussed below, the Commission recommends delivery confirmation fees that are based on the reduced unit cost figures.

(6) Elimination of One Pound Minimum

[5839] As noted, the Postal Service proposes to eliminate the one pound weight minimum for Parcel Post. A separate rate for Parcel Post mail weighing less than 16 ounces is not proposed. Instead, “the lowest rate in each category would be applicable to all pieces weighing up to two pounds.” USPS-T-36 at 12.

[5840] Witness Mayes suggests that eliminating the weight minimum will provide mailers with flexibility. USPS-T-32 at 42. First, retail mailers, *i.e.*, single piece mailers, will have a mailing option other than First-Class or Priority Mail. Such an option existed until Single Piece Standard Mail (A) was eliminated following Docket No. R97-1. *Ibid.* Second, bulk mailers may combine eligible mail of various weights as Parcel Post, utilizing worksharing rate categories to avoid the need to separate the mailing into separate subclasses. *Ibid.*

[5841] On behalf of PSA, witness Zimmermann endorses the proposal as beneficial to the Postal Service and mailers. Tr .29/14136. No testimony was submitted opposing the proposed change. On brief, however, UPS urges the Commission to reject it, arguing, *inter alia*, that the Postal Service failed to address the consequences of the proposal. Postal Service Brief at 89-92. UPS cites as particularly troublesome the Postal Service’s failure to consider the impact on Priority Mail. *Id.* at 91-92. In reply, the Postal Service argues that its proposal simplifies the classification schedule, which, among other things, will enable Parcel Post mailers to commingle merchandise of various weights. Postal Service Reply Brief at VI-100-101. Further, the Postal Service contends that there is no need for the analysis UPS seeks. *Id.* at VI-101.

[5842] The Commission recommends the proposal be implemented. The change is simple, provides mailers with greater flexibility, and is unopposed by and beneficial to mailers. Prior to its elimination in January 1999, Single-Piece Standard Mail (A) was an option available to mailers of lightweight (less than one pound) mailable matter not required to be mailed as First-Class Mail. This proposal restores that option. By the same token, as of January 1999, three new destination entry rate categories were made

available to bulk Parcel Post mailers. As both witnesses Mayes and Zimmermann note, this new provision will enable bulk Parcel Post mailers to more easily satisfy minimum volume requirements. USPS-T-32 at 42; Tr.29/14136.

[5843] UPS contends that “most or all” of the estimated 172 million pieces of Priority Mail weighing more than 13 ounces but less than a pound “could shift to Parcel Post.” UPS Brief at 90. UPS’s contention is unsupported by any showing about markets or rates that may influence mailers to switch from Priority Mail to Parcel Post. Absent such a showing, the volume that potentially might shift is purely speculative. In the abstract, however, the potential shift would not appear to be meaningful. Much of lightweight Priority Mail consists of items subject to the Private Express Statutes which could not “switch” to Parcel Post. Some former Single-Piece Standard Mail (A) might be expected to shift to Priority Mail. In its rollforward model, the Postal Service assumed that only five percent of Single-Piece Standard Mail (A) migrated to Priority Mail in FY 1999 with no cost level change or volume effect thereafter. USPS-ST-44 at 10. Thus, the potential shift would appear to be inconsequential. In any event, UPS suggests no compelling reason why the mailing option formerly available to mailers of Single-Piece Standard Mail (A) should not be restored in the form of Parcel Post.

[5844] UPS also argues that it is unclear whether the change is “either needed or wanted by mailers.” UPS Brief 91. The record, of course, reflects PSA’s endorsement. Furthermore, no mailer has opposed the change. On balance, the simplicity and benefits of the proposal support its recommendation.

[5845] Finally, the current Parcel Post rates are designed in one pound increments beginning with an up to two-pound rate. For purposes of this proceeding, the proposed rate for mail weighing less than one pound is satisfactory. In the next proceeding, however, the Postal Service will be expected to discuss the potential benefits of a separate rate for such mail, assuming continuation of the current classification and rate design.

2. Bound Printed Matter

a. Introduction

[5846] The Bound Printed Matter (BPM) subclass is restricted to advertising, promotional, directory, or editorial material, which is bound by permanent fastenings and weighs between one and 15 pounds. See proposed DMCS § 522.1. Correspondence of a personal nature is prohibited. Examples of BPM include catalogs, books, telephone directories, and similar bound volumes. USPS-T-37 at 26, revised April 17, 2000.

[5847] BPM rates are zoned, including a local zone through zone 8. The current rate structure consists of three rate categories: single piece, Bulk Presort (which the Postal Service proposes to relabel as Basic Presort), and Carrier Route Presort. Rates include a per piece and a per pound charge. To be eligible for presort rates, BPM mailings must contain at least 300 properly prepared and presorted pieces, *e.g.*, to 3 or 5-digit, or to carrier route. In addition, properly prepared mailings of at least 50 machinable Single Piece or Basic Presort BPM parcels are eligible for a barcode discount, which currently is \$0.03 per piece.

b. Postal Service Proposal

[5848] Postal Service Witness Kiefer proposes BPM rates that will increase, on average, by 18.1 percent. *Id.* at 2. This increase reflects a cost coverage of 117.6 percent, which was sponsored by witness Mayes. See USPS-T-32 at 43. Witness Kiefer proposes three rate design changes. First, he proposes to establish three dropship discounts for properly prepared and presorted BPM entered at the DBMC, DSCF, and DDU. In addition, witness Kiefer proposes to eliminate the local zone rate as well as the one pound weight minimum for BPM.

[5849] Witness Kiefer develops preliminary BPM rates as follows. He begins by allocating total volume variable costs between weight-related and non-weight-related costs, and between single piece and presort mail costs. See USPS-T-37 at 34 *et seq.*

For greater detail, see witness Kiefer's workpapers WP-BPM-10 *et seq.* To develop his preliminary per pound charges, he relies on witness Crum's estimated transportation costs per pound, using these estimates to allocate total costs into transportation and non-transportation costs. Non-transportation costs are allocated between single piece and presort using a 2 to 1 ratio for single piece to presort unit processing costs. The preliminary pound charge reflects all transportation costs, plus a two cents per pound add-on for weight-related non-transportation costs.

[5850] Witness Kiefer's preliminary single piece BPM rates are developed by marking up the estimated per unit non-weight-related non-transportation costs to achieve witness Mayes' cost coverage. *Id.* at 35. The markup includes the contingency. In addition, the per piece rate reflects revenue leakage from barcode mail discounts. The resulting preliminary per piece rate, \$1.48, represents a 2.8 percent increase over the existing rate. *Id.* at 38. To develop the single piece per pound charge, he marks up total estimated weight-related single piece costs, dividing the total by total estimated test year before rates single piece pounds. The resulting preliminary, single piece per pound rates increase by widely differing amounts, ranging from 1.9 percent for zone7 to 147 percent for zones 1&2. *Ibid.*

[5851] The preliminary per piece BPM Basic Presort rate is developed in a similar fashion. Per piece revenue leakages, however, reflect barcode and carrier route discounts, plus witness Crum's estimated dropship presort mail cost savings. The resulting preliminary, presort per piece rate increases to \$1.062, a 47.5 percent increase over the current rate. The preliminary per pound rate for Basic Presort is developed in a fashion similar to that used for single piece, except that it includes per pound revenue leakages based on estimated cost savings reported by witness Crum for dropshipped BPM. The resulting preliminary, per pound Basic Presort rates range widely, from a one percent decrease in zone 7 to a 147 percent increase in zone 1&2. *Ibid.*

[5852] Witness Kiefer's proposed destination entry discounts rely on witness Crum's estimated per piece and per pound cost savings. Witness Crum provides the per piece mail processing savings for DBMC-entered pieces compared to non-destination

entered pieces, and the DSCF and DDU mail processing savings relative to DBMC entered mail. USPS-T-27 at 14 (revised January 28, 2000) and 15. Based on these cost savings, the resulting preliminary per piece rates are DBMC \$0.6882, DSCF \$0.533, and DDU \$0.406, reflecting 100 percent passthrough of the estimated per piece cost savings. Kiefer workpaper WP-BPM-12. Witness Crum also estimates destination entry per pound transportation cost savings. See USPS-T-27 at 15-16 and Attachment K, Table 6; see *also* Tr. 13/5286.

[5853] The proposed Presort Carrier Route discount is also based on witness Crum's analysis. USPS-T-27 at 12. Witness Kiefer proposes to passthrough 100 percent of witness Crum's estimated per piece cost savings of \$0.077. The discount is calculated off the Basic Presort single piece rate.

[5854] Witness Kiefer's barcode discount is based on witness Eggleston's estimated cost savings of \$0.029. Eligibility for the proposed discount, \$.03, which is the same as the current discount, is limited to single piece and Basic Presort BPM. Witness Kiefer proposes that for operational reasons the barcode discount not be available for DSCF and DDU rates, or for DBMC mail entered at an ASF, except DBMC mail entered at the Phoenix, Arizona ASF. USPS-T-37 at 36.

[5855] Concluding that the preliminary rates would produce "severe rate shock" if not adjusted, witness Kiefer employs mitigation measures. He adjusts the single piece rate by lowering the per pound rate in zones 1&2 through 5, offsetting that revenue impact by raising the per piece charge and the pound charge in the remaining zones. For Basic Presort, he lowers the per piece charge and the per pound charge for zones 1&2 through 5. To offset that revenue reduction, witness Kiefer increases the DBMC, DSCF, and DDU per piece charges. Stated otherwise, he lowers the passthrough of witness Crum's estimated cost savings. He reduces the per pound rate for dropship rate categories to maintain appropriate rate relationships among the various rate categories. See Kiefer workpaper WP-BPM-15.

[5856] The Postal Service cites changed operations as the basis for eliminating the local zone. Witness Crum testifies that, given its zoned rate structure, BPM mail is

already entered deeply into the system, but often in ways that are inconsistent with current Postal Service operations. USPS-T-27 at 13. According to witness Crum, some mail, apparently deeply entered and qualifying for the local rate, can be more costly for the Postal Service to process than less deeply entered mail. This can occur, he asserts, “because the Local rate is no longer consistent with USPS mail processing and transportation networks . . .” *Ibid.* Witness Kiefer states that the assumption underlying Local mail, and therefore its lower rate, is that it would be deposited at the destination office. Witness Kiefer testifies that BPM is often deposited at a local office that is not the destination facility, thus imposing mail processing and transportation costs on the Postal Service that are not reflected in the Local rate. USPS-T-37 at 33.

c. Intervenor Proposals

[5857] Two intervenors submitted testimony concerning BPM rates. AAP, through the testimony of witness Siwek, roundly opposes the Postal Service’s proposed rates and rate structure. Witness Siwek argues that the Postal Service has failed to accurately estimate test year BPM volumes. Tr. 30/14564-67. He also contends that the Postal Service has overstated volume variable costs as well as the distribution of allied labor costs. *Id.* at 14568-75; AAP Brief at 10-14.

[5858] AAP urges the Commission to reject the proposed DSCF and DDU discounts, arguing that the Postal Service’s underlying cost study is flawed and its proposed passthroughs discriminatory. AAP Brief at 14-24; Tr. 30/14575-81. In lieu of separate discounts for destination entry mail, AAP proposes to increase the DBMC discount, representing a passthrough of 51.3 percent of cost savings, with DSCF and DDU-entered mail eligible for the same discount. AAP Brief at 23. AAP also argues that BPM’s cost coverage should be lowered substantially, to 105 percent, based principally on full criterion 8 consideration. AAP Brief at 3-10; Tr. 30/14586-90.

[5859] In support of that position, in addition to witness Siwek’s testimony, AAP sponsors the testimony of Patricia Schroeder, President and Chief Executive Officer of

AAP, and Rosemary Wells, an author of children's books. Among other things, witness Schroeder criticizes the Postal Service's proposed increase, provides data concerning book sales in the U.S., and urges the Commission to give full ECSI consideration to the BPM subclass. Tr. 28/13372-75. Witness Wells expresses her concern over the proposed increase and urges the Commission to consider the value of books, particularly those for children, sent as BPM. *Id.* at 13381.

[5860] Witness Siwek proposes rates for BPM based on a cost coverage of 105 percent and a single destination entry discount. Tr. 30/14591, 14614. Witness Siwek's BPM after rate revenues equal \$503.3 million, a reduction of \$60.1 million compared to the Postal Service's. Tr. 38/17106. In his supplemental testimony, witness Siwek urges the Commission to reduce the Postal Service's contingency, with any such reduction used to reduce test year costs for BPM, among others. *Id.* at 17096-100, 17118-20. The Postal Service contends that neither AAP nor witness Siwek address recovery of the total revenue shortfall under witness Siwek's proposal. See Postal Service Brief at VI-34 and VII-130.

[5861] MOAA sponsors the testimony of Roger C. Prescott, who advocates increasing the DDU passthrough to equal 50 percent of the estimated savings. Tr. 30/14354-63. In support of this proposal, witness Prescott states, among other things, that a passthrough of less than 100 percent burdens dropshipped mail with a higher institutional cost contribution than non-dropshipped mail. *Id.* at 14361. In addition, he contends that the proposed rate increase for DDU-entered parcels warrants increasing the passthrough for such mail. He suggests that his proposal, which increases the Postal Service's proposed discounts from \$0.031 to \$0.044 per pound and from \$0.297 to \$0.331 per piece, will not create a major change in BPM rates for other mailers. *Ibid.* see also AAP Brief at 27. MOAA states that these "increases can be accomplished with only a slight increase of .5 cents in the base rates under the BPM revenues requested by the Postal Service." MOAA Brief at 27.

[5862] MOAA argues for a sharply reduced cost coverage for BPM, contending that the proposed destination entry discounts, "combined with a very low passthrough of

savings, supports a cost coverage lower than the proposed 118 percent.” *Id.* at 23. According to MOAA, such a result would “mitigate the effects of the large cost increase,” while affording an opportunity to gain experience under the discounts. *Ibid.* In addition, MOAA contends that based upon criterion 8, ECSI, the cost coverage of BPM should be 101 percent. *Id.* at 26.

[5863] On brief, both AAP and MOAA claim that use of actual FY 1999 cost data by the Commission raises due process concerns. AAP asserts that the Commission cannot rely on actual FY 1999 data without impinging upon the parties’ due process rights. AAP Brief at 25-28. MOAA argues that the Commission should use FY 1998 data for base year purposes, contending that participants were not afforded an adequate opportunity to review the data. MOAA Brief at 25. These claims are addressed next.

d. Due Process Claims Are Without Substance

[5864] On brief, AAP expresses its belief that “the FY 99 cost data cannot be incorporated into any decision of the Commission without severely impinging upon the parties’ due process rights.” AAP Brief at 25. The gravamen of AAP’s complaint is that it was unable, notwithstanding its discovery attempts, to obtain any information from the Postal Service that would explain the FY 1999 increase in BPM costs. *Id.* at 26.

[5865] As discussed previously, the Commission issued NOI No.1 early in this proceeding to explore the issue of using actual F Y1999 data for purposes of developing test year costs in lieu of relying on an estimate of 1999 costs developed from FY 1998 data. Interested participants were invited to comment on the desirability of utilizing FY 1999 data. Notice of Inquiry, No.1 (February 2, 2000) at 5. AAP submitted comments, noting its concern over the proposed increase in BPM rates, and contending, among other things, that “[b]asic precepts of due process and fairness, common to any administrative law proceeding, require that this information [the actual FY19 99 data] be considered by the Commission.” AAP Comments in Response to Notice of Inquiry No. 1 Concerning Base Year Data, February 23, 2000, at 2. In addition, AAP argued that

“Ignoring the FY 1999 data would severely prejudice the Intervenor’s rights to a fair hearing.” *Id* at 5.

[5866] Following submission of the F Y1999 data by the Postal Service and an opportunity for the participants to review the data, the Commission issued NOI No.2, requesting interested participants to comment on the appropriate use of actual F Y1999 data. Notice of Inquiry, No. 2 (April 21 2000).¹⁵⁵ To enable the participants to evaluate the actual FY 1999 data, the Commission provided, as attachments to the NOI, comparisons of the estimated FY 1999 and actual FY 1999 costs by subclass and service. AAP did not submit comments in response to NOI No.2.

[5867] After reviewing comments submitted by the participants, the Commission issued Order No. 1294, directing the Postal Service to provide a basic update of its test year forecasts by “substituting the actual F Y1999 cost data for the estimates for that year presented by Postal Service witnesses Kashani and Tayman.” Order No. 1294, May 26, 2000, at 4. In P.O. Ruling R2000-1/71, the Presiding Officer modified the procedural schedule, providing time for the Postal Service to prepare the updates, and opportunities for participants to participate in technical conferences, engage in discovery, submit rebuttal testimony, and submit supplementary testimony to amend their case in chief. The Postal Service provided a timely response to Order No. 1294, submitting the testimony of three witnesses on July 7, 2000. In addition, to respond to discovery requests and Presiding Officer Information Requests, the Postal Service provided numerous library references relevant to the updates.

[5868] AAP argues that if the Commission employs FY 1999 cost data, “the parties must have first been accorded a meaningful opportunity to understand the computations and basis for such data.” AAP Brief at 26. Apparently attempting to demonstrate that it was denied this opportunity, AAP cites a response by witness Patelunas to one of its interrogatories for the proposition that it was unable to obtain information concerning the

¹⁵⁵ On April 4, 2000, the Postal Service filed the FY 1999 CRA as USPS-LR-I-275 and the Cost Segments and Components Report as USPS-LR-I-276. It also filed the supporting billing determinants as USPS-LR-I-259 on March 31, 2000.

reasons FY 1999 BPM costs increased. Specifically, AAP quotes a portion of witness Patelunas's answer indicating that he had not compared results from BY 1998 with actual results for FY 1999 for lack of time and because it was unnecessary for him to do so. *Ibid.* citing Tr. 35/16626. The excerpt cited by AAP fails to demonstrate that it lacked a meaningful opportunity to discover why FY1999 BPM costs increased.

[5869] First, as witness Patelunas observed, a comparison with base year 1998 was unnecessary for purposes of preparing his testimony, which “presents the changes to the Postal Service’s Docket No. R2000-1 revenue requirement and test year costs that result from utilizing FY 1999 actual audited accounting data and costs by class of mail as the base year.” USPS-ST-44 at 1.

[5870] Second, witness Patelunas explained, in explicit detail, how such a comparison could be undertaken. Hence, AAP had at its disposal the means by which to further investigate the increase in BPM costs.

[5871] Third, given what it obviously perceived as an unsatisfactory response, it was incumbent on AAP to investigate the matter further. This it failed to do, notwithstanding numerous opportunities.

[5872] Initially, technical conferences, convened pursuant to P.O. Ruling R2000-1/71, afforded participants an opportunity to question the Postal Service concerning its response to Order No. 1294. Subsequently, when it received unsatisfactory discovery responses it could have submitted follow-up interrogatories. AAP also had the opportunity to cross examine witness Patelunas, but specifically declined to do so, opting instead simply to designate as written cross the interrogatory responses it now asserts prove its inability to obtain relevant information. See Tr. 35/16724. During witness Patelunas’s appearance, he agreed to respond to several requests for additional information from other participants and from the bench. See Tr. 35/16799, and 16830-32. Again, AAP did not request additional information. While it did submit supplemental testimony, that testimony, as relevant to this issue, merely recites AAP’s discovery efforts. Tr. 38/17091-92.

[5873] Throughout this proceeding, the Commission has been responsive to the need for developing a complete record, requiring the Postal Service to supplement its filing through testimony to address, among other things, mail processing costs. In Order No. 1289, the Commission directed the Postal Service to provide testimony addressing processing costs of Periodicals, First-Class, and Standard A Regular flats. See PRC Order No. 1289 (March 28, 2000). See also PRC Order No. 1291 (April 6, 2000) (directing witnesses to be prepared to answer questions). The Presiding Officer issued twenty-one information requests, seeking, among other things, specific information concerning BPM as well as Special Mail. For example, in response to POIR 20, the Postal Service submitted, as USPS-LR-I-470, updates to BPM cost models necessary “to allow for the use of FY 1999 cost data.” Tr .46-D/21118; see also *id.* at 21147 (concerning the change in endorsement requirements for Special Mail and its impact on IOCS observations.) In addition, as AAP notes, the Commission directed the Postal Service to provide a witness to address issues concerning FY 1999 Special Mail costs. See PRC Order No. 1300 (August 18, 2000). AAP had the opportunity to request the Commission to broaden the inquiry to include BPM. It did not do so. AAP did not avail itself of its various opportunities, content, essentially, to sit on its hands. In sum, AAP’s inability to obtain information concerning the increase in FY 1999 BPM costs was not due to a lack of opportunity, but rather to its choice not to act on those opportunities.

[5874] For its part, MOAA was silent on this general issue until it submitted its initial brief. There it contends that “the parties have not had an opportunity to pursue adequately the question of how the new costs should affect rate levels, if at all.” MOAA Brief at 29. However, it then presents requests for relief that belie this assertion.

[5875] MOAA limits its discussion to the proper treatment of Standard A costs, although its concerns presumably extend to Bound Printed Matter. Recognizing that the Commission may use actual FY 1999 costs, MOAA specifically tailors its request based on an explicit understanding of the “new costs.” Noting that the “costs for Standard Mail ECR have increased to some extent between FY 98 and FY 99,” MOAA argues that despite the increase in costs “[t]here is no basis for any increase in the proposed ECR

rates.” *Id.* at 30. At the same time, citing decreased FY 1999 costs, it argues for reduced Standard Mail (A) Regular rates. *Ibid.*

[5876] MOAA offers the observation that changing the base year “without affording a reasonable period for the users to assess the data would fail to provide the minimum due process required by the Act.” *Id.* at 29. As far as it goes, this statement is uncontroversial. MOAA, however, fails to expand on it or substantiate any elements of its nebulous claim.

[5877] It makes no attempt to explain or support the implication that it did not have a reasonable opportunity to evaluate the FY 1999 cost data. In fact, it did not submit discovery on the Postal Service concerning either FY 1998 or FY 1999 CRA results, or orally cross-examine the relevant Postal Service witnesses. MOAA cannot sustain a charge that it was denied due process when it neither complained, nor made any attempt to use the opportunities available to it.

e. Cost Coverage

[5878] In Docket No. R97-1, the Commission recommended BPM rates that produced a cost coverage of approximately 136 percent and a markup index of 0.643. PRC Op. R97-1, para. 5721. In this proceeding, the Postal Service’s proposed coverage is 117.6 percent. USPS-T-32 at 44. As noted above, AAP proposes a coverage of 105 percent, while, on brief, MOAA suggests 101 percent. The BPM rates recommended by the Commission recover all costs attributable to BPM and, under the circumstances, make reasonable contribution to institutional costs. They incorporate a cost coverage of 114 percent and are, on balance, fair and equitable to all mailers.

[5879] In Docket No. R90-1, when the Commission considered including books without advertising in the BPM subclass, testimony was submitted concerning, *inter alia*, the impact of the proposed change on the BPM subclass. Based on volume trends, the Postal Service’s witness concluded that the migration of books from what was then Special Rate Fourth Class was essentially complete. PRC Op. R90-1, para. 6501-02.

AAP, among others, offered testimony indicating that most major publishers had already completed their migration to BPM. *Id.* at para. 6503. In addition, AAP, among others, sponsored testimony indicating that book mailers converting to BPM would take advantage of worksharing discounts not available in Special Rate Fourth Class. *Ibid.* In recommending the proposed classification change, the Commission observed:

Although section 3683 of the Act provides for special-rate fourth class for books, we believe that the intent of the Act is to encourage widespread dissemination of ideas by considering the postage paid by the senders of books. Our efforts to make low cost options available *if possible* furthers the policies found in the Act.

Id. at para. 6508 (emphasis added).

[5880] In recognition of the migration of books to the BPM subclass, the Commission “allow[ed] the markup for bound printed matter to decline . . . slightly below average . . .” *Id.* at para 6519. The Commission’s cost coverage was 146 percent. Despite the migration of books to BPM, the Commission specifically declined to give BPM the same ECSI consideration as was accorded Special Rate Fourth-Class mail. *Ibid.* In subsequent rate cases, the Commission reduced both the cost coverage and the markup, noting, in Docket No. R97-1, that the below average markup reflected consideration of ECSI due to the presence of books in the subclass. PRC Op. R97-1, para. 5722.

[5881] AAP’s argument that BPM should receive full ECSI consideration is not persuasive. The linchpin of the AAP argument is that books comprise 63.7 percent of the subclass based on FY 1998 data. AAP Brief at 6-7. The Postal Service takes issue with this figure, contending that books comprise approximately 52 percent of the subclass. Postal Service Reply Brief at V-33.¹⁵⁶ Regardless, the percent is substantially less than 100 percent, with the balance, apparently catalogs, not qualified for any ECSI consideration. Compounding this, books and catalogs may exhibit different cost characteristics. For example, catalogs may be entered into the system more deeply and, on average, weigh less per piece.

[5882] The Commission's recommendation in Docket No. R90-1 was predicated, in part, on the availability of a low cost option. Concerns were raised then that the inclusion of books would cause an increase in BPM unit costs. Over time, notwithstanding contentions that migration already had occurred and that book mailers would embrace worksharing, unit costs have increased. The specific causes for these rising unit costs are not successfully documented in this record. As a consequence, the low costs that made migration to BPM initially attractive are less beneficial. Rates for BPM are still substantially lower than the rates for Special (now Media) Mail; however, they apparently now more accurately reflect the impact of the migration of books into the subclass. In an effort to dampen that impact, AAP now argues that the Commission ought to give BPM full ECSI consideration.

[5883] In Docket No. R90-1, the Commission concluded that third-class regular rate and BPM should have a generally similar markup. PRC Op. R90-1, para. 6520. The Commission's recommendation in Docket R94-1 adhered to that view. PRC Op. R94-1, para. 5388-89. Notwithstanding this, over time the cost coverage and markup of BPM have continued to decline as the Commission has taken ECSI value into consideration.

[5884] AAP's reliance on the ECSI value of Periodicals as a benchmark for the value that ought to be ascribed to BPM is misplaced. AAP Brief at 5-7, and AAP Reply Brief at 5-6.¹⁵⁷ This argument ignores important distinctions between Periodicals and BPM. First, Periodicals have a long, statutorily preferred history. The migration over the past decade of books into BPM, which was established in 1939 as a classification designed for catalogs and similar bound advertising, was a marriage of convenience.

¹⁵⁶ The source of AAP's figure is the Household Diary Study. The Postal Service argues that the data reported in the Household Diary Study "does not purport to represent the percentage of books in the [BPM] mail stream as a whole," but only that percentage reported by households. Postal Service Reply Brief at V-33. It notes that for the period 1994-1998, the same data show a range fluctuating between 41.9 percent and 63.7 percent, averaging about 51 percent. The Postal Service also cites witness Mayes' testimony which, based on RPW data, indicates that books comprise about 52 percent of BPM. *Ibid.*

¹⁵⁷ MOAA makes a similar comparison. MOAA Brief at 23. Briefly reciting the history of the BPM subclass, MOAA argues that "advertisers should at least be given the benefit of the ECSI value to which the books are entitled." *Id.* at 25-26. The Commission is sympathetic to MOAA's concerns. Nonetheless, there is no basis on which catalogs (advertisers) merit ECSI consideration. See Tr. 11/4666-68.

Second, advertising in periodicals is integral to the publication, integrated with editorial matter, and bound together in one piece. Books and catalogs, which share none of these characteristics, are mailed separately. See Postal Service Brief at VI-32-33.

[5885] Section 3683 provides a statutory classification for, *inter alia*, books. As a practical matter, although the Commission's rates for Media Mail reflect full ECSI value, the rate structure mandated by that section may make it a less attractive alternative to book mailers. See AAP Reply Brief at 6, fn.1. A possible regulatory solution might be separate rate categories for books and catalogs. Indeed, in Docket No. R90-1, the Commission recommended a separate rate category be established for BPM catalogs. PRC Op. R90-1, para. 6510. The Governors rejected the proposed classification change. Decision of the Governors, R90-1 (January 22, 1991) at 4-5. At a minimum, the Commission encourages the Postal Service to study the distinct cost characteristics of books and catalogs mailed as BPM.

[5886] AAP also cites criterion 2, value of mail service actually provided, as warranting a reduced coverage. AAP notes that "[t]he lower the own-price elasticity, the higher the value of service." AAP Brief at 9. Citing witness Mayes' testimony, AAP states that BPM has an own-price elasticity of -0.392 , which is lower than several subclasses, e.g., Priority Mail, Standard Mail (A) Regular, and Parcel Post. *Ibid.*, citing USPS-T-32 at 5. Similarly, citing the FY 1999 own-price elasticity of -0.280 , AAP argues that if FY 1999 data are used, the revised own-price elasticity should be used to further reduce the cost coverage applied to BPM. *Id.* at 29. AAP's interpretation is contrary to Commission precedent. See Postal Service Brief at VI-31. Relatively higher economic value of service is a factor that, for mail not subject to the Postal Service's monopoly, may justify a somewhat higher cost coverage. On the other hand, the nonpreferential nature of the service received by BPM is indicative of a lower value of service and, consistent with Commission practice, is reflected in a lower cost coverage for BPM.

[5887] The Commission has also carefully considered criterion 4, effect of rate increases on the public, mailers, and alternate delivery carriers. The increase, while above the system average, must be measured against the more than 40 percent

increase in BPM unit costs from the base year in Docket No. R97-1 to the base year in this proceeding. In that light, the Commission's response to criterion 4 is evident. No testimony has been offered attempting to quantify any adverse effect of the proposed increase on users. The Commission recognizes that rate increases have a negative impact on volumes, but such generalizations cannot support the extraordinary relief sought by AAP and MOAA. The BPM rates recommended in this case will significantly reduce the relative contribution to institutional costs by BPM as a means of ameliorating the impact of the rate increase. In fact, absent the size of the current increase, a larger relative contribution would seem warranted. In addition, the revised rate structure affords opportunities for mailers to reduce costs, either through their own efforts or by using a consolidator. No competitor has complained about the proposed BPM rates. Similarly, no participant has raised criterion 5 concerns regarding BPM.

[5888] As noted above, adoption of the destination entry discounts gives appropriate recognition to criterion 6, degree of mail preparation. While this adds a level of complexity to the rate schedule, the "bulk" rate categories are well understood by industry. In addition, a single piece rate remains available for individuals. In sum, the recommended rates balance all the statutory factors, and are fair and equitable.

f. Rate Design

[5889] The Postal Service proposes material changes to the BPM rate design, including implementing destination entry discounts, and eliminating the minimum weight threshold and the local zone.¹⁵⁸ Aside from these changes, however, the Postal Service proposes, essentially, to maintain the status quo. As discussed below, the Commission recommends that these rate design proposals be implemented. Details concerning rate levels are addressed below.

¹⁵⁸ In a minor related change, the Postal Service proposes an annual mailing fee of \$125 on BPM destination entry mailers. USPS-T-37 at 34, fn.14, revised March 14, 2000. The Commission recommends adoption of this fee, which, as witness Kiefer notes, also applies to Parcel Post Parcel Select mailers. *Ibid.*

(1) Existing Rate Design

[5890] Witness Kiefer develops preliminary Single-Piece and Basic Presort per piece and per pound charges as described in section b, above. See *a/so* USPS-T-37 at 35-36. Witness Crum estimates carrier route presort savings at 7.7 cents per piece. USPS-T-27, Attachment G. Witness Kiefer proposes a Carrier Route Presort discount of 7.7 cents off the Basic Presort per piece rate. The proposed rates for these rate categories follow the same rate design methodology as used in previous dockets. The rate design is unopposed on the record and accepted by the Commission. The Commission's attributable costs and cost coverage cause the recommended rates to differ from the Postal Service's proposed rates.

(2) Destination Entry Discounts

[5891] The Postal Service's rate design for the proposed destination entry (dropship) discounts contain both per piece and per pound rate elements. The per piece element reflects the mail processing cost savings associated with entry mail at destinating facilities. This mail avoids all processing activities at origin facilities. The cost savings associated with DBMC mail are estimated by witness Crum in the following manner. First, outgoing BMC costs avoided by DBMC parcels are estimated and added to the non-BMC outgoing costs. Next, the volume deposited upstream of the DBMC is derived through use of the Bound Printed Matter Mail Characteristics Study (BPM study) results. Finally, the unit cost savings associated with these pieces is calculated. Witness Crum estimates the unit cost savings for DBMC relative to origin entered mail at 38 cents. Witness Crum uses mailflow models to estimate the mail processing savings for DSCF and DDU mail pieces. The DSCF savings relative to DBMC are 14.9 cents, while the DDU savings relative to DSCF are 12.7 cents. The Postal Service's proposed per piece rates for DBMC, DSCF, and DDU reflect passthroughs of 16, 47, and 45 percent, respectively.

[5892] Transportation costs are developed for the dropship categories in a manner similar to Parcel Post. For DBMC, the total transportation cost is first divided into long-distance, intermediate, and local portions. Long-distance is further separated into zone and non-zone related. These costs are then allocated to categories and zones and per pound costs are developed. DSCF and DDU transportation costs are not zoned. See USPS-T-27 at 16, Attachment K.

[5893] Two parties, AAP and MOAA, address the discount proposals. AAP witness Siwek opposes the destination discounts, advocates a single discount for destination entry mail, and contends that the BPM study is flawed. Tr.30/14575 *et seq.* See also AAP Brief at 14 *et seq.* On brief, AAP argues that the volumes reported by the BPM study are unreliable. AAP Brief at 16-17. In addition, it asserts that the study contains methodological errors, *e.g.*, measurement error in the strata weights and use of an unsound method of “bootstrapping” sample results. *Id.* at 17; see also Tr. 30/14578.

[5894] In response to witness Siwek’s criticisms, the Postal Service submitted the testimony of witness Degen. Tr.38/17340-48. The crux of his testimony is that while Siwek’s criticisms may be technically valid they are invalid from a practical standpoint. Degen contends that witness Siwek’s criticisms imply use of a simple random sample rather than the stratified sample used. He claims that doing so would result in unusable data and unacceptably large standard errors. According to witness Degen, stratification is warranted when the population is composed of facilities that vary in size, the principal variables being measured are closely related to the size of the facility, and a good measure of size is available for developing the strata. Degen contends that presorted BPM satisfies all of these conditions. Given the concentration of BPM in a small number of postal facilities, Degen asserts that a simple random sample would “have the Postal Service making inferences about dropshipping based on a sample that contained few, if any dropshippers.” *Id.* at 17343. Degen takes issue with each of Siwek’s criticisms, contending, among other things, that the measurement error in stratum 4 is insignificant, that collapsing strata is a common practice, and that a small bias in the standard errors is

preferable to no standard error. *Id.* at 17344-7; *see also* Postal Service Brief at VII-121-126.

[5895] On brief, AAP denies that witness Siwek's criticisms imply abandoning the stratified sample in favor of a random sample, stating that witness Siwek's testimony was "severely mischaracterize[d]." AAP Brief at 18. It claims that witness Siwek sought to identify problems and improve the estimation procedure. In its reply brief, the Postal Service argues that AAP fails to demonstrate that the flaws it identifies have a material impact. Postal Service Reply Brief at VI-106-10.

[5896] While witness Siwek's criticisms may have some technical "bark," they do not possess sufficient practical "bite" to invalidate the survey. As the Postal Service notes, AAP has not demonstrated that its criticisms materially affect the study results so as to preclude their use for purposes of estimating cost savings. Accordingly, the Commission finds the survey results to be acceptable for estimating dropship cost savings. Nonetheless, in recognition of issues raised by AAP and because these rate categories are new to BPM, the Commission, to be conservative, has not passed through the full cost savings. This ameliorates any concern about the efficacy of the survey. In the next rate proceeding, actual data will be available for analysis and the rates adjusted accordingly.¹⁵⁹

[5897] AAP opposes the implementation of the dropship categories, arguing that the discounts be phased in over time starting with DBMC. AAP Brief at 22. To that end, witness Siwek proposes a DBMC discount for which all mail entered at DBMC, DSCF, and DDU would be eligible. In support, AAP claims that phasing is consistent with the way dropship discounts were introduced in Parcel Post.

¹⁵⁹ In its Reply Brief, AAP argues that the Postal Service has improperly attempted to shift the burden of proof, contending, *inter alia*, that it failed to supply credible volume estimates. AAP Reply Brief at 1-3. AAP's argument is not persuasive. The Postal Service's BPM proposal is supported by its direct case. The burden of going forward then shifted to AAP as an opponent of the proposal. AAP responded with the testimony of witness Siwek. In response, the Postal Service submitted the rebuttal testimony of witness Degen. Tr. 38/17340 *et seq.* In considering this record, the Commission concludes that the Postal Service has satisfied its burden. *See, e.g.,* Postal Service Reply Brief at IV-2-4.

[5898] On brief, the Postal Service argues that the circumstances behind the Parcel Post discounts are different from the ones facing BPM in this docket. The Postal Service identifies several distinctions, including insufficient data to support a full range of Parcel Post dropship options, the existence of the parcel consolidation industry, and that some BPM mail is already entered deep into the system. Postal Service Brief at VII-128-129. The Service also asserts that “witness Siwek’s notion of phasing benefits a limited interest group at the expense of the rest of Bound Printed Matter (and non-BPM) mailers. *Id.* at VII-128.

[5899] AAP’s arguments are not compelling. The comparison with Parcel Post is misplaced for the reasons suggested by the Postal Service. Moreover, destination entry discounts are common, better reflect costs, and are consistent with criterion 6. Furthermore, mailers’ endorsement of the proposal evidences demand for the service. In sum, there is no valid reason to defer implementation of these rate categories as suggested by AAP. Accordingly, the Commission recommends that the DMCS be amended to include the proposed destination entry rate categories. The Commission’s recommended per piece discounts for DBMC, DSCF, and DDU are 13, 28, and 34 cents, respectively.

[5900] MOAA witness Prescott argues that the passthrough for the DDU discount is too low. He proposes a passthrough of 50 percent. His proposal results in a per piece discount of 33.1 cents and a per pound discount of 4.4 cents. On brief, the Postal Service indicates that its interest in increasing the passthrough is trumped by its concern over the potential increase in other rates. Postal Service Brief at VII-132-133. The Commission agrees that a higher passthrough is warranted. It recommends a per piece DDU discount of 34 cents which reflects a passthrough of approximately 50 percent. The Commission’s recommended per pound element is the same as the Postal Service’s, 3 cents, and reflects the Commission’s desire to maintain a logical zone differential structure.

(3) Proposed Barcode Discount

[5901] As noted above, the current discount for barcoding is \$0.03 per piece. Witness Kiefer proposes to maintain this discount based on an analysis by witness Eggleston, who modeled the cost of the only mailhandling operation, the parcel sorting machine, affected by the presence of a barcode. USPS-T-26 at 10. Her estimated test year per piece cost savings is 2.9 cents. *Id.* at Attachment B. Witness Kiefer proposes to round the discount to \$0.03 per piece. The Postal Service's proposal is unopposed and, accordingly, the Commission recommends it be implemented.

(4) Local Zone

[5902] As discussed above, the Postal Service cites changed operations as the basis for eliminating the local zone. Although no participant opposes this proposal, the Commission has some reservation about its elimination. Specifically, the DDU rate category recommended in this proceeding provides bulk mailers a surrogate for the local zone that is not available to single piece mailers. The Postal Service, however, indicates that the local rate is no longer compensatory given its changed processing and transportation networks. USPS-T-37 at 33. As a consequence, and given the lack of opposition to the proposal, the Commission recommends elimination of the local zone.

(5) Elimination of one pound minimum

[5903] Witness Kiefer proposes to eliminate the one pound weight minimum for BPM. *Id.* at 34, revised March 14, 2000. Doing so, he suggests, will accommodate mailers wishing to mail BPM weighing less than one pound. *Ibid.* A separate rate for BPM weighing less than 16 ounces is not proposed. Instead, each piece weighing less than one pound "will be treated as if it weighed one pound exactly." *Ibid.*

[5904] The proposal, which is unopposed, has two apparent benefits. First, mailers benefit through the availability of an additional mailing option. Second, elimination of the

minimum weight for BPM and Parcel Post simplifies the Package Services classification, and may, particularly if demand for the service materializes, provide an impetus for further refinement of the parcel classifications. Accordingly, the Commission recommends the proposal be implemented.

[5905] Currently, the rates for BPM are designed in half-pound increments up to five pounds. For purposes of this proceeding, the proposed rate for mail weighing less than one pound is satisfactory. In the next proceeding, however, the Postal Service should address whether a separate rate for such mail is warranted.

g. Recommendation

[5906] The Commission recommends that BPM rates be increased, on average, by 17.6 percent. Several factors influence this recommendation. First, this increase is driven, in large part, by the substantially higher costs reported for the subclass. In the two years between the base year in Docket No. R97-1, and the base year in this proceeding, BPM unit costs increased by more than 40 percent. Tr. 13/5300. When contrasted with this substantial cost increase, the rates recommended by the Commission significantly mitigate the potential adverse impact of the Postal Service's operating experience. The increase may, as MOAA implies, be attributable to the changing character of the subclass. MOAA Brief at 24-25. The record is unclear on this point. However, neither AAP nor MOAA has demonstrated that the BPM costs reported by the Postal Service are inaccurate.

[5907] The Commission recommends adoption of the rate structure proposed by the Postal Service, albeit at different rate levels. The new rate structure recognizes mailer preparation activities (criterion 6) and affords a means to mitigate the size of the increase, while better aligning rates with costs.

3. Media Mail¹⁶⁰

a. Introduction

[5908] Media Mail is a statutorily derived, content-restricted classification. See 39 U.S.C. § 3683(a). Items eligible to be mailed at Media rates include books, 16-millimeter or narrower width film, printed music and test materials, sound recordings, playscripts, and manuscripts. See proposed DMCS § 523.1. Media rates are required to be uniform for mail of the same weight and may not vary with distance.

[5909] Media Mail has a relatively simple rate structure, consisting of three rate blocks: first pound, 2-7 pounds, and 8-70 pounds. As noted below, Library Mail shares this three-tiered rate structure. Rate categories include single piece, Level A Presort (5-digit), and Level B Presort (BMC). The current Media rates are as follows: first pound: single piece \$1.13, Presort A (5-digit) \$0.64, and Presort B (BMC) \$0.95; 2-7 pounds: \$0.45 per pound; and 8-70 pounds: \$0.28 per pound. In addition, properly prepared, machinable single piece and Level B presort rate Media Mail are eligible for a barcode discount, currently \$.03 per piece.

b. Postal Service Proposal

[5910] Postal Service witness Kiefer proposes to increase Media rates, on average, by 4.9 percent, yielding a cost coverage of 112.5 percent. USPS-T-37 at 1. Witness Kiefer develops his proposed Media rates in two stages. He begins by assigning volume variable costs to the subclass on a per piece and per pound basis. Preliminary per pound charges are developed by allocating all transportation costs, plus a two-cent per pound add-on for weight-related non-transportation costs, to the total postage pounds. He divides these weight-related costs by total postage pounds, and then marks up these

¹⁶⁰ USPS-T-37 at 1. As noted above, the Postal Service proposes to change the name of Special Standard Mail to Media Mail. The Commission recommends that the DMCS be amended with a conforming change.

unit costs by a cost coverage markup factor. See *Id.* at 9 and Kiefer workpaper WP-SS-10. The remaining costs are similarly marked up, added to revenue leakage, and allocated on a per piece basis. To develop Presort A (5-digit) and B (BMC) first pound rates, witness Kiefer relies on witness Eggleston's estimated cost savings for Media Mail. USPS-T-37 at 9-10. His proposed barcode discount also relies on witness Eggleston's estimated cost savings. *Id.* at 10.

[5911] Witness Kiefer's preliminary rates produce sharp increases in the first pound rate, ranging from 24 percent for the single piece rate to more than 60 percent for the Presort A rate. Preliminary rates in the remaining tiers are below existing rates, by 47 percent in the 2-7 pound rate, and by 14 percent in the 8-70 pound rate. *Id.* at 10-11. As a mitigation measure, witness Kiefer lowers the first pound rate substantially, while increasing the rates for the remaining blocks, particularly the 2-7 pound rate. *Id.* at 10; see also Kiefer workpaper WP-SS-11.

[5912] Actual FY 1999 costs presented by Witness Patelunas reported a 44.5 percent increase in Media mail costs, as compared to BY 1998 levels. Comparing BY 1998 and FY 1999, the Postal Service stated that mail processing costs of Media Mail had increased 43.6 percent under the Postal Service's methodology (\$80.9 million to \$116.2 million). Tr. 48/22458. In response to questions from the bench concerning the reasons for the increase, the Postal Service provided an institutional response stating that "[t]he increase is due primarily to an increase in [Media Mail] direct tallies." Tr. 46-C/21048.

[5913] The Commission found the Postal Service's responses failed to explain adequately the causes for the increase in Media Mail cost from FY 1998 to FY 1999. Thus, to develop the record more fully, the Commission directed the Postal Service to provide a witness capable of addressing the issue. Order No. 1300 (August 18, 2000). In response, the Postal Service submitted the testimony of witness Degen. See Tr. 45/20051-60.

[5914] The Presiding Officer also requested more detail about the increase, first, in P.O. Information Request No. 20, which explored methodological reasons for the

increase, and second, in P.O. Information Request No. 21, which inquired about the impact of an FY 1999 change in endorsement requirements for Special Standard Mail. The Postal Service provided responses to these requests. See Tr. 46-D/21458, and 21147.

[5915] Witness Degen testified that “the increase in [Media Mail] unit costs is broadly distributed across offices, pay periods, facility types, and cost pools, indicating improved identification or increased costs for which I have no specific explanation at this time.” Tr. 45/20052. That review identifies a group of tallies for which there may have been some confusion on the part of data collectors causing them to erroneously record certain Standard Mail (A) Regular as Media Mail. *Id.* at 20053, 20061. Beyond those tallies, however, the review revealed “no other anomalies in the Special Standard direct tallies.” *Id.* at 20061. Witness Degen proposes, assuming that the Commission adopts FY 99 costs, that the suspect tallies for Media Mail F Y1999 be reassigned, thereby reducing mail processing costs to \$101.7 million. *Id.* at 20053 and 20060. The IOCS data reported in USPS-LR-I-493 reflect this adjustment. Postal Service Brief at VII-134. On brief, the Postal Service notes that this adjustment would mitigate, but not eliminate, the reported increase in FY 1999 costs for Media Mail. *Ibid.*

c. Intervenor Proposals

[5916] Recording Industry of America (RIAA) witness Elliott argues, *inter alia*, that the FY 1999 increase in Media Mail processing costs is neither supported by historical trends nor adequately explained by the Postal Service. See Tr. 41/18029-37. In examining the cause of the 44 percent increase in processing costs between F Y1998 and FY 1999, witness Elliott first compares Media Mail’s pieces, pounds, and cubic feet for FY 1998 and FY 1999, concluding that the overall composition of Media Mail remained relatively stable. *Id.* at 18030-31. He notes that the data indicate an increase in presort volumes, which should cause a decrease in processing costs. Next, based on the Postal Service’s FY 1998 data, he argues that “it is possible to derive a 95 percent

confidence interval for mail processing costs for [Media Mail] that ranges from a low of \$71,150,000 to a high of \$90,582,000.” *Id.* at 18031 (footnote omitted). Given the relatively stable composition of Media Mail, he concludes that the failure of the FY1999 cost estimates to fall within the 95 percent confidence interval for the BY 1998 estimate suggests either erroneous figures or that the costs had changed significantly. To test this hypothesis, he examined mail processing costs from FY 1994 to FY 1999, adjusted for inflation and for different costing methods over time. Based on this analysis, witness Elliott concludes that the FY 1999 cost figure is anomalous.

[5917] Witness Elliott also discounts the Postal Service’s explanation of the FY 1999 cost increase, contending, essentially, that it is nothing more than speculation. In addition, he argues that if the change in endorsement requirements caused an increase in IOCS tallies, logically, a concomitant volume increase should have been observed in the DPRW. Citing the modest increase in FY 1999 Media Mail volumes, he contends that the changed endorsement requirements do not explain the increase in IOCS tallies. *Id.* at 18035. In lieu of the FY1999 cost estimate, witness Elliott provides an alternative estimate based on BY 1998 costs in 1999 dollars. *Id.* at 18037.

[5918] On brief, RIAA characterizes witness Degen’s explanation as unpersuasive, reiterating witness Elliott’s conclusion that the change in endorsement requirements fails to explain why Media Mail volumes were not similarly affected. RIAA Brief at 17-18. In addition, RIAA disputes witness Degen’s claim that notice of the change in endorsement requirements, which are not mandatory until January 2001, was widely publicized. *Id.* at 17.

d. Recommendation

[5919] In this proceeding, the estimated FY1999 mailhandling costs for Media Mail have increased substantially. The Postal Service’s examination of the cost increase, which it characterized as broadly distributed across offices, pay periods, office, and MODS operation pools, did not eliminate either improved identification or increased

costs as the possible cause of the increase. See Tr. 45/20052, 20062, and Postal Service Reply Brief at IV-61. The Postal Service did, however, suggest that a portion of the increase may be due to erroneous IOCS entries. See *id.* at 20053 and 20061. That analysis, while perhaps not as dispositive as the Commission would prefer, rests on the implicit premise, not contradicted on this record, that the Postal Service's cost estimation systems are fundamentally sound.

[5920] Witness Elliott's contention that improved identification should have caused a concomitant increase in Media Mail volumes has surface appeal. However, processing costs reflect data collected in the IOCS system, while volumes are measured by the RPW system. Misidentifying IOCS tallies should have no impact on RPW data. The Commission cannot lightly dismiss the presumption that the IOCS system is accurately sampling, and that costs have increased. Acceptance of witness Elliott's alternative proposal would require us to conclude, at least implicitly, that the Postal Service's cost estimation systems are unreliable. The record will not support such a finding. As the Postal Service observes, there is no reason to ignore Media Mail's actual FY 1999 costs, simply because relative to FY 1998 they exhibit an increase. See Postal Service Reply Brief at IV-61. Moreover, the Postal Service's adjustment to the IOCS tallies serves, at least in part, to reduce the abnormal size of the cost increase.

[5921] The Commission recommends an average increase of 6.3 percent in Media Mail rates. While above the system average, it is largely a product of increased costs. The Commission's reliance on the costs is consistent with its recommendation in the last rate proceeding. In Docket No. R97-1, based on the estimated costs reported for Media Mail, the Commission recommended that Media rates be reduced, on average, by 9.6 percent. In that proceeding, the Postal Service proposed a slight decrease in Media Mail rates. The Commission's larger decrease was based on lower Media Mail attributable cost levels. PRC Op. R97-1, para. 5748. While of course preferring results demonstrating declining costs, the Commission has not, in either docket, accepted the Postal Service's estimates uncritically. Furthermore, considering the decrease in Media Mail rates which became effective in January 1999, and assuming rates in this

proceeding will be effective for at least two years, Media rates remain, on average, below their Docket No. R94-1 levels.¹⁶¹

e. Cost Coverage

[5922] The Commission's cost coverage for Media Mail is 102 percent, which, while substantially below the system average, satisfies Section 3622(b) criteria. As required by criterion 3, the recommended rates cover attributable costs and make a modest contribution to institutional costs. Historically, Media Mail's below average cost coverage derives principally from three factors. See, e.g., PRC Op. R97-1, para. 5754 and PRC Op. R94-1, para. 5370. The record in this proceeding provides no reason to vary from the historical practice. First and foremost, since Media Mail is a content-restricted subclass available for mailing educational and informational materials, the Commission is particularly mindful of its educational, cultural, scientific, and informational value to the recipient. The Commission's cost coverage reflects consideration of that ECSI value. Second, Media Mail is perceived to have a relatively low value of service, indicative of its nonpreferential processing and transportation. Third, criterion 5, available alternate means, is also a consideration. While business mailers may have options, including using BPM, alternatives for individual users are more limited. See USPS-T-32 at 46.

[5923] The recently enacted legislation providing a preference for Library Mail also affects the Commission's cost coverage considerations. Pursuant to the PL 106-384, Media rates are based on the combined attributable costs of Media Mail and Library Mail. This causes Media Mail costs to increase above a stand-alone level, and, as a result, justifies further moderation of the cost coverage. Standing alone, the test year after rates unit cost of Library Mail is \$1.84 compared to \$1.61 for Media Mail, or, in percentage

¹⁶¹ As a point of comparison, the Postal Service's proposed Special (Media) rates in Docket No. R97-1 and in this proceeding were developed similarly. In Docket No. R97-1, the Postal Service's Special rate witness eschewed his preliminary rates, which would have caused the first pound rate to increase from \$1.24 to 1.54, in order to mitigate rate shock. See PRC Op. R97-1, paras. 5749-50. Witness Kiefer follows the same practice in this proceeding.

terms, approximately 14 percent greater than Media Mail. Library Mail is a relatively small subclass. Nonetheless, absorbing increases of this nature may be perceived as imposing an unfair burden on users of Media Mail. To allay this concern, the Commission has reduced its cost coverage in recognition of this unusual situation.

[5924] Under the circumstances, the 6.3 percent rate increase, although somewhat above the system average, is reasonable. There is no evidence suggesting that the users will be unfairly burdened. Nor is there evidence indicating any concern by any competitor. The rate structure is relatively simple, while providing mailers with worksharing incentives. In sum, the Commission finds, based on a careful consideration of all the applicable criteria, that its recommended Media rates are fair and equitable.

f. Rate Design

[5925] Neither the Postal Service nor any participant proposed any change in the current rate design. The recommended rates are designed in a manner similar to that used by witness Kiefer, which, in turn, is the design long used by the Commission. See USPS-T-37 at 9. The Commission's attributable costs and cost coverage cause the recommended rates to differ from the Postal Service's proposed rates.

[5926] The recommended Media rates are as follows: first pound: single piece \$1.30, Presort A (5-digit) \$0.70, and Presort B (BMC) \$1.00, 2-7 pounds: \$0.45 per pound; and 8-70 pounds: \$0.42 per pound. The first pound rate for Presort Level A represents a discount of \$0.42 per piece, while the discount for Presort Level B represents a discount of \$0.12 per piece. These discounts are based on witness Eggleston's analysis, adjusted to reflect the Commission's costing approach. The recommended barcode discount is \$0.03 per piece for properly prepared single piece and Presort Level B Media Mail. Like the barcode discount for all the Package Service classes, this discount is based on witness Eggleston's estimated unit cost savings, adjusted to reflect the Commission's costing methodology. The Commission also recommends that the annual presort mailing fee be increased to \$125.

4. Library Mail

a. Introduction

[5927] Library Mail is a creature of statute. First, it is a preferred subclass. Recently enacted legislation, PL 106-384, provides that Library rates be set, as nearly as practicable, five percent lower than the corresponding Media Mail rates.¹⁶² As discussed above, the Media rates are based on the combined costs of Media Mail and Library Mail. Second, pursuant to section 3626 of the Act, eligibility to mail at Library rates is restricted by content and use. For example, certain matter, *e.g.*, books, printed matter, bound volumes of academic theses, sound recordings, museum materials, specimens, and teaching aids, may only be sent between eligible institutions or organizations, such as schools, colleges or universities, and public libraries, museums and herbaria, and various nonprofit organizations or associations. See DMCS proposed § 524.13; see also DMM §§ 630.5.3 and 5.4. The nonprofit organizations include, *e.g.*, religious, educational, scientific, or charitable institutions, and labor, veterans' or fraternal organizations. Library Mail may also be utilized to mail items between such organizations and their members, readers, or borrowers.

[5928] In addition, certain matter, *e.g.*, 16 millimeter or narrower film, sound recordings, museum materials, specimens, and scientific or mathematical kits, may only be sent to or from certain institutions or organizations, *e.g.*, schools, colleges, universities, public libraries, and museums and to or from various nonprofit organizations or associations. See DMCS proposed § 524.14; see *also* DMM § 630.5.4. Finally, Library rates are required to be uniform for mail of the same weight and may not vary with distance. 39 U.S.C. § 3683(a).

¹⁶² Prior to the passage of PL 106-384, Library rates were based on the Revenue Foregone Reform Act of 1993 (RFRA) under which Library rates were phased upward over a period of six years, ending in FY 1998. 39 U.S.C. § 3626(a). Pursuant to RFRA as of FY 1999, Library Mail is prescribed a markup equal to one-half of that of Special Mail.

[5929] In Docket No. R97-1, the unit costs of Library Mail were significantly higher than those for Special Standard Mail, precluding a markup for Library Mail consistent with RFRA while maintaining Library rates below those of Special Standard.¹⁶³ Initially, as an interim measure, the Commission recommended, in lieu of discrete Library Mail rates, that all matter eligible to be mailed as Library Mail be mailable as Special Standard Mail. PRC Op. No. R97-1, paras. 5743-45. Concerned about the continued viability of Library Mail as a separate subclass, the Governors requested the Commission to reconsider that recommendation, suggesting that the Library Mail rate schedule reflect the lowest rates for which such mail was eligible. Acceding to this suggestion, the Commission recommended Library Mail rates, set forth in a separate rate schedule, equal to those of Special Standard. Opinion and Further Recommended Decision, Docket No. R97-1, September 24, 1998, at 14-17.

b. Postal Service Proposal

[5930] Witness Kiefer's proposed rates decouple Library Mail from Special Standard. Specifically, he proposes that Library Mail rates be set one cent lower than Special Standard in every rate cell. This results in a rate increase of 4.5 percent and reflects a cost coverage of 104.7 percent. Witness Kiefer notes that the proposed increase does not comply with existing law. He indicates, however, that the Postal Service anticipates passage of legislation that would "codify the principles followed in this rate case to develop Library Mail rates when preferred rates cannot be achieved using the cost coverage formula described in RFRA." USPS-T-37 at 23; see also Postal Service Brief at VII-135.

¹⁶³ For purposes of this discussion, the term Special Standard shall be used as a matter of convenience notwithstanding the Commission's recommendation to relabel that subclass as Media Mail.

c. Intervenor Proposals

[5931] The American Library Association (ALA) witness Sheketoff expresses concerns that the proposed increase, coupled with cumulative effect of prior increases, could jeopardize various library programs, e.g., interlibrary loan and “Book by Mail.” See Tr. 28/13393-97. Witness Sheketoff contends that the Postal Service has long been on notice about the inadequacy of existing cost data for library mail. Consequently, she urges the Commission “to reject claims of increasing costs” absent a demonstration that such costs will be incurred. *Id.* at 13397. On brief, ALA reiterates these points. ALA Brief at 2-3. In addition, ALA “urges the Commission not to attribute to library rate mail the costs of needless manual or non-automated processing that would have been avoided by economical and efficient levels of investment in automated equipment for processing flats and parcels.” *Id.* at 3-4.

d. Recommendation

[5932] As discussed above, PL 106-384 amends the Postal Reorganization Act to provide, *inter alia*, reduced rates for certain preferred subclasses of mail. As a result, rates for Library Mail shall be established by reference to Media Mail rates. Specifically, the Library rate shall be, as nearly as practicable, 5 percent lower than the corresponding Media Mail rate. The Commission’s recommended Library Rates are consistent with this provision.¹⁶⁴ The recommended rates yield an average increase of 4.9 percent.

¹⁶⁴ The Commission also recommends that the annual presort mailing fee be increased to \$125.

F. Special Services

[5933] *Introduction.* The Postal Service proposes fee and classification changes to most special services. The proposed classification changes are summarized below:

- A proposal to establish an annual advance deposit account fee for bulk parcel return service (BPRS);
- A proposal concerning business reply mail (BRM) to split Qualified Business Reply Mail (QBRM) into two fee categories, and establish a quarterly fee category for fixed billing costs that would apply to one of the new QBRM fee categories;
- A proposal to modify the DMCS language for certified mail to reflect that records are retained by the Postal Service at a central location and not at the office of delivery;
- A proposal to increase the maximum collect on delivery amount to \$1,000;
- A proposal to extend delivery confirmation to Standard Mail Regular and Nonprofit pieces that pay the residual shape surcharge;
- A proposal to offer separate bulk discounts for unnumbered and numbered insurance, and extend bulk insurance to Standard Mail;
- A proposal to allow customers who return a parcel to the shipper using merchandise return to purchase insurance, to eliminate the current per piece fee for merchandise returns, and to establish an annual advance deposit account fee for merchandise return;
- A proposal to restructure the fees for on-site meter settings, and eliminate on-site meter setting fees for secured postage meters;
- A proposal to change DMCS language for consistency in permit fees, divide the special and library standard mail presort mailing permit fee into two separate fees, and establish a bound printed matter permit fee;
- A proposal to establish a new fee structure for post office boxes, and establish fees for replacing keys and changing locks;
- A proposal to modify DMCS terminology for return receipt service, and extend return receipt for merchandise service to Standard Mail Regular and Nonprofit parcels;
- A proposal to add an annual accounting fee to shipper paid forwarding, and make Parcel Post available for shipper paid forwarding;
- A proposal to provide signature confirmation as an independent service; and

- A proposal to merge fees for #6-3/4 stamped envelopes with #10 stamped envelopes, eliminate banded #6-3/4 and #10 stamped envelopes, and rename a stamped envelope group from “hologram” to “special.”

[5934] *DMCS Proposals.* In the Opinion in Docket R97-1, the Commission accepted a Postal Service proposal to reorganize the DMCS special services sections into seven categories: Addressing (910), Delivery Alternatives (920), Payment Alternatives (930), Accountability and Receipts (940), Parcel Handling (950), Stamped Paper (960), and Postal Money Orders (970). A separate fee schedule (1000) is provided for permits. Subsequently, the Commission recommended the addition of a category for Acceptance Alternatives (980). In the instant docket, the Postal Service reviews each of the DMCS special services sections and offers proposals to rewrite each section for clarity, consistency, and organization. The proposals generally improve the readability of the DMCS special services sections. Therefore, the Commission has incorporated a majority of the Postal Service proposals into its DMCS recommendations. The Commission recommendations for the DMCS text appear in Appendix Two and recommendations for the DMCS Fee Schedules appear in Appendix One.

[5935] *Special Services Cost Coverages.* The DMCS category structure provides a convenient framework for review of the special services cost coverages. Services that have similar functions, and that theoretically might have similar cost coverages are grouped within categories. However, note that the specifics of each service cause the individual service to diverge from the ideal cost coverage for the category. For instance, several of the proposed rate increases have been tempered by the negative effect of a rate increase upon the general public (criterion 4), resulting in lower than ideal cost coverage.

[5936] *Addressing (910).* Addressing services generally result in lower Postal Service mail processing costs by providing correct delivery address information to mailers. This directly affects the degree of preparation of mail for delivery into the postal system and reduces the overall costs to the Postal Service (criterion 6). The addressing services make for an efficient mail stream that justifies a low markup. One of the addressing services, address changes for election boards and registration commissions,

aids election boards in carrying out their vital function in our democracy. This service justifies the lowest markup possible that still covers costs (criterion 9).

[5937] Delivery Alternatives (920). The post office box and caller service is a high value premium service that can justify a high cost coverage (criterion 2). Post office box service is optional for most mailers. Mailers pay box fee rate “E” when post office box service is the only delivery option. The Postal Service proposes, in this docket, to restructure the post office box service to have the rates more accurately reflect costs (criterion 3). The Postal Service has capped the average increase it proposes due to the fee restructuring to avoid an excessive adverse impact on post office box users. Capping the rate changes considers the effect of the proposed rate increases on the general public (criterion 4). This consideration tends to lower the implicit cost coverages within some of the post office box fee groups to the moderate range. It may take one or more rate proceedings to more fully align rates with costs, and reflect the proper cost coverage in all fee groups.

[5938] Payment Alternatives (930). Payment alternative services generally facilitate the use of other mail services. Except for on-site meter setting service, a permit fee and an accounting fee are integral parts of each service. In determining a cost coverage for these services, the Commission is concerned with adequately covering the cost of the service and providing a moderate contribution to institutional costs (criterion 3).

[5939] Accountability and Receipts (940). Services in this category are generally high value services that enhance the value of the underlying host mail piece to the mailer (criteria 2). This could justify a moderate to high cost coverage for each of the included services. However, other factors tend to lower the cost coverage for several of the services. For example, the impact a rate increase may have on the mailer influences the cost coverage for the collect on delivery service (criterion 4). The Commission considers users of this service may be people of modest means, with few alternatives for business transactions. Therefore, a lower cost coverage is justified. Delivery confirmation is a relatively new service and a modest cost coverage is recommended to allow the service

to develop to its fullest potential. The costs for certified mail have risen to such an extent that setting a rate that represents the true value of this service may create consumer sticker-shock. Again, this results in a lower cost coverage for certified mail. The differences and interrelationships among the services within this category also influence the value of service, and tend to lower the cost coverage below the high cost coverage that is otherwise justified.

[5940] Parcel Handling (950). Parcel airlift and special handling require individual consideration when discussing cost coverages. Both services are relatively low volume, and as such, it is difficult to accurately predict their costs. The services also are used only by limited groups. Parcel airlift provides service to certain military post offices on a space available basis. It has a lower value of service because there are alternatives that are more expeditious for sending parcels (criterion 2). The effect of a rate increase on the mailer also justifies a lower cost coverage because this service is used by military personnel that may not be able to afford a higher priced service (criterion 4). In Docket R97-1, an organization of poultry producers successfully argued to not increase the rates for special handling. Their argument was based on the lack of reliable cost information to justify that increase (criterion 3). This reasoning continues to justify current special handling rates.

[5941] Stamped Paper (960). The stamped envelope and stamped card service provides a high value of service because of the convenience it offers postal customers by allowing the purchase of a limited quantity of mailing supplies while at the post office (criterion 2). When purchased in greater quantities the stamped paper service may save postal customers the expense of applying stamps to envelopes and the expense of keeping an inventory of stamps. This could justify a high cost coverage. Balancing the justification for a high cost coverage is the effect of the rate increase on the general public, especially in the case of stamped cards, that tends to lower the final coverage into the moderate range (criterion 6). The Commission's philosophy of maintaining First-Class Cards as a low cost method to send mail also applies to keeping the stamped card rate as low as possible. The integer rounding constraint frequently restricts the

Commission in its ability to set a precisely appropriate cost coverage, thereby resulting in coverages that may be above or below the target coverage.

[5942] Postal Money Orders (970). The postal money order service is a high value service because of the quality of the product in both its recognition and negotiability (criteria 2). There apparently are many available alternatives to the Postal Service product of varying qualities (criterion 5). These factors argue in favor of a higher cost coverage. However, the Commission balances the above factors against the effect of a rate increase upon the general public and moderates rates to maintain a somewhat lower cost coverage than the value of service would otherwise indicate (criterion 5). For example, military personnel that purchase APO-FPO money orders are providing a vital service to our country and may have difficult absorbing price increases. The Commission also continues to view purchasers of domestic money orders as people of modest means with a more limited access to alternative financial vehicles. Thus, the Commission's goal is for a moderate cost coverage for the postal money order service.

[5943] Acceptance Alternatives (980). Mailing Online is the only acceptance alternative special service. A comprehensive review of the factors of the act is provided in PRC Op. MC2000-2. The cost coverage for this service is set near the system-wide average. This recommendation was partially based on Mailing Online being a high value experimental service. After operations experience is available, the appropriate level of cost coverage for this will be reexamined.

[5944] *Special Services Discussion*: A discussion of each special service follows. Separate discussions on permit fees and the DMCS rewrite proposals are included. The recommended fees for special services appear in Appendix One.

1. Address Correction Service (Schedule 911)

[5945] Address Correction Service provides a mailer with an addressee's correct or forwarding address if known, or a reason why the Postal Service is unable to deliver a mailpiece as addressed. Both manual and automated services are available. Manual

address correction service provides a mailer with a photocopy of the mailpiece along with the correct address information on Form 3547 (for First-Class Mail, Standard A Mail, or Standard B Mail), or the cover sheet of a periodical with the correct address information attached on Form 3579 (for Periodicals). Automated address correction service provides a mailer with correct address information or a reason for non-delivery electronically—accessible by the mailer using a computer and a modem. Periodicals automatically receive address correction service for 60 days following a change-of-address order. Address correction service is available by itself, or in conjunction with forwarding and return service. USPS-T-39 at 10-14.

[5946] The Postal Service projects test year costs, including contingency, of 13.4 cents for automated address correction and 55.8 cents for manual address correction. USPS-T-29 at 5. The Service proposes retaining the current fee of 20 cents for automated address correction and increasing the fee of 50 cents to 60 cents for manual address correction. USPS-T-39 at 10, 13.

[5947] The Commission recommends the Service's proposed fees of 20 cents for automated address correction and 60 cents for manual address correction. These rates produce a 125 percent cost coverage. This modest cost coverage is appropriate for a service that results in lower Postal Service mail processing costs by providing correct delivery addresses to mailers.

2. Mailing List Services (Schedule 912)

a. ZIP Coding of Mailing Lists

[5948] The Postal Service projects test year costs, including contingency, of \$71.15 per one thousand addresses for sorting of mailing list address cards by five-digit ZIP Code. USPS-T-29 at 26. The Service proposes increasing the current fee of \$70.00 per one thousand addresses contained in a mailing list to \$73.00 per one thousand addresses contained in a mailing list. USPS-T-39 at 162-164. The Commission

recommends the \$73.00 per one thousand addresses fee proposed by the Postal Service. At these rates, test year costs will equal \$70.45, producing a 104 percent cost coverage.

b. Correction of Mailing Lists

[5949] Eligible mailers may submit a name and address list, or an occupant list (address only list) to the Postal Service for correction. The mailing list may be submitted on cards or on sheets of paper, and must be separated by Post Office or carrier route as required. Name and address list corrections include eliminating names to which mail cannot be delivered or forwarded, providing forwarding information if an order is on file, correcting spelling of names and addresses, correcting ZIP Codes, post office box numbers, and rural box numbers, and providing the name of the head of household when two or more names appear on the list. Occupant list corrections include deleting invalid addresses, correcting the last lines of the address, placing directional signals to indicate carrier route information, and providing the number of units in multiple unit dwellings. *Id.* at 50-53.

[5950] The Postal Service projects test year costs, including contingency, of 23.2 cents per address for the correction of mailing list service. USPS-T-29 at 25-26. The Service proposes increasing the current fee of 20 cents per address to 25 cents per address contained on the mailing list. USPS-T-39 at 50-53. The Service further proposes to increase the minimum charge per corrected list from \$7.00 to \$7.50. Under the proposal, the number of addresses submitted per address list equivalent to the minimum charge effectively decreases from 35 to 30 addresses. The Commission recommends the Postal Service's proposed 25-cent fee per address and minimum charge of \$7.50. At this rates, test year costs will equal 23 cents, producing a 109 percent cost coverage.

c. Address Changes for Election Boards and Registration Commissions

[5951] This service provides election boards and voter registration commissions with change-of-address information. Election boards and voter registration commissions also have the option of using a “Return Service Requested” endorsement or the National Change of Address system to gather similar address information. USPS-T-39 at 6-9.

[5952] The Postal Service uses projected test year costs for the correction of mailing lists as a proxy for the cost of address changes for election boards and registration commissions. USPS-T-29 at 25-26. The Service proposes increasing the 17-cent fee for this service to 24 cents. The Commission recommends a slightly lower fee of 23 cents for this service. At this rate, test year costs will equal 23 cents, producing a 100 percent cost coverage. The recommendation is consistent with prior opinions that require this service to cover costs, but only provide a minimal contribution to institutional costs, because “election boards serve a vital function in our democracy.” PRC Op. R97-1, para. 5896.

d. Arrangement of Address Cards in Carrier Delivery Sequence

[5953] This service provides mailers with address cards sorted into delivery sequence. Three levels of service are offered: (1) basic carrier route walk sequencing of cards, including the removal of cards with undeliverable or incorrect addresses, (2) the service described in (1) plus the insertion of blank cards indicating missing addresses, or (3) the service described in (1) plus the insertion of completed cards for the omitted addresses. New address cards are provided free of charge for rural route delivery addresses that have been converted to city delivery route addresses. There is no charge for the delivery sequence sort, or for inserting blank cards. There is a fee applied to every card removed with an incorrect or undeliverable address, and to new completed cards inserted into the delivery sequence. USPS-T-39 at 31-34.

[5954] The Postal Service uses the correction of mailing lists projected test year costs, including contingency, of 23.2 cents as a proxy for the cost of arrangement of

address cards in carrier delivery sequence. USPS-T-29 at 25-26. The Service proposes increasing the 20-cent fee for this service to 25 cents. The Commission recommends the Postal Service's proposed 25-cent fee. At these rates, test year costs will equal 23 cents, producing a 109 percent cost coverage.

3. Post Office Boxes, Caller Service, and Reserve Call Numbers (Schedule 921)

[5955] The Postal Service proposes a major restructuring of post office box fees. Postal Service witnesses Mayo (USPS-T-39) and Kaneer (USPS-T-40), using location cost data developed by Postal Service witness Yezer (USPS-T-31), would restructure the current five post office box fee groups into seven groups primarily differentiated by location costs.¹⁶⁵ Rate design witness Kaneer proposes the following fee classifications:

- Group B2 – former Group A with cost per sq. ft. \geq \$12.50, former Group B with cost per sq. ft. \geq \$12.50;
- Group C3 – former Group A with Cost per sq. ft. $<$ \$12.50, former Group B with cost per sq. ft. \geq \$10.00 & $<$ \$12.50, and former Group C with cost per sq. ft. \geq \$10.00;
- Group C4 – former Group B with cost per sq. ft. $<$ \$10.00 and former Group C with cost per sq. ft. \geq \$7.50 & $<$ \$10.00;
- Group C5 – former Group C with cost per sq. ft. $<$ \$7.50;
- Group D6 – former Group D with cost per sq. ft. \geq \$4.00;
- Group D7 – former Group D with cost per sq. ft. $<$ \$4.00; and
- Group E – box service at zero-fee for customers ineligible for carrier delivery.

[5956] This new grouping is the result of a methodological change that discards the historical approach of basing post office box fees on the type of carrier delivery available at each post office. In Docket No. R90-1 the Postal Service began to align fees with costs more closely by proposing two new fee groups for higher cost locations,

¹⁶⁵ The current groups box fees are assessed according to groups defined in the Domestic Mail Manual (DMM, § D910.5). Group A fees are the highest, Group B fees, the second highest, etc. Group E fees apply to customers who are ineligible for carrier delivery for postal policy reasons.

recognizing that the market costs of space are not the same in all city carrier offices throughout the country. Rather, these costs vary widely by location. In Docket Nos. R97-1 and MC96-3, OCA proposed to group post office boxes by cost ascertainment group (CAG) as a means to more closely align fees with costs. PRC Op. R97-1, para. 5906. The Commission encouraged these efforts. *Id.* at para. 5913. In response, the Postal Service has developed a comprehensive source of location-cost information for future use as the basis for optimal fee group design. The Commission commends both the OCA, for providing the impetus towards a more cost based fee structure, and the Postal Service for its efforts to more accurately measure the cost differences between facilities and to design fees which reflect those differences.

[5957] The linchpin of the restructuring is Yezer's development of location-based costs by five-digit ZIP Code, which are then applied by Kaneer. Kaneer contends that the current fee groups do not necessarily correspond with actual space costs. USPS-T-40 at 5. There likely are thousands of ZIP Codes in the low-rate Groups C and D that have location costs as high as ZIP Codes in high-rate Groups A and B. Because space costs are about 45 percent of total post office box service costs, there is a mismatch between these costs and the current fee groups. Undesirable consequences of cost and fee misalignment can include higher fees in low rent urban areas than in high rent "non-city" areas.

[5958] Kaneer explains that cost homogeneous groups can be defined based on Space Provision costs, since Space Support and All Other, the remaining two cost categories, do not vary by location. Space Provision costs are related to the cost per square foot and the space occupied by post office boxes at each facility. Space Support accounts for costs that arise from custodial and maintenance services, fuel and utilities, and custodial/building supplies and services. All Other accounts for costs arising from Postmasters, Supervisors & Technicians, Clerks, Carriers, Motor Vehicle Services, and Other Supplies and Service.

[5959] Costs are allocated in the new methodology just as they have been in the past, except that the costs of space are now distributed based on Yezer's analysis of

location space costs. However, if locations were strictly assigned to these seven fee groups based solely on cost, fee shock might result. Therefore, Kaneer sets forth a methodology to temper the shock, which considers current fee levels as well as space costs. *Id.* at 13.

[5960] In developing the new classification, the Postal Service relied in part on information gathered after implementation of the R97-1 rate changes. The Postal Service reassigned 21 “transition sites” having very high or low location costs and post office box utilization rates to different fee groups (increasing fees where costs and utilization were exceptionally high and decreasing fees where costs and utilization were exceptionally low). Changing fees in 21 sites permitted the Postal Service to observe customer reaction and gain experience in the dynamics of regrouping boxes.

[5961] Kaneer says several lessons were learned. First, the burdens of administering post office box fees by facility have convinced the Service not to define the new fee groups in that way. Rather, the use of five-digit ZIP Codes holds the best potential for customer understanding and administrative convenience. Second, to keep the new classification schedule simple, the Service decided not to propose capacity use as a fee factor at this time.

[5962] In order to gauge the effect of the proposed fee changes on the number of post office boxes in use and the subsequent effect on post office box revenues, the Service also estimated the price elasticity of demand. *Id.* at 15-17. This was estimated from the 1998 and 1999 Post Office Box (POB) Surveys, one conducted just before the implementation of the R97-1 fees, the second re-surveying the responding locations during July 1999. In both surveys, counts of boxes in use were taken, thus measuring customer behavior in response to the price increase. Boxes were categorized into two groups, Size 1 (used primarily by non-business users) and All Other Sizes, to control for differences in price sensitivity for these two customer groups. The study obtained elasticity estimates of -0.229 for size one boxes and -0.306 for size two-five boxes.

[5963] Kaneer calculates test year before rates post office box costs of \$585 million. He apportions these costs to the nearly 18 million post office boxes estimated to

be in use during the test year to derive their unit costs (*i.e.*, average cost per box for each fee group and box size). These unit costs serve as the basis for setting box fees.

[5964] Kaneer states that the general goal of achieving true cost and fee alignment while carefully mitigating fee shock for current box customers is consistent with fairness and equity, and the other statutory classification criteria. A fundamental principle of fairness, pricing in accord with cost causation, is better accommodated by the new rate design system, according to Kaneer. The proposed classification groups increase the desirability of post office box service by apportioning post office box costs to each group and box size in relation to the cost of the resources employed. Many box customers in low cost locations will see fee decreases from the new classification, while people who prefer box service in costly locations can better be accommodated because fees that better reflect costs encourage the addition of new boxes in those areas. Kaneer says the new methodology is desirable for the Postal Service and users, as it will provide accurate price signals to service providers and consumers, allowing the forces of supply and demand to operate. In terms of societal benefit, cost-based pricing encourages entry by alternative service providers only where warranted and thus conserves society's resources.

[5965] Yezer estimates the rent per square foot at Postal Service facilities, particularly those that provide post office box service. He uses data on leased properties such as annual rent paid, square feet of space rented, date of endorsement and term of the lease, provisions for payments of utility and maintenance costs, physical characteristics of the space, and the physical location of the property. According to Yezer, rents are based on all these factors, and vary with market conditions at the time that the lease is signed. USPS-T-31 at 3. He also projects rents per square foot forward based on recent market trends.

[5966] The variables used in his statistical analysis are all taken from Postal Service data. In brief, the dependent variable ($R/SQFT_j$) in the statistical analysis is the quotient of total annual rent for the entire facility divided by size of the rented space in square feet, for facility j . A vector of seven dummy variables reflects responsibility for

maintenance and utilities. A vector of eight dummy variables indicates the facility setting, e.g., business park, office building, etc. He notes that setting should have an effect on rent per square foot, e.g., facilities within malls are generally higher cost. Variables also indicate the time at which the current lease was endorsed and lease length. Dummy variables indicate particular physical features of the facility such as branch offices or presence of a loading dock. The natural logarithm of the square feet of interior space is also included. A vector of variables measures the physical location of the facility. For example, for facilities located within the 65 largest MSAs, location is based on the distance between the facility and the center of the central business district (CBD) as well as distance north-south or east-west from the CBD. The expectation is that rents should decline with distance from the CBD, although this effect may not be significant in cities with multiple centers. The general form of the equation used to estimate rent per square foot is: $R/SQFT_j = \alpha_0 + \sum_{\alpha=1} \alpha_i M_{ij} + \sum_{\beta=1} \beta_m S_{mj} + \Theta_T T_j + \Theta_{T95} T95_j + \Theta_{DT} DT_j + \Theta_{TL} TL_j + \Theta_{DTL} DTL_j + \Theta_B B_j + \Theta_D D_j + \Theta_{ID} ID_j + \Theta_{LI} LI_j + \gamma_{NoP} NoP_j + \gamma_P P_j + \sum_{k=1} \lambda_k L_{kj} + \varepsilon_j$. USPS-T-31 at 3-9.

[5967] Yezer's data set included information extracted from 27,407 leases and 11,608 owned Postal Service properties. Yezer also explained how he handled incomplete documents (e.g., 434 documents were so incomplete that their results were not used). *Id.* at 10-11.

[5968] Mayo proposes new post office box fees that represent both increases and decreases when compared to the equivalent current fees. Under Postal Service methodology, the cost coverage for post office boxes (including caller service and reserve number) would be 138 percent. The range of the post office box fee changes in the individual fee cells is -25 percent to 73 percent. The total proposed percentage increase is about nine percent. See USPS-T-39 at 102.

[5969] Mayo discusses the pricing criteria for post office boxes. She states that provision of boxes offers a high value of service, citing elements such as privacy, convenience, protection, and, in some cases, a prestigious address. The proposed fees cover the cost of the service and contribute beneficially to other costs. As to effects on

customers, she states that the cases having the highest percentage increases represent a little over one-half of one percent of all boxes. Although 33 percent of all boxes are proposed to increase 31 to 43 percent, 35 percent of all boxes (including Group E boxes at no fee) are proposed to decrease or have no change. She argues that while some increases are not small, they do not represent a substantial outlay for most users and should not have a substantial impact on them. Further, the alternative of free carrier delivery is an option, as is using a commercial mail receiving agency.

[5970] *Services Related to Post Office Boxes.* In addition, Mayo adds three classification proposals for services related to post office boxes: (1) a new classification for a fee to provide more than two keys for a box, or to replace a key due to loss, damage or breakage, (2) a new classification for a fee for a customer initiated post office box lock change, and (3) a classification change to eliminate the DMCS section concerning transfer of street-addressed mail to a post office box.

[5971] The proposed classifications for post office box keys and customer initiated post office box lock changes would have fees of \$4.00 and \$10.00, respectively. The implicit cost coverage for additional or replacement post office box keys under Postal Service methodology is 142 percent, and for a customer initiated post office box lock change it is 143 percent. Mayo states key replacement and lock change fees will apply to highly valued services. The two fees cover the cost of the services and make a reasonable contribution to other costs. The proposed cost coverages are reasonable when one considers these services used to be provided free-of-charge. The effects of the proposed fees should be negligible because most customers will probably never be in the situation where they would have to pay the fees. The fees are simple and fair (as the costs incurred are recovered from those who caused them).

[5972] Mayo also proposes a fee increase for caller service and a fee decrease for reserve numbers. Caller service is a premium service that allows business customers to pick up their box mail at a post office call window or loading dock during the time the office is open. Reserve number is a service that allows a company to reserve a box number for future caller service use. Businesses could find this useful if they are

planning a promotion, campaign or advertisement and would like to use a number that would correspond. The caller service fee is proposed to increase by 36 percent to \$375 for a six-month period. The implicit cost coverage is 123 percent under Postal Service methodology. Witness Campbell provides the test year cost estimates for caller service. USPS-T-29 at 22 *et seq.* The estimates are derived from a 1999 Caller Service Study. The study included a review of the total storage space required and calculation of annual window accounting cost. Mayo testifies that caller service has a high value to users. Caller service customers are able to pick up their mail early in the day to process orders and financial transactions and it provides them a means to receive post office box type service when their volumes are too large or post office boxes are not available. Although 123 percent is not a high cost coverage for this type of service, the proposed fee increase was limited to 36 percent to reduce the adverse impact on caller service customers. Even so, caller service customers have private sector alternatives. The proposed fee is simple—it is uniform nationwide.

[5973] The reserve number fee would decrease by 17 percent to \$30 per year. The proposed fee for reserve number was designed by applying a markup over the per-piece cost of \$16.98, with a ten-dollar rounding constraint. Although the proposal represents a fee decrease, the fee revenue will cover the cost of the service and contribute substantially to other costs.

[5974] Finally, Mayo proposes to eliminate DMCS section 921.222, which provides a limited right for box customers to redirect delivery of mail from some other address to a box. Redirection of mail to a customer's post office box often depends upon the memory of individuals, or recognizing the significance of a handwritten note. Misdeliveries thus may occur. Section 921.222 can also conflict with current policy which calls for delivery of mail containing both street and box addresses to the address that appears directly above the city/state line. However, customers will be able to have their mail forwarded from one address to another, including a post office box, based on current forwarding procedures.

[5975] Intervenor Popkin on brief opposes the Postal Service's proposal to alter the method for determining post office box fees.¹⁶⁶ He complains that a post office location in New Jersey has been assigned to the highest cost category, stating that the said locality is located in a 40-year old strip mall. He states the ZIP Code assignment of the post office is related to mail processing needs and not to the cost of the facility. He argues that the library reference associated with Yezer's study was not filed until March 24, 2000, after the period for discovery expired, limiting his time for examination. He questions the validity of data, such as facilities showing a negative Erent¹⁶⁷ value and facilities that use a generic rent value. Erents for a California location are characterized as low while his knowledge of the area tells him real estate values are high. He is concerned that the average cost per square foot for all facilities in a certain three-digit ZIP Code area is higher than for Manhattan facilities. Popkin questions how 160 facilities could have no boxes in use. He states that offices listed in the database show an apparently incorrect number of boxes installed, and that data is not shown for all existing facilities. He concludes that the data are so unreliable that using the data would be inappropriate. Popkin Brief at 4.

[5976] The Service replied to these issues in interrogatory responses (also filed under seal). The Service asserts it is not surprising that there are some locations without post office boxes being in use, given a large number of facilities that have only a few boxes being rented. Further, the 160 locations represent less than one-sixth of one percent of all ZIP Codes. It states that as to errors that may appear in grouping certain post office locales within specified groups, it will be updating the data (which it would have had to do anyway, given that post office changes occur continually). It argues that

¹⁶⁶ As a consequence of P.O. Ruling 11, which required certain underlying data that was applied to Yezer's model to be filed under seal, Popkin's initial brief also was filed under seal. This requires that certain facts not be disclosed in the decision.

¹⁶⁷ Yezer defines Erents as the dependent variable in his equation #2. They are computed based on a forecast of new five-year leases with specific terms that will be executed in the future. He notes that actual rents may be for leases executed years ago, for time periods other than for five years, and under various lease terms, stating that Erents permit direct comparisons among facilities while actual rents do not.

the proposed reclassification should be seen as an ongoing process and acknowledges that there may be errors in the data, which is to be expected given the large data set.

[5977] As to some negative Erent results, Yezer states that the Erents reported are uncensored estimates from the estimating equations reported in his supplementary testimony, but that the actual rents per square foot as reported are not negative. He states that uncensored estimates may produce negative Erents, reflecting the fact that expected rent per square foot is close to zero, perhaps less than \$5.00. Yezer notes that the actual lease rental figures per square foot in Manhattan are low also. As to “generic” costs per square foot being used, he acknowledges that he did not have detailed characteristics for each facility within a specified area and therefore Erents were computed based on location alone. Regarding the complaint that a specific New Jersey location has a high Erent, Yezer states that small facilities tend to have higher rents per square foot, and that the computed Erent for this location is below the non-standardized rent per square foot actually being paid. As to Popkin’s assertion that Erents for a California location are low in comparison to purported property values, Yezer states that the data he used were correct.

[5978] *Commission Analysis.* In R97-1, the Commission urged the Postal Service to reexamine this issue and offer a more cost-based approach. The proposal in this docket is a large step in the right direction. The Commission adopts the Service’s analysis of the statutory pricing and classification criteria for post offices boxes and the related services.

[5979] A fee structure that reflects a closer alignment with costs is fairer to the public as a whole. Although some rate cells (for certain size boxes in certain fee groups) experience large percentage increases, the resulting cost coverages for those rate cells continue to be much lower than cost coverages for other rate cells. Conversely, cost coverages for rate cells receiving fee reductions are in some cases still relatively high. For example, while Group D6 experiences increases that range from 14 percent to 73 percent under PRC methodology, cost coverages will still be in the 66 percent to 87 percent ranges. Conversely, Group C5 fees will be reduced from 12 percent to 25

percent under PRC methodology. As discussed, the Service is proposing that the post office box fees in this docket for individual cells represent a transition to a time when all cells more directly align costs and fees. The gradual adjustment of box fees to avoid rate shock is appropriate.

[5980] The Service's responses to Popkin's arguments are reasonable. It can be expected that in a large data set some anomalies will be present. The overall methodology used by Yezer appears appropriate. As to questions about the validity of a small portion of the underlying data, it is sufficient that the Service relied on the latest internal censuses. Further, the Service indicates that it will be updating data over time as part of its ongoing reappraisal in this area. As to the location costs for a specified New Jersey location, official government published records show this to be an area with an extremely high per capita income.¹⁶⁸ Consequently, it is not surprising that property values are high also. Popkin's assertions regarding California locations are unsupported by factual analysis and cannot be given much weight.

[5981] Popkin's complaint on brief about having had little time to analyze Yezer's library reference, filed March 24, 2000, is tardy. Popkin had until May 22, 2000 to file a case-in-chief in rebuttal to the Service, yet he failed to avail himself of this opportunity, or to ask for additional time to prepare evidence. Initial briefs were not due until September 13, 2000, which means that he had about 5½ months to analyze the library reference for his brief. Further, he conducted a substantial amount of discovery on the library reference (filed under seal), e.g., DBP/USPS-144, 145, 146, 148, 155, 156, 206, 207, 208, 209 (with 24 sub-parts), and 216, and responses thereto. The Commission finds that no adverse due process consequences occurred.

[5982] The Commission concurs with the Postal Service's analyses of the statutory pricing and classification criteria as to post office boxes and related services, and recommends the rates as proposed by the Postal Service. The cost coverage for this category is a moderate 139 percent overall, under Commission cost methodology. Two

¹⁶⁸ Bureau of Economic Analysis, U.S. Dept. of Commerce, 1998 Local (Metropolitan) Area Personal Income and Per Capita Personal Income, released June 15, 2000.

points merit emphasis. First, the Service's post office box fee proposal, in better aligning fees with costs, is consistent with the statutory mandates to establish and maintain fair and equitable schedules and classifications. Second, the mitigation of rate changes for individual cells reflects the statutory command that the Commission consider the effect of rate increases on the general public. The Commission also agrees with the Postal Service's analysis regarding its proposal to eliminate DMCS section 921.222. This change seems desirable from the point of view of the public and the Service itself.

[5983] In closing, the record discloses there are post offices having no or low utilization of existing boxes. The Postal Service should explore whether discounts from box fees could be developed for post offices having very low box utilization rates.

4. Business Reply Mail (Schedule 931)

[5984] Business Reply Mail (BRM) is a special service for First-Class Mail and Priority Mail. BRM allows the distribution of reply mail envelopes or cards indicating that no postage is necessary for mailing back to the distributor. On receipt of reply mail, the addressee must pay postage plus the applicable BRM fee.

[5985] There are currently three fee categories associated with BRM. USPS-T-29 at 6-7. Qualified Business Reply Mail (QBRM) pieces are those cards and one- and two-ounce envelopes that are automation compatible, have both a Facing Identification Mark (FIM) C and a unique ZIP+4 barcode, and have qualified for Business Reply Mail Accounting System (BRMAS) processing. QBRM mailers pay a per-piece fee of five cents in addition to postage. They also must maintain an advance deposit account, with a balance sufficient to cover the projected postage due and per-piece fees for a specified future period, and pay an annual advance deposit account fee. A rate discount from the First-Class mail postage is given to QBRM pieces.

[5986] The second category encompasses non-QBRM advance deposit BRM pieces. They are not required to qualify for BRMAS processing, although these pieces are often prebarcoded. Like QBRM, per-piece fees and postage due are deducted from

an advance deposit account. Non-QBRM advance deposit BRM mailers pay a per-piece fee of eight cents in addition to postage.

[5987] Advance deposit weight-averaged nonletter-size BRM qualifies for a one-cent per-piece fee. PRC Op. MC99-2. Mailers of such pieces also pay a \$600 monthly fee and an annual permit fee. BRM flats and parcels, as well as BRM letters weighing more than two ounces, are eligible for the classification. Weight averaging entails weighing and rating eligible BRM in bulk at postal facilities, and eliminates the need for manual counting and rating. In MC99-2, the Commission found that “weight averaging, relative to manual accounting, substantially reduces postal costs . . .” *Id.* at 2.

[5988] The third category is non-advance deposit BRM pieces, which may or may not be automation compatible or barcoded. Non-advance deposit BRM mailers do not pay the postage due and per-piece fees through an advance deposit account. Instead, these pieces are delivered to the BRM originating mailer upon payment of postage and fees due. Mailers receiving low volumes of BRM generally use non-advance deposit BRM. Non-advance deposit BRM mailers currently pay a 30-cent per-piece fee in addition to postage.

[5989] In addition to the applicable postage and BRM per piece fees, BRM mailers pay an annual permit fee, and those mailers with advanced deposit accounts also pay an annual accounting fee. The advanced deposit account allows mailers to have postage and fees automatically deducted from their accounts as mail pieces are delivered.

[5990] Postal Service witness Campbell describes BRM mail flows that affect BRM costs. USPS-T-29 at 7 *et seq.* To determine the per-piece counting, rating, and billing costs associated with QBRM and BRM, one must focus on destinating facility operations. BRM letters and cards are generally separated out in the Incoming Primary operation and sent to either the BRMAS operation or to a manual sortation operation (often the Postage Due Unit or Box Section). This differs from other non-presort First-Class Mail letters and cards which, after sortation in the Incoming Primary operation, are processed in an Incoming Secondary operation (either automated or manual), and are then sorted

to address either in a Delivery Point Sequence (DPS) operation or in a manual operation (*i.e.*, cased by the carrier).

[5991] This discussion will focus on QBRM processing, for it is that rate category whose fees are in dispute. Campbell testifies that QBRM goes through the Incoming Primary operation, and then can be sorted to permit number (corresponding to a unique ZIP + 4 Code) in a BRMAS or Barcode Sorter (BCS) operation. *Id.* at 8. Because the ZIP + 4 Code is unique to a BRM customer, this sort is equivalent to that obtained in a DPS operation. Thus, these pieces avoid the Incoming Secondary distribution that other First-Class Mail pieces get. BRMAS operations vary according to facility, *e.g.*, employing either Delivery Barcode Sorters or Mail Processing Barcode Sorters. See *id.* at 9, for a fuller description. For those pieces finalized by BRMAS, the BRMAS program also performs counting and rating functions, and can provide a report (*i.e.*, a bill) for the BRM originating mailers of postage due. BRMAS does not deduct the postage due from the advance deposit account.

[5992] Campbell testifies that even at facilities that have the BRMAS operation, “not all QBRM gets finalized to permit number in the BRMAS operation.” *Ibid.* For example, there may be operational limitations such as the number of bins available for sortation, or diversion to other mail streams (*e.g.*, mixing with other First-Class Mail that got distributed in a DPS operation). These residual pieces are usually sorted, counted and rated manually in the Postage Due Unit. Even when all QBRM pieces for a mailer are finalized in BRMAS, verification and accounting activities are performed in the Postage Due Unit.

[5993] According to Campbell, at facilities without BRMAS operations, QBRM is counted, rated and billed using a variety of methods, both manual and automated. *Id.* at 10. Manual counting of mail pieces, end-of-run (EOR) report counts and weight averaging techniques are all employed. Rating and billing functions are typically performed manually or through the PERMIT system or other software. *Ibid.* As shall be seen, the parties dispute the frequency with which particular methods for processing

QBRM are used, e.g., BRMAS versus manual counting. They also dispute the productivity of each method.

[5994] Postal Service witness Mayo, USPS-T-39, proposes two interrelated classification changes and several fee changes for BRM. The two classification changes would split QBRM into two fee categories. The first category, useful for high-volume users, would have a low per-piece fee and a quarterly fixed fee. The second QBRM classification, useful for lower-volume users, would only have a higher per-piece fee.

[5995] Currently, QBRM per-piece fees cover the cost of what may be described broadly as performing QBRM piece-counting, as well as the rating and billing functions. As Campbell notes, though, some costs incurred in the process are fixed in nature. “[T]he costs of rating, preparing meter readings, and completing postage due forms are incurred each time a QBRM account requires a transaction, regardless of the QBRM volume or the method used (manual or automated). For example, if a QBRM account receives 1,000 QBRM pieces, the time required to generate a bill is the same as if the account receives 10,000 pieces. Similarly, rating 1,000 QBRM pieces (*i.e.*, calculating postage due given a piece-count) requires the same amount of time as rating 10,000 QBRM pieces.” USPS-T-29 at 14. As a result, productivities for rating and billing, previously incorporated into the per-piece costs, have been isolated and incorporated into a monthly fixed cost for potential high-volume users. Arguably, smaller volume users will find the per-piece fee simple and financially advantageous, while larger volume users will find their total QBRM fees to be lower if they choose the new two-part structure. According to Mayo, at the proposed fees, the volume at which it will pay to switch to the two-part fee structure is approximately 113,000 pieces per year.

[5996] Mayo thus proposes that the per-piece fee for the existing QBRM category, currently 5 cents, increase by 20 percent to 6 cents, producing a 122 percent implicit cost coverage. The proposed QBRM per-piece fee for those mailers paying a quarterly fee would be 3 cents, yielding a 146 percent implicit cost coverage. The quarterly billing fee for the new category would be \$850 (resulting in annual payments of \$3,400) resulting in a 119 percent implicit cost coverage.

[5997] Both categories would qualify for the proposed QBRM postage discount of 3 cents. Postal Service witness Campbell finds the test year mail processing cost avoidance of a QBRM piece to be 3.38 cents. *Id.* at 41. He says that improvements in RBCS character recognition have lowered the cost associated with handwritten single-piece processing, and thus have reduced QBRM's cost avoidance. Postal Service witness Fronk (USPS-T-33) uses this cost avoidance to propose retaining the current 3.0 cents QBRM discount off the single-piece First-Class letter rate.

[5998] The current eight cents per-piece fee for regular BRM with an advance deposit account would increase by 25 percent to 10 cents, providing a 132 percent implicit cost coverage. The current 30 cents per-piece fee for non-advance deposit account BRM would increase by 17 percent to 35 cents, providing a 128 percent implicit cost coverage. The weight-averaging nonletter-size BRM monthly fee of \$600 and the per-piece one-cent fee would remain unchanged, resulting in 117 and 173 percent implicit cost coverages. The annual advance deposit accounting fee for BRM would rise from \$300 to \$375, a 25 percent increase, with an implicit cost coverage of 116 percent. The annual permit fee for BRM would increase from \$100 to \$125, a 25 percent increase, with an implicit cost coverage is 117 percent. The overall cost coverage for BRM would be 123 percent.

[5999] Mayo argues that BRM (including QBRM) is a high-value special service. Alternatives to BRM include toll-free phone numbers and company-supplied envelopes with pre-affixed postage. USPS-T-39 at 27. With BRM, the distributor only incurs the cost of postage for returned mailpieces, which aids organizations unsure of a mailing's potential response rate. BRM also makes a good impression on customers because it demonstrates a company is willing to pay the postage. Mayo says the proposed BRM fees individually and as a whole cover their costs and moderately contribute to institutional costs. She asserts that at the highest increases of 25 percent, there would be no adverse impact on users, especially QBRM users that also receive a postage discount. However, Mayo notes that over the past 5 years BRM volume has decreased 39 percent and BRM revenue has decreased 11 percent. From 1997 to 1998, BRM

revenue decreased 9 percent. Mayo states that the proposed fees were designed to attain an overall moderate cost coverage.

[6000] *Intervenors' Arguments.* Intervenors KeySpan Energy and the Long Island Power Authority (KeySpan) agree that QBRM fees should be deaveraged by establishing separate fee structures for high and low volume recipients. However, KeySpan believes the Service's plan is flawed because it effectively assumes that volume has no effect on the counting methods used or the costs of counting.

[6001] KeySpan recommends per-piece fees of 0.5 cents for high-volume users, based on its calculation of a unit cost of 0.17 cents, and 4.5 cents for low-volume users, based on a unit cost of 3.43 cents. It also recommends that the First-Class rate for QBRM reply mail be raised by only 0.5 cents (to 30.5 cents based on a 34.0 cent single-piece rate), stating that the cost avoidance is 5.242 cents per piece. Tr. 44/19107.

[6002] KeySpan proposes a higher accounting fee (\$12,000 versus \$3,400 annually) to insure the Service can employ efficient counting methods. The higher annual fee will mean a higher breakeven point, so only mailers with very high volumes that clearly justify using bulk counting procedures (like BRMAS) will use the new rate category. It calculates that the breakeven volume for high volume recipients would be 300,000 pieces per year; there are 288 recipients who have received more than this amount of mail in the past 12 months or in FY1999. However, KeySpan witness Bentley states that the monthly fee "is also much greater than any markup that might be reasonably justified from application of the statutory criteria of the Act." Tr.29/13992. KeySpan also says that if the Commission is concerned about access to the high volume plan, "there is plenty of room to lower that fee." KeySpan Brief at 23.

[6003] KeySpan's arguments concerning the proper per-piece fees focus on the allocation of projected volumes among the different methods used to process pieces (BRMAS, end-of-run or EOR, special counting machines or SCM, weight averaging, and manual) and how efficient each method is. Bentley determined the percentages that would be counted by each counting technique using volume data from the Corporate Business Customer Information System (CBCIS) coupled with his analysis of a survey of

high volume offices done by Campbell (Campbell Survey), and various estimation techniques. Tr. 29/14053-54.

[6004] The Postal Service utilizes costs developed from an allocation of volumes based on an update of the BRM Practices Study. The BRM Practices Study was originally prepared for use in R97-1.¹⁶⁹ Campbell claimed to update results of the BRM Practices Study, based on discussions with on-site personnel. Tr. 14/6026, 6029-30. He makes no distinction between high-volume and low-volume users. The comparison of Campbell's and Bentley's findings is summarized in Table 5-21 (see Tr. 29/13998):

Table 5-21
QBRM Counting Methods

QBRM Category	Data Source	Percent of QBRM Counted By:					Total
		BRMAS	ECR	SCM	Weight	Manual	
High Volume QBRM	BRM Practices Study	14	19	10	9	47	100
	CBCIS Data System	52	28	1	8	11	100
Low Volume QBRM	BRM Practices Study	14	19	10	9	47	100
	CBCIS Data System	21	23	1	7	48	100
All QBRM	BRM Practices Study	14	19	10	9	47	100
	CBCIS Data System	44	27	1	8	20	100

[6005] For the cost of counting low-volume QBRM, Bentley uses the same productivities for hand counting and weight conversion techniques that he developed for high-volume QBRM. Tr. 29/14027, KeySpan Reply Brief at 14. He assumes that above 400 pieces per day, it would not make economic sense to hand count. He also calculates that there is a close match among the post offices that receive substantial volumes of both high- and low-volume material and that it is logical to assume that such facilities will use the same counting methods for relatively high-volume accounts. He also makes the conservative assumption that for the 46 million QBRM pieces received

¹⁶⁹ Docket No. R97-1, Business Reply Mail Practices Study, USPS-LR-H-179. The surveys underlying the study were conducted in the fall of 1996. *Id.* at 1.

by low-volume accounts in volumes less than 100,000 per year, all such pieces would be hand counted, although he contends such mail may be counted using more efficient methods.

[6006] KeySpan notes by way of comparison that the recently approved rate for nonletter-size BRM, primarily consisting of small bulky packages that contain film canisters, has a one-cent per piece counting fee, based on a unit cost of 0.57 cents. KeySpan Brief at 6. “[I]mplicit in this comparison is the absurd notion that it costs three and one-half times as much to process uniform, compact QBRM letters and cards as it does to process non-uniform, bulky parcels.” *Ibid.* It notes Campbell’s agreement that the 7,272 pieces per hour productivity factor for weighing bulky non-letter size parcels derived in Docket No. MC99-2, might be a reasonable, even “conservative” productivity factor for counting uniform QBRM pieces by weight averaging. Tr.14/6174-75.

[6007] In support of the contention that the Service’s overall QBRM costing approach is flawed, KeySpan states that Campbell admits he wanted to study whether it costs less to count QBRM received in high volumes than it costs to count QBRM received in low volumes, and admits “that data obtained from such a study could improve the cost estimates presented in this rate case filing,” (Tr. 14/6015) but claims that “time constraints” precluded him from conducting such a study. Tr. 14/6014-17. According to KeySpan, Campbell also acknowledged that, although he traveled to three facilities to observe QBRM processing, he “[did] not have specific recollection of discussions with Postal Service personnel regarding whether the QBRM reply letters they were counting were addressed to high volume recipients or addressed to low volume recipients” and “[did] not recall specific volumes or percentages of the ‘high volume’ pieces observed in relation to the QBRM recipient’s total pieces received on that day.” Tr. 14/5978, 5980-81, 5982.

[6008] KeySpan argues that the Service’s statements to the Commission in Docket No. MC99-2 are particularly important. KeySpan Brief at 15. In responding to an information request concerning the status of any work or planning related to cost

effective methods for counting, rating and billing letter or card size BRM, the Service said:¹⁷⁰

In response to the Decisions of the Governors in Docket No. R97-1 (June 29, 1998), management has established two objectives. The first is to focus on improved utilization of machine- or automation-based QBRM accounting alternatives to the manual accounting method . . .

Given the relatively high degree of automation-compatibility of BRM letters and cards, the Postal Service is committed to more fully utilizing its capacity to perform automated or machine-based accounting, where appropriate. Particularly with higher-volume QBRM letter and card recipients, as each separate recipient's mail is isolated, the opportunity exists – either during mail processing or in the accounting function – to obtain a machine count of such mail, to a greater extent than is currently being done.

[6009] As to efficiency of the counting methods, instead of relying on Campbell's 951 piece-per-hour (PPH) manual productivity figure, Bentley performed two demonstration studies that led him to conclude the productivity factor for counting QBRM manually was 2,746 PPH and by weight averaging was 68,901 PPH. Tr.29/14032-35. Bentley says these are conservative estimates, assuming a low level of clerical productivity, *i.e.*, he multiplied the initial productivity results by 0.6. *Id.* at 14035.

[6010] Bentley states that the 951 PPH figure, which is based on a 10-year old study, is flawed. Tr. 29/14050-51. Furthermore, he contends that increased automation likely means less sorting needs to be done in the postage due unit. *Id.* at 14050. Bentley argues that because Campbell had no data on the productivities used for special counting machines or weighing techniques, he erroneously assumed the figure for manual productivity applied to those techniques. Tr. 14/5957.

[6011] *Postal Service Counter Arguments.* In rebuttal to Bentley, Campbell states that Bentley had no basis for assuming that the counting methods used for accounts

¹⁷⁰ Docket No. MC99-2, Response of United States Postal Service to Presiding Officer's Information Request (June 18, 1999) at 3.

receiving between one and ten million pieces annually would apply to accounts receiving 250,000 to one million pieces annually. Tr. 39/17506. As to counting methods for low-volume accounts (less than 300,000 pieces annually), Bentley's analysis is said to be arbitrary, especially the assumption that the allocations applied to higher volumes would apply for accounts receiving 100,000 pieces annually (or about 400 pieces per day). Tr. 39/17506-07. Campbell also contends that in contrast to Bentley's analysis, the Practices Study underlying his analysis represents a comprehensive sampling effort. *Id.* at 17509. Campbell states: "Although it might be 'logical' to assume that more efficient counting methods are used to a higher degree with larger accounts, the only information which definitively shows what methods are applied to particular accounts is reflected in response to KE/USPS-T29-49 (Tr. 14/6025, 6026, 6030)."¹⁷¹ *Id.* at 17509-10.

[6012] On brief, the Service maintains there are defects in Bentley's analysis of per-piece counting costs as a result of inflated manual counting productivities and manipulation of data. Postal Service Brief at VIII-23. It opines that Bentley does not understand the sorting relevant to QBRM processing, and that the 1989 study by Postal Service witness Pham on the issue is more reliable than Bentley's derived productivity. It contends that Bentley's counting method percentages are skewed in favor of low-cost, automated accounting methods for both high and low-volume accounts. *Id.* at VIII-24-25. He is said to have erroneously included 56 million QBRM pieces in his high-volume analysis, which results in his underestimating the unit cost to count QBRM received in high volumes. Tr. 39/17503-04.¹⁷² The Service cautions against use of extra-record material concerning the inclusion of data from a customer with multiple accounts. Postal Service Reply Brief at VII-3-4.

[6013] It takes issue with KeySpan's comparison to the 0.57-cent average unit cost estimate for nonletter-size BRM, saying this figure solely reflects weight averaging alone. *Id.* at VII-4. It argues that there are many reasons why the highly efficient BRMAS

¹⁷¹ This is the so-called Campbell Survey.

¹⁷² This refers to Bentley's inclusion of data from the highest volume QBRM customer, with 56 million pieces annually. Currently, the customer uses 2,500 separate accounts.

processing method is not used more. “Foremost among these is the fact that the BRMAS accounting window and the Delivery Point Sequencing window are open concurrently and DPS has preferential access to automated equipment, often shifting BRMAS-eligible QBRM to less efficient counting methods.” *Id.* at VII-6. Also, “The Postal Service is utilizing its automated equipment to do more automated mail processing, cutting down on opportunities to run BRMAS.” *Id.* at VII-6-7. It notes that CBCIS contains no actual counting methods data, just BRM customer volumes. *Id.* at VII-9. It continues to urge that Bentley’s analysis of counting methods employed is an unreliable estimate. *Id.* at VII-10; Tr. 39/17502 *et seq.*

[6014] It concedes, however, that Campbell’s “2.00-cent average unit counting cost estimate for QBRM is too high.” *Id.* at VII-5. The Service concludes that another comprehensive BRM Practices Study is needed before it can take de-averaging to the next level. Postal Service Brief at VIII-25. If the Commission feels it cannot rely on Campbell’s analysis, the Service encourages the Commission to “consider a reasonable adjustment to Campbell’s methodology to establish an appropriate ‘middle ground’ estimate upon which to base its QBRM high-volume per-piece fee recommendations.” *Id.* at 26.

[6015] The Service contends that Mayo’s quarterly fee is cost-based and opens up lower fees to more mailers than Bentley’s proposal, estimating 1,300 mailers meet the breakeven test for its plan as opposed to 300 under Bentley’s plan. *Ibid.* Mayo indicates that under her proposed quarterly fee, mailers will be allowed to opt in or out by quarter depending on their mail volumes. Tr. 39/17652-53.

[6016] Finally, it also criticizes the weight-averaging and manual-counting productivities derived from Bentley’s demonstration studies. Postal Service Brief at VIII-23-24. It states that the studies underlying its productivity figures reflect real world operations, and incorporate such factors as set-up time and clerk fatigue. *Id.* at 24, n. 20.

[6017] *Commission Analysis.* The Commission recommends the proposed BRM fees and classifications advanced by Mayo, except for the fees and rates for QBRM

discussed below. Mayo's discussion of how the pricing and classification criteria apply to this service is sound, and is adopted by the Commission.

[6018] As to the QBRM issues, the Commission finds that the cost of the counting function is closely related to the number of pieces counted, while the cost of the remaining functions is driven by the number of bills that must be prepared. Thus, the splitting of QBRM into two fee structures is appropriate. However, the Commission cannot recommend the Service's fee proposals for QBRM.

[6019] *Counting Methods.* In determining the proper per-piece fees for high- and low-volume mailers, one must evaluate the frequency with which certain methods (e.g., BRMAS, manual, etc.) are used to count the mail pieces. This data can then be projected onto expected QBRM volume patterns under the new rate structure. The extent to which BRMAS is used is important because BRMAS counts as well as sorts in one operation. Tr. 39/17543. For high-volume QBRM, using BRMAS means that most such pieces come to the postage due unit in full trays and require no added sorting. *Id.* at 17545.

[6020] The Service states "it is apparent" that the BRM Practices Study relied on by Campbell understates the percentage of high-volume QBRM that is counted by BRMAS. Postal Service Brief at VIII-22. It says that "[s]hould the Commission conclude that it cannot rely completely on Campbell's analysis, the Postal Service encourages the Commission to . . . consider a reasonable adjustment to Campbell's methodology to establish an appropriate 'middle ground' estimate" *Id.* at VIII-25-26. It recognizes that "a limitation of the BRM Practices Study is that it was not a census which permits one to determine which accounting methods are employed at every site for every account, large and small." *Id.* at VIII-21. Campbell in fact agreed that just the volume associated with the highest 77 accounts was two times greater than his predicted BRMAS usage for QBRM overall. Tr. 39/17616.

[6021] A problem with the Service's concession is that it does not explain why, if Campbell's survey disclosed such glaring defects in the Practices Study for analyzing BRMAS usage, it should be relied upon at all. Indeed, at one point Campbell is of the

opinion that “there is really no data available currently to deaverage by counting method.” *Id.* at 17548. Further, once one adjusts the BRMAS usage figures shown in the Campbell Survey data, which is necessary given the state of data in the Practices Study, one has to adjust the figures for the four remaining methods. *Id.* at 17627-28. Campbell gives no guidance on how this should be done. He states: “We’ve got data on the top 75. We don’t know any further down the line, how the – what volumes, what accounts, *are going to be counted in what methods.*” *Id.* at 17616. [emphasis added] The Service suggests adopting a middle ground, without explaining how or why to get there. In contrast, KeySpan has offered an approach that seems plausible and reasoned.

[6022] The Commission finds that KeySpan’s high-volume analysis presents the best available evidence, incomplete as it is. KeySpan uses a combination of volume and customer number data from the Service’s CBCIS system, supplemented with the Campbell Survey and other estimating procedures set forth above. Tr. 29/14057 *et seq.* Bentley’s assumptions appear reasonable overall. For example, he removes data from the two largest accounts when analyzing remaining high-volume accounts. He accepts data that show hand counting is taking place in some post offices despite there being high volumes at those offices.¹⁷³

[6023] The updated processing information supplied by Campbell shows results that implausibly seem to favor manual counting, the most inefficient counting method. (Tr. 14/6030) It is easy to believe that high volume offices would use the more efficient counting methods; it strains credulity to think that offices receiving large volumes would hand count most or all of the pieces, as Appendix 2, Tr.14/6030, indicates to some extent. Indeed, Campbell admits that low volume customer accounts are sometimes processed on automation. Tr. 39/17548.

¹⁷³ In fact, Bentley’s overall estimates may understate the efficiency of the handling techniques used in the test year for low and high volume accounts. The Service discloses that a national QBRM task force is now studying the development of “best practices” to be deployed locally. Tr. 21/9466-67. Further, it is reasonable to assume that cost-based accounting and per-piece fees should encourage QBRM volume. As volume increases, the ability to use relatively more efficient counting techniques should rise also.

[6024] Campbell argues that Bentley erroneously included in his cost analysis data concerning a recipient with 2,500 separate accounts. *Id.* at 17523-24, 17586. Campbell says he does not know “how many of those accounts would be considered high volume and which ones would be considered low volume.” Tr. 39/17523, *see also* Tr. 39/17591. He states that many of these accounts could comprise the universe of recipients qualifying for the Service’s high-volume fee. *Id.* at 17524.

[6025] The Commission finds that Bentley’s handling of this data is reasonable.¹⁷⁴ In arriving at this conclusion the Commission did not give any consideration to material not admitted into evidence regarding account consolidation. *Id.* at 17600 *et seq.* However, it infers that account realignment of substantial magnitude would take place under the revised fee structure the Commission recommends; the inference that no realignment would take place is patently unreasonable. The Service itself has used assumptions concerning how potential users might switch mailing methods upon introduction of a new classification; *see, e.g.,* the estimates of Postal Service witness Fronk for Prepaid Reply Mail and QBRM in PRC Op. R97-1, paras. 5128-29.

[6026] *Productivity in Handling Pieces.* KeySpan’s unit cost of 0.17 cents for high-volume QBRM depends in part on productivity factors Bentley develops for pieces counted manually, and for weight conversion techniques or special counting machines. Instead of Campbell’s 951 piece-per-hour (PPH) manual productivity, derived from work Postal Service witness Pham did for Docket No. R90-1, Bentley performed studies that led him to conclude the productivity factor for counting QBRM manually was 2,746 PPH, and by the weight averaging method 68,901 PPH.

[6027] As to that part of QBRM processed through weight averaging, the Service at first asserts the PPH is 6,390, based on the 1987 Reply Mail Study. But Campbell recognizes non-letter BRM processing (film cans in bags) has been found to be 7,272 piece per hour. He agrees that it would be less costly to apply weight techniques to letter

¹⁷⁴ Note that Campbell agrees that “Mr. Bentley correctly removes the 56 million pieces to estimate counting method percentages for high-volume accounts not in the ‘Top 77’.” Tr. 39/17503 fn. 22.

size QBRM than it would be to apply weight techniques to nonletter sized bulky packages, and therefore 7,272 PPH probably is too low.¹⁷⁵

[6028] The Commission agrees it is logical to assume that weighing letters is much more efficient than weighing bags containing film, based on the simple physics that uniform, slender shapes are easier to handle than bulkier, non-uniform shapes. Under one processing scenario discussed at the hearings it might take nine times longer to weigh non-letter BRM than letter-sized QBRM. Tr. 39/17584. The Service, having discredited its own initial findings, then in essence suggests a higher figure (7,272 PPH) also may be too low. Upon viewing the video of Bentley's demonstration, the physical actions of the demonstration worker are moderately paced. Furthermore, Bentley's results are formulated by multiplying his original results by 0.6, which should make up for defects in the design of his demonstration. This mathematical adjustment is intended to account for times when clerks are not being productive or are not performing optimally. Campbell agrees that the 0.6 figure is more conservative than the 22 to 23 percent figure representing mail processing overhead costs that is traditionally assumed by the Service. Tr. 39/17569. The Commission therefore adopts Bentley's recommended hand-weighing productivity for use in QBRM costing analysis.

[6029] Similar reasoning leads to adoption of Bentley's manual productivity figure. The Postal Service argues that "[u]nlike witness Bentley's video demonstration, the productivity derived by the Postal Service encompasses numerous tasks and incorporates such factors as set-up time, clerk fatigue, and travel time." Postal Service

¹⁷⁵ In telling cross-examination on the comparison between non-letter size BRM and QBRM, Campbell agrees that the non-letter BRM processing was 7,272 piece per hour. Tr.14/6173. He agreed that "this is a productivity for . . . big, bulky, nonletter size BRM pieces"; and that it would be less costly to apply weight techniques to letter size QBRM than it would be to apply weight techniques to nonletter sized bulky packages: "I would expect that productivity to be a conservative productivity." *Id.* at 6174, 6175. "[O]ne could apply this productivity and perhaps obtain a reasonable estimate as [sic] weight averaging productivities for letter size mail." *Id.* at 6175. In his rebuttal statement, Campbell, noting that letter-sized material is processed at 6,390 PPH while bulkier pieces are processed at a rate of 7,272, says: "The relationship between these two productivities is counter intuitive." T r.39/17501. He continues: "unlike for nonletter-size BRM, the Service has developed no standards or procedures for applying weight averaging to trays of letters." *Id.* at 17501-02. The Commission notes that the 1987 Reply Mail Study was conducted at just one site. Tr. 14/5992. This suggests the study was not necessarily representative.

Brief at VIII-24 fn. 20, citing Tr. 39/17499. However, Bentley's study does not appear unreasonable; the pace of the workers appears moderate. Further, Bentley has substantially pared down his study results (multiplying his result by 0.6) in order to be conservative. In addition, the idea that it would take one hour to count 995 pieces (or, less than 17 pieces per minute) of uniformly-sized letter mail by hand, as the Service suggests, seems unreasonably slow on its face, even with fatigue and set-up times considered.

[6030] Concluding that KeySpan has the better of both the method allocation and productivity arguments, the Commission finds that for high-volume users, it is reasonable to accept Bentley's unit cost calculation. On the basis of these findings, the Commission recommends a one-cent piece rate. This piece rate is the same as that proposed and recommended for weight-averaged non-letter BRM. Though there are differences in how the pieces are handled (all weight averaging versus a variety of methods) the fact remains that processing letter material is apparently at least as efficient as handling bulky film containers overall. The Commission does not recommend the lower 0.5 cent per-piece fee KeySpan suggests in this case due to the imprecision in the costing data and its commitment to ensuring that costs are covered. Hopefully, this precision will improve when actual experience with high-volume QBRM is reviewed.

[6031] For low-volume users, the Commission recommends retaining the current per-piece rate. The Service has failed to justify any per-piece rate increase, given the inadequate state of the method allocation and productivity evidence it relies on. The low PPH figures initially advanced by the Service are flawed, as discussed, and the Campbell Survey brings the entirety of the BRM Practices Study into question. The Commission declines, however, to cut the low-volume rate, as KeySpan suggests, though there is some evidence pointing in that direction. KeySpan's assumptions about how low-volume QBRM is handled seem reasonable. However, they do require additional steps in the estimating process. Following the system wide implementation of best practices methods for handling QBRM, it should be possible to justify a lower, cost-based per-piece fee.

[6032] The Commission declines to follow the KeySpan suggestion, offered on brief, that it recommend an alternative combined low-and-high volume piece rate in case the Governors decide to reject these recommendations. There is ample evidence upon which to recommend a two-part QBRM rate structure, and continuance of the current rate structure would be inconsistent with the statutory guide to recommend rates that are fair and equitable.

[6033] *Accounting fee.* KeySpan proposes a higher accounting fee for high-volume QBRM to ensure the Service can employ efficient counting methods, which is a commendable goal in view of how processing method choice affects overall costs. USPS claims the breakeven figure for its \$3,400 per year fee is 113,000 pieces per year, which it says would cover 1,358 recipients, though Bentley argues the Postal Service misestimated and the real figure is 522 recipients. Tr. 29/14001 fn. 18. KeySpan admits its \$12,000 fee is higher than statutory criteria warrant and says there is room to change the fee. The Commission adopts a middle ground approach, and will recommend setting the fee at \$1800 quarterly (the equivalent to \$600 monthly). This produces a break even figure of 180,000 annually (or 15,000 monthly), and at current usage patterns (see KE-LR-1) one might expect about 431 high-volume recipients to take advantage of the new QBRM fee structure. In addition to encouraging more efficient processing, as suggested by KeySpan, this figure will be consistent with the non-letter size fixed fee (of \$600 a month). At the same time, the fee is not so high as to unfairly limit usage to the highest volume accounts. The Service's opt-in opt-out procedure will tend further to encourage the most efficient usage of QBRM as recipients focus their use on high-volume seasons.

[6034] *The QBRM Discount.* Campbell finds the cost avoidance of a QBRM piece to be 3.38 cents, and rounds the discount to 3.0 cents off the First-Class rate. The Commission calculates this cost avoidance to be 3.36 cents, an insignificant difference. KeySpan suggests a 3.5 cents discount off the First-Class rate, but Bentley's calculation includes, inter alia, avoided window costs. KeySpan Brief at 42. The Commission will

not follow this cost avoidance approach for the reasons stated in the discussion of the Pitney Bowes proposal for a metered mail discount.

[6035] *Classification and Pricing Criterion.* The recommended new fee categories for QBRM will allow fees that are aligned more closely with costs than existing fee, and therefore more fair and equitable to QBRM mailers. The Commission notes that BRM volume has decreased substantially over time. This may have occurred in part because firms that would otherwise use BRM have been deterred by a non-cost based fee structure for QBRM that made its use uneconomical. Adopting a more cost-based QBRM fee structure may spur volume. Because such mail pieces are often related to bill paying, greater usage may aid the Service in staving off electronic diversion. Improvements in QBRM pricing and costing are therefore quite important, and the new structure is desirable from the point of view of both users and the Postal Service.

[6036] The recommended rates for high volume QBRM should provide a generous contribution to institutional costs. The Postal Service estimates high volume accounting costs of less than \$250 per month. USPS-T-29 at 15, 21. The recommended fee of \$600 per month will easily recover these costs. Similarly the \$0.01 per piece fee substantially exceeds projected costs of \$0.0017. This should ameliorate any concerns that Bentley's cost analysis was optimistic in assessing the efficiency of QBRM processing. These fees should encourage more efficient, high volume rating and billing, fully recover QBRM costs, and provide a contribution to institutional costs that reflect the high value of BRM to both senders and recipients.

[6037] When the Governors rejected the Service's own Prepaid Reply Mail category in Docket No. R97-1, they directed the Service to "explore further such matters as the extent to which reply mail volume should influence fees charged to different recipients."¹⁷⁶ Work remains to be done in the QBRM costing area. Further, there are no guidelines to tell field employees how best to process varying QBRM volumes.

¹⁷⁶ Decision of the Governors of the United States Postal Service on the Recommended Decisions of the Rate Commission on Prepaid Reply Mail and Courtesy Envelope Mail, Docket No. R97-1, issued June 29, 1998, at 3.

Processing method decisions appear to be conducted on an ad hoc basis. In the Service response to an information request in Docket No. MC99-2, the Service said it was committed to more fully using its capacity to perform automated or machine based counting, saying that this was particularly true as to QBRM. Docket No. MC99-2, Postal Service response to POIR Request at 3-4, filed June 18, 1999. The Service should expeditiously introduce a plan to guide local facilities' processing decisions.

5. Merchandise Return (Schedule 932)

[6038] Introduced in MC79-4, Merchandise Return allows a permit holder, for a piece fee plus postage, to receive parcels containing merchandise being returned to the permit holder by a mailer without the mailer having to pay the postage. Similar to business reply mail, it can be utilized for parcels mailed at First-Class, Priority and Standard B rates. The permit holder can purchase additional services such as registry, insurance or special handling. USPS-T-39 at 67. The Postal Service has proposed classification changes to allow senders using merchandise return to purchase insurance, to eliminate the per-piece fee, and to establish an annual advance deposit account fee of \$375.00. *Id.* at 66.

[6039] *Commission Analysis.* The Postal Service bases its proposals on cost data provided by witness Eggleston. Originally, costs for Merchandise Return included weighing and rating as part of the acceptance cost function, and was thought to include an additional sortation. According to the Postal Service, the Merchandise Return cost study update in 1986 changed this view. USPS-T-26 at 42. That cost study had three components: distribution and separation, weighing and rating, and billing and trust fund accounting. It was determined that, for the most part, weighing and rating takes place in postage due units. Thus, weighing and rating should not be reflected in both the per piece fee and the underlying postage fee. *Id.* at 41. Eggleston isolates the proposed cost reduction by using as a benchmark a parcel which an individual "sends to a business by taking it to the window for weighing and rating." She determines that

Merchandise Return parcels incur no additional costs. *Id.* at 42. To reflect absence of additional costs the Postal Service proposes to eliminate the per-piece fee. *Id.* at 44. The Postal Service's proposal was unopposed by the parties.

[6040] *Recommendation.* The Commission finds that the evidence supports the Postal Service proposals. The Commission recommends the elimination of the per-piece fee, the establishment of an annual deposit account fee in the amount of \$375, and the authorization for all mailers, not just shippers, to purchase insurance on Merchandise Return parcels.

6. On-Site Meter Settings (Schedule 933)

[6041] On-site meter service is a service whereby a Postal Service employee travels to a customer site or to a meter manufacturer site, and sets a meter, examines a meter, or checks a meter in or out of service. The nature of postage meter service has changed over the past few years due to the recent de-certification of all mechanical meters and proliferation of electronic meters. Over 90 percent of postage meters in use today are remote-set electronic meters that are set by the manufacturer, not the Postal Service. USPS-T-39 at 80-87. The Postal Service proposes to change the name of this service from on-site meter setting to on-site meter service. The new name will reflect the changes in postage meter technology and that the service provides more than meter setting. The Commission recommends the name change to "on-site meter service."

[6042] The Postal Service proposes to restructure the fee classifications for on-site meter service. The current fee structure differentiates between a scheduled visit, \$27.50, and an unscheduled or emergency visit, \$31.00. The charge for the visit includes resetting or examining one meter. The fee for resetting or examining additional meters is \$4.00 each. A separate fee of \$8.50 is charged for each meter checked in or out of service.

[6043] Under the proposed fee structure, the Service will charge \$31.00 per visit to a customer or manufacturer site. This fee includes employee and travel related

expenses in getting to the site, but no longer includes resetting or examining the first meter. A separate fee of \$4.00 will be charged for each meter that is reset, examined, or checked in or out of service. For a site with one meter that has an appointment for meter service, the effective fee increase is from \$27.50 to \$35.00 (\$31.00 Meter Service plus \$4.00 Meter Reset and/or Examination fee). The Service proposes to reduce the fee for check in or out of service from \$8.50 to \$4.00. This reflects the lower cost of the service due to the introduction of modern postage meters and the de-certification of the older mechanical type meters. The fee structure changes are summarized in Table 5-22.

Table 5-22
On-Site Meter Setting

	Current	Proposed	Recommended
First Meter By Appointment	\$27.50	Eliminated	Eliminated
First Meter Unscheduled Request	\$31.00	Eliminated	Eliminated
Additional Meter	\$4.00	Eliminated	Eliminated
Meter Service (per Employee)	—	\$31.00	\$31.00
Meter Reset and/or Examined (per Meter)	—	\$4.00	\$4.00
Check In/Out of Service (per Meter)	\$8.50	\$4.00	\$4.00

Source: Adapted from USPS-T-39 at 81.

[6044] The Postal Service proposes that the check in/out of service fee not be applied to “Secured Postage” meters. Secured Postage meters are remotely set, contain a postal security device and print information based indicia. Postal Service witness Davis states that these meters do not have significant check in/out costs. USPS-T-30 at 18. The Commission recommends that the check in/out of service fee not be applied to “Secured Postage” meters.

[6045] The proposed fees will result in a cost coverage of 123 for the on-site meter service as a whole. The Postal Service proposals simplify the fee schedule and the proposed fees include an adequate contribution to recovering institutional costs. The

Commission recommends the new rates and classification proposed by the Postal Service for the on-site meter service.

7. Bulk Parcel Return Service (Schedule 935)

[6046] BPRS, introduced in Docket No. MC97-4, is designed to allow a qualifying bulk mailer of machinable Standard A parcels to have its undeliverable parcels returned to either specific postal facilities for pick-up by the shipper or for delivery to the shipper by the Postal Service after a payment of a fee for each returned parcel. Prior to its establishment, shippers relied upon Standard A single piece mail (which was discontinued after R97-1) as the only mailing option for the return of undeliverable merchandise. PRC Op. MC97-4/C97-1 at 3.

[6047] In Docket No. MC 97-4, the Commission accepted a stipulation and agreement offered by participants that set the piece fee at \$1.75 and the annual authorization permit fee at \$85.00. The \$1.75 fee represented a cost coverage of 156 percent, the systemwide average at the time, as determined in Docket No. R97-1. It differed with the original Postal Service request by lowering the annual qualifying minimum volume for BPRS recipients from 50,000 to 10,000 pieces, while maintaining the requirement that qualifying parcels must weigh less than 16 ounces. *Id.* at 6. The Agreement also directed the Postal Service to complete a study that would develop an estimate of unit volume variable costs for BPRS. The Bulk Parcel Return Service Study Plan was completed and provided to the Commission on October 30, 1998, and included a total estimated FY 1998 volume variable unit cost for BPRS of \$0.93. Bulk Parcel Return Service Cost Study (Oct. 29, 1998) (Postal Service 1998 BPRS cost study) at 7.

[6048] BPRS originally was restricted to parcels that were determined under postal regulations to be undeliverable as addressed (UAA) and thus unopened. PRC Op. MC99-4 at 1. In Docket No. MC99-4, the Postal Service proposed to change the definition of BPRS to include those parcels which had been opened, resealed and redeposited in the mail by the shipper's customer. It also provided for the shipper to

include in each parcel a return label enabling the customer to return the parcel, under BPRS, at the expense of the shipper. It did not address fees. A settlement agreement to this effect was recommended by the Commission and approved by the Governors.

[6049] During the course of its consideration of Docket No. MC99-4, the Commission received a complaint initiated by the Continuity Shippers Association (CSA) objecting to the BPRS fee. The Commission will note, that as was pointed out both in briefs and in testimony, that even though CSA filed this complaint, it was a signatory to the agreement that led to the Commission's decision in MC99-4. CSA's complaint was received as Docket No. C99-4. CSA complained that the \$1.75 per piece fee, in effect since Docket No. MC97-4, was excessive when compared to the costs identified in the Postal Service's Bulk Parcel Return Service Study.

[6050] For the purposes of Docket No. C99-4, and as a result of using the Commission's mail processing cost methodology and identifying additional cost data, the Postal Service revised its earlier BPRS unit attributable cost figure from \$0.93 to \$1.037. While there was some discussion regarding the appropriateness of certain cost adjustments to reflect FY 1998 to FY 2000 cost changes, the Commission adopted the \$1.037 cost figure. PRC Op. C99-4 at 12.

[6051] The Postal Service filed its request in this case while Docket No. C99-4 was pending before the Commission. Contained in the Request is a proposal, based on still more updated cost and volume data, to decrease the per piece fee from \$1.75 to \$1.65. The Postal Service also requests that the matters initiated within Docket No. C99-4 be suspended and consolidated with Docket No. R2000-1. The Commission decided the arguments presented in the complaint case indicated a need to address the complaint promptly rather than consolidating it with Docket No. R2000-1. On April 14, 2000, the Commission issued its Decision in C99-4. The Commission recommended the Postal Service lower the per piece fee from \$1.75 to \$1.62 to reflect the previously agreed to 156 percent cost coverage. On June 5, 2000, the Governors rejected the proposed fee change in C99-4¹⁷⁷.

[6052] *Participant Positions.* Postal Service witness Mayo proposes one classification and one fee change for BPRS. USPS-T-39 at 15. She proposes to lower, by six percent, the existing \$1.75 per piece fee to \$1.65 and to establish an annual advance deposit account fee “similar to the accounting fee for Business Reply Mail (BRM)” of \$375.00. Mayo estimates test year unit costs for BPRS of \$1.135 per piece and a cost coverage of 146 percent. *Ibid.*

[6053] Costs are provided by Postal Service witness Eggleston, who submits cost data based largely on the cost study performed as part of Docket No. MC 97-4, with corrections. USPS-T-26 at 30. Witness Buc, in testimony on behalf of the Continuity Shippers Association *et al.*, provides a different cost analysis and suggests that the appropriate unit cost should be \$98.2 cents without a contingency or 99.9 cents including a one percent contingency. He proposes a cost coverage of 132.9 percent, “the same as for Standard A Regular.” He concludes that the fee for BPRS should be \$1.33. Tr. 23/10643.

[6054] OCA dismisses the arguments for fee reductions from both the Postal Service and CSA and argues strenuously for maintaining a cost coverage of at least the systemwide average. OCA Brief at 215 *et seq.* OCA contends BPRS has a relatively high level of value of service and low price elasticity of demand. OCA states that certain service characteristics of BPRS provide high levels of intrinsic value of service. To support its argument it cites Buc’s testimony that Cosmetique prefers to receive its returns via BPRS and that it now receives those returns directly from customers without having to go to Postal Service Mail Recovery Centers. OCA concludes that the existing rate of \$1.75 is far more fitting, based on its high level of service, than either of those proposed by the Postal Service or CSA.

[6055] Throughout this Docket there has been a good deal of discussion as to the true nature of BPRS and what is a suitable proxy for identifying an appropriate

¹⁷⁷ Decision of the Governors of the United States Postal Service on the Recommended Decision of the Postal Rate Commission on Complaint on Charges for the Bulk Parcel Return Service Docket No. C99-4, June 5, 2000.

contribution to institutional costs from this service. In her direct testimony, Eggleston estimates the volume variable costs of BPRS in five different components: collection, mail processing, transportation, delivery and postage due. Buc accepts the Postal Service's unit costs for the delivery and postage due components, but he argues that the Postal Service overestimates the unit costs for collection by 1.2 cents, mail processing by 6.6 cents and transportation by 3.8 cents. Tr .23/10643.

[6056] Buc states that the Postal Service's collection cost component includes 1.16 cents per piece for window acceptance. The Service uses historical Standard A single-piece collection costs as a proxy for BPRS. Standard A window acceptance activities such as weighing, rating, and collecting postage are not performed for BPRS. Buc proposes that the collection costs for Merchandise Return are a more appropriate proxy for BPRS. Buc argues that Eggleston found that Merchandise Return parcels do not incur weighing and rating during window acceptance because they are incurred in the postage due unit, not at the window. BPRS parcels, according to Buc, are handled the same way. Tr. 23/10644. Thus, to avoid double counting, Buc concludes collection costs for BPRS should be reduced by 1.16 cents, from 3.22 cents to 2.06 cents. *Ibid.*

[6057] In response, the Postal Service complains that Buc does not understand the definition of "acceptance" as applied in the Eggleston cost study and that his comparison is incorrect because Merchandise Return "is a service for customers paying postage for an underlying class of mail. That postage would cover window costs for MRS parcels. Unlike MRS, the BPRS fee is a hybrid that must cover costs, such as acceptance costs, normally covered by postage." Postal Service Brief at VIII-7.

[6058] Buc also takes exception to the manner in which the Postal Service applies the CRA adjustment factor in its calculation of mail processing costs. In this instance he proposes that the Standard Mail Special CRA adjustment be reduced by 70 percent to reflect the cube and weight difference between BPRS and Standard Mail Special, which was used as proxy. The Postal Service's mail processing unit costs, as calculated by Buc, are overestimated by 6.6 cents. Buc focuses on the use of the Special Standard CRA adjustment, and the assumed inter- and intra-BMC weights. The Service uses both

proportional and fixed CRA adjustment factors. The fixed cost pools that CRA adjustment factors are applied to contain both “expected” and “unexpected” costs. Buc argues that both expected and unexpected fixed costs are affected by cube and weight, similar to the proportional cost pools. Proportional costs are modeled at about 70 percent of the modeled costs of Special Standard B. Therefore, the fixed costs should have a fixed CRA adjustment factor that is 70 percent of the Standard B Special fixed CRA adjustment. By applying this 70 percent factor to the fixed costs, Buc concludes that the Postal Service has overestimated mail processing costs by 6.34 cents. Tr. 23/10645-10647.

[6059] The Postal Service argues that the cube and weight differences are already reflected in the modeled weighted average cost of BPRS, which had been reduced by 70 percent before the adjustment factor was applied. It further cited several reasons why BPRS parcels could be more expensive than Standard B Special Mail to process.

[6060] Additionally, Buc takes exception to the Postal Service's attribution of mail processing costs as they relate to inter-BMC versus intra-BMC. The Postal Service assumes that 95.2 percent of BPRS parcels are inter-BMC parcels and 4.8 percent are intra-BMC parcels. Buc alleges that this assumption is clearly incorrect since one of the eight BMC recipients surveyed (accounting for 3.5 percent of the BPRS volume) does not receive returns on a national basis. Buc assumes that all of this recipient's returns are intra-BMC. By incorporating this assumption, only 91.9 percent of BPRS parcels should be considered inter-BMC. Given a mail processing cost difference of 8.7 cents between inter-BMC and intra-BMC parcels, and the assumed lower percentage of inter-BMC parcels, Buc asserts the Postal Service has overestimated this portion of mail processing costs by 0.3 cents. Id.

[6061] Buc alleges the Postal Service made two erroneous assumptions that result in transportation costs being overestimated by 3.8 cents. First, zone distribution of inter-BMC parcels is the same as that for inter-BMC Parcel Post parcels, and second, only one out of every 21 BPRS parcels is intra-BMC.

[6062] When calculating inter-BMC transportation costs, Parcel Post inter-BMC volumes are distributed between eight zones. Buc notes that four of the eight BPRS recipients, accounting for 61 percent of BPRS volume, rarely receive packages from zones six through eight. Assuming that no recipient receives parcels from zones six through eight, Buc calculates inter-BMC transportation unit costs. He claims his transportation cost estimate provides a lower bound while the Postal Service's calculations provide an upper bound estimate, therefore, he averages the two cost estimates. He then subtracts his averaged estimate from the Postal Service's estimate and multiplies the result by 91.9 percent (his percentage estimate of total inter-BMC parcels) in concluding that the Postal Service has overestimated inter-BMC transportation costs by 2.9 cents. He reduces this by another 0.9 cents by applying his assumptions regarding the intra-BMC versus inter-BMC split, 91.9 percent of which are inter-BMC and claims a 0.9 cent difference in inter-BMC versus intra-BMC distributions. Buc concludes that total transportation costs are overestimated by 3.8 cents, assuming the 2.9-cent difference for inter-BMC zone costs and the 0.9-cent difference for intra-versus inter-BMC distributions. This argument is made more difficult in that as both CSA and the Postal Service agree, neither have any origin-destination data. Postal Service Brief at VIII-9.

[6063] During the process of updating for a 1999 base year, in response to Commission Order No. 1294, the costs increased over those originally submitted and discussed above. CSA on brief filed cost data that demonstrated costs by function for collection did not change, but mail processing, delivery and postage due increased by 0.9, 1.0 and 0.1 cents respectively. Transportation decreased by 1.7 cents. CSA argues that the new unit costs for BPRS are now 99.2 cents as opposed to their earlier 98.9 cents. CSA Reply Brief at 4-5. The Postal Service's updated information reported that the costs had increased to \$1.315 from \$1.105. USPS-T-26 Attachment Q at 1.

[6064] *Commission Analysis.* The Commission has found that the systemwide average cost coverage is often appropriate for new products and services, which often do not have actual cost data to support the rates requested. However, it never intended

the application of the systemwide average to BPRS to preclude its ability to take into consideration other factors that would become available as the service reached its audience.

[6065] In this case the Postal Service has proposed a cost coverage of 146 percent and CSA has argued instead that the appropriate cost coverage should be the same as for Standard A Regular, or 133 percent. Both of these are significantly lower than the 156 percent applied to the existing rate. OCA argues for a coverage close to the systemwide average in the Postal Service's proposed case of 168 percent. OCA Brief at 215. The Commission believes BPRS should be evaluated as a special service that was ardently sought after by shippers of merchandise, including CSA. Thus, its high level of service and demand are self-evident and borne out by its history. Under these circumstances, a mark-up near systemwide average remains appropriate.

[6066] As to the individual costing arguments, those made by CSA as to collection costs have merit. The Commission agrees with CSA that BPRS parcels should receive little, if any, handling at the post office window. These parcels are small, less than 16 ounces, and the Commission agrees with CSA that the majority of these parcels will be returned by being placed in collection boxes or left for carriers, thereby avoiding window collection costs. The Commission therefore reduces the attributable collection costs to the 2.1 cents proposed by CSA on brief.

[6067] Since there were no disagreements among the parties as to the attributable costs for the Delivery or Postage Due components, the Commission accepts the amounts proposed by the Postal Service of 4.3 and 4.7 cents, respectively. Similarly, the Commission accepts the Postal Service's claims regarding transportation costs. While CSA made a valiant attempt to shed light on the transportation costs of BPRS, the fact is it is a new service with little data for light to be shed upon. Therefore, the Commission accepts the transportation costs of the Postal Service of 40.6 cents.

[6068] The arguments regarding mail processing costs made by CSA also have merit. Intuitively, if one reduces the modeled cost by 70 percent it makes sense to reduce its components by a similar number. Therefore, the Commission accepts CSA's

proposed costs of 51.4 cents. Adding a appropriate amount for a contingency provides a unit cost for BPRS of \$1.046, which is only slightly higher than the \$1.037 calculated in C99-4.

[6069] *Recommendation.* The proposal to add an advance deposit account fee in the amount of \$375 was unopposed. The fee is necessary, according to witness Mayo to recoup the costs of providing the accounting service and to make a small contribution to institution costs. USPS-T-39 at 17. The Commission agrees with the Postal Service's request for an advance deposit account fee and makes that recommendation.

[6070] The Commission recommends a per piece fee of \$1.62 based on the Commission's cost analysis for BPRS. This rate is slightly lower than the rate proposed by the Postal Service. It provides a cost coverage of 155 percent, which is close to the systemwide average, and reflects the high value of BPRS posited by OCA.

8. Shipper Paid Forwarding (Schedule 936)

[6071] Shipper paid forwarding provides forwarding service for a period of one year from the date a recipient files a change of address form. The service is available to eligible shippers mailing machinable standard parcels. Standard A mailers have the option to pay either the single-piece First-Class rate or the Priority rate for the return. Standard B mailers pay the applicable single piece rate for the return. Address change service is a prerequisite for shipper paid forwarding service.

[6072] The Postal Service proposes to add the availability of Parcel Post rates to shipper paid forwarding service. This will reflect the concurrent proposal to make Parcel Post rates available to parcels weighing one pound or less. The Postal Service also proposes to establish an annual accounting fee similar to the advance deposit account accounting fee for Business Reply Mail. The Business Reply Mail cost of \$323.06 is used as a proxy for the shipper paid forwarding accounting fee cost in arriving at a \$375.00 fee for this service. USPS-T-39 at 138-40. The Commission recommends the addition of Parcel Post rates to shipper paid forwarding and the annual accounting fee as

proposed by the Postal Service. The Service proposes that this fee appear in a new Fee Schedule 936. The Commission recommends grouping all advance deposit account accounting fees in Fee Schedule 1000, and reserving Fee Schedule 936 for future use.

9. Certified Mail (Schedule 941)

[6073] Certified mail is a special service for use with First-Class and Priority mail. The mailer receives a mailing receipt if the mail is deposited at a post office window or given to a rural carrier. The Postal Service obtains a signature upon delivery and retains a delivery record of the item mailed. Certified mail may be used in conjunction with return receipt or restricted delivery service. The fee for certified mail is in addition to postage. USPS-T-39 at 40-43.

[6074] The Postal Service proposes a 50 percent increase in the fee for certified mail from \$1.40 to \$2.10. The proposed fee divided by the estimated volume variable cost of \$1.68 results in a cost coverage of 125 percent. However, certified mail exhibits a large difference between volume variable costs and incremental costs. The fee is not designed around a cost coverage, but is designed to cover the incremental cost of \$2.00. Witness Kay asserts that 77 percent of the difference between incremental costs and volume variable costs can be accounted for in four city carrier (C/S 7) cost pools, Letter Route Load SDR, Letter Route Load MDR, Letter Route Load BAM, and Street Support Load. USPS-T-23 at 18. Witness Mayo states that certified mail is a high value service and acknowledges that a fee increase of this magnitude will have an adverse impact on users. Eight-two percent of certified mail customers also use return receipt service. Under the Postal Service rate proposal, the fee for mail sent using both certified mail and return receipt increases from \$2.65 to \$3.60, plus postage.

[6075] The Postal Service also proposes a DMCS classification change to reflect the use of electronic signature capture for certified mail. The Postal Service now scans signatures for accountable mail for inclusion in a centralized database, rather than storing hard copy signatures at each office of delivery. Thus, DMCS references to

keeping delivery records at the “office of delivery” are proposed to change to “retention of delivery records by the Postal Service.”

[6076] *Intervenor Comments.* Intervenor Popkin argues that a 50 percent rate increase should not be granted because provision of certified mail service is not in conformance with requirements for the service. Furthermore, he contends there is no alternative for certified mail other than an expensive expedited service, so mailers have no choice but to pay the increase.

[6077] Intervenor Carlson argues that delivery problems with certified mail lower the value of service. Therefore the Commission should reject an increase, or lower the rate for this service. He also compares return receipt for merchandise with certified mail plus return receipt and questions why the rate for certified mail plus return receipt is higher than for return receipt for merchandise given the similarities in the services. He states that both services provide a mailing receipt, a record of delivery, and a return receipt. However, the combined fee for certified mail plus return receipt return receipt is \$3.60, and the fee for return receipt for merchandise is \$2.35. Finally, he requests the Commission to recommend that the Postal Service cease advertising certified mail and return receipt, in the context of mailing income tax returns, until alleged delivery problems are fixed.

[6078] *Commission Analysis.* Certified mail should be a high value service that would justify a cost coverage above the system-wide average. In R97-1, the Commission recommended a smaller increase than proposed by the Postal Service to lessen the impact on the mailing public and to bring the increase closer to the system-wide rate increase. The high cost of this service still does not allow setting a fee providing a sufficient cost coverage without an adverse impact to the public.

[6079] The Commission acknowledges the intervenors’ concerns with the allegations of certified mail delivery problems. There exists no national measures of the speed or reliability of certified mail, but anecdotal individual and press reports leave a persistent perception that service is inconsistent at best. The problems cited are in execution of the service, not with the concept of the service.

[6080] The Postal Service, if it has not already done so, must take appropriate corrective action to fix known problems so that certified delivery operates as advertised. It should also consider collecting data to evaluate the speed and reliability of this service so that problems can be identified and remedied. Persistent problems may indicate that something is wrong with the service itself and require a closer evaluation of the value of service in the future.

[6081] Comparisons to return receipt for merchandise are misplaced. Certified mail plus return receipt function in a different market than return receipt for merchandise, which results in significantly different costs. Certified mail plus return receipt is generally used with letters, whereas return receipt for merchandise is generally used for parcel shaped mail. The Postal Service provides several reasons that may explain the cost differences. Acceptance costs may be lower for return receipt for merchandise because more return receipt for merchandise parcels may be entered in bulk than certified mail plus return receipt parcels. Window costs for certified mail plus return receipt may be higher because two individual services are being sold as opposed to one service. Merchandise parcels with return receipt are generally larger than certified mail parcels. Thus, the delivery person is more likely to have to approach the door to make a delivery. This may lower the cost for return receipt for merchandise because some of the cost for return receipt for merchandise parcels is already being absorbed by the delivery person approaching the door with the host parcel. Return receipt for merchandise has the option of waiving the signature requirement. This may lower costs because the delivery person does not have to obtain a signature for a portion of the parcels, and delivery can be made on the first attempt. Finally, the Postal Service set the return receipt for merchandise cost coverage deliberately low to avoid sticker-shock because of the magnitude of the proposed price increase. T r.14/5790-2, Postal Service Reply Brief at VII-19-20. The Commission finds there are significant differences between certified mail plus return receipt and return receipt for merchandise.

[6082] The Commission has no recommendation for advertising certified mail, assuming that the Postal Service is, or has implemented corrective actions to address the alleged problems.

[6083] The magnitude of the proposed increase in the fee for certified mail is large enough that the Commission is concerned with the possibility of an adverse impact on consumers. The Commission is also concerned that the service problems described by the intervenors affect the value of service of certified mail.¹⁷⁸ However, the magnitude of the rising cost of this service requiring an increase to cover costs is balanced with the concern for value of service. Therefore, the Commission recommends a rate less than the rate proposed by the Postal Service to mitigate the effect on the consumer. The Commission recommends a fee of \$1.90 for certified mail. This rate represents a considerable increase of over 35 percent. At this rate, test year costs will equal \$1.60, producing a 119 percent cost coverage. The Commission also recommends the proposed classification change to the DMCS language.

[6084] In its last omnibus rate case opinion, the Commission suggested that the Postal Service examine incorporating some of the information technology and infrastructure used for delivery confirmation to modernize certified mail. It should help lower costs compared to certified mail's relatively high cost of collecting delivery information manually. PRC Op. R97-1, para. 5924. In this docket, the Commission reiterates its concern with the rising cost of providing certified mail service. Although the Service has introduced electronic signature capture, the Commission suggests that the Postal Service explore other methods to reduce the cost of this service.

¹⁷⁸ See also Area Coordination Audit, Special Services, May 18, 1999, Case No. 040-1241887-PA(2), U.S. Postal Inspection Service Northeast Division, Final Report, filed as USPS-LR-I-200 in response to DFC/USPS-24. Tr. 21/8833. Although not admitted into evidence, this report discusses findings and recommendations of the U.S. Postal Inspection Service concerning problems with certified mail. The certified mail section of this report was also filed in response to DFC/USPS-T39-3. Tr. 14/5468-74.

10. Registered Mail (Schedule 942)

[6085] Registered mail is the most secure method of sending mail offered by the Postal Service. There is a system of receipts used to monitor and account for the flow of the mailpiece from acceptance to delivery. The sender is provided with a mailing receipt, and the Postal Service retains a delivery record of the item mailed. USPS-T-39 at 121-26.

[6086] The Postal Service proposes a 23 percent total increase in the fees for this service. The fee for registered mail without insurance is proposed to increase from \$6.00 to \$7.25. Registered mail may also be purchased with insurance on a graduated scale up to the actual value of the mailpiece (from \$0.01 through \$25,000). The fee for the first step of registered mail with insurance would increase from \$6.20 to \$7.50, and each successive step is proposed to increase from \$0.55 per step to \$0.75 per step. A handling fee is imposed on items valued over \$25,000. The Postal Service proposes to increase the handling fee from \$0.55 per \$1,000 to \$0.75 per \$1,000. Special arrangements must be made for items valued at over \$15,000,000. Fees are assessed based on the special arrangements. The proposed total cost coverage for registered mail is 111 percent.

[6087] The Postal Service claims that registered mail provides a very high value of service, but aims for a moderate cost coverage to alleviate the impact that a more substantial rate increase would have on customers of this service. The Commission concurs and recommends the fees proposed by the Postal Service. These rates produce a 131 percent cost coverage.

11. Insurance (Schedule 943)

[6088] This special service provides up to \$5,000 in indemnity coverage for lost, rifled or damaged articles. The service is available for Express Mail, Package Services, and First Class Mail or Priority Mail that contains items that could be sent as Standard

Mail. Express Mail provides for \$500 of indemnity coverage free-of-charge. Above \$500, insurance fees for Express Mail are charged based on each \$100 increment, or fraction thereof. For Package Services and Standard Mail matter mailed at First-Class Mail and Priority Mail rates, no automatic insurance is provided; hence any level of indemnity coverage from \$0.01 to \$5,000 is assessed a fee. A per-piece discount is available for bulk mailers who mail a minimum of 10,000 insured mail pieces annually.

[6089] The Postal Service proposed increases in all existing fees for insurance. The current incremental fee of 95 cents between value levels is proposed to increase to \$1.00. This proposed incremental fee increase also applies to Express Mail insurance value levels above \$500. The proposed overall cost coverage for insurance is 138 percent. USPS-T-39 at 59.

[6090] OCA witness Collins argues that the Postal Service fails to provide any credible justification for the proposed increase and recommends no increase in the per \$100 increment fee and a modification of the interval to \$250 or \$500 for insured value over \$100 with a corresponding adjustment in the per increment fee. Collins implies that the Postal Service did not gather and analyze data on USPS insurance purchases. Collins states that without this data the Postal Service established whatever price it felt justified. Tr .29/14197-8.

[6091] On brief, OCA implies witness Mayo's fee for unnumbered insurance (items valued at or below \$50) is based upon erroneous cost information and must be reduced, and low insurance usage for values exceeding \$900 may be due to a high fee relative to a low valued service. OCA comments that the value to the customer has not increased, the amount of competition has not changed, and the level of service has not improved. OCA Brief at 209-210.

[6092] Before hearings, witness Davis presented errata reducing the cost of unnumbered insurance to \$0.95. USPS-T-30 at 14, revised April 17, 2000. Assuming the proposed unnumbered fee of \$1.35, the cost coverage for this increment would increase from 104.5 to 138.6 percent, approximately the same as the overall insurance cost coverage. Mayo states that if she had known of the lower cost when developing the

original fee, she would have proposed a lower fee, though a decrease in proportion to the cost decrease would not be warranted. Tr. 39/17726-27. Therefore the Commission could recommend a lower fee. Mayo indicated that a fee of \$1.20 would eliminate an undesirably steep increase in the unnumbered insurance fee. *Ibid.*

[6093] The Postal Service proposes two classification changes applicable to bulk insurance. The first would establish separate bulk discounts for numbered and unnumbered insurance. The second classification change would extend bulk insurance to Standard A Mail. The intent is to meet the needs of more parcel mailers for insurance. The Commission agrees the change would provide a measure of safety to a mail class that does not have a high degree of speed of delivery, and that mailers should find this an enhancement to Standard A service.

[6094] *Commission Analysis.* As a whole, insurance covers its own costs and makes a moderate contribution to institutional costs. The fee increases are modest and should not have a negative impact. The Commission recommends an increase in the unnumbered insurance fee from \$0.85 to \$1.10 resulting in a 29 percent increase. For numbered insurance (items valued above \$50.01) the Commission accepts the rate proposed by the Postal Service. The initial fee for items valued between \$50.01 and \$100.00 will increase from \$1.80 to \$2.00. The fee for each subsequent \$100.00 in value will increase from \$0.95 to \$1.00.

[6095] The Commission also recommends new discounts for bulk insurance. The discount for unnumbered pieces will change from \$0.40 to \$0.60 with a pass through of 63 percent. The net fee for bulk unnumbered insurance will thereby increase from \$0.45 to \$0.50. For the numbered pieces, the bulk discount will increase from \$0.40 to \$0.80 which provides a 59 percent implied pass through. The overall cost coverage is 126 percent with an overall rate increase of 13.1 percent.

12. Collect on Delivery (Schedule 944)

[6096] Collect on delivery (C.O.D.) is a service a mailer may use to mail merchandise prior to the recipient paying for the item. Upon delivery, the recipient pays for the merchandise plus the applicable C.O.D. fee. The Postal Service then transmits the amount collected back to the sender. Collect on delivery mail is insured. USPS-T-39 at 44-49.

[6097] The Postal Service proposes a classification change to increase the maximum value of the C.O.D. item from \$600 to \$1,000. The purpose of the increase is to attract a potential new customer base—those who purchase items using the Internet. This will give Internet purchasers who are reluctant to divulge credit card information over the Internet an optional payment method. This also provides Internet businesses that do not accept credit cards an alternate method of accepting payments. The Service further claims that increasing the maximum value will aid small businesses without a credit card payment option, that require payment prior to shipping, and that accept payment by check, by providing faster delivery of goods. Faster delivery results from eliminating the delay in receiving a check and waiting for the check to clear prior to shipment.

[6098] The fees are based on the C.O.D. amount to be collected, or insurance coverage desired for the particular item. The fee for items up to \$50 in value would increase from \$4.00 to \$4.50. The fee for items up to \$100 in value would increase from \$5.00 to \$5.50. The fee for each successive \$100 increment, up to \$1,000, would increase by \$1.00 per step. The Postal Service does not propose changes to the fee for registered C.O.D. of \$4.00, the notice of non-delivery fee of \$3.00, or the alteration of C.O.D. fee of \$3.00. A fee increase is proposed for restricted delivery C.O.D. from \$2.75 to \$3.20.

[6099] The Commission recommends the classification change to allow C.O.D. items valued up to \$1,000. There may be a market for C.O.D. for items of this value given the rapid expansion of Internet services. The proposed rates are not opposed by

any party. Although the Commission recommends expanding C.O.D. to a higher value limit, a low cost coverage remains appropriate for this service. See, PRC Op. R97-1, para. 5941. The Commission finds the proposed rates reasonable and thus, recommends the proposed rates for this service. These rates produce a 118 percent cost coverage.

13. Return Receipt (Schedule 945)

[6100] Return receipt service is designed to provide customers with proof of delivery of mail. The return receipt customer receives the signature of the recipient, the delivery date, and the address where the mailpiece was delivered if it differs from the address on the mailpiece. A box is checked on the return receipt to indicate if the delivery address is the same as the address on the mailpiece.

[6101] "Regular return receipt" can be used with Certified, COD, Registered, Express Mail, and Numbered Insurance. "Return receipt for merchandise" can be used with Priority Mail and Package Services mail.

[6102] The Postal Service proposes two fee increases and one fee decrease to the return receipt fees. The regular return receipt fee proposal is an increase by 20 percent, from \$1.25 to \$1.50, with a cost coverage of 116 percent. The return receipt for merchandise fee would increase 68 percent from \$1.40 to \$2.35 with a cost coverage of 101 percent. The third change is a decrease in the return receipt after mailing fee by 50 percent, from \$7.00 to \$3.50 with a cost coverage of 153 percent. The overall cost coverage is 116 percent.

[6103] Intervenor Carlson asked witness Davis to explain the differences between the cost study for return receipt for merchandise conducted for Docket No. R2000-1 and the cost study conducted for Docket No. 97-1. Witness Davis indicates the new cost study includes updated wage rates, piggyback factors, labor times for clerk and carrier review functions, weighting factors, and retrieval time for return receipts after mailing. See USPS-LR-I-108 at 47-55. The new study bases the costs of return receipt for

merchandise on the costs of certified mail, since the operations are similar. The costs of obtaining the return receipt signature, printing the return receipt, and returning the return receipt through the mailstream are added to the unit cost of certified mail. An adjustment is made to reflect the unit cost savings from the electronic signature capture process.

[6104] Intervenor Popkin questions the quality of service that return receipt provides to the mailer. Popkin requested “details of all studies and tests that have been performed or conducted by the Postal Service in the past ten years (since Docket R90-1) to determine the mailing public’s needs and desires for return receipt service.”

Tr. 14/5417. In response Mayo refers to Plunkett’s response to DBP/USPS-33 in R97-1. *Id.* at 5418.

The Postal Service utilizes many methods to ensure that employees and managers provide the services customers expect. The fact that studies have not been performed at a national level to determine the level to which the Postal Service has been able to meet this goal vis a vis return receipts should not be construed as meaning that there has been no concerted effort toward this end. Local managers have access to customer feedback via consumer service cards and other means. They are expected to utilize these data to improve their performance not only as regards return receipts, but for all products and services.

Docket No. R97-1, Tr. 3/924.

[6105] *Commission Analysis.* Since Docket 97-1 the costs for return receipt requested at time of mailing have increased by 29.9 percent because of the combined increases of various cost inputs. Return receipts are potentially a high value service, but persistent problems with the quality of service imply a lower cost coverage. The service fills an important function by providing the mailer with delivery information. Although the total return receipt service cost coverage suggested by the Postal Service is low, the proposed fees cover the costs of the service and contribute modestly to other costs.

[6106] The Commission recommends the fees for return receipts proposed by the Postal Service. The Commission also recommends a classification change to extend return receipt for merchandise service to Standard Mail Regular and Nonprofit parcels.

The intent is to meet the needs of more parcel mailers for return receipt for merchandise service, which should in turn make Postal Service products more attractive. Providing this additional service option to those businesses that mail lightweight parcels should benefit mailers as well as the Postal Service. § 3623(c)(2) and (5). Also, the Commission recommends a language change in DMCS Section 945.25 from “duplicate return receipt” to “evidence of delivery from the delivery record.” The new language more accurately describes what the Postal Service provides to customers.

14. Restricted Delivery (Schedule 946)

[6107] Restricted delivery is a special service that allows a mailer to direct mail delivery only to the addressee or the addressee’s authorized agent. The addressee or agent must be an individual (natural person) specified by name. Restricted delivery is only available in conjunction with certified mail, C.O.D. mail, mail insured for greater than \$50.00, or registered mail. Restricted delivery is available at the time of mailing, or after mailing. If purchased after mailing, additional charges may be assessed to cover the cost of contacting the delivery post office. USPS-T-39 at 127-130.

[6108] The fee for restricted delivery is charged in addition to postage and any other applicable fee. The Postal Service proposes increasing the fee for restricted delivery from \$2.75 to \$3.20. Test year costs will equal \$2.02. The cost coverage of 158 percent is close to the system wide average and is appropriate for a high value special service that is desirable to either mailers or the recipients concerned with controlling or restricting the delivery of mail. The Commission recommends the proposed fee of \$3.20 for restricted delivery.

15. Certificates of Mailing (Schedule 947)

[6109] A certificate of mailing provides a mailer with evidence of mailing. It does not provide proof of delivery or insurance against damage or loss. Certificates of mailing are provided on Form 3817 for individual mailpieces, on Form 3877 (firm mailing book) for three or more mailpieces, and on Form 3606 for bulk mailings. A duplicate certificate of mailing is available for a fee at the time of the mailing or upon presentment of the original certificate. USPS-T-39 at 35-39.

[6110] The Postal Service proposes to increase the individual piece certificate from 60 cents to 75 cents, the individual piece duplicate fee from 60 cents to 75 cents, the bulk up to 1,000 piece certificate from \$3.00 to \$3.50, and the bulk duplicate fee from 60 cents to 75 cents. The proposed cost coverages are 124 percent, 156 percent, 118 percent, and 188 percent respectively. The firm mailing book fee is proposed to remain at 25 cents and the additional 1,000 piece bulk fee is proposed to remain at 40 cents. The associated cost coverages are 122 percent and 134 percent respectively. The proposed overall cost coverage for certificates of mailing is 123 percent. The fees are summarized in Table 5-23.

[6111] *Intervenor Proposal.* Intervenor Popkin argues that the fee for individual piece certificate of mailing should not be higher than the proposed retail fee for delivery confirmation. He alleges that delivery confirmation also provides proof of mailing, in addition to providing the confirmation of delivery. Thus, it is hard to understand why the fee for certificate of mailing is greater. He proposes a fee of 30 cents or less for certificate of mailing. Popkin Brief at 6-7. The Postal Service explains that window acceptance costs are greater for certificate of mailing, while delivery confirmation utilizes newer technology which exhibits greater cost efficiencies. Postal Service Reply Brief at VII-20.

[6112] *Commission Analysis.* The Commission finds that differences in the services and cost structures between individual piece certificate of mailing and retail delivery confirmation make comparison difficult. Delivery confirmation has approximately

four times the volume of certificates of mailing. Delivery confirmation utilizes modern technology whereas certificate of mailing is basically a manual service. Certificate of mailing has approximately two-and-one-half times the acceptance costs of delivery confirmation. A mailing receipt is not provided for more than 20 percent of delivery confirmation articles. The total cost for delivery confirmation is less than the acceptance cost for certificate of mailing. Thus, the services and costs are different, and the rates for the two services can be set independently.

[6113] Intervenor Popkin's concern regarding the higher fee for a service of lower value is particularly telling because delivery confirmation is not available with First-Class Mail. Individual mailers could benefit if the Postal Service should make delivery confirmation available with First-Class Mail (including single-piece First-Class Mail). First-Class mailers would then have an option for a lower cost alternative to Certified Mail. The Postal Service may benefit also by eventually replacing what is essentially a manual service with a service that utilizes more modern technology, at a lower cost. Mailers should be eager to use delivery confirmation to obtain a mailing receipt since that would also get the added bonus of confirmation of delivery. The Commission suggests that the Postal Service consider expanding delivery confirmation to make it available with First-Class Mail. Consideration also should be given to offering this service to mailers sending large First-Class or Standard Mail envelopes.

[6114] Witness Mayo states that certificates of mailing provide a high value of service to individuals requiring proof of mailing. She acknowledges that the overall proposed cost coverage is moderate, which is low for a high value service. USPS-T-39 at 39. In R97-1, the Commission recommended an overall rate increase of 15 percent that corresponded with an overall cost coverage of 132 percent. The rate was approved noting that the increase brought the cost coverage closer to the system wide average. PRC Op. R97-1, para. 5953.

[6115] The Commission recommends the fees proposed by the Postal Service. The recommended fees result in an overall cost coverage of 124 percent. Although higher rates could be justified to bring the cost coverage closer to the system wide

average, the recommended rates adequately cover costs and are selected to moderate the impact of the rate increase on mailers.

Table 5-23
Summary of Rates for Certificates of Mailing

	Current	Proposed	Recommended
Individual Pieces			
Original Certificate (Form 3817)	\$0.60	\$0.75	\$0.75
Firm Mailing Book (Form 3877)	\$0.25	\$0.25	\$0.25
Duplicate Copy	\$0.60	\$0.75	\$0.75
Bulk Pieces			
Up to 1,000 Pieces (Form 3606)	\$3.00	\$3.50	\$3.50
Each Additional 1,000 Pieces	\$0.40	\$0.40	\$0.40
Duplicate Copy	\$0.60	\$0.75	\$0.75

Source: Adapted from USPS-T-39 at 14.

16. Delivery Confirmation (Schedule 948)

[6116] Delivery confirmation provides a mailer with information about the date and time that an article was delivered, or, if delivery was not successful, the date and time of attempted delivery. Delivery confirmation can be purchased as a manual (retail) or an electronic (commercial) service. A mailing receipt is provided with the manual service. Mailers can access manual delivery information over the Internet or through the toll-free corporate call management system by telephone. Electronic delivery confirmation requires a mailer to apply a barcode to the mailpiece, and provide an electronic manifest to the Postal Service. An electronic link must be established with the Postal Service to exchange electronic acceptance and delivery data. Delivery confirmation is currently available with Priority Mail and Standard Mail B. USPS-T-39 at 54-59.

[6117] The Postal Service initially estimated total volume variable costs for delivery confirmation of: 17 cents for Priority Mail electronic, 52 cents for Priority Mail retail,

17 cents for Standard Mail electronic, and 52 cents for Standard Mail retail. USPS-T-30 at 3-7. Priority Mail includes the 17 cents of delivery confirmation costs within its base costs. Witness Davis subtracts the 17 cents accounted for with Priority Mail and adds the contingency to arrive at a net volume variable plus contingency cost for delivery confirmation of: 0 cents for Priority Mail electronic, 36 cents for Priority Mail retail, 17 cents for Standard Mail electronic, and 53 cents for Standard Mail retail. The Postal Service initially proposed fees of 0 cents for Priority Mail electronic, 40 cents for Priority Mail retail, 25 cents for Standard Mail electronic, and 65 cents for Standard Mail retail. USPS-T-39 at 55.

[6118] *Intervenor Proposal.* Parcel Shippers Association witness Zimmermann testifies that there should be “no charge to an electronic manifest Parcel Select mailer” for the use of delivery confirmation. He recognizes that there may be some volume variable costs, but argues that delivery confirmation should be a standard operating procedure. Tr. 29/14141-42.

[6119] In response to witness Zimmermann’s testimony, Postal Service witness Davis reexamined the underlying cost study supporting the delivery confirmation fees. He concluded that there are costs associated with delivery confirmation service, but his original assumptions were too conservative and in many cases included activities that were not necessary, or that could be completed during the time for normal delivery activities. Therefore, witness Davis revised his cost estimates downward. Tr. 39/17426-31. As a result, the Postal Service would not object to a fee of 10 cents for Standard Mail electronic, and 50 cents for Standard Mail retail. Postal Service Brief at VIII-29-31.

[6120] *Commission Analysis.* Delivery confirmation is a relatively high value of service that conveniently provides delivery information to a mailer. In some ways, the value of service is not as high as return receipt for merchandise, or certified mail with return receipt, as these services provide for a signature upon delivery. On the other hand, major private delivery services that compete with the Postal Service have the cost of equivalent or better services than delivery confirmation built into the base price of their

services. Delivery confirmation is a relatively new service that also can utilize a lower cost coverage to allow the service to develop to its fullest potential.

[6121] The Commission recommends a rate for the electronic service that has a cost coverage approximating the originally proposed cost coverage. In recommending rates for the manual services, the Commission also approximates the cost coverage originally proposed for Priority Mail manual service, and accepts witness Davis' revised cost estimates for Standard Mail retail. To achieve its cost coverage target the Commission recommends fees for delivery confirmation of 0 cents for Priority Mail electronic, 40 cents for Priority Mail retail, 12 cents for Standard Mail electronic, and 50 cents for Standard Mail retail.

[6122] The Postal Service proposes to extend delivery confirmation to Standard Mail Regular and Nonprofit pieces that pay the residual shape surcharge. The Service believes that mailers of these parcels have an interest in delivery confirmation. The revised fee proposed by the Postal Service for this new service is 10 cents—the same as Standard Mail B electronic. USPS-T-39 at 54-58, Postal Service Brief at VIII-31. The Commission recommends that this service be extended as proposed by the Postal Service, but at a rate of 12 cents consistent with the recommendation for Standard Mail electronic.

[6123] *OCA Proposal*. The OCA proposes that the Postal Service offer delivery confirmation service for Priority Mail to individuals through the Postal Service website at no charge. Tr. 29/14199-201. The OCA alleges that several Internet companies, including SmartShip.com, are currently offering no charge delivery confirmation service through their websites to individual shippers.

[6124] The Postal Service identifies costs that are associated with manual (retail) Priority Mail delivery confirmation that need to be recovered. See USPS-T-30 at 3-7. Furthermore, an individual does not perform the mail preparation tasks that qualify a high volume (commercial) mailer for the no fee Priority Mail electronic service. Although providing a free service to a mailer may be desirable from the mailer's viewpoint, it does not meet the § 3622(b)(3) requirement that delivery confirmation service bear its own

direct and indirect postal cost. The Postal Service may, if it chooses, place delivery confirmation on its website at the recommended rate, or it may in the future propose a reduced rate for customers accessing delivery confirmation only through the internet. However, at this time the Commission does not recommend the OCA proposal to extend delivery confirmation service for Priority Mail to individuals through the Postal Service website at no charge.

17. Signature Confirmation (Schedule 949)

[6125] The Postal Service proposes to establish signature confirmation as an independent service. Currently, delivery confirmation is a prerequisite to signature confirmation, with signature confirmation acting as a form of return receipt. The new service, as proposed, would include the functions of delivery confirmation within signature confirmation.

[6126] Signature confirmation provides a mailer with access to delivery confirmation information and an image of the recipient's signature. It can be purchased as a manual (retail) or an electronic (commercial) service. With the manual service, a receipt is provided containing the signature confirmation number. Mailers can access manual signature confirmation information over the Internet or through the toll-free corporate call management system by telephone. Electronic signature confirmation requires a mailer to apply a barcode to the mailpiece, and provide an electronic manifest to the Postal Service. Unlike delivery confirmation, users of electronic signature confirmation can access delivery information both over the Internet and through the corporate call management system. Signature confirmation may only be purchased at the time of mailing and is only available with Priority Mail and Standard Mail B. USPS-T-39 at 141-45.

[6127] The Postal Service's estimated total volume variable costs for signature confirmation are: \$1.18 for Priority Mail electronic, \$1.54 for Priority Mail manual, \$1.18 for Standard Mail electronic, and \$1.54 for Standard Mail manual. USPS-T-30 at 8-11.

Priority Mail includes 17 cents of the delivery confirmation costs within the base delivery service costs. Witness Davis subtracts the 17 cents accounted for with Priority Mail and adds the contingency to determine a net volume variable plus contingency costs for delivery confirmation of: \$1.04 for Priority Mail electronic, \$1.40 for Priority Mail manual, \$1.21 for Standard Mail electronic, and \$1.58 for Standard Mail manual. The Postal Service proposes fees of \$1.25 for Priority Mail electronic, \$1.75 for Priority Mail manual, \$1.25 for Standard Mail electronic, and \$1.75 for Standard Mail manual. USPS-T-39 at 142. The corresponding proposed cost coverages are 120 percent for Priority Mail electronic, 125 percent for Priority Mail manual, 103 percent for Standard Mail electronic, and 111 percent for Standard Mail manual. The overall proposed cost coverage for delivery confirmation is 122 percent.

[6128] *Commission Analysis.* The Commission recommends the classification change to establish signature confirmation as an independent service, including the proposed changes to the DMCS language and the addition of Fee Schedule 949. The addition of signature capture makes signature confirmation a higher value service than delivery confirmation. Signature confirmation provides a mailer with comparable information to the return receipt service at a lower overall cost, when considering return receipt must be purchased in addition to another special service. The Postal Service cost should also be lower for signature confirmation given the electronic technology employed to capture the signature and delivery date. Because signature confirmation is a new service, a moderate cost coverage is justified. A higher cost coverage, to match signature confirmation's true value of service, may be appropriate in the future.

[6129] The Postal Service estimates cost for signature confirmation in a similar fashion to delivery confirmation. During the proceeding, witness Davis revised his cost estimates for delivery confirmation downward. T r.39/17426-31. On brief, the Postal Service states that the signature confirmation cost study already includes a 50 percent absorption factor for carriers' retrieval and replacement of scanners. Thus, the revised delivery confirmation cost assumptions may have little effect on the signature confirmation cost estimates. Postal Service Brief at VIII-46. In light of witness Davis'

new assumptions for delivery confirmation and a 50 percent absorption factor for signature confirmation, the Commission estimates costs for signature confirmation of: \$0.97 for Priority Mail electronic, \$1.50 for Priority Mail manual, \$0.97 for Standard Mail electronic, and \$1.50 for Standard Mail manual. The Commission recommends the rates for signature confirmation as proposed by the Postal Service. This produces a 124 percent overall cost coverage.

18. Parcel Airlift (Schedule 951)

[6130] Parcel airlift provides air transportation of parcels to military post offices outside the 48 contiguous states, for onward dispatch to other overseas military post offices, or for parcels from overseas military post offices to post offices within the 48 contiguous states. The service is available on a space available basis for Standard Mail B parcels limited to 30 pounds in weight, or 60 inches in length and girth combined. The Postal Service is expecting no volume or revenue from this service during the test year. Customers are choosing Priority Mail over parcel airlift, often at a lower price. The Postal Service proposes retaining the current fees for parcel airlift while it considers the ramifications of eventually eliminating this service. USPS-T-39 at 88-91. The Commission recommends retaining the current fees for parcel airlift.

19. Special Handling (Schedule 952)

[6131] Special handling provides preferential handling of a mailpiece during processing and transportation, but does not provide preferential delivery. A mailer may request the service with First-Class Mail, Priority Mail, and Standard Mail B. Special handling is required when shipping honeybees or baby poultry using Standard Mail B. USPS-T-39 at 146-148.

[6132] In Docket No. R97-1, the Postal Service proposed to triple the special handling fees, provoking a negative response from several beekeeper and poultry organizations. The Commission questioned the accuracy of the IOCS costs reported for special handling and noted the devastating impact that such a large increase in fees could have on small businesses that rely upon this service, a service with few alternatives. The Commission concluded that pending the completion of a special study of costs, no increase could be justified based on the R97-1 record. PRC Op. R97-1, paras. 5989-5997.

[6133] The Postal Service, in the instant docket, proposes retaining the current fees for special handling. Special handling transactions have decreased dramatically from 15 million pieces in 1970 to 39 thousand pieces in 1998. The low volume exacerbates the problem of accurately tracking costs and brings into question the reliability of the cost and volume estimates in the CRA reports (there were only two tallies with encircled special handling activity codes in FY98). The Service considered whether a special study could be designed to quantify the special service costs. From field observations however, the Service concludes that costs would be difficult to measure through a special study. Those observations also cause the Postal Service to conclude the BY98 CRA estimate of \$57 per transaction overstates the actual special handling volume variable unit cost. USPS-T-28 at 30-31.

[6134] The cost estimates for special handling, as was the case in Docket No. R97-1, are questionable. Without sufficient record evidence, the Commission cannot recommend a change to the special handling rates.

20. Stamped Envelopes (Schedule 961)

[6135] Stamped envelopes, *i.e.*, envelopes with postage pre-attached, may be purchased from the Postal Service as individual envelopes, in household quantities of 50, or in bulk quantities of 500. Size 6-3/4, size 10, and intermediate size envelopes are available. Envelope formats include basic (no window), single window, and double

window. They may be purchased with printed personalized information, or purchased plain. Envelopes may be printed with different postage values, including pre-cancelled.

[6136] The Postal Service proposes to increase the fees for all categories of stamped envelopes, and to make three classification changes to the service. Fees are based on modeled costs, the contingency, and an applicable markup. The modeled cost components for stamped envelopes are manufacturing costs, distribution costs, and selling costs. Contract costs from July 1, 1999 through June 30, 2000 are used in the model as a proxy for test year manufacturing costs, because a manufacturing contract is not in place for fiscal year 2001. Costs were modeled for 59 different style/quantity characteristics of envelopes. USPS-T-29 at 31-37. The Service then groups the different envelope characteristics under 10 different classifications. Fees, and the associated cost coverages, are determined using the highest cost style/quantity characteristic within each classification. The fee changes are summarized in Table 5-24. The proposed stamped envelope overall cost coverage is 128 percent. USPS-T-39 at 152-61.

[6137] The Postal Service proposes three classification changes to the stamped envelope special service. The first change is to merge the household #6-3/4 and #10 categories into a single household basic category. The costs for the two current categories are similar. The second proposal is to eliminate the banded #6-3/4 and #10 categories. This will reflect that banded envelopes are not sold in box lots. They are only sold in vending machines at the single sale fee. The final proposal is to rename the hologram designation to "special." Special will reflect the higher value, and higher cost, of an envelope that may present a fancier appearance. However, manufacturing has been discontinued for the hologram envelopes because the patched in stamps are not recyclable. The special envelope category includes patched stamp envelopes in the event that these envelopes are manufactured in the future.

[6138] The Commission recommends the proposed classification changes to merge the household #6-3/4 and #10 categories into a single household basic category,

to eliminate the banded #6-3/4 and #10 categories, and to rename the hologram designation “special.” Parties have not opposed these classification changes.

[6139] The rates proposed by the Postal Service are high when compared with the Commission recommended rates in Docket No R97-1, which resulted in a 105 percent cost coverage. Witness Mayo bases rates and cost coverages on the highest costs in each category presented by witness Campbell. This distorts the proposed cost coverage to appear lower than the actual cost coverage. However, the Commission recommends the rates as proposed by the Postal Service. Stamped envelopes provides a relatively high value of service when viewed as a convenient method of purchasing a limited number of envelopes. The Commission estimates that the actual cost coverage is 148 percent for stamped envelopes.

[6140] *Intervenor Argument.* Intervenor Popkin argues, on brief, for the elimination of the shipping and handling charge imposed on orders placed with the Philatelic Fulfillment Service Center. Popkin Brief at 9. The Commission, in dismissing a complaint on the same subject matter, ruled “that the services involved – the handling and shipping of catalog orders placed with the Philatelic Fulfillment Service Center – are not closely related to the delivery of mail and, therefore, the charges for such services do not constitute “fees for postal services” within the scope of section 3662 of title 39, United States Code.” See Docket No. C95-1, PRC Order No. 1075. Because the charges in question do not constitute “fees for postal services,” and consistent with the prior ruling, the Commission declines to make a recommendation concerning the shipping and handling charges imposed by the Philatelic Fulfillment Service Center.

[6141] *DMCS Fee Schedule 961.* The Postal Service proposes to replace the current DMCS Fee Schedule 961 with a revised fee schedule. The proposed fee schedule omits information on envelope configurations and options that may be valuable to a customer purchasing envelopes. Descriptive terms such as regular, window, double window, pre-cancelled, multi-color printing, and savings bond, that are in the current fee schedule, are removed in the proposed fee schedule. Although the Commission recommends restructuring Fee Schedule 961 to streamline the information displayed, it

Table 5-24
Summary of Rates for Stamped Envelopes

	Current	Proposed	Recommended
Single Sale:			
Basic	\$0.07	\$0.08	\$0.08
Special (<i>Hologram</i>)	\$0.08	\$0.09	\$0.09
Printed Household:			
6-3/4 Basic (50)	\$3.00	N/A	N/A
10 Basic (50)	\$3.25	N/A	N/A
Basic (50)	N/A	\$3.50	\$3.50
Special (<i>Hologram</i>)	\$3.50	\$4.50	\$4.50
Plain 6-3/4: Banded (500)	\$9.50	N/A	N/A
Plain 10: Banded (500)	\$12.00	N/A	N/A
Plain 6-3/4 Basic (500)	\$8.50	\$12.00	\$12.00
Plain 10 Basic (500)	\$11.50	\$14.00	\$14.00
Plain 10 Special (500) (<i>Hologram</i>)	\$15.50	\$19.00	\$19.00
Printed 6-3/4 Basic (500)	\$14.00	\$17.00	\$17.00
Printed 10 Basic (500)	\$15.00	\$20.00	\$20.00
Printed 10 Special (500) (<i>Hologram</i>)	\$19.00	\$25.00	\$25.00

Source: Adapted from USPS-T-39 at 154.

Fees do not include the price of postage.

Basic envelopes include regular, window, pre-cancelled regular, and pre-cancelled window. The special envelopes are those with patched in stamps.

also recommends retaining much of the information that alerts a consumer to the available stamped envelope options.

21. Stamped Cards (Schedule 962)

[6142] Stamped Cards are cards with postage pre-affixed to the card. They are available from the Postal Service for the price of First-Class postage, plus a fee for the card. The Postal Service proposes to double the fee for a single card from 1 cent to 2

cents, not including postage. Correspondingly, the fees for a double stamped card will increase to 4 cents, and for a sheet of 40 stamped cards to 80 cents. This results in a proposed cost coverage of 139 percent given the Postal Service projected cost of 1.4 cents for printing, materials, and distribution of a single card, including contingency. USPS-T-39 at 149-51.

[6143] *Intervenor Comments.* Intervenor Popkin argues that the sale of stamped cards for more or less than its face value is in violation of 18 U.S.C. 1721. Popkin Brief at 7. This view is not consistent with the Commission's interpretation of the statute. See, e.g., P.O. Ruling R97-1/31.

[6144] Intervenor Carlson argues against increasing the stamped card fee. He asserts that the mail processing costs for stamped cards is less than the mail processing costs for private post cards. Carlson calculates the total cost for a mailed stamped card at the proposed rates is 23 cents (21 cents for postage, plus 2 cents for the stamped card) versus 21 cents for a private post card (21 cents for postage). He infers that this cost relationship is backwards because the higher priced product incurs lower processing costs. Carlson also claims that because of the cost differences, stamped cards are unfairly subsidizing the larger cards subclass. Carlson Brief at 20, see also Popkin Brief at 9. The Postal Service points out that the stamped card special service fee just covers the printing and manufacturing costs of the stamped card. Postage and mail processing costs are First-Class Mail Cards rate design issues. Even if there is a mail processing cost difference between stamped cards and private post cards, the Postal Service asserts there is no record evidence in this docket to show the difference. Postal Service Reply Brief at VII-30.

[6145] *Commission Analysis.* Concerning intervenor Carlson's proposal to maintain the current stamped card fee, the Commission finds that the special service stamped card fee does not include mail processing costs. Thus, the postage rate for stamped cards is a separate issue from the issues being examined under this special service. Therefore, arguments based on mail processing costs do not affect the determination of the fee for this special service.

[6146] The Postal Service claims that stamped cards provide a high value of service justifying a moderate cost coverage. Businesses may save labor costs by not having to affix postage, and individuals may benefit by purchasing their stationary and postage at the same time. In PRC Op. R97-1, para. 6005, the Commission expressed an interest in a relatively low cost coverage so that this service will provide a low cost method by which individuals can send mail. In this docket, the Commission is constrained from setting a lower rate by the whole cent rounding criteria. This service has costs above one cent per card. Therefore, the Commission recommends the rates for stamped cards as proposed by the Postal Service. These rates produce a 295 percent cost coverage.

22. Money Orders (Schedule 971)

[6147] The Postal Service offers a domestic money order, an APO/FPO (military) money order, and an inquiry service. Traditionally, domestic money order users have been thought to be people with modest income levels, people without checking accounts, or people without credit cards. Postal money orders are popular in rural areas that do not have access to alternative money order services. Money orders also may become a popular means of transacting Internet business. APO/FPO money orders are generally sold to military personnel at military installations. Both domestic and APO/FPO money orders can be issued up to a maximum amount of \$700. Inquiry service verifies whether a postal money order was cashed, and provides a copy of the paid money order. USPS-T-39 at 73-79.

[6148] The Postal Service proposes to increase the domestic money order fee from 80 cents to 90 cents, the APO/FPO money order fee from 30 cents to 35 cents, and the inquiry fee from \$2.75 to \$3.00. The corresponding overall proposed cost coverage is 198 percent. The Service contends that because incremental costs are high in relation to volume variable costs, the ratio of revenue to incremental costs is 142 percent. The

fees are designed to create a moderate overall cost coverage, while keeping fee increases reasonable.

[6149] The Postal Service foresees the Internet as a potential new source for money order customers. For example, Internet auction cites may require payment by money order, customers may be reluctant to provide personal information such as credit card numbers over the Internet, and business can potentially be lost by waiting for traditional checks to clear. This new market for money orders is in contrast to the accepted view that money order customers may be people of modest income. It suggests this new customer base may support higher fees for money orders. *Id.* at 78.

[6150] *OCA Proposals.* The OCA proposes lowering the fee for domestic money orders by 5 cents, reducing the current 80-cent fee to 75 cents. Tr. 29/14187-193. The OCA alleges the current and proposed fees are too high in relation to those recommended in previous dockets. In making its recommendations, the OCA notes that money orders have a large difference between volume variable and incremental costs, and recognizes that different treatment of the non-fee revenue will result in different cost coverages. In support of arguments that the Postal Service money order fees are high, and that lowering the fees will not hurt competition, the OCA performed a limited survey in the Washington, D.C. area. The survey shows the majority of money order outlets charging less than the fee proposed by the OCA for money orders. *Id.* at 14191. Finally, the OCA cites the Commission's historic preference for mitigating increases in money order fees since a large proportion of money order users are people with modest incomes, people lacking access to financial institutions, or people living in rural areas.

[6151] The OCA also proposes lowering the fee for APO-FPO money orders by 5 cents, reducing the 30-cent fee to 25 cents. *Id.* at 14193-194. These money orders are available to military personnel at APOs and FPOs. The retail transaction costs associated with APO-FPO money orders are borne by the military. The OCA presents a philosophical argument that military personnel serving this country have limited banking options available outside the United States, and also because of their service, should pay the lowest possible fee.

[6152] *Commission Analysis.* The Commission views money orders as a vehicle for people of modest means or limited access to financial alternatives to pay for necessary goods and services. For military personnel, isolated rural residents, or people lacking access to credit cards and checking accounts, money orders facilitate these groups transacting business. Rates should not be raised, and in fact should be lowered, for this service when attributable costs are more than adequately covered. The Postal Service argues for a cost coverage that is high when this service can justify a very low cost coverage. The Service attempts to justify higher rates for money orders by requesting the Commission to consider the positive potential impact that the Internet may have on money order sales. The desirable aspects of using money orders for Internet transactions would suggest that money orders provide a high level service. While there is merit in this argument, increasing rates would abandon the people that most need this service.

[6153] Therefore, the Commission recommends reducing the money order fees by 5 cents to reduce the money order cost coverage to a more appropriate level. The information on other money order providers contained in the OCA proposal assures the Commission that this recommendation results in rates that are in line with the marketplace. The Commission recommends a fee of 75 cents for a domestic money order and 25 cents for an APO/FPO money order. The Commission also recommends that the inquiry fee remain at \$2.75. The corresponding overall cost coverage is 153 percent.

[6154] *OCA Internet Proposal.* The OCA requests that the Postal Service consider offering a new service for the sale of money orders over the Internet. With merchandise sales over the Internet increasing rapidly, the OCA sees consumers and small businesses conducting Internet business as a potential source of new money order customers. Several suggestions are presented as to how this new service can be offered. Tr. 29/14194-196. While the Commission can not recommend a proposal for money order sales over the Internet on this record, the Postal Service might explore this alternative revenue generating idea.

23. Mailing Online (Schedule 981)

[6155] Mailing Online is a three-year experiment under which individuals and businesses transmit documents to the Postal Service via the Internet for printing, finishing, and posting as hard copy mail. The Mailing Online Opinion and Recommended Decision, PRC Docket No. MC2000-2, issued June 21, 2000, reflects the Commission's recommended rates and classifications for this special service. The Decision of the Governors of the United States Postal Service on the Recommended Decision of the Postal Rate Commission on Mailing Online Experiment, Docket No. MC2000-2, issued August 7, 2000, approved the Commission's Opinion and Recommended Decision.

[6156] The Postal Service initial filing does not contain rate or classification proposals for this service. However, the Postal Service has proposed a change to the Mailing Online certification fee on brief. This fee is discussed along with the other annual permit fees. The Commission does not recommend rate or classification changes to Mailing Online, other than the level of certification fee.

24. Annual Permit Fees (Schedule 1000)

[6157] The Postal Service proposes fee increases and three classification changes to permits. The Postal Service proposes to increase the permit fee from \$100 to \$125 for: (1) Business Reply Mail (BRM), (2) bulk parcel return service, (3) First-Class presort, (4) merchandise return, (5) permit imprints, (6) destination entry Standard Mail B, (7) Standard Mail A bulk, and (8) Standard Mail B special and library presort. USPS-T-39 at 96-98. The Commission recommends an increase in the permit fee to \$125. The resulting low cost coverage of 106 is appropriate for a permit fee that allows access to other higher value services. The Commission also recommends grouping all permit fees under Fee Schedule 1000.

[6158] Subsequently, on brief, the Postal Service proposes an increase to the certification fee for Mailing Online from \$100 to \$125. The purpose of this increase is to maintain consistency with other permit fees proposed in this proceeding. Postal Service Brief at VIII-41. The impact of the proposed increase is minimal because the foreseeable universe of potential customers that might desire certification for Mailing Online is limited. Although the Postal Service made this proposal extremely late in the proceeding, the overall impact of the proposal, is small. Therefore, the Commission recommends consistent increases in all certification fees.

[6159] The Postal Service also proposes changes to the periodicals applications fees contained in Fee Schedule 1000. It proposes to increase the original entry fee from \$305 to \$350, decrease the re-entry fee and registration for news agents fee from \$50 to \$40, and maintain the additional entry fee at \$50. USPS-T-39 at 92-95. No participant commented on these proposals. The Commission recommends the changes to the periodicals applications fees as proposed by the Postal Service.

[6160] The Postal Service proposes three classification changes. The first classification proposal is to make the language consistent in DMCS sections 280, 380, and 581 through 584 regarding annual mailing fees. The Postal Service states that the changes will have no effect on the current administration of the payment of permit fees. The second classification proposal is to divide the “Special and Library Standard Mail Presort Mailing” fee into separate fees for “Media Mail Presorted Mailing” and “Library Mail Presorted Mailing”, with no change to the rate. The final classification proposal is to establish a permit fee for destination entry Bound Printed Matter (BPM). The Commission recommends these changes.

25. Special Services DMCS Proposals

[6161] The Postal Service performed a general review of each Domestic Mail Classification Schedule (DMCS) special services section and offers proposals designed to revise each section to improve clarity, consistency, and organization. USPS-T-39

at 165-166. During the proceeding, the Postal Service identified several other changes to the DMCS special services sections that augment their original proposals.

Tr. 39/17673-76, Tr. 39/17681-85. The proposals generally improve the readability of the DMCS special services sections.

[6162] Included within the rewrite proposal, the Postal Service proposes to eliminate the listings of services that are available in conjunction with other services. The Postal Service proposes to list only services that have the first service as a prerequisite. The Service also states a preference to specify the listings of services that are available in conjunction with other services in the Domestic Mail Manual (DMM).

[6163] The Commission perceives a benefit to the mailing public in maintaining a complete listing of services that are available in conjunction with other services within the DMCS. The information contained in an accurate listing is helpful in understanding the scope of different mailing options. Therefore, the Commission does not recommend eliminating the listings as proposed by the Postal Service at this time.

[6164] The Commission has reviewed the current DMCS, the current DMM, and the Postal Service's proposed DMM changes presented in *Federal Register*, Vol. 65, No. 168, August 29, 2000, to determine if an accurate listing could be developed. Upon comparing the information contained in the above documents, along with the Commission's understanding of each special service, it became apparent that there are potential inconsistencies that need to be explained. For example, compare DMCS § 945.21, proposed DMCS § 945.21, DMM § S915.1.2, proposed DMM § S915.1.2 (*Federal Register*, Vol. 65, No. 168, August 29, 2000), and proposed DMM § S915.1.7 (*Id.*), concerning return receipt service. These sections contain several apparent inconsistencies. For instance, compare the different availability of registered mail, delivery confirmation, and restricted delivery with return receipt. Similar examples can be found with other special services. Because of this, a review is necessary before the Commission can recommend changes throughout the DMCS to the listings of services that are available in conjunction with other services. The Commission's DMCS

recommendation maintains the current listings until this area can be thoroughly reviewed and clarified.

[6165] The Commission recommends two additional organizational changes that affect both the text and the fee schedules. The Commission recommends grouping all permit fees under Fee Schedule 1000 and grouping all accounting fees for advance deposit accounts fees under Fee Schedule 1000. This adds convenience in locating permit fee and accounting fee rates, and facilitates modifying the fee schedules when changes occur.

[6166] The Commission has incorporated a majority of the Postal Service proposals into its DMCS recommendations. The Commission recommendations for the DMCS text appear in Appendix Two and recommendations for the DMCS Fee Schedules appear in Appendix One.

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

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

Postal Rate and Fee Changes, 2000

Docket No. R2000-1

RECOMMENDED DECISION

(Issued November 13, 2000)

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.

Docket No. R2000-1

2. Except to the extent granted or otherwise disposed of herein, all motions, exceptions, and other outstanding requests filed in Docket No. R2000-1 hereby are denied.

By the Commission.

Chairman Gleiman, Commissioners Goldway
and Omas joined in a concurring Opinion.

(S E A L)

A handwritten signature in black ink, appearing to read "Margaret P. Crenshaw". The signature is fluid and cursive, with a large initial "M" and a long, sweeping underline.

Margaret P. Crenshaw
Secretary

CONCURRING OPINION OF CHAIRMAN GLEIMAN
COMMISSIONER GOLDWAY AND COMMISSIONER OMAS

We recommend that the Postal Service review the confusing array of special services that provide the customer with information about delivery for an additional fee. These services include certified mail, return receipt, delivery confirmation, signature confirmation, and certificates of mailing. Each service comes with a separate menu of attributes, but many of these services share some of the same attributes. Each also comes with a separate set of usage restrictions, e.g., delivery confirmation and signature confirmation cannot be used for First-Class letters, while basic return receipt can only be purchased with another service, such as certified.

Return receipt and certified, which are based on costly manual operations, have high fees and a history of poor service quality. See Carlson Brief at 10-16; Popkin Brief at 2-4; PRC Op. R97-1, para. 5951. The Commission has been concerned with this quality of service issue since R90-1. See PRC Op. R90-1, paras. 6576-77, fn. 110. Apparently, the Inspection Service also has been concerned. A Postal Service Inspection Service audit report reveals nationwide problems with certified and return-receipt mail, e.g., failure to maintain proper control over the return receipts, especially with regard to mail sent to the IRS and the state tax agencies, and mail delays. USPS-LR-I-200 at 18–20.

Because return receipt and certified are often used in high volume situations (e.g., mailers sending in tax returns, where volume tends to peak around filing deadlines) improvements to these manual-based systems may be difficult. Indeed, the Service admits “obtaining signatures of each return receipt before delivery is not always practical when many return receipts are delivered at one time.” Postal Service Reply Brief at VII-16. It argues that employing more personnel to solve the problem would increase fees. *Ibid.* It concludes that allowing large organizations to sign for receipt of all certified mail at the time of delivery, and then complete the return receipt cards later “may at least be temporarily necessary in order to avoid even more problematic delivery delays.” *Id.* at VII-17.

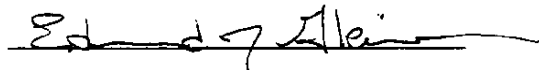
We have constrained fees for return receipt and certified because of the quality of service issue. The Service on brief asserts that if the fees for these services are set too

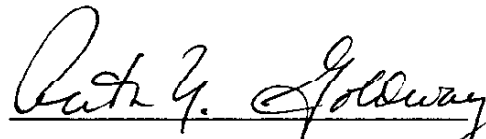
low it "may actually discourage such service improvements, however, since attention might be diverted to products with higher contributions." Postal Service Reply Brief at VII-14. *See also Id.* at VII-18: "[P]ostal management may have a reduced financial incentive to focus resources on a particular product for which fees do not provide a significant contribution above costs." We cannot accept this argument in a rate setting context given the clear directives of the statute; customers receiving poor service should not also pay premium rates.

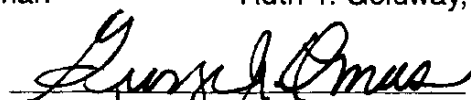
We suggest that extending the more electronically-based delivery and signature confirmation services to First-Class letter mail would have a mitigating effect on or, perhaps, even obviate the need to address many problems associated with the manual accountable services. Electronic confirmation services do not require the extensive interaction between postal employees and the sender and recipient of First-Class Mail, as do the currently available manual services. They are, therefore, less costly to the Postal Service. For example, the Service's cost for each of its roughly 275 million Certified Mail transactions is on the order of \$1.60 per piece, compared to approximately \$0.40 for a Delivery Confirmation transaction.

An opportunity to extend one highly regarded existing service as a substitute for another poorly perceived service should not be ignored. This is especially so when the potential exists to drive more than \$300 million in costs out of the system and to offer customers a high-tech, lower price option.

These possibilities suggest a bottoms-up review of the panoply of delivery-related services, with an eye toward offering a narrower, but more reliable array of electronically-based services. Providing customers with better choices at lower prices is appropriate and desirable.


Edward J. Gleiman, Chairman


Ruth Y. Goldway, Commissioner


George A. Omas, Commissioner

EXPRESS MAIL SCHEDULES 121, 122 AND 123

(Dollars)				
Weight not Exceeding (Pounds)	Schedule 121	Schedule 122	Schedule 123	Schedule 123
	Same Day Airport Service	Custom Designed	Next Day and Second Day PO to PO	Next Day and Second Day PO to Addressee
1/2		9.25	9.40	12.25
1		13.75	13.90	16.00
2		13.80	13.90	16.00
3		16.65	16.80	18.85
4		19.45	19.60	21.70
5		22.25	22.40	24.50
6		25.05	25.20	27.30
7		27.75	27.90	30.00
8		28.95	29.10	31.20
9		30.20	30.35	32.45
10		31.40	31.55	33.65
11		32.90	33.05	35.15
12		35.30	35.45	37.55
13		36.55	36.70	39.25
14		37.95	38.10	40.20
15		39.15	39.30	41.40
16		40.50	40.65	42.75
17		41.85	42.00	44.10
18		43.10	43.25	45.35
19		44.40	44.55	46.65
20		45.75	45.90	48.00
21		47.00	47.20	49.25
22		48.30	48.45	50.55
23		49.65	49.85	51.90
24		50.90	51.05	53.15
25		52.20	52.40	54.45
26		53.50	53.65	55.75
27		54.85	55.00	57.05
28		56.10	56.25	58.35
29		57.45	57.60	59.65
30		58.75	58.90	61.00
31		60.05	60.20	62.25
32		61.35	61.50	63.60
33		62.65	62.80	64.85
34		63.95	64.10	66.20
35		65.25	65.40	67.45
36		66.55	66.70	68.80
37		67.80	67.95	70.30
38		69.35	69.30	71.90
39		70.95	70.60	73.50
40		72.55	72.00	75.10
41		74.15	73.60	76.70
42		75.75	75.20	78.35
43		77.35	76.80	79.90
44		78.95	78.40	81.50
45		80.55	80.00	82.90
46		81.85	81.55	84.15
47		83.25	83.20	85.60
48		84.60	84.75	86.90
49		85.90	86.05	88.20
50		87.20	87.35	89.50

EXPRESS MAIL SCHEDULES 121, 122 AND 123 (continued)

(Dollars)				
Weight not Exceeding (Pounds)	Schedule 121	Schedule 122	Schedule 123	Schedule 123
	Same Day Airport Service	Custom Designed	Next Day and Second Day PO to PO	Next Day and Second Day PO to Addressee
51		88.60	88.80	90.95
52		89.90	90.05	92.20
53		91.30	91.45	93.60
54		92.60	92.75	94.90
55		93.90	94.10	96.25
56		95.35	95.50	97.65
57		96.60	96.75	98.90
58		97.95	98.10	100.30
59		99.45	99.60	101.75
60		101.00	101.15	103.30
61		102.70	102.85	105.00
62		104.25	104.40	106.60
63		105.85	106.00	108.15
64		107.50	107.70	109.85
65		109.10	109.25	111.40
66		110.80	110.95	113.10
67		112.35	112.50	114.65
68		114.05	114.20	116.35
69		115.60	115.75	117.90
70		117.20	117.35	119.50

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 \$10.25 for each pickup stop.
- ³ Add \$10.25 for each Custom Designed delivery stop.

**FIRST-CLASS MAIL
RATE SCHEDULE 221**

LETTERS AND SEALED PARCELS

	Rate (cents)
Regular	
Single Piece: First Ounce	34.0
Presort ¹	32.0
Qualified Business Reply Mail	31.0
Additional Ounce ²	21.0
Nonstandard Surcharge	
Single Piece	11.0
Presort	5.0
Automation-Presort¹	
Letters ³	
Basic Presort ⁴	27.8
3-Digit Presort ⁵	26.7
5-Digit Presort ⁶	25.3
Carrier Route Presort ⁷	24.3
Flats ⁸	
Basic Presort ⁹	31.0
3-Digit Presort ¹⁰	29.5
5-Digit Presort ¹¹	27.5
Additional Ounce ²	21.0
Nonstandard Surcharge	5.0

SCHEDULE 221 NOTES

- ¹ A mailing fee of \$125.00 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 and, for the Basic Presort rate, documents provided for entry as mail using Mailing Online or a functionally equivalent service, pursuant to section 981.
- 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, and, for the Basic Presort rate, to documents provided for entry as mail using Mailing Online or a functionally equivalent service, pursuant to section 981.
- ⁹ Rate applies to flat-size Automation-Presort category mail not mailed at the 3-Digit or 5-Digit rate.
- ¹⁰ Rate applies to flat-size Automation-Presort category mail presorted to single or multiple three-digit ZIP Code destinations specified by the Postal Service.
- ¹¹ Rate applies to flat-size Automation-Presort category mail presorted to single or multiple five-digit ZIP Code destinations specified by the Postal Service.

FIRST-CLASS MAIL RATE SCHEDULE 222

CARDS

	Rate (cents)
Regular	
Single Piece	20.0
Presort ¹	18.0
Qualified Business Reply Mail	17.0
Automation-Presort^{1, 2}	
Basic Presort ³	16.4
3-Digit Presort ⁴	15.8
5-Digit Presort ⁵	15.1
Carrier Route Presort ⁶	14.0

SCHEDULE 222 NOTES

- ¹ A mailing fee of \$125.00 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 and, for the Basic Presort rate, to documents provided for entry as mail using Mailing Online or a functionally equivalent service, pursuant to section 981.
- 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)	Zones L,1,2,3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
1	3.50	3.50	3.50	3.50	3.50	3.50
2	3.95	3.95	3.95	3.95	3.95	3.95
3	5.15	5.15	5.15	5.15	5.15	5.15
4	6.35	6.35	6.35	6.35	6.35	6.35
5	7.55	7.55	7.55	7.55	7.55	7.55
6	7.90	8.10	8.15	8.25	9.50	10.35
7	8.25	8.65	8.75	8.95	10.45	11.65
8	8.50	9.20	9.35	9.65	11.40	12.95
9	8.65	9.75	9.95	10.35	12.35	14.25
10	8.75	10.30	10.55	11.05	13.30	15.55
11	9.00	10.85	11.15	11.75	14.25	16.85
12	9.25	11.40	11.75	12.45	15.20	18.15
13	9.60	11.95	12.35	13.15	16.15	19.45
14	9.95	12.50	12.95	13.85	17.10	20.75
15	10.30	13.05	13.55	14.55	18.05	22.05
16	10.65	13.60	14.15	15.25	19.00	23.35
17	11.00	14.15	14.75	15.95	19.95	24.65
18	11.35	14.70	15.35	16.65	20.90	25.95
19	11.70	15.25	15.95	17.35	21.85	27.25
20	12.05	15.80	16.55	18.05	22.80	28.55
21	12.40	16.35	17.15	18.75	23.75	29.85
22	12.75	16.90	17.75	19.45	24.70	31.15
23	13.10	17.45	18.35	20.15	25.65	32.45
24	13.45	18.00	18.95	20.85	26.60	33.75
25	13.80	18.55	19.55	21.55	27.55	35.05
26	14.15	19.10	20.15	22.25	28.50	36.35
27	14.50	19.65	20.75	22.95	29.45	37.65
28	14.85	20.20	21.35	23.65	30.40	38.95
29	15.20	20.75	21.95	24.35	31.35	40.25
30	15.55	21.30	22.55	25.05	32.30	41.55
31	15.90	21.85	23.15	25.75	33.25	42.85
32	16.25	22.40	23.75	26.45	34.20	44.15
33	16.60	22.95	24.35	27.15	35.15	45.45
34	16.95	23.50	24.95	27.85	36.10	46.75
35	17.30	24.05	25.55	28.55	37.05	48.05
36	17.65	24.60	26.15	29.25	38.00	49.35
37	18.00	25.15	26.75	29.95	38.95	50.65
38	18.35	25.70	27.35	30.65	39.90	51.95
39	18.70	26.25	27.95	31.35	40.85	53.25
40	19.05	26.80	28.55	32.05	41.80	54.55

PRIORITY MAIL SUBCLASS (continued)

(dollars)

Weight not Exceeding (Pounds)	Zones L,1,2,3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
41	19.40	27.35	29.15	32.75	42.75	55.85
42	19.75	27.90	29.75	33.45	43.70	57.15
43	20.10	28.45	30.35	34.15	44.65	58.45
44	20.45	29.00	30.95	34.85	45.60	59.75
45	20.80	29.55	31.55	35.55	46.55	61.05
46	21.15	30.10	32.15	36.25	47.50	62.35
47	21.50	30.65	32.75	36.95	48.45	63.65
48	21.85	31.20	33.35	37.65	49.40	64.95
49	22.20	31.75	33.95	38.35	50.35	66.25
50	22.55	32.30	34.55	39.05	51.30	67.55
51	22.90	32.85	35.15	39.75	52.25	68.85
52	23.25	33.40	35.75	40.45	53.20	70.15
53	23.60	33.95	36.35	41.15	54.15	71.45
54	23.95	34.50	36.95	41.85	55.10	72.75
55	24.30	35.05	37.55	42.55	56.05	74.05
56	24.65	35.60	38.15	43.25	57.00	75.35
57	25.00	36.15	38.75	43.95	57.95	76.65
58	25.35	36.70	39.35	44.65	58.90	77.95
59	25.70	37.25	39.95	45.35	59.85	79.25
60	26.05	37.80	40.55	46.05	60.80	80.55
61	26.40	38.35	41.15	46.75	61.75	81.85
62	26.75	38.90	41.75	47.45	62.70	83.15
63	27.10	39.45	42.35	48.15	63.65	84.45
64	27.45	40.00	42.95	48.85	64.60	85.75
65	27.80	40.55	43.55	49.55	65.55	87.05
66	28.15	41.10	44.15	50.25	66.50	88.35
67	28.50	41.65	44.75	50.95	67.45	89.65
68	28.85	42.20	45.35	51.65	68.40	90.95
69	29.20	42.75	45.95	52.35	69.35	92.25
70	29.55	43.30	46.55	53.05	70.30	93.55

SCHEDULE 223 NOTES

- ¹ The 1-pound rate is charged for matter sent in a 'flat rate' envelope provided by the Postal Service.
- ² Add \$10.25 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 321A**

**REGULAR SUBCLASS
PRESORT CATEGORIES¹**

	Rate (cents)
Letter Size	
Piece Rate	
Basic	25.0
3/5-Digit	23.0
Destination Entry Discount per Piece	
BMC	1.9
SCF	2.4
Non-Letter Size²	
Piece Rate	
Minimum per Piece ³	
Basic	31.9
3/5 Digit	26.3
Destination Entry Discount per Piece	
BMC	1.9
SCF	2.4
Pound Rate ³	66.8
Plus per Piece Rate	
Basic	18.1
3/5-Digit	12.5
Destination Entry Discount per Pound	
BMC	9.3
SCF	11.4

SCHEDULE 321A NOTES

- ¹ A fee of \$125.00 must be paid each 12-month period for each bulk mailing permit.
- ² Residual shape pieces are subject to a surcharge of \$0.18 per piece. For parcel barcode discount, deduct \$0.03 per piece.
- ³ Mailer pays either the minimum piece rate or the pound rate, whichever is higher. The transitional weight between the minimum per piece rate and the pound rate in Standard Mail is 3.3 ounces.

**STANDARD MAIL
RATE SCHEDULE 321B**

**REGULAR SUBCLASS
AUTOMATION CATEGORIES¹**

	Rate (cents)
Letter Size²	
Piece Rate	
Basic Letter ³	19.7
3-Digit Letter ⁴	18.7
5-Digit Letter ⁵	17.4
Destination Entry Discount per Piece	
BMC	1.9
SCF	2.4
Flat Size⁶	
Piece Rate	
Minimum per Piece ⁷	
Basic Flat ⁸	27.5
3/5-Digit Flat ⁹	23.6
Destination Entry Discount per Piece	
BMC	1.9
SCF	2.4
Pound Rate ⁷	66.8
Plus per piece Rate	
Basic Flat ⁸	13.7
3/5-Digit Flat ⁹	9.8
Destination Entry Discount per Pound	
BMC	9.3
SCF	11.4

SCHEDULE 321B NOTES

- ¹ A fee of \$125.00 must be paid once each 12-month period for each bulk mailing permit.
- ² For letter-size automation pieces not exceeding 3.3 ounces 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. The transitional weight between the minimum per piece rate and the pound rate in Standard Mail is 3.3 ounces.
- 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 322

ENHANCED CARRIER ROUTE SUBCLASS¹

	Rate (cents)
Letter Size	
Piece Rate	
Basic	17.6
Basic Automated Letter ²	15.5
High Density	15.1
Saturation	14.3
Destination Entry Discount per Piece	
BMC	1.9
SCF	2.4
DDU	2.9
Non-Letter Size³	
Piece Rate	
Minimum per Piece ⁴	
Basic	17.6
High Density	15.4
Saturation	14.7
Destination Entry Discount per Piece	
BMC	1.9
SCF	2.4
DDU	2.9
Pound Rate ⁴	63.8
Plus per Piece Rate	
Basic	4.4
High Density	2.2
Saturation	1.5
Destination Entry Discount per Pound	
BMC	9.3
SCF	11.4
DDU	14.0

SCHEDULE 322 NOTES

- ¹ A fee of \$125.00 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 \$0.15 per piece.
- ⁴ Mailer pays either the minimum piece rate or the pound rate, whichever is higher. The transitional weight between the minimum per piece rate and the pound rate in Standard Mail is 3.3 ounces.

STANDARD MAIL RATE SCHEDULE 323A

NONPROFIT SUBCLASS PRESORT CATEGORIES¹

	Rates (cents)
Letter Size	
Piece Rate	
Basic	15.5
3/5-Digit	14.3
Destination Entry Discount per Piece	
BMC	1.9
SCF	2.4
Non-Letter Size²	
Piece Rate	
Minimum per Piece ³	
Basic	21.7
3/5-Digit	16.8
Destination Entry Discount per Piece	
BMC	1.9
SCF	2.4
Pound Rate ³	55.0
Plus per Piece Rate	
Basic	10.4
3/5-Digit	5.5
Destination Entry Discount per Pound	
BMC	9.3
SCF	11.4

SCHEDULE 323A NOTES

- ¹ A fee of \$125.00 must be paid once each 12-month period for each bulk mailing permit.
- ² Residual shape pieces are subject to a surcharge of \$0.18 per piece. For parcel barcode discount, deduct \$0.03 per piece.
- ³ Mailer pays either the minimum piece rate or the pound rate, whichever is higher. The transitional weight between the minimum per piece rate and the pound rate in Standard Mail is 3.3 ounces.

**STANDARD MAIL
RATE SCHEDULE 323B**

**NONPROFIT SUBCLASS
AUTOMATION CATEGORIES¹**

	Rate (cents)
Letter Size²	
Piece Rate	
Basic Letter ³	13.0
3-Digit Letter ⁴	12.0
5-Digit Letter ⁵	10.5
Destination Entry Discount per Piece	
BMC	1.9
SCF	2.4
Flat Size⁶	
Piece Rate	
Minimum per Piece ⁷	
Basic Flat ⁸	17.6
3/5-Digit Flat ⁹	15.1
Destination Entry Discount per Piece	
BMC	1.9
SCF	2.4
Pound Rate ⁷	55.0
Plus per Piece Rate	
Basic Flat ⁸	6.3
3/5-Digit Flat ⁹	3.8
Destination Entry Discount per Pound	
BMC	9.3
SCF	11.4

SCHEDULE 323B NOTES

- ¹ A fee of \$125.00 must be paid once each 12-month period for each bulk mailing permit.
- ² For letter-size automation pieces not exceeding 3.3 ounces 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. The transitional weight between the minimum per piece rate and the pound rate in Standard Mail is 3.3 ounces.
- 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 324

NONPROFIT ENHANCED CARRIER ROUTE SUBCLASS¹

	Rate (cents)
Letter Size	
Piece Rate	
Basic	11.6
Basic Automated Letter ²	10.3
High Density	9.3
Saturation	8.7
Destination Entry Discount per Piece	
BMC	1.9
SCF	2.4
DDU	2.9
Non-Letter Size³	
Piece Rate	
Minimum per Piece ⁴	
Basic	11.6
High Density	10.0
Saturation	9.5
Destination Entry Discount per Piece	
BMC	1.9
SCF	2.4
DDU	2.9
Pound Rate ⁴	37.0
Plus per Piece Rate	
Basic	4.0
High Density	2.4
Saturation	1.9
Destination Entry Discount per Pound	
BMC	9.3
SCF	11.4
DDU	14.0

SCHEDULE 321.5 NOTES

- ¹ A fee of \$100.00 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 \$0.15 per piece.
- ⁴ Mailer pays either the minimum piece rate or the pound rate, whichever is higher. The transitional weight between the minimum per piece rate and the pound rate in Standard Mail is 3.3 ounces.

PERIODICALS RATE SCHEDULE 421

OUTSIDE COUNTY SUBCLASS^{1, 2, 12}

	Postage Rate Unit	Rate³ (cents)
Per Pound		
Nonadvertising Portion:	Pound	17.3
Advertising Portion: ¹¹		
Delivery Office ⁴	Pound	14.8
SCF ⁵	Pound	18.8
1 & 2	Pound	23.0
3	Pound	24.5
4	Pound	28.3
5	Pound	34.1
6	Pound	40.1
7	Pound	47.4
8	Pound	53.7
Science of Agriculture		
Delivery Office	Pound	11.1
SCF	Pound	14.1
Zones 1 & 2	Pound	17.3
Per Piece		
Less Nonadvertising Factor ⁶		6.5
Required Preparation ⁷	Piece	32.5
Presorted to 3-digit	Piece	27.6
Presorted to 5-digit	Piece	21.4
Presorted to Carrier Route	Piece	13.6
Discounts:		
Prepared to Delivery Office ⁴	Piece	1.7
Prepared to SCF ⁵	Piece	0.8
High Density ⁸	Piece	2.5
Saturation ⁹	Piece	4.3
Automation Discounts for Automation Compatible Mail ¹⁰		
From Required:		
Prebarcoded letter size	Piece	6.5
Prebarcoded flats	Piece	4.1
From 3-Digit:		
Prebarcoded letter size	Piece	5.1
Prebarcoded flats	Piece	3.4
From 5-Digit:		
Prebarcoded letter size	Piece	4.0
Prebarcoded flats	Piece	2.4

SCHEDULE 421 NOTES

- ¹ The rates in this schedule also apply to Nonprofit (DMCS Section 422.2) and Classroom rate categories. These categories receive a 5 percent discount on all components of postage except advertising pounds. Moreover, the 5 percent discount does not apply to commingled nonsubscriber, nonrequestor, complimentary, and sample copies in excess of the 10 percent allowance under DMCS sections 412.34 and 413.42, or to Science of Agriculture mail.
- ² Rates do not apply to otherwise Outside County mail that qualifies for the Within County rates in Schedule 423.
- 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.
- ¹¹ Not applicable to qualifying Nonprofit and Classroom publications containing 10 percent or less advertising content.
- ¹² For a "Ride-Along" item enclosed with or attached to a periodical, add \$0.10 per copy (experimental).

PERIODICALS RATE SCHEDULE 423⁵

WITHIN COUNTY

	Rate (cents)
Per Pound	
General	14.4
Delivery Office ¹	11.3
Per Piece	
Required Presort	10.0
Presorted to 3-digit	9.2
Presorted to 5-digit	8.3
Carrier Route Presort	4.7
Per Piece Discount	
Delivery Office ²	0.5
High Density (formerly 125 piece) ³	1.5
Saturation	2.1
Automation Discounts for Automation Compatible Mail ⁴	
From Required:	
Prebarcoded Letter size	5.1
Prebarcoded Flat size	2.7
From 3-digit:	
Prebarcoded Letter size	4.5
Prebarcoded Flat size	2.4
From 5-digit:	
Prebarcoded Letter size	3.9
Prebarcoded Flat size	2.1

SCHEDULE 432 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.
- ⁵ For a "Ride-Along" item enclosed with or attached to a periodical, add \$0.10 per copy (experimental).

**PACKAGE SERVICES
RATE SCHEDULE 521.2A**

**PARCEL POST SUBCLASS
INTER-BMC RATE S**

(dollars)

Weight not Exceeding (Pounds)	Zone 1 & 2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
1	3.34	3.39	3.44	3.45	3.45	3.45	3.45
2	3.34	3.39	3.44	3.45	3.45	3.45	3.45
3	3.81	4.13	4.56	4.61	4.66	4.71	4.76
4	3.95	4.41	5.20	5.67	5.82	5.87	5.92
5	4.09	4.65	5.65	6.84	6.99	7.04	7.09
6	4.23	4.90	6.05	7.53	7.84	8.06	8.64
7	4.36	5.11	6.43	8.18	8.85	9.28	10.44
8	4.49	5.31	6.76	8.76	9.60	10.49	12.24
9	4.59	5.50	7.11	9.29	10.30	11.71	14.05
10	4.72	5.68	7.41	9.78	11.00	12.93	15.19
11	4.81	5.86	7.71	10.24	11.70	14.10	16.07
12	4.92	6.02	7.98	10.66	12.40	15.15	16.91
13	5.01	6.16	8.24	11.07	13.10	16.08	17.72
14	5.11	6.33	8.49	11.45	13.66	16.68	18.49
15	5.19	6.47	8.73	11.80	14.11	17.26	19.24
16	5.28	6.60	8.96	12.14	14.52	17.78	19.97
17	5.37	6.72	9.18	12.44	14.92	18.29	20.67
18	5.45	6.85	9.38	12.74	15.29	18.75	21.34
19	5.54	6.97	9.58	13.03	15.65	19.21	22.00
20	5.61	7.08	9.75	13.29	15.97	19.63	22.64
21	5.68	7.21	9.93	13.56	16.30	20.03	23.26
22	5.76	7.30	10.11	13.80	16.60	20.42	23.87
23	5.83	7.43	10.29	14.02	16.89	20.78	24.46
24	5.88	7.53	10.44	14.26	17.16	21.14	25.03
25	5.96	7.62	10.61	14.46	17.43	21.45	25.59
26	6.02	7.72	10.76	14.67	17.68	21.77	26.14
27	6.10	7.81	10.90	14.86	17.91	22.07	26.68
28	6.15	7.91	11.06	15.05	18.15	22.36	27.20
29	6.21	8.00	11.19	15.22	18.37	22.63	27.71
30	6.28	8.09	11.31	15.39	18.57	22.90	28.21
31	6.34	8.16	11.45	15.55	18.78	23.16	28.70
32	6.39	8.26	11.58	15.71	18.97	23.40	29.18
33	6.44	8.34	11.70	15.87	19.15	23.64	29.65
34	6.51	8.41	11.81	16.02	19.33	23.86	30.11
35	6.56	8.49	11.94	16.15	19.50	24.07	30.57
36	6.61	8.55	12.06	16.29	19.67	24.27	31.01
37	6.67	8.63	12.16	16.43	19.83	24.49	31.45
38	6.72	8.71	12.27	16.55	19.98	24.67	31.88
39	6.78	8.78	12.37	16.66	20.13	24.85	32.30
40	6.83	8.85	12.48	16.79	20.28	25.04	32.71

PARCEL POST SUBCLASS
INTER-BMC RATES (continued)

(dollars)

Weight not Exceeding (Pounds)	Zone 1 & 2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
41	6.89	8.93	12.57	16.91	20.42	25.21	33.11
42	6.93	8.99	12.67	17.01	20.54	25.37	33.34
43	6.97	9.05	12.77	17.12	20.68	25.52	33.54
44	7.03	9.11	12.86	17.21	20.80	25.67	33.75
45	7.07	9.18	12.95	17.32	20.92	25.82	33.94
46	7.12	9.24	13.04	17.43	21.04	25.97	34.12
47	7.18	9.31	13.12	17.51	21.16	26.11	34.31
48	7.22	9.37	13.22	17.61	21.25	26.24	34.48
49	7.26	9.42	13.30	17.69	21.37	26.37	34.64
50	7.30	9.48	13.37	17.78	21.48	26.50	34.81
51	7.36	9.54	13.46	17.86	21.57	26.62	34.96
52	7.40	9.60	13.54	17.95	21.67	26.73	35.11
53	7.44	9.66	13.60	18.02	21.76	26.85	35.27
54	7.48	9.72	13.68	18.10	21.86	26.97	35.40
55	7.53	9.75	13.77	18.17	21.93	27.06	35.54
56	7.58	9.83	13.83	18.25	22.03	27.17	35.68
57	7.62	9.88	13.91	18.32	22.11	27.27	35.80
58	7.66	9.92	13.97	18.39	22.19	27.37	35.92
59	7.71	9.97	14.05	18.45	22.27	27.45	36.04
60	7.75	10.03	14.13	18.52	22.33	27.55	36.17
61	7.80	10.09	14.18	18.58	22.42	27.64	36.33
62	7.84	10.13	14.25	18.65	22.48	27.72	36.47
63	7.87	10.19	14.32	18.70	22.56	27.80	36.62
64	7.91	10.23	14.38	18.75	22.62	27.88	36.76
65	7.95	10.28	14.44	18.82	22.69	27.96	36.90
66	8.00	10.34	14.50	18.87	22.75	28.04	37.03
67	8.05	10.38	14.56	18.93	22.82	28.11	37.16
68	8.08	10.42	14.64	18.98	22.87	28.19	37.30
69	8.12	10.46	14.69	19.03	22.94	28.26	37.41
70	8.16	10.53	14.76	19.09	22.99	28.32	37.55
Oversize parcels ⁵	34.75	38.94	45.10	54.87	66.41	82.14	106.00

SCHEDULE 521.2A NOTES

- ¹ For Origin Bulk Mail Center Discount, deduct \$0.90 per piece.
- ² For BMC Presort, deduct \$0.23 per piece.
- ³ For barcode discount, deduct \$0.03 per piece.
- ⁴ For nonmachinable Inter-BMC parcels, add \$2.00 per piece.
- ⁵ See DMCS section 521.61 for oversize Parcel Post.
- ⁶ Parcel Post 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.
- ⁷ For each pickup stop, add \$10.25.

**PACKAGE SERVICES
RATE SCHEDULE 521.2B**

**PARCEL POST SUBCLASS
INTRA-BMC RATES**

(dollars)

Weight not Exceeding (Pounds)	Local	Zone 1 & 2	Zone 3	Zone 4	Zone 5
1	2.72	2.97	2.97	2.97	2.97
2	2.72	2.97	2.97	2.97	2.97
3	2.96	3.36	3.46	3.46	3.46
4	3.18	3.52	3.78	3.79	3.93
5	3.38	3.66	4.08	4.11	4.40
6	3.48	3.79	4.38	4.40	4.83
7	3.55	3.91	4.63	4.66	5.23
8	3.64	4.05	4.87	4.91	5.61
9	3.71	4.14	5.06	5.15	5.96
10	3.79	4.27	5.31	5.38	6.29
11	3.86	4.37	5.49	5.59	6.59
12	3.93	4.48	5.65	5.80	6.90
13	4.01	4.58	5.79	5.99	7.16
14	4.07	4.67	5.88	6.18	7.43
15	4.13	4.76	6.02	6.35	7.68
16	4.21	4.83	6.16	6.52	7.91
17	4.26	4.93	6.29	6.69	8.13
18	4.31	5.00	6.41	6.84	8.36
19	4.37	5.10	6.53	6.99	8.56
20	4.44	5.17	6.65	7.14	8.75
21	4.48	5.24	6.76	7.28	8.94
22	4.54	5.32	6.86	7.42	9.12
23	4.59	5.38	6.99	7.56	9.30
24	4.64	5.45	7.08	7.67	9.46
25	4.70	5.51	7.18	7.79	9.62
26	4.74	5.59	7.27	7.89	9.78
27	4.79	5.65	7.38	7.98	9.92
28	4.83	5.70	7.47	8.07	10.06
29	4.90	5.78	7.57	8.15	10.20
30	4.95	5.83	7.65	8.23	10.35
31	4.99	5.89	7.72	8.30	10.47
32	5.04	5.96	7.81	8.38	10.59
33	5.09	6.01	7.90	8.45	10.73
34	5.13	6.06	7.96	8.51	10.83
35	5.17	6.12	8.05	8.58	10.94
36	5.20	6.17	8.12	8.64	11.07
37	5.25	6.23	8.18	8.70	11.17
38	5.29	6.29	8.27	8.76	11.28
39	5.34	6.34	8.34	8.81	11.37
40	5.38	6.38	8.41	8.86	11.48

**PARCEL POST SUBCLASS
INTRA-BMC RATES (continued)**

(dollars)

Weight not Exceeding (Pounds)	Local	Zone 1 & 2	Zone 3	Zone 4	Zone 5
41	5.43	6.44	8.49	8.91	11.57
42	5.47	6.49	8.54	8.96	11.66
43	5.51	6.53	8.62	9.10	11.76
44	5.57	6.58	8.67	9.14	11.84
45	5.60	6.63	8.73	9.19	11.93
46	5.64	6.69	8.81	9.23	12.01
47	5.68	6.74	8.86	9.27	12.09
48	5.72	6.78	8.93	9.31	12.19
49	5.76	6.83	8.99	9.35	12.26
50	5.80	6.86	9.04	9.38	12.34
51	5.84	6.92	9.09	9.42	12.41
52	5.87	6.96	9.17	9.45	12.48
53	5.91	7.00	9.22	9.48	12.55
54	5.96	7.04	9.28	9.51	12.63
55	6.00	7.08	9.32	9.54	12.69
56	6.03	7.13	9.38	9.57	12.75
57	6.06	7.18	9.44	9.61	12.83
58	6.11	7.22	9.48	9.64	12.89
59	6.15	7.26	9.54	9.66	12.95
60	6.17	7.30	9.59	9.70	13.02
61	6.23	7.36	9.61	9.76	13.08
62	6.25	7.40	9.64	9.81	13.13
63	6.30	7.43	9.66	9.87	13.19
64	6.33	7.47	9.68	9.91	13.25
65	6.37	7.52	9.70	9.96	13.30
66	6.39	7.57	9.72	10.02	13.37
67	6.44	7.61	9.74	10.07	13.41
68	6.48	7.63	9.76	10.11	13.46
69	6.52	7.67	9.78	10.16	13.52
70	6.55	7.72	9.80	10.21	13.57
Oversize parcels ³	19.82	28.99	28.99	28.99	28.99

SCHEDULE 521.2B NOTES

- ¹ For barcode discount, deduct \$0.03 per piece.
- ² For nonmachinable Intra-BMC parcels, add \$1.35 per piece.
- ³ See DMCS section 521.61 for oversize Parcel Post.
- ⁴ Parcel Post 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.
- ⁵ For each pickup stop, add \$10.25.

**PACKAGE SERVICES
RATE SCHEDULE 521.2C**

**PARCEL POST SUBCLASS
PARCEL SELECT – DESTINATION BMC RATE S**

(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
1	2.10	2.45	2.73	2.92	36	6.08	8.07	8.59	11.02
2	2.10	2.45	2.73	2.92	37	6.15	8.13	8.65	11.12
3	2.33	2.85	3.27	3.41	38	6.21	8.22	8.71	11.23
4	2.54	3.23	3.74	3.88	39	6.27	8.29	8.76	11.32
5	2.74	3.59	4.06	4.35	40	6.33	8.36	8.81	11.43
6	2.92	3.92	4.35	4.78	41	6.39	8.44	8.86	11.52
7	3.10	4.24	4.61	5.18	42	6.44	8.49	8.91	11.61
8	3.27	4.54	4.86	5.56	43	6.48	8.57	9.05	11.71
9	3.42	4.82	5.10	5.91	44	6.53	8.62	9.09	11.79
10	3.57	5.09	5.33	6.24	45	6.58	8.68	9.14	11.88
11	3.72	5.35	5.54	6.54	46	6.64	8.76	9.18	11.96
12	3.86	5.60	5.75	6.85	47	6.69	8.81	9.22	12.04
13	3.99	5.74	5.94	7.11	48	6.73	8.88	9.26	12.14
14	4.11	5.83	6.13	7.38	49	6.78	8.94	9.30	12.21
15	4.24	5.97	6.30	7.63	50	6.81	8.99	9.33	12.29
16	4.35	6.11	6.47	7.86	51	6.87	9.04	9.37	12.36
17	4.47	6.24	6.64	8.08	52	6.91	9.12	9.40	12.43
18	4.58	6.36	6.79	8.31	53	6.95	9.17	9.43	12.50
19	4.68	6.48	6.94	8.51	54	6.99	9.23	9.46	12.58
20	4.78	6.60	7.09	8.70	55	7.03	9.27	9.49	12.64
21	4.88	6.71	7.23	8.89	56	7.08	9.33	9.52	12.70
22	4.98	6.81	7.37	9.07	57	7.13	9.39	9.56	12.78
23	5.07	6.94	7.51	9.25	58	7.17	9.43	9.59	12.84
24	5.16	7.03	7.62	9.41	59	7.21	9.49	9.61	12.90
25	5.25	7.13	7.74	9.57	60	7.25	9.54	9.65	12.97
26	5.34	7.22	7.84	9.73	61	7.31	9.56	9.71	13.03
27	5.42	7.33	7.93	9.87	62	7.35	9.59	9.76	13.08
28	5.50	7.42	8.02	10.01	63	7.38	9.61	9.82	13.14
29	5.58	7.52	8.10	10.15	64	7.42	9.63	9.86	13.20
30	5.66	7.60	8.18	10.30	65	7.47	9.65	9.91	13.25
31	5.73	7.67	8.25	10.42	66	7.52	9.67	9.97	13.32
32	5.81	7.76	8.33	10.54	67	7.56	9.69	10.02	13.36
33	5.88	7.85	8.40	10.68	68	7.58	9.71	10.06	13.41
34	5.95	7.91	8.46	10.78	69	7.62	9.73	10.11	13.47
35	6.02	8.00	8.53	10.89	70	7.67	9.75	10.16	13.52
Oversize parcels ³						18.65	20.61	27.84	28.94

SCHEDULE 521.2C NOTES

- ¹ For barcode discount, deduct \$0.03 per piece. Barcode discount is not available for DBMC mail entered at an ASF, except at the Phoenix, AZ ASF.
- ² For nonmachinable DBMC parcels, add \$1.45 per piece.
- ³ See DMCS section 521.61 for oversize Parcel Post.
- ⁴ Parcel Post 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.
- ⁵ A mailing fee of \$125.00 must be paid once each 12-month period for Parcel Select.

**PACKAGE SERVICES
RATE SCHEDULE 521.2D**

**PARCEL POST SUBCLASS
PARCEL SELECT – DESTINATION SCF RATES**

(dollars)

Weight not Exceeding (Pounds)		Weight not Exceeding (Pounds)	
1	1.68	36	3.71
2	1.68	37	3.75
3	1.80	38	3.78
4	1.91	39	3.82
5	2.01	40	3.85
6	2.10	41	3.88
7	2.19	42	3.92
8	2.27	43	3.95
9	2.35	44	3.98
10	2.43	45	4.01
11	2.50	46	4.04
12	2.57	47	4.07
13	2.63	48	4.10
14	2.69	49	4.13
15	2.76	50	4.16
16	2.81	51	4.19
17	2.87	52	4.22
18	2.93	53	4.24
19	2.98	54	4.27
20	3.03	55	4.30
21	3.08	56	4.32
22	3.13	57	4.35
23	3.18	58	4.38
24	3.23	59	4.40
25	3.27	60	4.43
26	3.32	61	4.45
27	3.36	62	4.48
28	3.40	63	4.50
29	3.44	64	4.52
30	3.49	65	4.55
31	3.52	66	4.57
32	3.56	67	4.59
33	3.60	68	4.62
34	3.64	69	4.64
35	3.68	70	4.66
Oversize parcels ¹			11.61

SCHEDULE 521.2D NOTES

- ¹ See DMCS section 521.61 for oversize Parcel Post.
- ² Parcel Post 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.
- ³ A mailing fee of \$125.00 must be paid once each 12-month period for Parcel Select.

**PACKAGE SERVICES
RATE SCHEDULE 521.2E**

**PARCEL POST SUBCLASS
PARCEL SELECT – DESTINATION DELIVERY UNIT RATE S**

(dollars)

Weight not Exceeding (Pounds)		Weight not Exceeding (Pounds)	
1	1.25	36	1.91
2	1.25	37	1.92
3	1.30	38	1.93
4	1.34	39	1.94
5	1.38	40	1.95
6	1.42	41	1.96
7	1.45	42	1.97
8	1.48	43	1.98
9	1.51	44	1.99
10	1.54	45	2.00
11	1.57	46	2.01
12	1.59	47	2.02
13	1.61	48	2.03
14	1.63	49	2.04
15	1.65	50	2.05
16	1.67	51	2.06
17	1.69	52	2.07
18	1.70	53	2.08
19	1.72	54	2.09
20	1.73	55	2.10
21	1.75	56	2.11
22	1.76	57	2.12
23	1.77	58	2.13
24	1.79	59	2.14
25	1.80	60	2.15
26	1.81	61	2.16
27	1.82	62	2.17
28	1.83	63	2.18
29	1.84	64	2.19
30	1.85	65	2.20
31	1.86	66	2.21
32	1.87	67	2.22
33	1.88	68	2.23
34	1.89	69	2.24
35	1.90	70	2.25
		Oversize parcels ¹	7.53

SCHEDULE 521.2E NOTES

- ¹ See DMCS section 521.61 for oversize Parcel Post.
- ² Parcel Post 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.
- ³ A mailing fee of \$125.00 must be paid once year 12-month period for Parcel Select.

**PACKAGE SERVICES
RATE SCHEDULE 522A**

**BOUND PRINTED MATTER SUBCLASS
SINGLE PIECE RATES**

Weight not Exceeding (Pounds)	(dollars)						
	1 & 2	3	4	Zones 5	6	7	8
1	1.73	1.76	1.79	1.85	1.90	1.97	2.10
1.5	1.73	1.76	1.79	1.85	1.90	1.97	2.10
2	1.77	1.81	1.86	1.93	2.01	2.10	2.27
2.5	1.82	1.87	1.92	2.02	2.11	2.22	2.44
3	1.87	1.92	1.99	2.10	2.22	2.35	2.61
3.5	1.91	1.98	2.06	2.19	2.32	2.48	2.78
4	1.96	2.03	2.12	2.27	2.43	2.60	2.95
4.5	2.00	2.09	2.19	2.36	2.53	2.73	3.12
5	2.05	2.14	2.26	2.44	2.64	2.86	3.29
6	2.14	2.26	2.39	2.62	2.85	3.11	3.62
7	2.23	2.37	2.52	2.79	3.06	3.36	3.96
8	2.32	2.48	2.66	2.96	3.27	3.62	4.30
9	2.41	2.59	2.79	3.13	3.48	3.87	4.64
10	2.51	2.70	2.92	3.30	3.68	4.12	4.98
11	2.60	2.81	3.06	3.47	3.89	4.38	5.32
12	2.69	2.92	3.19	3.64	4.10	4.63	5.66
13	2.78	3.03	3.32	3.81	4.31	4.88	6.00
14	2.87	3.14	3.46	3.98	4.52	5.14	6.34
15	2.96	3.25	3.59	4.15	4.73	5.39	6.68
Per Piece Rate	1.59	1.59	1.59	1.59	1.59	1.59	1.59
Per Pound Rate	0.09	0.11	0.13	0.17	0.21	0.25	0.34

SCHEDULE 522A NOTES

¹ For barcode discount, deduct \$0.03 per piece.

**PACKAGE SERVICES
RATE SCHEDULE 522B**

**BOUND PRINTED MATTER SUBCLASS
BASIC PRESORT AND CARRIER ROUTE PRESORT RATES**

(dollars)

Zone	Per Piece		Per Pound
	Basic ¹	Carrier Route ²	
1 & 2	0.91	0.81	0.07
3	0.91	0.81	0.09
4	0.91	0.81	0.11
5	0.91	0.81	0.15
6	0.91	0.81	0.19
7	0.91	0.81	0.23
8	0.91	0.81	0.32

SCHEDULE 522B NOTES

¹ For barcode discount, deduct \$0.03 per piece.

² Applies to mailings of at least 300 pieces presorted to carrier route as specified by the Postal Service.

**PACKAGE SERVICES
RATE SCHEDULE 522C**

**BOUND PRINTED MATTER SUBCLASS
DESTINATION ENTRY BASIC PRESORT**

(dollars)

	DBMC Zone 1 & 2	DBMC Zone 3	DBMC Zone 4	DBMC Zone 5	DSCF	DDU
Per Piece Rate	0.78	0.78	0.78	0.78	0.63	0.57
Per Pound Rate	0.06	0.09	0.11	0.15	0.05	0.03

SCHEDULE 522C NOTES

- ¹ For barcode discount, deduct \$0.03 per piece. Barcode discount is not available for DDU and DSCF rates and DBMC mail entered at an ASF (except Phoenix, Arizona ASF).
- ² A mailing fee of \$125.00 must be paid once each 12-month period to mail at any destination entry Bound Printed Matter rate.

**PACKAGE SERVICES
RATE SCHEDULE 522D**

**BOUND PRINTED MATTER SUBCLASS
DESTINATION ENTRY CARRIER ROUTE PRESOR T**

(dollars)

	DBMC Zone 1 & 2	DBMC Zone 3	DBMC Zone 4	DBMC Zone 5	DSCF	DDU
Per Piece Rate	0.68	0.68	0.68	0.68	0.53	0.47
Per Pound Rate	0.06	0.09	0.11	0.15	0.05	0.03

SCHEDULE 522D NOTES

- ¹ A mailing fee of \$125.00 must be paid once each 12-month period to mail at any destination entry Bound Printed Matter rate.

**PACKAGE SERVICES
RATE SCHEDULE 523**

MEDIA MAIL SUBCLASS

		Current Rates (dollars)
First Pound	Not presorted ⁴	1.30
	Level A Presort (5-digits) ^{1, 2}	0.70
	Level B Presort (BMC) ^{1, 3, 4}	1.00
Each additional pound through 7 pounds		0.45
Each additional pound over 7 pounds		0.30

SCHEDULE 523 NOTES

- ¹ A mailing fee of \$125.00 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 barcode discount, deduct \$0.03 per piece.

**PACKAGE SERVICES
RATE SCHEDULE 524**

LIBRARY MAIL SUBCLASS

		Current Rates (dollars)
First Pound	Not presorted ⁴	1.24
	Level A Presort (5-digits) ^{1, 2}	0.67
	Level B Presort (BMC) ^{1, 3, 4}	0.95
Each additional pound through 7 pounds		0.43
Each additional pound over 7 pounds		0.29

SCHEDULE 524

¹ A mailing fee of \$125.00 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 barcode discount, deduct \$0.03 per piece.

FEE SCHEDULE 911

ADDRESS CORRECTIONS

Description	Fee
Per manual correction	\$0.60
Per automated correction	\$0.20

FEE SCHEDULE 912

ZIP CODING OF MAILING LISTS

Description	Fee
Per thousand addresses	\$73.00

CORRECTION OF MAILING LISTS

Description	Fee
Per submitted address	\$0.25
Minimum charge per list corrected	\$7.50

ADDRESS CHANGES FOR ELECTION BOARDS AND REGISTRATION COMMISSIONS

Description	Fee
Per change of address	\$0.23

SEQUENCING OF ADDRESS CARDS

Description	Fee
Per correction	\$0.25

SCHEDULE 912 NOTES

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. Post Office Boxes

Semi-annual Box Fees¹

Box Size ²	Fee Group						
	B2	C3	C4	C5	D6	D7	E
1	\$ 30.00	\$ 27.50	\$ 22.50	\$ 19.00	\$ 10.00	\$ 8.50	\$ 0.00
2	45.00	40.00	32.50	27.50	16.00	13.00	0.00
3	85.00	75.00	60.00	50.00	25.00	22.50	0.00
4	170.00	150.00	125.00	87.50	50.00	40.00	0.00
5	300.00	250.00	212.50	150.00	90.00	65.00	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. Key Duplication and Lock Charges

Description	Fee
Key duplication or replacement	\$4.00
Post office box lock replacement	\$10.00

III. Semi-annual Caller Service Fee \$375.00

IV. Annual Call Number Reservation Fee

(All applicable Fee Groups)	\$30.00
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FEE SCHEDULE 931

BUSINESS REPLY MAIL

Description	Fee
Active business reply advance deposit account: Per piece	
Qualified (without optional Quarterly fee)	\$0.05
Qualified (with optional Quarterly fee)	\$0.01
Nonletter-size, using weight averaging	\$0.01
Other	\$0.10
Payment of postage due charges if active business reply mail advance deposit account not used: Per piece	\$0.35
Monthly Fees for customers using weight averaging for nonletter-size business reply	\$600.00
Optional Qualified BRM Quarterly Fee	\$1,800.00
Accounting fee for advance deposit account (see Fee Schedule 1000)	
Permit fee (with or without advance deposit account) (see Fee Schedule 1000)	

FEE SCHEDULE 932

MERCHANDISE RETURN

Description	Fee
Accounting fee for advance deposit account (see Fee Schedule 1000)	
Permit fee (see Fee Schedule 1000)	

FEE SCHEDULE 933

ON-SITE METER SERVICE

Description	Fee
Meter Service (per employee)	\$31.00
Meters reset and/or examined (per meter)	\$4.00
Checking meter in or out of service (per meter)	\$4.00 ¹

SCHEDULE 933 NOTES

¹ Fee does not apply to Secured Postage meters.

FEE SCHEDULE 934

[RESERVED]

FEE SCHEDULE 935

BULK PARCEL RETURN SERVICE

Description	Fee
Per Returned Piece	\$1.62
Accounting fee for advance deposit account (see Fee Schedule 1000)	
Permit fee (see Fee Schedule 1000)	

FEE SCHEDULE 936

SHIPPER PAID FORWARDING

Description	Fee
Accounting fee for advance deposit account (see Fee Schedule 1000)	

FEE SCHEDULE 941

CERTIFIED MAIL

Description

Fee

(in addition to postage)

Per piece

\$1.90

FEE SCHEDULE 942**REGISTERED MAIL**

Declared Value of Article¹			Fee	Handling Charge
			(in addition to postage)	
\$	0.00		\$7.25	None
	0.01	to 100	7.50	
	100.01	to 500	8.25	
	500.01	to 1,000	9.00	
	1,000.01	to 2,000	9.75	
	2,000.01	to 3,000	10.50	
	3,000.01	to 4,000	11.25	
	4,000.01	to 5,000	12.00	
	5,000.01	to 6,000	12.75	
	6,000.01	to 7,000	13.50	
	7,000.01	to 8,000	14.25	
	8,000.01	to 9,000	15.00	
	9,000.01	to 10,000	15.75	
	10,000.01	to 11,000	16.50	
	11,000.01	to 12,000	17.25	
	12,000.01	to 13,000	18.00	
	13,000.01	to 14,000	18.75	
	14,000.01	to 15,000	19.50	
	15,000.01	to 16,000	20.25	
	16,000.01	to 17,000	21.00	
	17,000.01	to 18,000	21.75	
	18,000.01	to 19,000	22.50	
	19,000.01	to 20,000	23.25	
	20,000.01	to 21,000	24.00	
	21,000.01	to 22,000	24.75	
	22,000.01	to 23,000	25.50	
	23,000.01	to 24,000	26.25	
	24,000.01	to 25,000	27.00	
	25,000.01	to \$1 million	27.00	plus 75 cents for each \$1,000 (or fraction thereof) over \$25,000
Over \$1 million	to \$15 million		758.25	plus 75 cents for each \$1,000 (or fraction thereof) over \$1 million
Over \$15 million			11,258.25	plus amount determined by the Postal Service based on weight, space and value

SCHEDULE 942 NOTES

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.....	\$1.00 for each \$100 (or fraction thereof) over \$500 in value

General Insurance

Coverage	Fee ¹
	(in addition to postage)
\$ 0.01 to \$ 50.....	\$1.10
50.01 to 100.....	\$2.00
100.01 to 5000.....	\$2.00 plus \$1.00 for each \$100 (or fraction thereof) over \$100 in coverage

SCHEDULE 943 NOTES

¹ For bulk insurance coverage between \$0.01 to \$50.00, deduct \$0.60 per piece.
For bulk insurance coverage between \$50.01 to \$5,000.00, deduct \$0.80 per piece.

FEE SCHEDULE 944**COLLECT ON DELIVERY****Description****Fee**

(in addition to postage)

Amount to be collected,
or Insurance Coverage Desired

\$ 0.01	to	\$ 50.....	\$4.50
50.01	to	100.....	\$5.50
100.01	to	200.....	\$6.50
200.01	to	300.....	\$7.50
300.01	to	400.....	\$8.50
400.01	to	500.....	\$9.50
500.01	to	600.....	\$10.50
600.01	to	700.....	\$11.50
700.01	to	800.....	\$12.50
800.01	to	900.....	\$13.50
900.01	to	1000.....	\$14.50
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 requested at time of mailing¹	
Items other than merchandise	\$1.50
Merchandise (without another special service)	\$2.35
Receipt requested after mailing²	\$3.50

SCHEDULE 945 NOTES

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

Description	Fee (in addition to postage)
Per Piece	\$3.20

FEE SCHEDULE 947

CERTIFICATE OF MAILING

Description	Fee (in addition to postage)
Individual Pieces	
Original certificate of mailing for listed pieces of all classes of ordinary mail (per piece)	\$0.75
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)	\$0.75
Bulk Pieces	
Identical pieces of First-Class and 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)	\$3.50
Each additional 1,000 pieces or fraction	\$0.40
Duplicate copy	\$0.75

FEE SCHEDULE 948**DELIVERY CONFIRMATION**

Description	Fee (in addition to postage)
Used in Conjunction with Priority Mail	
Electronic	\$0.00
Manual	\$0.40
Used in Conjunction with Parcel Post, Bound Printed Matter, Library Mail, and Media Mail	
Electronic	\$0.12
Manual	\$0.50
Used in Conjunction with Regular and Nonprofit Standard Mail	
Electronic	\$0.12

FEE SCHEDULE 949

SIGNATURE CONFIRMATION

Description	Fee (in addition to postage)
Used in Conjunction with Priority Mail	
Electronic	\$1.25
Manual	\$1.75
Used in Conjunction with Parcel Post, Bound Printed Matter, Library Mail, and Media Mail	
Electronic	\$1.25
Manual	\$1.75

FEE SCHEDULE 951**PARCEL AIR LIFT**

Description	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

Description	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: #6-3/4 size and #10 size	
Basic	\$0.08
Special	\$0.09
Household (50): #6-3/4 size through #10 size	
Basic	\$3.50
Special	\$4.50
Bulk (500): #6-3/4 size	
Plain Basic	\$12.00
Printed Basic	\$17.00
Bulk (500): >#6-3/4 size through #10 size	
Plain Basic ^{1, 2}	\$14.00
Printed Basic	\$20.00
Plain Special	\$19.00
Printed Special	\$25.00

SCHEDULE 961 NOTES

“Basic” envelopes include “regular” (no window), “window” (single window), “pre-cancelled regular”, and “pre-cancelled window” styles. “Special” envelopes include all envelopes with patched in indicia. “Printed” envelopes are available with multi-color printing.

¹ Available in “double window” style.

² Available in “savings bond” style.

FEE SCHEDULE 962

STAMPED CARDS

Description	Fee (in addition to postage)
Stamped Card	\$0.02
Double Stamped Card	\$0.04

FEE SCHEDULE 971**MONEY ORDERS**

Description		Fee
Domestic	\$0.01 to \$700	\$0.75
APO-FPO	\$0.01 to \$700	\$0.25
Inquiry Fee, which includes the issuance of copy of a paid money order		\$2.75

FEE SCHEDULE 981

MAILING ONLINE

Description	Fee
Fees are calculated by multiplying 1.52 times the sum of printer contractual costs for the particular mailing and 0.5 cents per impression for other Postal Service costs. P = Printer Contractual Costs I = Number of Impressions	$1.52 \times (P + 0.5\text{¢} \times I)$
Certification of a system as functionally equivalent to Mailing Online (see Fee Schedule 1000)	

This provision expires the later of:

- a. three years after the implementation date specified by the Postal Service Board of Governors, or
- b. if, by the expiration date specified in (a), a proposal to make Mailing Online permanent is pending before the Postal Rate Commission, the later of:
 1. three months after the Commission takes action on such proposal under section 3624 of Title 39, or
 2. —if applicable—on the implementation date for a permanent Mailing Online.

FEE SCHEDULE 1000

Description	Fee¹
First-Class Presorted Mailing	\$125.00
Regular, Enhanced Carrier Route, Nonprofit, and Nonprofit Enhanced Carrier Route Standard Mail Bulk Mailing	\$125.00
Periodicals	
A. Original Entry	\$350.00
B. Additional Entry	\$50.00
C. Re-entry	\$40.00
D. Registration for News Agents	\$40.00
Parcel Select	\$125.00
Bound Printed Matter: Destination BMC, SCF, and DDU	\$125.00
Media Mail Presorted Mailing	\$125.00
Library Mail Presorted Mailing	\$125.00
Authorization to Use Permit Imprint	\$125.00
Special Services	
Bulk Parcel Return Service	
A. Permit	\$125.00
B. Accounting Fee (advance deposit account)	\$375.00
Business Reply Mail	
A. Permit (with or without advance deposit account)	\$125.00
B. Accounting Fee (advance deposit account)	\$375.00
Mailing Online ²	
A. Certification of a system as functionally equivalent to Mailing Online	\$125.00
Merchandise Return	
A. Permit	\$125.00
B. Accounting Fee (advance deposit account)	\$375.00
Shipper Paid Forwarding	
A. Accounting Fee (advance deposit account)	\$375.00

SCHEDULE 1000 NOTES

- ¹ Fees must be paid once each 12-month period.
- ² This provision expires the later of:
 - a. three years after the Mailing Online implementation date specified by the Postal Service Board of Governors, or
 - b. if, by the expiration date specified in (a), a proposal to make Mailing Online permanent is pending before the Postal Rate Commission, the later of:
 1. three months after the Commission takes action on such proposal under section 3624 of Title 39, or
 2. —if applicable—on the implementation date for a permanent Mailing Online.

RECOMMENDED CHANGES IN THE DOMESTIC MAIL CLASSIFICATION SCHEDULE

The Commission's Opinion and Recommended Decision on the Postal Service's Request entails numerous substantive, structural, and organizational changes in the Domestic Mail Classification Schedule (DMCS). The DMCS is published here in legislative format.¹ Recommended additions are underlined; recommended deletions appear in brackets.

The presentation of several sections differs markedly from the current version. For example, in Periodicals, changes reflect the establishment of a new "Outside County" subclass through the formal merger of several subclasses in Periodicals. In Standard Mail, the component generally referred to as Standard A (formerly referred to as third-class mail) is retained; the component now comprised of the Parcel Post, Bound Printed Matter, Library, and Special subclasses (referred to as Standard B) is moved to a separate section, renumbered and renamed. In Special Services, the changes, for the most part, reflect the Service's proposed recodification. Minor conforming and editorial changes have been made.

¹ The base text reflects the DMCS provisions as codified in 39 CFR Part 3001, Subpart C, Appendix A, plus changes resulting from Docket Nos. MC99-1 through MC99-4, Docket No. MC2000-1, and applicable provisions of the Mailing Online cases (Docket Nos. MC98-1 and MC2000-2).

EXPEDITED MAIL CLASSIFICATION SCHEDULE

110 DEFINITION

Expedited Mail is mail matter entered as Express Mail 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 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 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:

- d. Service cannot be provided for reasons beyond the control of the Postal Service or because of changes in Postal Service facilities or operations, or
- e. 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 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 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 specified 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
b. Return receipts	945
c. COD	944
d. Express Mail Insurance	943
e. Mailing Online	981

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 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) specified 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) specified 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) specified 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) specified 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, 520, 544.2, and 446;
- c. Matter having the character of actual and personal correspondence except as specifically permitted by sections 312, 313, [323, 344.22, 520, 544.2, 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 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 Rate Category.** The single-piece rate category applies to regular rate Letters and Sealed Parcels subclass mail not mailed under section 221.22 or 221.24.

221.22 **Presort Rate Category.** The 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 specified by the Postal Service; and
- c. Meets the addressing and other preparation requirements specified by the Postal Service.

[221.23 **Reserved]**

221.23 **Information Based Indicia Program Mail Rate Category.** The Information Based Indicia Program mail rate category applies to Letters and Sealed parcels subclass mail in envelopes that:

- a. Are prepared in accordance with the Information Based Indicia Program requirements, as specified 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 proper postage and addressing information machine printed directly on the envelope, as specified by the Postal Service; and
- e. Meet automation compatibility criteria, as 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 Reserved]

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 13 ounces or less that:

- a. Is prepared in a mailing of at least 500 pieces, or is provided for entry as mail using Mailing Online or a functionally equivalent service, pursuant to section 981;
- 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 specified by the Postal Service; and

- d. Meets the machinability, addressing, barcoding, and other preparation requirements specified by the Postal Service.

221.32 Letter Categories

221.[32]321 **[Basic Rate Category.]**Basic Rate Category. The basic rate category applies to letter-size automation rate category mail not mailed under section 221.[33]322, 221.[34]323, or 221.[35]324.

221.[33]322 **[Three-Digit Rate Category.]**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 specified by the Postal Service.

221.[34]323 **[Five-Digit Rate Category.]**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 specified by the Postal Service.

221.[35]324 **[Carrier Route Rate Category.]**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 specified by the Postal Service.

221.33 Flats Categories

221.[36]331 **[Basic Flats Rate Category.]**Basic Flats Rate Category. The basic flats rate category applies to flat-size automation rate category mail not mailed under section 221.[37]332 or 221.333.

221.[37]332 **[Three- and Five-Digit Flats Rate Category.]**Three-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.

221.333 Five-Digit Flats Rate Category. The five-digit flats rate category applies to flat-size automation rate category mail presorted to single or multiple five-digit ZIP Code destinations as specified by the Postal Service.

221.[38]334 **[Nonstandard Size Surcharge.]**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]34 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.

222 Cards Subclass**222.1 Definition**

222.11 Cards. The Cards subclass consists of Stamped Cards, defined in section 962.1[1], and postcards. A postcard is a privately printed mailing card for the transmission of messages. To be eligible to be mailed as a First-Class postcard, a card must be of uniform thickness and must not exceed any of the following dimensions:

- a. 6 inches in length;
- b. 4 1/4 inches in width;
- c. 0.016 inch in thickness.

222.12 Double Cards. Double Stamped Cards or double postcards may be mailed as Stamped Cards or postcards. Double Stamped Cards are defined in section 962.1[2]. A double postcard consists of two attached cards, one of which may be detached by the receiver and returned by mail as a single postcard.

222.2 Restriction. A mailpiece with any of the following characteristics is not mailable as a Stamped Card or postcard unless it is prepared as 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 Cards subclass mail not mailed under section 222.32 or 222.34.

222.32 **Presort Rate Category.** The presort rate category applies to 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; and
- c. Meets the addressing and other preparation requirements specified by the Postal Service.

222.33 **Reserved**

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 Cards subclass mail that:

- a. Is prepared in a mailing of at least 500 pieces, or is provided for entry as mail using Mailing Online or a functionally equivalent service, pursuant to section 981;
- 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 specified by the Postal Service; and

- d. Meets the machinability, addressing, barcoding, and other preparation requirements 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 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 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 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 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 rate category applies to Priority Mail subclass mail[not mailed under section 223.4].

223.3 **Reserved**

223.4 **Reserved**

223.5 **Flat Rate Envelope.** Priority Mail subclass mail sent in a “flat rate” envelope provided by the Postal Service is charged the [two]one-pound rate.

223.6 **Pickup Service.** Pickup service is available for Priority Mail subclass mail under terms and conditions 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 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**

The following services may be obtained in conjunction with mail sent under this classification schedule upon payment of applicable fees:

Service	Schedule
a. Address [c] <u>C</u> orrection	911
b. Business [r] <u>R</u> eplay [m] <u>M</u> ail	931
c. Certificates of [m] <u>M</u> ailing	947
d. Certified [m] <u>M</u> ail	941
e. COD	944
f. Insurance	943
g. Registered [m] <u>M</u> ail	942
h. Return [r] <u>R</u> eceipt (limited to merchandise sent by Priority Mail)	945
i. Merchandise [r] <u>R</u> eturn	932
j. Delivery [c] <u>C</u> onfirmation (limited to Priority Mail)	948
k. Reserved	
l. Mailing Online	981

270 **RATES AND FEES**

271 **First-Class Mail.** The rates and fees for First-Class Mail are set forth in the following rate schedules:

	Schedule
a. Letters and Sealed Parcels	221
b. Cards	222
c. Priority Mail	223

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 mailing fee set forth in [S]schedule 1000 must be paid once each year at each office of mailing [by any person who mails]or office of verification, as specified by the Postal Service, by or for mailers of other than single-piece First-Class Mail [or courtesy envelope mail](including Information Based Indicia Program 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 weighing less than 16 ounces 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 **Reserved]**

321[.2] **Regular Subclass**

321.[2]1 **General.** The Regular subclass consists of Standard Mail [weighing less than 16 ounces] that is not mailed under sections 322, 323, or 324. [321.3, 321.4, 321.5 or 323.]

321.[2]2 **Presort Rate Categories**

321.[2]21 **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 specified by the Postal Service; and
- c. Meets the machinability, addressing, and other preparation requirements specified by the Postal Service.

- 321.[2]22 **Basic Rate Categories.** The basic rate categories apply to presort rate category mail not mailed under section 321.23 [321.223].
- 321.[2]23 **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 specified by the Postal Service.
- 321.[2]3 **Automation Rate Categories**
- 321.[2]31 **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, or is provided for entry as mail using Mailing Online or a functionally equivalent service, pursuant to section 981;
 - 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 specified by the Postal Service;
 - d. Meets the machinability, addressing, barcoding, and other preparation requirements specified by the Postal Service.
- 321.[2]32 **Basic Barcoded Rate Category.** The basic barcoded rate category applies to letter-size automation rate category mail not mailed under section 321.[2]33 or 321.[2]34.
- 321.[2]33 **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 specified by the Postal Service.
- 321.[2]34 **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 specified by the Postal Service.
- 321.[2]35 **Basic Barcoded Flats Rate Category.** The basic barcoded flats rate category applies to flat-size automation rate category mail not mailed under section 321.[2]36.

321.[2]36 **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 specified by the Postal Service.

321.[2]4 **Destination Entry Discounts.** The destination entry discounts apply to Regular subclass mail prepared as 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.[2]5 **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.

321.6 **Barcode Discount.** The barcode discount applies to Regular Subclass mail that is subject to the residual shape surcharge in 321.5, 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.

322[1.3] **Enhanced Carrier Route Subclass**

322.1[1.31] **Definition.** The Enhanced Carrier Route subclass consists of Standard Mail weighing less than 16 ounces that is not mailed under section 321, 323, or 324[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 specified by the Postal Service;
- c. Is presorted to carrier routes as specified by the Postal Service;
- d. Is sequenced as specified by the Postal Service; and
- e. Meets the machinability, addressing, and other preparation requirements specified by the Postal Service.

322.[1.3]2 **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] 322.3, 322.4 or 322.5.

322.[1.3]3 **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 by the Postal Service, and which meets the machinability, addressing, and barcoding specifications and other preparation requirements specified by the Postal Service.

322.[1.3]4 **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 specified by the Postal Service.

322.[1.3]5 **Saturation Rate Category.** The saturation rate category applies to Enhanced Carrier Route subclass mail presented in walk-sequence order and meeting the saturation requirements specified by the Postal Service.

322.[1.3]6 **Destination Entry Discounts.** Destination entry discounts apply to Enhanced Carrier Route subclass mail prepared as 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.

322.[1.3]7 **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.

323[1.4] **Nonprofit Subclass**

323.[1.4]1 **General.** The Nonprofit subclass consists of Standard Mail weighing less than 16 ounces that is not mailed under section 321, 322, or 324[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.

323.[1.4]11 **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.

323.[1.4]12 *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 nonprofit Standard rates to any other person, organization or association.

323.[1.4]2 **Presort Rate Categories**

323.[1.4]21 **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 specified by the Postal Service; and
- c. Meets the machinability, addressing, and other preparation requirements specified by the Postal Service.

323.[1.4]22 **Basic Rate Categories.** The basic rate categories apply to presort rate category mail not mailed under section 322.[1.4]23.

323.[1.4]23 **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 specified by the Postal Service.

323.[1.4]3 **Automation Rate Categories**

323.[1.4]31 **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, or is provided for entry as mail using Mailing Online or a functionally equivalent service, pursuant to section 981;
- 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 specified by the Postal Service;
- d. Meets the machinability, addressing, barcoding, and other preparation requirements specified by the Postal Service.

323.[1.4]32 **Basic Barcoded Rate Category.** The basic barcoded rate category applies to letter-size automation rate category mail not mailed under section 323.[1.4]33 or 323.[1.4]34.

323.[1.4]33 **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 specified by the Postal Service.

323.[1.4]34 **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 specified by the Postal Service.

323.[1.4]35 **Basic Barcoded Flats Rate Category.** The basic barcoded flats rate category applies to flat-size automation rate category mail not mailed under section 323.[1.4]36.

323.[1.4]36 **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 specified by the Postal Service.

323.[1.4]4 **Destination Entry Discounts.** Destination entry discounts apply to Nonprofit subclass mail prepared as 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.

323.[1.4]5 **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.

323.6 **Barcode Discount.** The barcode discount applies to Nonprofit subclass mail that is subject to the residual shape surcharge in 323.5, 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.

324[1.5] **Nonprofit Enhanced Carrier Route Subclass**

324.[1.5]1 **Definition.** The Nonprofit Enhanced Carrier Route subclass consists of Standard Mail [weighing less than 16 ounces] that is not mailed under section 321, 322, or 323[321.2, 321.3, 321.4 or 323], that is mailed by authorized nonprofit organizations or associations (as defined in section 323[1.41]) under the terms and limitations stated in section 323.[1.4]12, 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 specified by the Postal Service;
- c. Is presorted to carrier routes as specified by the Postal Service;
- d. Is sequenced as specified by the Postal Service; and
- e. Meets the machinability, addressing, and other preparation requirements specified by the Postal Service.

- 324.[1.5]2 **Basic Rate Category.** The basic rate category applies to Nonprofit Enhanced Carrier Route subclass mail not mailed under section 324.3, 324.4, or 324.5.[321.53, 321.54 or 321.55.]
- 324.[1.5]3 **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 specified by the Postal Service, and which meets the machinability, addressing, and barcoding specifications and other preparation requirements specified by the Postal Service.
- 324.[1.5]4 **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 specified by the Postal Service.
- 324.[1.5]5 **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 specified by the Postal Service.
- 324.[1.5]6 **Destination Entry Discounts.** Destination entry discounts apply to Nonprofit Enhanced Carrier Route subclass mail prepared as 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.
- 324.[1.5]7 **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.

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.]rate categories. 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, except that merchandise samples mailed with detached address cards, prepared as specified by the

Postal service, may exceed those dimensions. [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 16 ounces. [70 pounds. Additional weight limitations apply to individual Standard Mail subclasses.]

340 **POSTAGE AND PREPARATION**

341 **Postage**

Postage must be paid as set forth in section 3000. When the postage [computed at a Regular, Enhanced Carrier Route, Nonprofit or Nonprofit Enhanced Carrier Route Standard rate] is higher than the rate prescribed in any of the Package Services[Standard] subclasses [listed in 322] 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 specified by the Postal Service, and must contain the ZIP Code of the addressee when specified by the Postal Service. All Standard mailings must be prepared and presented as specified by the Postal Service. Two or more Standard mailings may be commingled and mailed only when specific methods approved by the Postal Service for 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 determining and verifying postage are followed.

344 **Attachments and Enclosures**

344.1 **[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 Mail containing books, catalogs, and merchandise[entered under section 321]. The piece must be marked as specified by the Postal Service. Except as provided in section 344.[1]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 First-Class rate for which it qualifies.

344.[1]2 **Incidental First-Class Attachments and Enclosures.** First-Class Mail, as defined in subsections b through d of section 210, may be attached to or enclosed with Standard Mail[merchandise entered under section 321, including] containing merchandise, 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 (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 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 specified by the Postal Service and as described in subsections a and e of section 323.11, 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, 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 **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 Mail pieces will be returned as specified by the Postal Service. Except as provided in section 935, the applicable First-Class Mail rate is charged for each piece receiving return only service. Except as provided in 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 sections 935 and 936, the charge for those returned pieces is the appropriate First-Class Mail rate for the piece plus that rate multiplied by a factor equal to the number of [section 321] Standard Mail 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 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 single-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
b. Certificates of mailing indicating that a specified number of pieces have been mailed	947

Certificates of mailing are not available for Standard Mail [Regular, Enhanced Carrier Route, Nonprofit and Nonprofit Enhanced Carrier Route subclass mail] when postage is paid with permit imprint.

[362 **Parcel Post, Bound Printed Matter, Special, and Library Subclasses]**

[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
b. COD	944
c. Insurance	943
d. Special handling	952
e. Return receipt (merchandise only)	945
f. Merchandise return	932
g. Delivery Confirmation	948]

[Insurance, special handling, and COD services may not be used selectively for individual pieces in a multi-piece Standard Mail mailing unless specific

methods approved by the Postal Service for determining and verifying postage are followed.]

362[3] **Regular and Nonprofit**

362.1 Regular and Nonprofit subclass mail will receive the following additional services upon payment of the appropriate fees.

Service	Schedule
a. Bulk Parcel Return Service	935
b. Shipper-Paid Forwarding	936

362.2 **Regular and Nonprofit subclass mail subject to the residual shape surcharge in 321.5 and 323.6, respectively, will receive the following additional services upon payment of the appropriate fees.**

<u>Service</u>	<u>Schedule</u>
a. <u>Bulk Insurance</u>	<u>943</u>
b. <u>Return receipt (merchandise only)</u>	<u>945</u>
c. <u>Delivery Confirmation</u>	<u>948</u>

Bulk insurance may not be used selectively for individual pieces in a multi-piece Standard Mail mailing unless specific methods approved by the Postal Service for determining and verifying postage are followed.

363[4] **Regular**

Regular subclass mail will receive the following additional services upon payment of the appropriate fees:

Service	Schedule
a. Mailing Online	981

365 **Nonprofit**

Nonprofit subclass mail will receive the following additional services upon payment of the appropriate fees:

Service	Schedule
a. Mailing Online (starting on a date to be specified by the Postal Service)	981

370 **RATES AND FEES**

The rates and fees for Standard Mail are set forth as follows:

	Schedule
a. Regular subclass	[321.2]
<u>Presort category</u>	<u>321A</u>
<u>Automation category</u>	<u>321B</u>
b. Enhanced Carrier Route subclass	322[1.3]
c. Nonprofit subclass	[321.4]
<u>Presort category</u>	<u>323A</u>
<u>Automation category</u>	<u>323B</u>
d. Nonprofit Enhanced Carrier Route subclass	324[1.5]
[e. Parcel Post subclass]	
[Inter-BMC	322.1A]
[Intra-BMC	322.1B]
[Destination BMC	322.1C]
[Destination SCF	322.1D]
[Destination Delivery Unit	322.1E]
[f. Bound Printed Matter subclass]	
[Single-Piece	322.2A]
[Bulk and Carrier Route	322.2B]
[g. Special subclass	323.1]
[h. Library subclass	323.2]
[i.] <u>e.</u> Fees	1000

380 **AUTHORIZATIONS AND LICENSES**

[381 **Regular, Enhanced Carrier Route, Nonprofit and Nonprofit Enhanced
Carrier Route Subclasses]**

[A] The mailing fee [as] set forth in Schedule 1000 must be paid once each year at each office of mailing or office of verification, as specified by the Postal Service, by or for mailers of [Regular, Enhanced Carrier Route, Nonprofit and Nonprofit Enhanced Carrier Route subclass] Standard [m]Mail. Payment of the fee allows the mailer to mail at any Standard Mail rate.

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 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] Outside County Periodicals, but are not eligible for preferred rate discounts. 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] Outside County Periodicals, but are not eligible for preferred rate discounts. 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] Outside County Subclass**

421.1 **Definition.** The [Regular] Outside County subclass consists of Periodicals class mail that is not mailed under section 423 and that:

- a. Is presorted, marked, and presented as specified by the Postal Service; and

- b. Meets machinability, addressing, and other preparation requirements specified by the Postal Service.

421.2 **[Regular] Outside County Pound Rates**

An unzoned pound rate applies to the nonadvertising portion of [Regular] Outside County 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] Outside County Piece Rates**

421.31 **Basic Rate Category.** The basic rate category applies to all [Regular] Outside County subclass mail not mailed under section 421.32, 421.33, or 421.34.

421.32 **Three-Digit City and Five-Digit Rate Category.** The three-digit rate category applies to [Regular] Outside County subclass mail presorted to single or multiple three-digit ZIP Code destinations as specified by the Postal Service.

421.33 **Five-Digit Rate Category.** The five-digit rate category applies to [Regular] Outside County 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] Outside County subclass mail presorted to carrier routes as specified by the Postal Service.

421.4 **[Regular] Outside County Subclass Discounts**

421.41 **Barcoded Letter Discounts.** Barcoded letter discounts apply to letter size [Regular] Outside County subclass mail mailed under sections 421.31, 421.32, and 421.33 which bears a barcode representing not more than 11 digits (not including "correction" digits) as specified by the Postal Service, and which meets the machinability, addressing, and barcoding specifications and other preparation requirements specified by the Postal Service.

421.42 **Barcoded Flats Discounts.** Barcoded flats discounts apply to flat size [Regular] Outside County subclass mail mailed under sections 421.31, 421.32, and 421.33 which bear a barcode representing not more than 11 digits (not including "correction" digits) as specified by the Postal Service,

and meet the flats machinability, addressing, and barcoding specifications and other preparation requirements specified by the Postal Service.

- 421.43 **High Density Discount.** The high density discount applies to [Regular] Outside County subclass mail mailed under section 421.34, presented in walk sequence order, and meeting the high density and preparation requirements specified by the Postal Service.
- 421.44 **Saturation Discount.** The saturation discount applies to [Regular] Outside County subclass mail mailed under section 421.34, presented in walk-sequence order, and meeting the saturation and preparation requirements specified by the Postal Service.
- 421.45 **Destination Entry Discounts.** Destination entry discounts apply to [Regular] Outside County 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] Outside County 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.
- 421.47 **Preferred Rate Discount.** Periodicals Mail qualifying as Nonprofit or Classroom mail under sections 422.2 and 422.3 is eligible for the Preferred rate discount set forth in Rate Schedule 421.
- 422 **Preferred Qualification Categories**
- 422.1 **Definition.** Preferred Qualification Outside County Subclass Periodicals consist of Periodicals Mail, other than publications qualifying as Requester Publications, that meets applicable requirements in sections 422.2, 422.3, or 422.4.
- 422.2 **Nonprofit**
- The Periodicals Outside County Subclass Nonprofit category consists of publications 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.

and the publications of the following types:

- 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, or
- 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.

422.3 **Classroom**

The Periodicals Outside County Subclass Classroom rate category consists of religious, educational, or scientific publications designed specifically for use in school classrooms or religious instruction classes.

422.4 **Science of Agriculture**

422.41 **Definition.** Science of Agriculture mail consists of 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.

- 422.42 **Rates.** Science of Agriculture mail is subject to pound rates, piece rates, and piece rate discounts (except for the discount set forth in section 421.47) for Outside County Subclass Periodicals Mail, except for DDU, DSCF and Zone 1 & 2 pound rates. Rates for Science of Agriculture are set forth in Rate Schedule 421.
- 422.43 **Nonadvertising Discount.** The nonadvertising discount for Outside County Subclass Periodicals Mail applies to Science of Agriculture Periodicals, 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.
- 422.44 **Destination Entry Discounts.** Destination entry discounts apply to Science of Agriculture 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 it is entered, as defined by the Postal Service. The DDU discount only applies to Carrier Route rate category mail.
- 423 **[Preferred Rate Periodicals] Within County Subclass**
- 423.1 **Reserved [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 **General [Within County Subclass]**
- 423.21 **Definition.** Within County mail consists of Periodicals class mail, other than publications qualifying as Requester Publications, [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 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.

423.23 Pound Rate. One pound rate applies to Within County pieces presorted to carrier routes to be delivered within the delivery area of the originating post office, and another pound rate applies to all other pieces.

[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.

- I. 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]3 **[Preferred Rate] Within County Piece Rates**

423.[71]31 **Basic Rate Category.** The basic rate category applies to [all Preferred Rate] Within County Periodicals not mailed under section 423.[7]32, 423.[7]33, or 423.[7]34.

423.[72]32 **Three-digit Rate Category.** The three-digit rate category applies to [Preferred Rate] Within County Periodicals [entered under sections 423.2, 423.3, 423.4, or 423.5] that are presorted to single or multiple three-digit ZIP Code destinations as specified by the Postal Service.

423.[73]33 **Five-Digit Rate Category.** The five-digit rate category applies to [Preferred Rate] Within County 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]34 **Carrier Route Rate Category.** The carrier route rate category applies to [Preferred Rate] Within County Periodicals presorted to carrier routes as specified by the Postal Service.

423.[8]4 **[Preferred Rate]Within County Discounts**

423.[8]41 **Barcoded Letter Discounts.** Barcoded letter discounts apply to letter size [Preferred Rate] Within County Periodicals mailed under sections 423.[7]31, 423.[7]32, and 423.[7]33 which bear a barcode representing not more than 11 digits (not including “correction” digits) as specified by the Postal Service, and which meet the machinability, addressing, and barcoding specifications and other preparation requirements specified by the Postal Service.

423.[8]42 **Barcoded Flats Discounts.** Barcoded flats discounts apply to flat size [Preferred Rate] Within County Periodicals mailed under sections 423.[7]31, 423.[7]32, and 423.[7]33 which bear a barcode representing not more than 11 digits (not including “correction” digits) as specified by the Postal Service, and meet the flats machinability, addressing, and barcoding specifications and other preparation requirements specified by the Postal Service.

423.[8]43 **High Density Discount.** The high density discount applies to [Preferred Rate] Within County Periodicals mailed under section 423.[7]34, presented in walk sequence order, and meeting the high density and preparation requirements specified by the Postal Service[, except that mailers of] Alternatively, 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.[8]44 **Saturation Discount.** The saturation discount applies to [Preferred Rate] Within County Periodicals mailed under section 423.[7]34, presented in walk sequence order, and meeting the saturation and preparation requirements specified by the Postal Service.

423.[8]45 **Destination Entry Discount[s].** A [D]destination delivery unit [entry] discount[s] applies[y] to [Preferred Rate] Within County [Periodicals] carrier route category mail which [are]is destined for delivery within [the service area of the destination sectional center facility (SCF) or] the destination delivery unit (DDU) in which [they are] it is 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.]

- [423.256 **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**

Periodicals Mail may not weigh more than 70 pounds or exceed 108 inches in length and girth combined. Additional size limitations apply to individual Periodicals rate categories. [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. [When the postage computed for a particular issue using the Nonprofit or Classroom rate schedule is higher than the postage computed using the Regular rate schedule, that issue is eligible to use the Regular rate schedule. For purposes of this section, the term issue is subject to certain exceptions related to separate mailings of a particular issue, as specified by the Postal Service.]

- 442 **Presortation.** Periodicals class mail must be presorted 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 (Regular, Enhanced Carrier Route, Nonprofit or Nonprofit Enhanced Carrier Route)] may be attached to or enclosed with Periodicals class mail. The piece must be marked as 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.

- 443.1a **“Ride-Along” Attachments and Enclosures.** A limit of one Standard Mail piece, not exceeding the weight of the host copy and weighing a maximum of 3.3 ounces, from any of the subclasses listed in section 321 (Regular,

Enhanced Carrier Route, Nonprofit or Nonprofit Enhanced Carrier Route) may be attached to or enclosed with an individual copy of Periodicals Mail for an additional postage payment of ten cents. Periodicals containing "Ride-Along" attachments or enclosures must maintain uniform thickness as specified by the Postal Service. The Periodicals piece with the "Ride-Along" must maintain the same shape and automation compatibility as it had before addition of the "Ride-Along" attachment or enclosure and meet other preparation requirements as specified by the Postal Service.

This provision expires on February 26, 2002.

443.2 **Incidental First-Class Mail Attachments and Enclosures.** First-Class Mail that meets one or more of the definitions in section 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 under 39 U.S.C. 3685.

446 **Enclosures and Supplements**

Periodicals class mail may contain enclosures and supplements as 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 specified by the Postal Service. Undeliverable-as-addressed combined First-Class and Periodicals class mail pieces will be forwarded or returned, as specified by the Postal Service. Additional charges when Periodicals class mail is returned will be based on the applicable First-Class Mail rate.

470 **RATES AND FEES**

The rates and fees for Periodicals class mail are set forth as follows:

	Schedule
a. [Regular] <u>Outside County</u>	421
b. Within County	423[.2]
[c. Nonprofit	423.3]
[d. Classroom	423.4]
[e.] <u>c.</u> Science of Agriculture	421
[f.] <u>d.</u> 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] Nonprofit, Classroom and Science of Agriculture Authorization**

Prior to entering [mailing at] Nonprofit, Classroom, and Science of Agriculture Periodicals Mail, [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 Schedule 1000.

PACKAGE SERVICES
CLASSIFICATION SCHEDULE

5[3]10 **DEFINITION**

5[3]11 **General**

Any mailable matter may be mailed as Package Services [Standard M]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.)

[3]12 **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.]

512[3]13] **Written Additions**

Package Services [Standard M]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.

5[3]20 DESCRIPTION OF SUBCLASSES

[322 Subclasses Limited to Mail Weighing 16 Ounces or More]

521[322.1] Parcel Post Subclass

521.[322.1]1**Definition.** The Parcel Post subclass consists of Package Services [Standard M]mail [weighing 16 ounces or more] that is not mailed under sections [322.3, 323.1, or 323.2] 522, 523, or 524.

521.[322.1]2**Description of Rate Categories**

521.[322.1]21**Inter-BMC Rate Category.** The inter-BMC rate category applies to all Parcel Post subclass mail not mailed under sections 521.22, 521.23, 521.24, or 521.25 [322.122, 322.123, 322.124, or 322.125].

521.[322.1]22**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.

521.[322.1]23**Parcel Select—Destination Bulk Mail Center (DBMC) Rate Category.** The Parcel Select—DBMC [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.

521.[322.1]24 Parcel Select—Destination Sectional Center Facility (DSCF) Rate

Category. The Parcel Select—DSCF [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.

521.[322.1]25 Parcel Select—Destination Delivery Unit (DDU) Rate Category. The Parcel Select—DDU [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.

521.[322.1]3 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.

521.[322.1]31 Barcode[d] Discount. The barcode[d] 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.

521.[322.1]4 Bulk Mail Center (BMC) Presort Discounts

521.[322.1]41 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.

521.[322.1]42 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.

521.[322.1]5 Barcode[d] Discount. The barcode[d] discount applies to Inter-BMC, Intra-BMC, and Parcel Select—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.

521.[322.1]6Oversize Parcel Post

521.[322.1]61Excessive 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.

521.[322.1]62Balloon 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.

521.[322.1]7Nonmachinable Surcharge. Inter-BMC, Intra-BMC, and Parcel Select—DBMC Parcel Post [subclass] mail that does not meet machinability criteria specified by the Postal Service is subject to a nonmachinable surcharge.

521.[322.1]8Pickup Service. Pickup service is available for Parcel Post subclass mail under terms and conditions specified by the Postal Service.

522[322.3] Bound Printed Matter Subclass

522.[322.3]1Definition. The Bound Printed Matter subclass consists of Package Services [Standard M]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;
- e. Is not stationery, such as pads of blank printed forms.

522.2 **Description of Rate Categories.**

522.[322.3]²¹**Single-Piece Rate Category.** The single-piece rate category applies to Bound Printed Matter subclass mail which is not mailed under section 522.3 [322.33] or 522.4 [322.34].

522.[322.33]²²**Basic Presort [Bulk] Rate Category.** The [bulk] basic presort rate category applies to Bound Printed Matter subclass mail prepared in a mailing of at least 300 pieces, prepared and presorted as specified by the Postal Service.

522.[322.34]²³**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 by the Postal Service.

522.24 **Destination Bulk Mail Center (DBMC) Rate Category.** The destination bulk mail center rate category applies to Basic Presort Rate or Carrier Route Presort Rate Bound Printed Matter subclass mail prepared as specified by the Postal Service in a mailing entered at a designated destination BMC, auxiliary service facility, or other equivalent facility, as specified by the Postal Service.

522.25 **Destination Sectional Center Facility (DSCF) Rate Category.** The destination sectional center facility rate category applies to Basic Presort Rate or Carrier Route Presort Rate Bound Printed Matter subclass mail prepared as specified by the Postal Service in a mailing 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.

522.26 **Destination Delivery Unit (DDU) Rate Category.** The destination delivery unit rate category applies to Basic Presort Rate or Carrier Route Presort Rate Bound Printed Matter subclass mail prepared as specified by the Postal Service in a mailing entered at a designated destination delivery unit, or other equivalent facility, as specified by the Postal Service.

522.[322.35]³**Barcode[d] Discount.** The barcoded discount applies to single-piece rate and [bulk] Basic Presort [r]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]

523[323.1] Media Mail [Special] Subclass

5[3]23.11 Definition. The Media Mail [Special] subclass consists of Package Services mail [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. These order forms 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 may contain as part of their format a single order form, which may also serve as a postcard. These order forms 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; and
- j. Computer-readable media containing prerecorded information and guides or scripts prepared solely for use with such media.

523.2 Description of Rate Categories.

5[3]23.[1]21 Single-Piece Rate Category. The single-piece rate category applies to Media Mail [Special subclass mail] not mailed under section 523.22 or 523.23 [323.13 or 323.14.] prepared as specified by the Postal Service.

5[3]23.[13]22 Level A Presort Rate Category. The Level A presort rate category applies to mailings of at least 500 pieces of Media Mail, [Special subclass mail,] prepared and presorted to five-digit destination ZIP Codes as specified by the Postal Service.

5[3]23.[14]23 Level B Presort Rate Category. The Level B presort rate category applies to mailing of at least 500 pieces of Media Mail, [Special subclass mail,] prepared and presorted to destination Bulk Mail Centers as specified by the Postal Service.

5[3]23.[15]3 Barcode[d] Discount. The barcode[d] discount applies to single-piece rate and Level B presort rate Media Mail [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.

524[323.2] Library Mail Subclass

524.[323.2]1 Definition

524[323.2]11 General. The Library Mail subclass consists of Package Services [Standard M]mail of the following types[, separated or presorted as specified by the Postal Service]:

- a. Matter designated in section 524.13 [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 section 524.[323.2]14, 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 section 524.[323.2]15, mailed from a publisher or a distributor to a school, college, university or public library.

524.[323.2]12 Definition of Nonprofit Organizations and Associations. Nonprofit organizations or associations are defined in section 1009.

524.[323.2]13 Library subclass mail under section 524.[323.2]11.a. Matter eligible for mailing as Library Mail [subclass mail] under subsection a of section [323.2]524.11 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.

524.[323.2]14 *Library Mail [subclass mail] under section 524.[323.2]11.b.* Matter eligible for mailing as Library [subclass m]Mail under subsection b of section 524.[323.2]11 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;
- e. Catalogs of the materials in subsections a through d of section 524.[323.2]14 and guides or scripts prepared solely for use with such materials.

524.[323.2]15 *Library [subclass m]Mail under section 524.[323.2]11.c.* Matter eligible for mailing as Library subclass mail under subsection c of section 524.[323.2]11 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.

524.2 Description of Rate Categories.

524.[323.2]21 **Single-Piece Rate Category.** The single-piece rate category applies to Library [subclass m]Mail not mailed under section [323.23 or 323.24]524.22 or 524.23 prepared as specified by the Postal Service.

524.[323.23]22 **Level A Presort Rate Category.** The Level A presort rate category applies to mailings of at least 500 pieces of Library [subclass m]Mail,

prepared and presorted to five-digit destination ZIP Codes as specified by the Postal Service.

524.[323.24]**23Level B Presort Rate Category.** The Level B presort rate category applies to mailings of at least 500 pieces of Library [subclass m]Mail, prepared and presorted to destination Bulk Mail Centers as specified by the Postal Service.

524.[323.25]**3Barcode[d] Discount.** The barcode[d] discount applies to Single-Piece Rate and Level B Presort Rate Library [subclass m]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.

5[3]30 **PHYSICAL LIMITATIONS**

5[3]31 **Size**

Except as provided in section 521.[322.1]61, Package Services [Standard M]mail may not exceed 108 inches in length and girth combined. Additional size limitations apply to individual Package Services [Standard M]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.]

5[3]32 **Weight**

Package Services [Standard M]mail may not weigh more than 70 pounds. Additional weight limitations apply to individual Package Services [Standard M]mail subclasses.

5[3]40 **POSTAGE AND PREPARATION**

5[3]41 **Postage**

Postage must be paid as set forth in section 3000. [When the postage computed at a 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.

5[3]42 Preparation

All pieces in a Package Services [Standard] mailing must be separately addressed. All pieces in a Package Services [Standard] mailing must be identified as specified by the Postal Service, and must contain the ZIP Code of the addressee when specified by the Postal Service. All Package Services [Standard] mailings must be prepared and presented as specified by the Postal Service. Two or more Package Services [Standard] mailings may be commingled and mailed only when specific methods approved by the Postal Service for determining and verifying postage are followed.

5[3]43 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 determining and verifying postage are followed.

5[3]44 Attachments and Enclosures

[344.2 Parcel Post, Bound Printed Matter, Special, and Library Subclasses]

544.1[344.21]General. First-Class Mail or Standard Mail [from any of the subclasses listed in section 321 (Regular, Enhanced Carrier Route, Nonprofit or Nonprofit Enhanced Carrier Route)] may be attached to or enclosed in Package Services [Standard M]mail [mailed under sections 322 and 323]. The piece must be marked as specified by the Postal Service. Except as provided in sections 544.2 and 544.3, [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 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.]

5[3]44.2[2] Specifically Authorized Attachments and Enclosures. Package Services [Standard M]mail [mailed under sections 322 and 323] may contain enclosures and attachments as specified by the Postal Service and as described in subsections a and e of section 523.1[323.11], with postage paid

on the combined piece at the Package Services [Standard] rate applicable to the host piece.

5[3]44.[2]3 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, may be attached to or enclosed with Package Services [Standard M]mail [mailed under section 322 or 323], with postage paid on the combined piece at the Package Services [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.

5[3]50 DEPOSIT AND DELIVERY

5[3]51 Deposit

Package Services [Standard M]mail must be deposited at places and times designated by the Postal Service.

5[3]52 Service

Package Services [Standard M]mail may receive deferred service.

5[3]53 Forwarding and Return

[353.2 Parcel Post, Bound Printed Matter, Special, and Library Subclasses]

Undeliverable-as-addressed Package Services [Standard M]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 Package Services [Standard M]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 by the Postal Service. When Package Services [Standard M]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 single-piece Package Services [Standard M]mail rate[under 322 or 323].

5[3]60 **ANCILLARY SERVICES**

[361 **All Subclasses]**

Package Services [All Standard M]mail will receive the following services upon payment of the appropriate fees:

	Service	Schedule
a.	Address correction	911
b.	Certificates of mailing indicating that a specified number of pieces have been mailed]	[947]

[Certificates of mailing are not available for Regular, Enhanced Carrier Route, Nonprofit and Nonprofit Enhanced Carrier Route subclass mail when postage is paid with permit imprint.]

[362 **Parcel Post, Bound Printed Matter, Special, and Library Subclasses]**

[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.]	<u>b.</u> Certificates of mailing	947
[b.]	<u>c.</u> COD	944
[c.]	<u>d.</u> Insurance	943
[d.]	<u>e.</u> Special handling	952
[e.]	<u>f.</u> Return receipt (merchandise only)	945
[f.]	<u>g.</u> Merchandise return	932
[g.]	<u>h.</u> Delivery Confirmation	948
i.	<u>Shipper Paid Forwarding</u>	<u>936</u>
j.	<u>Signature Confirmation</u>	<u>949</u>
k.	<u>Parcel Airlift</u>	<u>951</u>

Insurance, special handling, and COD services may not be used selectively for individual pieces in a multi-piece Package Services [Standard Mail] mailing unless specific methods approved by the Postal Service for determining and verifying postage are followed.

5[3]70 RATES AND FEES

The rates and fees for Package Services [Standard M]mail are set forth as follows:

	Schedule
[a. Regular subclass	321.2]
[b. Enhanced Carrier Route subclass	321.3]
[c. Nonprofit subclass	321.4]
[d. Nonprofit Enhanced Carrier Route subclass	321.5]
<u>a.[e. Parcel Post subclass</u>	
Inter-BMC	[322.1]522.2A
Intra-BMC	[322.1]522.2B
<u>Parcel Select</u>	
Destination BMC	[322.1]522.2C
Destination SCF	[322.1]522.2D
Destination Delivery Unit	[322.1]522.2E
<u>b.[f.] Bound Printed Matter subclass</u>	
Single-Piece	[322.3]522A
[Bulk] <u>Basic Presort</u> and Carrier Route	[322.3]522B
<u>Destination Entry Basic Presort</u>	522C
<u>Destination Entry Carrier Route Presort</u>	522D
<u>c.[g.] Media Mail</u> [Special] subclass	323.1
<u>d.[h.] Library Mail</u> subclass	323.2
<u>e.[i.] Fees</u>	1000

5[3]80 AUTHORIZATIONS AND LICENSES**[382 Special and Library Subclasses]**

[A presort mailing fee as set forth in Schedule 1000 must be paid once each year at each office of mailing by or for any person who mails presorted Special or Library subclass mail. Any person who engages a business concern or other individuals to mail presorted Special or Library subclass mail must pay the fee.]

581[383] Parcel Post Subclass

[A] The mailing fee [as] set forth in Schedule 1000 must be paid once each 12-month period [year] at each office of mailing or office of verification, as specified by the Postal Service, by or for mailers of any Parcel Select [Destination BMC, Destination SCF or Destination Delivery Unit] rate category mail in the Parcel Post subclass. Payment of the fee allows the mailer to mail at any Parcel Select rate.

582 Bound Printed Matter Subclass

The mailing fee set forth in Schedule 1000 must be paid once each 12-month period at each office of mailing or office of verification, as specified by the Postal Service, by or for mailers of Destination BMC, Destination SCF or Destination Delivery Unit rate category mail in the Bound Printed Matter subclass. Payment of the fee allows the mailer to mail at any destination entry Bound Printed Matter rate.

583 Media Mail Subclass

The mailing fee set forth in Schedule 1000 must be paid once each 12-month period at each office of mailing or office of verification, as specified by the Postal Service, by or for mailers of presorted Media Mail. Payment of the fee allows the mailer to mail at any presorted Media Mail rate.

584 Library Mail Subclass

The mailing fee set forth in Schedule 1000 must be paid once each 12-month period at each office of mailing or office of verification, as specified by the Postal Service, by or for mailers of presorted Library Mail. Payment of the fee allows the mailer to mail at any presorted Library Mail rate.

SPECIAL SERVICES CLASSIFICATION SCHEDULE

910 **ADDRESSING**

911 **ADDRESS CORRECTION SERVICE**

911.1 **Definition**

911.11 Address [c]Correction [s]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.]provides a mailer both an addressee's former and current address, if the correct address is known to the Postal Service. If the correct address is not known to the Postal Service, Address Correction Service provides the reason why the Postal Service could not deliver the mailpiece as addressed.

911.2 **[Description of Service]Availability**

911.21 Address [c]Correction service is available to mailers of postage prepaid mail of all classes[. Periodicals class mail will receive address correction service.], except for mail addressed for delivery by military personnel at any military installation. Address Correction Service is mandatory for Periodicals class mail.

[911.22 Address correction service is not available for items addressed for delivery by military personnel at any military installation.]

911.22 Automated Address Correction Service is available to mailers who can receive computerized address corrections and meet the requirements specified by the Postal Service.

[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 **Mailer Requirements [of the Mailer]**

911.31 Mail, other than Periodicals class mail, sent under this section must bear a request for [a]Address [c]Correction service.

911.4 **Other Services**

911.41 Address Correction Service serves as a prerequisite for Shipper Paid Forwarding.

911.[4]5 **Fees**

911.[41]51 [There is no charge for address correction service]The fees for Address Correction Service are set forth in Fee Schedule 911. These fees do not apply when the correction is provided incidental to the return of the mailpiece to the sender.

[911.42 A fee, as set forth in Fee Schedule 911, is charged for all other forms of address correction service.]

912 **MAILING LIST SERVICES**

912.1 **Definition**

912.11 Mailing [l]List services [include]enable an eligible mailer to obtain the following services:

- a. Correction of [m]Mailing [l]Lists;
- b. Change-of-[a]Address [i]Information for [e]Election [b]Boards and [r]Registration [c]Commissions;
- c. ZIP [c]Coding of [m]Mailing [l]Lists; and
- d. [Arrangement]Sequencing of [a]Address [c]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 Code addresses in areas served by multi-ZIP coded postal facilities.]

912.2 **Description of Services**

[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]

a. Correction of Mailing Lists. This service provides current information concerning name and address mailing lists or correct information concerning occupant mailing lists. New names will not be added to a name and address mailing list, and street address numbers will not be added or changed for an occupant mailing list.

[912.22 The following corrections will be made to name and address lists:]

(1) The Postal Service provides the following corrections to name and address lists:

[a.]i. deletion of [N]names to which mail cannot be delivered or forwarded [will be deleted];

[b.]ii. correction of [I]incorrect house, rural, or post office box numbers[will be corrected;] and

[c.]iii. furnishing of new addresses, including Zip Codes. [W]when permanent forwarding orders are on file for customers who have moved[,], new addresses including ZIP Codes will be furnished;]

This service does not include the addition of new names.

[d. New names will not be added to the list.]

[912.23 The following corrections will be made to occupant lists:]

(2) The Postal Service provides the following corrections to occupant lists:

[a.]i. deletion of [N]numbers representing incorrect or non-existent street addresses[will be deleted];

[b.]ii. identification of [B]business [or]addresses and rural route addresses [will be distinguished if], to the extent known; and

[c.]iii. grouping of [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.]

b. Change-of-Address Information for Election Boards and Registration Commissions. This service provides election boards and voter registration commissions with the current address of a resident addressee, if known to the Postal Service.

[912.26 ZIP coding or mailing list service provides that addresses will be sorted to the finest possible ZIP Code sortation.]

c. ZIP Coding of Mailing Lists. This service provides sortation of addresses to the finest possible ZIP Code level.

[912.27 Gummed labels, wrappers, envelopes, Stamped Cards, or 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.]

- d. Sequencing of Address Cards. This service provides for the removal of incorrect addresses, notation of missing addresses and addition of missing addresses.

912.3 **Requirements of Customer**

912.31 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.[31]32 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 specified by the Postal Service.

912.33 Gummed labels, wrappers, envelopes, Stamped Cards, or postcards indicative of one-time use will not be accepted as mailing lists.

912.4 **Fees**

912.41 The fees for [m]Mailing [l]List services are set forth in Fee Schedule 912.

920 **DELIVERY ALTERNATIVES**

921 **POST OFFICE BOX AND CALLER SERVICE**

[Editorial Note: The order of appearance of old section 921.1 Caller Service and old section 921.2 Post Office Box Service have been reversed.]

921.[2]1 **Post Office Box Service**

921.[21]11 **Definition**

921.[211]111 Post [o]Office [b]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.]specified by the Postal Service.

921.[22]12 **[Description of Service]Limitations**

921.[221]121 The Postal Service may limit the number of post office boxes occupied by any one customer.

[921.222 A post office 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, under existing regulations.]

921.[223]122 Post [o]Office [b]Box service [cannot be used when the sole purpose is, by subsequently filing change-of-address orders, to have mail forwarded or transferred to another address by the Postal Service free of charge.]is not available to a customer whose sole purpose for using this service is to obtain free forwarding or transfer of mail by filing change-of-address orders.

921.[23]13 **Fees**

921.[231]131 Fees for [p]Post [o]Office [b]Box service are set forth in Fee Schedule 921.

921.[232]132 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 semiannual fee
96 to 140 days	¾ semiannual fee
141 to 190 days	Full semiannual fee
191 to 230 days	1¼ semiannual fee
231 to 270 days	1½ semiannual fee
271 days to full year	[Full] <u>Twice semiannual fee</u>

921.[233]133 No refunds will be made for post office box fees paid under section 921.[232]132.[For purposes of this section, the full annual fee is twice the amount of the semi-annual fee.]

921.134 Two box keys are available upon payment of a refundable deposit, as specified by the Postal Service. Additional keys, including replacement keys, will be provided, as specified by the Postal Service, only upon payment of the key fee set forth in Fee Schedule 921. Changing the lock on a box is available upon request of the primary box customer and payment of the lock replacement fee set forth in Fee Schedule 921.

921.[1]2 **Caller Service**

921.[11]21 **Definition**

921.[111]211 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.]provides a means for receiving mail, and enables an eligible customer to have properly addressed mail delivered through a call window or loading dock.

921.[12]22 **Availability**[**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]221 Caller service is provided to customers at the discretion of the Postal Service, based on [the basis of]mail volume received and [number]capacity and utilization of post office boxes [used]at any one facility.

[921.124 A customer may reserve a caller number.]

921.[125]222 Caller service [cannot be used when the sole purpose is, by subsequently filing change-of-address orders, to have mail forwarded or transferred to another address by the Postal Service free of charge.]is not available to a customer whose sole purpose for using this service is to obtain free forwarding or transfer of mail by filing change-of-address orders.

921.[13]23 **Fees**

921.[131]231 Fees for [c]Caller service are set forth in Fee Schedule 921.

930 **PAYMENT ALTERNATIVES**

931 **BUSINESS REPLY MAIL**

931.1 **Definitions**

931.11 Business [r]Reply [m]Mail [is a service whereby business reply cards, envelopes, cartons and labels may be distributed by or for a business reply distributor for use]service enables a Business Reply Mail permit holder, or the permit holder's authorized representative, to distribute Business Reply Mail cards, envelopes, cartons and labels, which can then be used 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.]The permit holder guarantees payment on delivery of postage and fees for the Business Reply Mail pieces that are returned to the addressee, including any pieces that the addressee refuses.

[931.12 A business reply mail piece is nonletter-size for purposes of this section if it meets addressing and other preparation requirements, but does not meet the machinability requirements specified by the Postal Service for mechanized or automated letter sortation.]

[931.2 **Description of Service]**

[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]2 **Mailer Requirements[of the Mailer]**

931.[31]21 Business reply cards, envelopes, cartons and labels must [be preaddressed and bear business reply markings.]meet the addressing and preparation requirements specified by the Postal Service. Qualified Business Reply Mail must in addition meet the requirements presented in sections 221.24 or 222.34 for the First-Class Mail Qualified Business Reply Mail rate categories.

931.[32]22 [Handwriting, typewriting or handstamping are not acceptable methods of preaddressing or marking business reply cards, envelopes, cartons, or labels.]To qualify for the advance deposit account per piece fees, the customer must maintain sufficient money in an advance deposit account to cover postage and fees due for returned Business Reply Mail.

931.23 To qualify for the nonletter-size weight-averaging per piece and monthly fees set forth in Fee Schedule 931, the permit holder must be authorized for weight averaging, and receive Business Reply Mail pieces that meet the addressing and other preparation requirements specified by the Postal Service, but do not meet the machinability requirements specified by the Postal Service for mechanized or automation letter sortation.

931.3 **Other Services**

931.31 **Reserved**

931.4 **Fees**

931.41 The fees for [b]Business [r]Reply [m]Mail are set forth in Fee Schedule 931.

[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]42 [An accounting fee as set forth in Fee Schedule 931 must be paid each year for each advance deposit business reply account at each facility where the mail is to be returned.]The annual accounting fee set forth in Fee Schedule 1000 must be paid each year for each business reply advance deposit account at each facility where the mail is to be received.

[931.5 **Nonletter-Size Weight Averaging Fees**]

931.43 [A]The nonletter-size weight averaging monthly fee [as]set forth in Fee Schedule 931 must be paid each month during any part of which [the distributor's weight averaging account is active.]the permit holder is authorized to use the weight averaging fees.

931.[6]5 **Authorizations and Licenses**

931.[61]51 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 Fee Schedule [931]1000.

931.[62]52 Except as provided in section 931.[73]53, 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.[63]53 If the [b]Business [r]Reply [m]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 [b]Business [r]Reply [m]Mail.

931.[64]54 The license to mail [b]Business [r]Reply [m]Mail may be canceled for failure to pay business reply postage and fees when due, and for distributing business reply cards or envelopes that do not conform to prescribed form, style or size.

931.[65]55 Authorization to pay nonletter-size weight-averaging [b]Business [r]Reply [m]Mail fees as set forth in Fee Schedule 931 may be canceled for failure of a [b]Business [r]Reply [m]Mail advance deposit trust account holder to meet the standards specified by the Postal Service for the weight averaging accounting method.

932 **MERCHANDISE RETURN SERVICE**

932.1 **Definition**

932.11 Merchandise [r]Return service [provides a method whereby a shipper may]enables a Merchandise Return service permit holder to authorize its customers to return a parcel with the postage paid by the permit holder.~~[shipper. A shipper is the holder of a merchandise return permit.]~~

932.2 **[Description of Service]Availability**

932.21 Merchandise [r]Return service is available to all [shippers who obtain the necessary permit and]Merchandise Return service permit holders who guarantee payment of postage and fees for all returned parcels.

932.22 Merchandise [r]Return service is available for the return of any parcel under the following classification schedules:

- a. First-Class Mail
- b. Standard Mail
- c. Package Services

932.3 **Mailer Requirements[of the Mailer]**

932.31 Merchandise return labels must be prepared [at the shipper's expense to specifications set forth]as specified by the Postal Service, and be made available to the permit holder's customers.

[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:

Service	Fee Schedule
a. Certificate of [m] <u>M</u> ailing	947
b. Insurance	943
c. Registered [m] <u>M</u> ail	942
d. Special [h] <u>H</u> andling	952

[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 Fee Schedule 932. This fee is paid by the shipper.]The permit holder must pay the accounting fee specified in Fee Schedule 1000 once each 12-month period for each advance deposit account.

932.6 **Authorizations and Licenses**

932.61 A permit fee as set forth in Schedule 1000 must be paid once each [calendar year]12-month period by shippers utilizing [m]Merchandise [r]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]SERVICE**

933.1 **Definition**

933.11 On-[s]Site [m]Meter [setting or examination service is a service whereby the Postal Service will service a postage meter]service enables a mailer or meter manufacturer to obtain the following meter-related services from the Postal Service at the mailer's or meter manufacturer's premises[.]:

a. checking a meter in or out of service; and

b. setting or examining a meter.

933.2 **[Description of Service]Availability**

933.21 On-[s]Site [m]Meter [setting or examination]service is available on a scheduled basis, and meter setting may be 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 [o]On-[s]Site [m]Meter [setting or examination]service are set forth in Fee Schedule 933. The basic meter service fee is charged whenever a postal employee is available to provide a meter-related service in section 933.11 at the mailer's or meter manufacturer's premises, even if no particular service is provided.

934 **Reserved**

935 **BULK PARCEL RETURN SERVICE**

935.1 **Definition**

935.11 Bulk Parcel Return Service provides a method whereby high-volume parcel mailers may have machinable Standard Mail parcels returned to designated postal facilities for pickup by the mailer at a predetermined frequency specified by the Postal Service or delivered by the Postal Service in bulk in a manner and frequency specified by the Postal Service. Such parcels are being returned because they:

[(1)]a. are undeliverable-as-addressed;

[(2)]b. have been opened, resealed, and redeposited into the mail for return to the mailer using the return label described in section 935.36 below; or

[(3)]c. are found in the mailstream, having been opened, resealed, and redeposited by the recipient for return to the mailer, and it is impracticable or inefficient for the Postal Service to return the mailpiece to the recipient for payment of return postage.

935.2 **[Description of Service]Availability**

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 **Mailer 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 specified by the Postal Service.

935.35 Bulk Parcel Return Service mailers must meet the documentation and audit requirements of the Postal Service.

935.36 Mailers of parcels endorsed for Bulk Parcel Return Service may furnish the recipient a return label, prepared at the mailer's expense to specifications set forth by the Postal Service, to authorize return of opened, machinable parcels at the expense of the original mailer. There is no additional fee for use of the label.

935.4 **Other Services**

935.41 The following services may be purchased in conjunction with Bulk Parcel Return Service:

Service	Fee Schedule
a. Address Correction Service	911
b. Certificate of Mailing	947
c. Shipper-Paid Forwarding	936

935.5 **Fees**

935.51 The per return fee for Bulk Parcel Return Service is set forth in Fee Schedule 935.

935.52 The permit holder must pay the accounting fee specified in Fee Schedule 1000 once each 12-month period for each advance deposit account.

935.6 **Authorizations and Licenses**

935.61 A permit fee as set forth in Schedule 1000 must be paid once each [calendar year]12-month period 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, including distribution of return labels that do not conform to Postal Service specifications.

936 **SHIPPER-PAID FORWARDING**

936.1 **Definition**

936.11 Shipper-Paid Forwarding [provides a method whereby mailers may]enables mailers to have undeliverable-as-addressed machinable Standard Mail parcels forwarded at applicable First-Class Mail or Package Service 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[,]for a parcel that is returned, the mailer will pay the applicable First-Class Mail or Package Service mail rate, or the Bulk Parcel Return Service fee, if that service was elected.

936.2 **[Description of Service]Availability**

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.

936.22 Shipper-Paid Forwarding is available only if automated Address Correction Service, as described in section 911, is used.

936.3 **Mailer Requirements[of the Mailer]**

[936.31 Shipper-Paid Forwarding is available only in conjunction with automated Address Correction Service in section 911.]

936.[32]31 Mail for which Shipper-Paid Forwarding is purchased must meet the preparation requirements of the Postal Service.

936.[33]32 Payment for Shipper-Paid Forwarding is made through advance deposit account, or as otherwise specified by the Postal Service.

936.[34]33 Mail for which Shipper-Paid Forwarding is requested must bear endorsements specified by the Postal Service.

936.4 **Other Services**

936.41 The following services may be purchased in conjunction with Shipper-Paid Forwarding:

Service	Fee Schedule
a. Certificate of Mailing	947
b. Bulk Parcel Return Service	935

936.5 **Applicable Rates and Fees**

936.51 Except as provided in section 935, single-piece rates under the Letters and Sealed Parcels subclass or the Priority Mail subclass of First-Class Mail, or the Parcel Post subclass of Package Services, as set forth in Rate Schedules 221[and], 223, and 521.2A, apply to pieces forwarded or returned under this section.

936.52 The accounting fee specified in Fee Schedule 1000 must be paid once each 12-month period for each advance deposit account.

940 **ACCOUNTABILITY AND RECEIPTS**

941 **CERTIFIED MAIL**

941.1 **Definition**

941.11 Certified [m]Mail service [is a service that provides a mailing receipt to the sender and a record of delivery at the office of delivery.]provides a mailer with evidence of mailing, and guarantees retention of a record of delivery by the Postal Service for a period specified by the Postal Service.

941.2 **[Description of Service]Availability**

941.21 Certified [m]Mail service is [provided]available for matter mailed as First-Class Mail.

941.3 **Included Services**

941.[22]31 If requested by the mailer, the Postal Service will indicate the time of acceptance [by the Postal Service will be indicated]on the mailing receipt.

[941.23 A record of delivery is retained at the office of delivery for a specified period of time.]

941.[24]32 If the initial attempt to deliver the mail is not successful, a notice of 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]33 [Additional copies of the original mailing receipt may be obtained by the mailer.]A mailer may obtain a copy of the mailing receipt on terms specified by the Postal Service.

941.[3]4 **[Deposit of Mail]Mailer Requirements**

941.[31]41 Certified [m]Mail must be deposited in a manner specified by the Postal Service.

941.42 The mailer must mail the article at a post office, branch, or station, or give the article to a rural carrier, in order to obtain a mailing receipt.

941.[4]5 **Other Services**

941.[41]51 The following services may be obtained in conjunction with mail sent under this section upon payment of the applicable fees:

Service	Fee Schedule
a. Restricted Delivery	946
b. Return Receipt	945

941.[5]6 **Fees**

941.[51]61 The fee[s] for [c]Certified [m]Mail service [are]is set forth in Fee Schedule 941.

942 **REGISTERED MAIL**

942.1 **Definition**

942.11 Registered [m]Mail [is a]service [that] provides added protection to mail sent under this section and indemnity in case of loss or damage. The amount of indemnity depends upon the actual value of the article at the time of mailing, up to a maximum of \$25,000, and is not available for articles of no value.

942.2 **[Description of Service]Availability**

942.21 Registered [m]Mail service is available [to mailers of prepaid mail sent as]for prepaid First-Class Mail [except that registered mail must]of any value, if the mail meets the minimum requirements for length and width [regardless of thickness.]specified by the Postal Service.

[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 not available for articles of no value.]

[942.23 There is no limit on the value of articles sent under this section.]

942.[24]22 Registered [m]Mail service is not available for:

- a. All delivery points because of the high security required for [r]Registered [m]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.

942.3 **Included Services**

942.[25]31 The following services are provided as part of [r]Registered [m]Mail service at no additional cost to the mailer:

- a. A mailing receipt;
- b. A record of delivery, retained by the Postal Service for a specified period of time;
- c. A notice of attempted delivery, [will be]left at the mailing address if the initial delivery attempt is unsuccessful; and
- d. A notice of nondelivery, [W]when [r]Registered [m]Mail is undeliverable-as-addressed and cannot be forwarded[, a notice of nondelivery is provided].

942.32 Registered Mail is forwarded and returned without additional registry charge.

942.4 **Mailer Requirements**

942.41 Registered Mail must be deposited in a manner specified by the Postal Service.

[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]42 Indemnity claims for [r]Registered [m]Mail must be filed within a period of time, specified by the Postal Service, from the date the article was mailed. A claim concerning complete loss of registered articles may be filled by the mailer only. A claim concerning damage to or partial loss of registered articles may be filed by either the mailer or addressee.

[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]5 **Other Services**

942.[61]51 The following services may be obtained in conjunction with mail sent under this section upon payment of applicable fees:

Service	Fee Schedule
a. Collect on [d] <u>D</u> elivery	944
b. Restricted [d] <u>D</u> elivery	946
c. Return [r] <u>R</u> eceipt	945
d. Merchandise [r] <u>R</u> eturn (shippers only)	932

942.[7]6 **Fees**

942.[71]61 The fees for [r]Registered [m]Mail are set forth in Fee Schedule 942.

942.62 There are no additional Registered Mail fees for forwarding and return of Registered Mail.

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]Availability**

943.121 Express Mail Insurance is available only for Express Mail.

943.13 Limitations and Mailer Requirements

943.[122]131 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 Fee Schedule 943.]The maximum liability for merchandise is \$5,000 per piece. For negotiable items, currency, or bullion, the maximum liability is \$15.

943.[123]132 Indemnity claims for Express Mail must be filed within a specified period of time from the date the article was mailed.

943.[124]133 Indemnity will be paid under terms and conditions specified by the Postal Service.

943.[125]134 Among other limitations 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.

913.14 **Other Services**

943.141 Reserved

943.[13]15 Fees

943.[131]151 The fees for Express Mail Insurance service are set forth in Fee Schedule 943.

943.2 **General Insurance**

943.21 **[Retail Insurance]Definition**

943.211 [Retail]General Insurance [is a service that]provides the mailer with indemnity for loss of, rifling of, or damage to mailed items. General Insurance provides a bulk option for mail meeting the conditions described below and specified further by the Postal Service.

[943.212 The maximum liability of the Postal Service for Retail Insurance is \$5000.]

943.22 **Availability**

943.[213]221 [Retail]General Insurance is available for mail sent under the following classification schedules:

- a. First-Class Mail, if containing matter that may be mailed as Standard Mail or Package Services;
- b. [Parcel Post, Bound Printed Matter, Special, and Library subclasses of Standard Mail.]Package Services;
- c. Regular and Nonprofit subclasses of Standard Mail, for Bulk Insurance only, for mail subject to residual shape surcharge.

943.[214]222 [Retail]General 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.

943.223 The Bulk Insurance option of General 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.

943.23 **Included Services**

943.[215]231 For [Retail]General Insurance, the mailer is issued a receipt for each item mailed. For items insured for more than \$50, a [receipt]record of delivery is [obtained]retained by the Postal Service for a specified period.

943.[216]232 For items insured for more than \$50, a notice of attempted delivery is left at the mailing address when the first attempt at delivery is unsuccessful.

943.233 Mail undeliverable as addressed will be returned to the sender as specified by the sender or by the Postal Service.

[943.217 Retail insurance provides indemnity for the actual value of the article at the time of mailing.]

943.[22]24 **[Bulk Insurance]Limitations and Mailer Requirements**

943.241 Mail insured under section 943.2 must be deposited as specified by the Postal Service.

[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]242 Bulk Insurance must bear[s] endorsements and identifiers specified by the Postal Service. Bulk Insurance mailers must meet the documentation requirements of the Postal Service.

943.243 By insuring an item, the mailer guarantees forwarding and return postage.

943.[223]244 General Insurance, other than Bulk Insurance, provides indemnity for the actual value of the article at the time of mailing. 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]245 For [Retail Insurance,]General insurance, other than Bulk Insurance, a claim for complete loss may be filed by the mailer only, and 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 may be filed only by the purchaser of the insurance.]

943.[233]246 Indemnity claims must be filed within a specified period of time from the date the article was mailed.

[943.24 **Deposit of Mail]**

[943.241 Mail insured under section 943.2 must be deposited 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 will be returned to the sender as specified by the sender or by the Postal Service.]

943.[26]25 **Other Services**

943.[261]251 The following services, if applicable to the subclass of mail, may be obtained in conjunction with mail sent under this section upon payment of the applicable fees:

Service	Fee Schedule
a. Parcel Airlift	951
b. Restricted [d] <u>D</u> elivery (for items insured for more than \$50)	946
c. Return [r] <u>R</u> eceipt (for items insured for more than \$50)	945
d. Special [h] <u>H</u> andling	952
e. Merchandise [r] <u>R</u> eturn (shippers only)	932

943.[27]26 **Fees**

943.[271]261 The fees for General Insurance are set forth in Fee Schedule 943.

944 **COLLECT ON DELIVERY**

944.1 **Definition**

944.11 Collect on Delivery (COD) service [is a service that]allows a mailer to mail an article for which 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]Availability**

944.21 COD service is available for collection of [~~\$600~~]\$1,000 or less upon the delivery of postage prepaid mail sent under the following classification schedules:

- a. Express Mail
- b. First-Class Mail
- c. [Parcel Post,

Bound Printed Matter, Special, and

Library subclasses of Standard Mail]Package Services

944.22 Service under this 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~~]consists 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 have not been ordered by the addressee.

944.3 **Included Services**

944.[23]31 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]32 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]33 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 attempted delivery will be left at the mailing address.

944.[26]34 The mailer may receive a notice of nondelivery if the piece mailed is endorsed appropriately.

944.[27]35 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 Fee Schedule 944.

[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]4 **Limitations and Mailer Requirements[of the Mailer]**

944.[31]41 [COD mail must be identified as COD mail.]The mailer must identify COD mail as COD mail, as specified by the Postal Service.

[944.4 **Deposit of Mail]**

944.[41]42 COD mail must be deposited in a manner specified by the Postal Service.

[944.5 **Forwarding and Return]**

944.[51]43 A mailer of COD mail guarantees to pay any return postage, unless otherwise specified on the piece mailed.

944.[52]44 For COD mail sent as [Standard Mail]Package Services 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 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.

944.45 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.

944.46 COD indemnity claims must be filed within a specified period of time from the date the article was mailed, and meet the requirements specified by the Postal Service.

944.[6]5 **Other Services**

944.[61]51 The following services, if applicable to the subclass of mail, may be obtained in conjunction with mail sent under this section upon payment of the applicable fee:

Service	Fee Schedule
a. Registered [m]Mail, if sent as First-Class	942
b. Restricted [d]Delivery	946
c. Special [h]Handling	952

944.[7]6 **Fees**

944.[71]61 Fees for COD service are set forth in Fee Schedule 944.

945 **RETURN RECEIPT**

945.1 **Definition**

945.11 Return [r]Receipt service [is a service that]provides evidence to the mailer that an article has been received at the delivery address. 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. 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.

945.2 **[Description of Service]Availability**

945.21 Return [r]Receipt service is available for mail sent under the following sections or classification schedules:

	<u>Service</u>	<u>Fee Schedule</u>
a.	Certified [m]Mail	941
b.	COD [m]Mail	944
c.	Insurance (if insured for more than \$50)	943
d.	Registered [m]Mail	942
[e.]	Delivery Confirmation	948]
[f.]e.	Express Mail	
[g.]f.	Priority Mail (merchandise only)	
[h.]g.	Standard Mail (limited to [merchandise sent by Parcel Post, Bound Printed Matter, Special, and Library subclasses]) <u>merchandise subject to residual shape surcharge and sent by Regular and Nonprofit subclasses)</u>	
[i.]	<u>Package Services</u>	

945.22 Return [r]Receipt service is available at the time of mailing or, when purchased in conjunction with [c]Certified [m]Mail, COD, Insurance (if for more than \$50), [r]Registered [m]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.]

945.3 **Included Services**

945.[25]31 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.]evidence of delivery from the delivery record, at no additional fee.[No fee is charged for a duplicate return receipt.]

945.4 Other Services**945.41 Reserved****945.[3]5 Fees**

945.[31]51 The fees for [r]Return [r]Receipt service are set forth in Fee Schedule 945.

946 RESTRICTED DELIVERY**946.1 Definition**

946.11 Restricted [d]Delivery service [is a service that provides a means by which a mailer may direct that delivery will be made only]enables a mailer to direct the Postal Service to limit delivery to the addressee or to someone authorized by the addressee to receive such mail.

946.2 [Description of Service]Availability

946.21 This service is available for mail sent under the following sections:

<u>Service</u>	<u>Fee Schedule</u>
a. Certified Mail	941
b. COD Mail	944
c. Insurance (if insured for more than \$50)	943
d. Registered Mail	942

946.22 Restricted [d]Delivery is available to the mailer at the time of mailing or after mailing.

946.23 Restricted [d]Delivery service is available for delivery only to natural persons specified by name.

946.3 Included Services

946.[24]31 A record of delivery will be retained by the Postal Service for a period specified [period of time]by the Postal Service.

[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.]

946.4 **Other Services**

946.41 **Reserved**

946.[3]5 **Fees**

946.[31]51 The fee[s] for [r]Restricted [d]Delivery service [are]is set forth in Fee Schedule 946.

946.52 The fee (or communications charges) will not be refunded for failure to provide restricted delivery service when requested after mailing, due to prior delivery.

947 **CERTIFICATE OF MAILING**

947.1 **Definition**

947.11 Certificate of [m]Mailing service [is a service that furnishes evidence of]furnishes evidence that mail has been presented to the Postal Service for mailing.

947.2 **[Description of Service]Availability**

947.21 Certificate of [m]Mailing service is available [to mailers of matter sent under the classification schedule to]for matter sent using 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 **Included Service**

947.31 The mailer may obtain a copy of a Certificate of Mailing on terms specified by the Postal Service.

947.4 **Limitations**

947.31 The service does not entail retention of a record of mailing by the Postal Service and does not provide evidence of delivery.

947.[3]5 **Other Services**

947.[31]51 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	Fee Schedule
a. Parcel [a]Airlift	951
b. Special [h]Handling	952

947.[4]6 **Fees**

947.[41]61 The fees for [c]Certificate of [m]Mailing service are set forth in Fee Schedule 947.

948 **DELIVERY CONFIRMATION**

948.1 **Definition**

948.11 Delivery [c]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]Availability**

948.21 Delivery [c]Confirmation service is available for Priority Mail and [the Parcel Post, Bound Printed Matter, Special and Library subclasses of Standard Mail.]Package Services mail, as well as mail subject to the residual shape surcharge in the Regular and Nonprofit subclasses of Standard Mail.

948.3 **Mailer Requirements**

948.[22]31 Delivery [c]Confirmation service may be requested only at the time of mailing.

948.[23]32 Mail for which [d]Delivery [c]Confirmation service is requested must meet preparation requirements [established]specified by the Postal Service, and bear a Delivery Confirmation barcode specified by the Postal Service.

948.[24]33 Matter for which [d]Delivery [c]Confirmation service is requested must be deposited in a manner specified by the Postal Service.

948.4 **Other Services**

948.41 **Reserved**

948.[3]5 **Fees**

948.[31]51 The fees for Delivery [c]Confirmation service [is subject to the fees]are set forth in Fee Schedule 948.

949 **SIGNATURE CONFIRMATION**

949.1 **Definition**

949.11 Signature Confirmation service provides electronic confirmation to the mailer that an article was delivered or that a delivery attempt was made, and a copy of the signature of the recipient.

949.2 **Availability**

949.21 Signature Confirmation is available for Priority Mail and Package Services mail.

949.3 **Mailer Requirements**

949.31 Signature Confirmation service may be requested only at the time of mailing.

949.32 Mail for which Signature Confirmation service is requested must meet preparation requirements specified by the Postal Service, and bear a Delivery Confirmation barcode specified by the Postal Service.

949.33 Matter for which Signature Confirmation is requested must be deposited in a manner specified by the Postal Service.

949.4 **Other Services**

949.41 **Reserved**

949.5 **Fees**

949.51 The fees for Signature Confirmation service are set forth in Fee Schedule 949.

950 **PARCEL HANDLING**

951 **PARCEL AIRLIFT (PAL)**

951.1 **Definition**

951.11 Parcel [a]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]Availability**

951.21 Parcel [a]Airlift service is available for mail sent under the Standard Mail Classification Schedule.

951.3 **[Physical Limitations]Mailer Requirements**

951.31 The minimum physical limitations established for the mail sent under the classification schedule for which postage is paid apply to [p]Parcel [a]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]32 Mail sent under this section must be endorsed as specified by the Postal Service.

[951.5 **Deposit of Mail]**

951.[51]33 [PAL]Parcel Airlift mail must be deposited in a manner specified by the Postal Service.

951.[6]4 **Forwarding and Return**

951.[61]41 [PAL]Parcel Airlift 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]Parcel Airlift mail sent for delivery within the contiguous 48 states is forwarded or returned as set forth in section 353 as appropriate.

951.[7]5 **Other Services**

951.[71]51 The following services, if applicable to the subclass of mail, may be obtained in conjunction with mail sent under this section upon payment of the applicable fees:

Service	Fee Schedule
a. Certificate of [m]Mailing	947
b. Insurance	943
c. Restricted [d]Delivery (if insured for more than \$50)	946
d. Return [r]Receipt (if insured for more than \$50)	945
e. Special [h]Handling	952

951.[8]6 **Fees**

951.[81]61 The fees for [p]Parcel [a]Airlift service are set forth in Fee Schedule 951.

952 SPECIAL HANDLING

952.1 **Definition**

952.11 Special [h]Handling service [is a service that]provides preferential handling to the extent practicable during dispatch and transportation.

952.2 **[Description of Service]Availability**

952.21 Special [h]Handling service is available for mail sent under the following classification schedules:

a. First-Class Mail

b. [Parcel Post,

Bound Printed Matter,

Special, and Library subclasses of Standard Mail]

Package Services

[952.22 Special handling service is mandatory for matter that requires special attention in handling, transportation and delivery.]

952.3 **Mailer Requirements**[of the Mailer]

952.31 Mail sent under this section must be identified as specified by the Postal Service.

[952.4 **Deposit of Mail**]

952.[41]32 Mail sent under this section must be deposited in a manner specified by the Postal Service.

952.33 Special Handling service is mandatory for matter that requires special attention in handling, transportation and delivery.

952.[5]4 **Forwarding and Return**

952.[51]41 If undeliverable as addressed, [s]Special [h]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]5 **Other Services**

952.[61]51 The following services, if applicable to the subclass of mail, may be obtained in conjunction with mail sent under this section upon payment of the applicable fees:

Service	Fee Schedule
a. COD [m] <u>M</u> ail	944
b. Insurance	943
c. Parcel [a] <u>A</u> irlift	951
d. Merchandise [r] <u>R</u> eturn (shippers only)	932

952.[7]6 **Fees**

952.[71]61 The fees for [s]Special [h]Handling service are set forth in Fee Schedule 952.

960 **STAMPED PAPER**

961 **STAMPED ENVELOPES**

961.1 **Definition**

961.11 Plain [s]Stamped [e]Envelopes and printed [s]Stamped [e]Envelopes are envelopes with postage thereon offered for sale by the Postal Service.

961.2 **[Description of Service]Availability**

961.21 Stamped [e]Envelopes are available for:

- a. First-Class Mail within the first rate increment.
- b. Standard Mail mailed at a minimum per piece rate as specified by the Postal Service.

961.22 Printed [s]Stamped [e]Envelopes may be obtained by special request.

961.3 **Fees**

961.31 The fees for [s]Stamped [e]Envelopes are set forth in Fee Schedule 961.

962 **STAMPED CARDS**

962.1 **Definition**

962.11 **[Stamped Cards.]** Stamped Cards are cards with postage imprinted or impressed on them[and], 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 **Availability**

962.[2]21 **[Description of Service.]** Stamped Cards are available for First-Class Mail.

962.3 Fees

962.[3]31 **[Fees.]** The fees for Stamped Cards are set forth in Fee Schedule 962.

970 POSTAL MONEY ORDERS**971 [DOMESTIC POSTAL]MONEY ORDER[S]SERVICE****971.1 Definition**

971.11 Money [o]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]Limitations

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 by law or under regulations prescribed by the Postal Service.

971.3 Included Services

971.[22]31 A receipt of purchase is provided at no additional cost.

971.[23]32 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]33 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]34 Inquiries or claims may be filed by the purchaser, payee, or endorsee.

971.4 Other Services**971.41 Reserved****971.[3]5 Fees**

971.[31]51 The fees for [domestic postal m]Money [o]Order[s] service are set forth in Fee Schedule 971.

980 **ACCEPTANCE ALTERNATIVES**

981 **MAILING ONLINE**

981.1 **Definition**

Mailing Online is a service that allows mailers to submit electronic documents, with address lists, for subsequent conversion into hard copy form, entry as mail, and delivery.

981.2 **Availability**

981.21 Mailing Online is available for documents submitted in an electronic form, along with an address list, to be entered under the following classification schedules:

- a. Express Mail;
- b. First-Class Mail;
- c. Regular and Nonprofit subclasses of Standard Mail.

981.22 Except as provided in section 981.23, documents presented through Mailing Online are eligible for only the following rate categories:

- a. Express Mail Next Day Service and Second Day Service
- b. First-Class Mail Letters and Sealed Parcels Automation Letters Basic
- c. First-Class Mail Letters and Sealed Parcels Automation Flats Basic
- d. First-Class Mail Cards Automation Basic
- e. First-Class Mail Single-Piece Priority Mail
- f. Standard Mail Regular Automation Basic Letters
- g. Standard Mail Regular Automation Basic Flats
- h. Standard Mail Nonprofit Automation Basic (starting on a date to be specified by the Postal Service)

- i. Standard Mail Nonprofit Automation Basic Flats (starting on a date to be specified by the Postal Service)

981.23 That portion of a Mailing Online mailing consisting of pieces with addresses that cannot be made to meet Postal Service addressing requirements is not eligible for any Automation Basic rate categories, but instead may be sent, at the option of the Mailing Online customer, at the applicable single-piece rates for First-Class Mail Letters and Sealed Parcels, First-Class Mail Cards, or Priority Mail.

981.3 **Mailer Requirements[of the Mailer]**

981.31 Documents and address lists must be presented in electronic form, as specified by the Postal Service, through the Internet site specified by the Postal Service. Documents must be prepared using application software approved by the Postal Service.

981.4 **Other Special Services**

Other special services that are available in conjunction with the subclass of mail chosen by the Mailing Online customer are available for Mailing Online pieces only as specified by the Postal Service.

981.5 **Fees**

981.51 The fees for Mailing Online are described in Fee Schedule 981.

981.6 **Functionally Equivalent Systems**

981.61 **General.** Mailpieces created by a system certified by the Postal Service to be functionally equivalent to Mailing Online are eligible for the same rate categories as Mailing Online mailpieces. Mailpieces created by a certified, functionally equivalent service are in no case eligible for rate categories providing larger discount than Mailing Online mailpieces would receive.

981.62 **Definition.** A functionally equivalent system is one which is capable of all of the following, comparable to Mailing Online, as specified by the Postal Service:

- a. accepting documents and mailing lists from remote users in electronic form, such as via the Internet or converting documents and mailing lists to electronic form;

- b. using the electronic documents, mailing lists, and other software including sortation software certified by the Postal Service that sorts to the finest level of sortation possible, to create barcoded mailpieces meeting the requirements for automation category mail, with 100 percent standardized addresses on all pieces claiming discounted rates;
- c. commingling mailpieces from all sources without diversion to any other system and batching them according to geographic destination prior to printing and mailing; and
- d. generating volumes that exceed on average any otherwise applicable volume minimums.

981.63 **Certification**

981.631 **General.** Functionally equivalent systems must meet the requirements for certification specified by the Postal Service.

981.632 **Fee.** Functionally equivalent systems are subject to the annual certification fee set forth in Fee Schedule 1000.

981.633 **Cancellation.** Certification can be cancelled by the Postal Service for failure to continue to meet the requirements of this section and those specified by the Postal Service.

981.7 **Duration of Experimental Service Period**

981.71 The provisions of section 981 expire the later of:

- a. three years after the implementation date specified by the Postal Service Board of Governors, or
- b. if, by the expiration date specified in (a), a proposal to make Mailing Online permanent is pending before the Postal Rate Commission, the later of:
 - 1. three months after the Commission takes action on such proposal under section 3624 of Title 39, or
 - 2. —if applicable—on the implementation date for a permanent Mailing Online.

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 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 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 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 that meets all 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 Fee Schedule 921.
- b. Carrier delivery service.
- c. General delivery.
- d. Post office box service. The fees for post office box service are set forth in Fee Schedule 921.

2020 **Conditions of Delivery**

2021 **General.** Except as provided in section 2022, 2030, and 3030, 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 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 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 mailpiece. All post offices will honor 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, 450, 550, 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 that is neither readily water soluble nor 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 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 with postage meter indicia, adhesive stamps, [or] permit imprint, or other payment methods [unless otherwise limited or] specified by the Postal Service. [The following methods of paying postage and fees require p]Prior authorization for use of certain payment methods may be required, as specified by [from] the Postal Service[:]. A fee is charged for authorization to use a permit imprint, as set forth in Schedule 1000.

- [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 Schedule 1000. No fee is charged for authorization to use a postage meter. Fees for setting postage meters are set forth in Fee Schedule 933. No fee is charged for authorization to use precanceled stamps, precanceled envelopes or mailer's precanceled postmark.]

3050 Reserved**3060 Special Service Fees**

Fees for special services may be prepaid in any manner appropriate for the class of mail indicated or as otherwise 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 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 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 armed 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 that is mailed at or addressed to an Armed Forces post office and is transported directly to or from 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 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 inch[es] 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,] 33Q [and]430, 521.6, and 530. 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

AADC	Automated Area Distribution Center
ACSS	Air Contract Support System
ADC	Area Distribution Center
AFCM	Advanced Facer Cancellor Machine
AFCS	Advance Facer Cancellor System
AFSM	Automated Flat Sorting Machine
AMC	Airport Mail Center
AMS	Address Management System
AO	Associate Offices
AR	Actual Rate
ASF	Auxiliary Service Facility
BAM	Business and Mixed
BARM	Bulk Automated Reply Mail
BCR	Barcode Reader
BCS	Barcode Sorters
BMC	Bulk Mail Center
BMEU	Business Mail Entry Unit
BMM	Bulk Metered Mail
BPM	Bound Printed Matter
BPRS	Bulk Parcel Return Service

BRM	Business Reply Mail
BRMAS	Business Reply Mail Accounting System
CAG	Cost Ascertainment Group
CAP	Capital
CAT/FAT	Curblin and Foot Access Test
CBCIS	Corporate Business Customer Information System
CBD	Central Business District
CCS	Carrier Cost System
CEM	Courtesy Envelope Mail
CFS	Computerized Forwarding System
C.O.D.	Collect on Delivery
COLA	Cost of Living Adjustment
CPI-W	Consumer Price Index-Urban Wage Earners and Clerical Workers
CPP	Centralized Postage Payment
CRA	Cost and Revenue Analysis
CRM	Courtesy Reply Mail
CSBCS	Carrier Sequence Bar Code Sorters
DBCS	Delivery Bar Code Sorters
DBMC	Destination Bulk Mail Center
DDU	Destination Delivery Unit
DMCS	Domestic Mail Classification Schedule
DMM	Domestic Mail Manual
DPS	Delivery Point Sequencing

DSCF	Destination Sectional Center Facility
ECP	Efficient Component Pricing
ECR	Enhanced Carrier Route
ECSI	Educational, Cultural, Scientific and Informational
EOR	End of Run
ES	Engineering Standards
EXFC	External First-Class Measurement System
FASB	Financial Accounting Standards Board
FERS	Federal Employees Retirement System
FGLS	Feasible Generalized Least Squares
FHP	First Handling Pieces
FIM	Facing Identification Mark
FSM	Flat Sorting Machine
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GFY	Government Fiscal Year
HCSS	Highway Contract Support System
HDS	Household Diary Study
HMM	Hazardous Medical Materials
HRS	Hours
IBI	Information Based Indicia
IBIP	Information Based Indicia Program
IMHS	Integrated Mail Handling System

IOCS	In-Office Cost System
IPPS	Irregular Parcels and Pieces
LDC	Labor Distribution Code
LIOCATT	In-Office Cost Attributable (computer program written by the Postal Service)
LIPS	Linear Integrated Parcel Sorters
LMLM	Letter Mail Labeling Machines
LOT	Line of Travel
LSM	Letter Sorting Machine
LTV	Load Time Variability
MBPCS	Mail Processing Bar Code Sorters
MDCD	Mobile Data Collection Device
MDR	Multiple Delivery Residential
MLOCR	Multi Line Optical Character Reader
MLOCR-ISS	Multi Line Optical Character Reader Input Sub System
MODS	Management Operating Data System
MPLSM	Multi-Position Letter Sorting Machine
MSA	Metropolitan Statistical Area
MTAC	Mailers Technical Advisory Committee
MTEC	Mail Transportation Equipment Centers
NASS	National Air and Surface System
NCOA	National Change of Address
NECR	Nonprofit Enhanced Carrier Route
NMC	National Mail Count

NMO	Nonmachinable outside
OBMC	Origin BMC
OBRA	Omnibus Budget Reconciliation Act
OCR	Optical Character Reader
OCS	In-Office Cost System
ODIS	Origin-Destination Information System
OHM	Other Hazardous Materials
OHMM	Other Hazardous Medical Materials
OLS	Ordinary Least Squares
OPM	Office of Personnel Management
OTR	Over-the-road
PERMIT	Permit Imprint
PETE	Priority-End-to-End
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
POB	Post Office Box
PPH	Piece Per Hour
PRA	Postal Reorganization Act
PRM	Prepaid Reply Mail
PSM	Parcel Sorting Machine

PVDS	Plant-verified Drop Shipment
PYL	Prior Years' Losses
QBRM	Qualified Business Reply Mail
RAF	Revenue Adjustment Factor
RBCS	Remote Bar Code Sorter
RCCS	Rural Carrier Cost System
RCR	Remote Computer Read
REC	Remote Encoding Center
RFRA	Revenue Foregone Reform Act
RPW	Revenue, Pieces and Weight
RPYL	Recovery of Prior Years' Losses
RR	Recommended Rate
RTS	Return-to-Sender
SCF	Sectional Center Facility
SCM	Special Counting Machines
SDR	Single Delivery Residential
SPBS	Small Parcel and Bundle Sorter
SPLY	Same Period Last Year
SS	Sector Segment
STS	Street Time Sampling
TMR	TMR Services
TPF	Total Pieces Fed
TPH	Total Piece Handlings

TRACS	Transportation Cost System
TY	Test Year
TYAR	Test Year After Rates
TYBR	Test Year Before Rates
UAA	Undeliverable-as-addressed
VBL	Computer program filename used by the U. S. Postal Service
VSD	Vehicle Service Driver

