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OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2001

Docket No. R2001-1

DIRECT TESTIMONY
OF
DON M. SPATOLA
ON BEHALF OF THE
UNITED STATES POSTAL SERVICE

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1 **Autobiographical Sketch**

2 My name is Don M. Spatola. My Postal Service career began in Brooklyn
 3 as a Distribution Clerk in November 1970. During the past thirty-one years, I
 4 have held various staff and management positions in Mail Processing and
 5 Network Operations. Examples include:

Position Title	Facility
➤ Postal Source Data System Technician	Brooklyn
➤ Management Associate	Washington, DC
➤ Delivery Programs Analyst	Northeast Region
➤ Manager, Quality Control	New York
➤ Manager, Retail & Sales	New York
➤ Manager, Customer Services	Bronx
➤ Field Director, Operations Support	Miami Field Division
➤ Director, City Operations	Miami Field Division
➤ Regional Director, Operations Support	Chicago Regional Office
➤ Area Manager, Processing & Distribution	Southeast Area
➤ Postmaster	Orlando Post Office
➤ Manager, Processing and Distribution Center	Orlando Processing and Distribution Center
➤ Manager, Priority Mail Processing Center Implementation	Network Operations Management, Postal Headquarters
➤ Manager, Shared Networks	Network Operations Management, Postal Headquarters

1 In my current position as Manager, Shared Networks, my group has
2 responsibility for implementing and managing the approximately \$7 billion
3 transportation agreement with Federal Express Corporation.

1 **I. Purpose and Scope of Testimony**

2

3 The purpose of my testimony is to describe the operation of the new
4 Shared Products Networks. On January 10, 2001, the United States Postal
5 Service and Federal Express Corporation (FedEx) signed an historic
6 transportation agreement. Under this contract, which was implemented on
7 August 27, 2001, FedEx agreed to share its transportation capacity with the
8 Postal Service. FedEx will provide daytime transportation, the day-turn, and
9 overnight transportation, the night-turn. The USPS-FedEx Shared Products
10 Networks replace virtually all of the Postal Service's existing dedicated air
11 operations including the Eagle Network, the Western Network (or WNET), and all
12 daytime dedicated airlift.

13 There are no workpapers or library references associated with my
14 testimony.

1 **II. Overall Objectives of the Shared Networks**

2

3 There are a number of objectives that the Shared Products Networks will
4 achieve. First, the networks will provide transportation service at a cost lower
5 than that of the previous dedicated air networks. Although my testimony does
6 not deal with the financial specifics, it is my understanding that the Shared
7 Products Networks will reduce Postal Service air transportation expenses over
8 the seven-year course of the contract.

9 Second, since the terms of the contract are, in many respects, relatively
10 simple and straightforward, the cost of the Shared Products Networks is
11 expected to be more predictable. For example, unlike previous, dedicated air
12 contracts, the U. S. Postal Service-FedEx Transportation Agreement does not
13 allow for routine passthrough of expenses. Under our old dedicated air
14 contracts, these passthrough expenses included such diverse items as deicing
15 operations and spraying aircraft for Japanese beetles. More importantly, large
16 expenses such as painting of aircraft and installation of noise reduction
17 technology (also known as hush kits) were borne by the Postal Service as
18 passthroughs. Many of these passthrough expenses had the potential to grow
19 dramatically in the near future, because the cost of maintaining, modifying, and
20 replacing aircraft would have escalated due to the advanced age of the Postal
21 Service dedicated contract air fleet.

22 Third, the Postal Service-FedEx Transportation Agreement and its costs
23 are expected to be more stable in the sense that, unlike dedicated air providers

1 in the recent past, FedEx will not be reliant on the Postal Service for the
2 preponderance of its financial health. Also, the contract contains very specific
3 volume and cost escalation factors, which lend an element of predictability to
4 operations and expenses.

5 Fourth, the Shared Products Networks increased the reach previously
6 provided by dedicated airlift to more markets than ever before. This allows the
7 Postal Service to offer reliable, economic service to the majority of the mailing
8 public.

9 Fifth, service on the Shared Products Networks is expected to be more
10 reliable and consistent. For most of the year, the contract requires a high level of
11 performance, beyond the level experienced in the past. Even though FedEx has
12 a reputation for operational excellence, the Postal Service-FedEx Transportation
13 Agreement contains service requirements designed to give FedEx added
14 incentive to provide outstanding service.

15 Sixth, the Postal Service-FedEx Transportation Agreement will be
16 supported by FedEx's outstanding information technology. All handling units
17 (e.g., air containers, loose outsides, sacks) will be scanned repeatedly from
18 acceptance by FedEx to delivery back to the Postal Service. This capability will
19 allow the Postal Service and FedEx to quickly diagnose and correct any
20 operational problems. Postal Service logistics management is placing increasing
21 emphasis on using quantitative analysis to improve decision making. The
22 Shared Products Networks are leading the way in providing a blueprint for
23 refined data-based decision making.

1 Seventh, in order to use FedEx assets efficiently, the Postal Service will
2 enhance its analytical planning capabilities. Forecasted volumes by origin are
3 required to make sure that space is used efficiently, that minimum volumes are
4 met, and that customers' needs are taken into account. This improved
5 quantitative approach to logistics management is expected to have positive
6 effects on other Postal Service transportation operations.

7 **III. Night-Turn Operations**

8
9 Under the terms of the contract, FedEx basically has agreed to transport,
10 and the Postal Service has agreed to provide, an average daily network-wide
11 minimum volume of 250,000 pounds of mail, five nights per week, 52 weeks per
12 year. For each origin on the night-turn, the Postal Service will provide volume
13 targets, based on a mutually agreeable operating plan. Actual Postal Service
14 volumes can exceed these targets by up to 20 percent for any origin on any
15 night. Beyond this "daily flex" amount, FedEx may accept additional volumes, so
16 long as the Postal Service can provide FedEx with sufficient advance notice (four
17 hours) to meet its needs. If, for example, a Postal Service customer plans to
18 conduct an exceptionally large mailing, once notified, the Postal Service will
19 notify FedEx of its need for additional capacity beyond the contract maximum. If
20 FedEx can handle the surge, the volumes will be moved on the overnight
21 network. All volumes moved on the night-turn are charged the same rates. If,
22 for some reason, the Postal Service does not provide an average daily volume
23 equivalent to 250,000 pounds, a monthly supplemental payment must be made

1 to FedEx. We expect that reconciliation payments, if any, will be infrequent and
2 insignificant.

3 The Postal Service pays FedEx for air transportation based on two types
4 of charges: a non-fuel transport charge and a fuel charge. These charges are
5 based on the pounds of mail accepted by FedEx. The Postal Service can avoid
6 these weight-based charges as well as handlings at the FedEx hub by preparing
7 air containers that bypass the FedEx sort. Payments for transport of these
8 bypass containers are based on cubic capacity, i.e., the size of the container.
9 However, because Postal Service night-turn volumes between markets are
10 relatively low, it is expected that most volume will be in working containers,
11 incurring sorts at the hub. Regardless of whether the night-turn mail is in working
12 or bypass containers, there is no distance element to night-turn charges.

13 Unlike the Eagle and WNET networks, the Postal Service is not
14 purchasing entire aircraft. Rather, the Postal Service is buying space on FedEx's
15 overnight network based on an operating plan jointly developed by FedEx and
16 the Postal Service. Under this plan, the Postal Service provides its average daily
17 volume estimates by origin city 148 days in advance. The plan is updated six
18 times per year. Each year the minimum average daily volume increases by an
19 amount stipulated in the contract.

20 Each night, Postal Service employees sort mail to the FedEx night-turn by
21 affixing a distribution and routing (D & R) tag to all handling units¹ and air
22 containers. Night-turn volumes are tendered to FedEx on their ramp at

¹ According to the contract, a handling unit is defined as an air container, mailbag, tub, tray, or outside that is individually processed by FedEx. See USPS Library Reference J-97 at 5.

1 originating airports. The Postal Service does not employ contractors to provide
2 terminal handling services on the night-turn. FedEx uses scans of D & R tags to
3 track all mail in their possession and to sort items at their hubs. These D & R
4 scans provide valuable management information to both the Postal Service and
5 FedEx and form the basis for all charges under the night-turn part of the
6 contract.

7 Night-turn volume consists of express Postal Service products. These
8 include domestic Express Mail, Express Mail International, and Global Priority
9 Mail. No other mail classifications are planned for the night-turn. However,
10 incidental volumes of non-express mail may occasionally appear on the night-
11 turn. This may occur because of operational failures or because mail is
12 incorrectly sorted into sacks with express D & R tags. I fully expect, however,
13 that the amount of non-express mail on the night-turn will be insignificant.

14 **IV. Day-Turn Operations**

15
16 Under the terms of the contract, FedEx basically agreed to provide a
17 guaranteed average daily capacity of 443,120 cubic feet, six days per week, 52
18 weeks per year. Each contract schedule block² the Postal Service provides
19 FedEx with its expected volumes by origin. The Postal Service can exceed
20 these volumes by obtaining permission from FedEx.

² A contract schedule block is "one or more Schedule Periods grouped together by FedEx for purposes of determining flight schedules during such period." See USPS Library Reference J-97 at 7. There are six schedule blocks each year.

1 All volumes above the minimum guaranteed volume are charged the
2 same rates. Rates are based on three separate charges: a non-fuel transport
3 charge, a fuel charge, and a handling unit charge. There is no mileage
4 component to the day-turn rates. A reconciliation payment is made at the end of
5 each schedule period, if Postal Service volumes fall short of the minimums.
6 Again, these reconciliation payments, if any, are expected to be infrequent and
7 insignificant. Contract minimum volumes increase each year by an escalation
8 factor included in the contract. As with the night-turn operation, planned volumes
9 for the day-turn will be updated six times per year.

10 Most mail on the day-turn will be tendered in full air containers filled with
11 mail. (There will be some spillover volumes that will use partial containers.)
12 Since the Postal Service is buying cubic capacity, it has an incentive to provide
13 the densest mail that is consistent with the level of service³ FedEx is providing.
14 There are some constraints, however, on the density of loads the Postal Service
15 can provide. Loads above a certain density level are known to be operationally
16 infeasible or unsafe.

17 The structure of day-turn rates gives the Postal Service an incentive to
18 tender its mail in an efficient manner. To minimize overall costs, containers
19 should be filed to the maximum extent possible, in terms of both cube and
20 weight. Also, handling unit charges for sortation at the FedEx hub provide the
21 Postal Service with an incentive to build direct containers that bypass the FedEx
22 hub's sorting operation. These direct containers are typically offloaded at

1 Memphis, but are never opened by FedEx. The Postal Service has set 50
2 percent as its target for bypass containers.

3 To help achieve these operating efficiencies, the Postal Service has
4 contracted with private sector companies to provide certain terminal handling
5 services. These contractors are responsible for maximizing the amount of mail
6 in each FedEx container. They are also required to accept arriving mail from
7 FedEx at destination airports, and separate the mail according to local
8 distribution plans.

9 Most day-turn mail is tendered to FedEx in air containers. However, at six
10 cities near FedEx's Memphis hub, the Postal Service will transport the mail to
11 FedEx's facility using bedloaded trucks. The six cities are Nashville, Jackson, St.
12 Louis, Little Rock, Memphis and Birmingham. (Similar feeder truck service
13 existed with the Eagle and Daynet operation in Indianapolis.)

14 As with the old Daynet, the day-turn will transport First-Class Mail and
15 Priority Mail. The fact that day-turn rates do not include a mileage component
16 means that FedEx is an especially attractive alternative to long-haul commercial
17 air carriers, which charge according to the ASYS contract by the pound and
18 pound-mile. In designing the day-turn operating plan, the Postal Service also
19 considers service performance and available capacity between markets served
20 by ASYS carriers. The FedEx day-turn is also an attractive option for those
21 markets that have historically experienced service problems or are capacity
22 constrained. Finally, the day-turn rates are based on cubic capacity rather than

³ Obviously, the Postal Service could provide its densest mail, but much of this mail such as Standard catalogues and Periodicals does not require the level of service provided by, nor justify

1 weight. Since First-Class Mail is typically denser than Priority Mail, the Postal
2 Service wants to make sure that it includes First-Class Mail on the day-turn. In
3 planning the day-turn, we considered ASYS cost and service for both First-Class
4 and Priority Mail, as well as mail density on each origin-destination pair. As a
5 result, some origins and destinations use ASYS carriers for both First-Class and
6 Priority Mail. And some use FedEx for both.

7 **V. A Single, Integrated Carrier**

8
9 The previous dedicated air networks were operated by an assortment of
10 contractors. Under this system, a contractor may have had responsibility for only
11 part of the trip between origin and destination. By way of example, consider a
12 piece of mail originating from a city on the West Coast and destined for an
13 airport in the Northeast. The first leg of the trip might be an Eagle day-turn plane
14 (operated by Emery) into the WNET hub. Next, a WNET flight (operated by Kitty
15 Hawk) would carry the mail to the Eagle hub in Indianapolis. Once on the
16 ground at Indianapolis, the mail was sorted by Evergreen personnel under the
17 TNET contract. Next, the mail was flown by a fourth contractor from Indianapolis
18 to the airport serving the destination. This arrangement created the potential
19 for conflict and operational breakdowns as mail was handed off from one
20 contractor to the next. The FedEx transportation agreement greatly reduces the
21 potential for these kinds of problems. Under the contract, FedEx has
22 responsibility for performance from origin airport to destination airport.

the expense of, using the FedEx day-turn.

1 **VI. Summary**

2

3 The Postal Service-FedEx Transportation Agreement replaces a number
4 of contracts previously in place for dedicated air transportation. Two networks, a
5 day-turn and a night-turn, provide transportation by sharing capacity on FedEx
6 aircraft with FedEx's products. Night-turn operations are designed to provide
7 reliable, economical overnight transportation for Postal Service express
8 products. Day-turn operations provide similar service during the daytime for
9 First-Class Mail and Priority Mail. The FedEx contract provides an integrated
10 solution to the Postal Service's network air transportation requirements.