

DOCKET SECTION

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

RECEIVED
SEP 29 4 53 PM '97
POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 1997

Docket No. R97-1

TRIAL BRIEF OF
THE UNITED STATES POSTAL SERVICE

UNITED STATES POSTAL SERVICE

By its attorneys:

Anthony Alverno
Richard T. Cooper
Susan M. Duchek
Kenneth Hollies
Eric Koetting
Anne B. Reynolds
Scott L. Reiter
David H. Rubin
Michael T. Tidwell

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2989; Fax -5402
September 29, 1997

TABLE OF CONTENTS

I.	Introduction	1
II.	Postal Service Policy and the Revenue Requirement	10
III.	The Postal Service Has Devoted Substantial Effort to Providing the Commission With Improved Economic Tools For Ratemaking	13
IV.	Overview of the Postal Service's Testimony	18
	A. Revenue Requirement	18
	B. Volume Forecasting	19
	C. Costing Testimony	20
	D. Cost Studies	26
	E. Rate Policy	31
	F. Rate Design	35
	G. Classification Changes	41
V.	Conclusion	44

I. Introduction

The Presiding Officer at the prehearing conference in this docket (July 30, 1997) directed parties to submit trial briefs prior to the appearances by their witnesses for cross-examination.¹ As explained by the Presiding Officer, this requirement arose, in part, out of a reaction to the burdens created for the Commission and the parties by the schedules in complex general rate cases, and by the instant case in particular. In asking for trial briefs from all parties, the Presiding Officer expressed the expectation that the briefs would provide guidance to assist the Commission and parties in understanding and dealing with the interrelated testimony and issues in the case, and to facilitate development of the record during cross-examination and at subsequent stages. In this respect, the Postal Service's trial brief will supplement the information customarily provided by the Postal Service for this purpose in Commission proceedings, including the Compliance Statement attached to the Postal Service Request (Attachment G),² the listing of the Postal Service's testimony and workpapers (Attachment F to the Request), technical conferences,³

¹The Presiding Officer's directive (Tr. 1/26-29) was subsequently modified by Presiding Officer's Ruling No. R97-1/4 (Aug. 1, 1997).

²The Compliance Statement indicates which parts of the Postal Service's testimony and exhibits are intended to respond to the Commission's Rules of Practice and Procedure, which specify the basic issues to be addressed in a request under 39 U.S.C. §§ 3622, 3623, and the information and documentation required to be supplied with the Postal Service's filing.

³At the prehearing conference, the Postal Service encouraged parties to request
(continued...)

substantial informal consultation with Postal Service attorneys, and the written answers to thousands of inquiries directed to individual witnesses and the Postal Service during discovery.

The second avowed purpose of trial briefs was to provide an opportunity for the parties to summarize or outline their "theory of the case." According to the Presiding Officer, "[e]ach party should include an explanation of the theoretical and public policy considerations which it believes the Commission should give weight to." Tr. 1/27. In this regard, the Presiding Officer observed that "[t]he Postal Service case does not include testimony from a so-called policy witness at this time, to explain how the Postal Service views its future and why its request is both consistent with and in furtherance of that future." *Id.* Referring to the Postal Service's filing, he further commented:

At first blush, its evidence focuses on individual rates and subclasses without presenting a picture of the whole, and why the constituent parts of its proposal sum to a result that is consistent with a particular public policy."

Id. He expressed the intention that the Postal Service's trial brief would be used during oral cross-examination "so that we can understand the Postal Service's view and question witnesses about aspects of their testimony which appear to be inconsistent with that view." *Id.* at 28.

³(...continued)
technical conferences if necessary to understand the Postal Service's case. To date, only one full conference has been conducted.

The Postal Service believes that it understands the spirit and intent of the comments supporting this second purpose of trial briefs, particularly with respect to the Postal Service. Furthermore, it does not consider the goal of expressing a unifying policy orientation to be inappropriate, providing the Postal Service's proposals embody such a focus. In this regard, we interpret the Presiding Officer's comments as not necessarily implying that the Postal Service's filing does or should advance a single policy, whether it is expressed as "public policy," or some institutional goal or philosophy. Rather, it would seem that the Presiding Officer's definition would likely also embrace a constellation of Postal Service objectives that would provide the framework for the decisions and judgments that motivated the proposals in this case, apart from the facts that shaped them. Nevertheless, inasmuch as the Presiding Officer expressed an intention to use the statements in this trial brief as references in questioning the Postal Service's witnesses, it is necessary to attempt to clarify the context in which "policy" and "theory of the case" have meaning in the instant filing, and to indicate if or where these unifying principles might be found in the testimony.

In the first instance, it may be useful to contrast this case with other recent proceedings in which explanation of policy goals was more explicitly central to the proposals. In this regard, the Presiding Officer's reference to "policy witness" suggests two pertinent examples.⁴ Most recently, in Docket No. MC95-1, the Postal

⁴The notion that a rate or classification proceeding might involve a policy witness has been sometimes been suggested in connection with regulatory reform creating an
(continued...)

Service sought sweeping Domestic Mail Classification Schedule (DMCS) revisions that were oriented around certain guiding classification principles. These arose out of particular preferred operating policies and practices related to automation and worksharing that were seen as critical to the Postal Service's future viability, in light of expectations for future business and economic conditions. Furthermore, the case was somewhat unusual, inasmuch as it was constructed on the financial foundation of the previous general rate changes, and was presented as "contribution neutral." In that proceeding, the Postal Service presented the testimony of Charles McBride who

⁴(...continued)

"oversight" function in Commission proceedings. The 1992 Report of the Joint Task Force on Postal Ratemaking proposed a particular ratemaking regime that employed such a witness as a part of the Postal Service's periodic rate reviews. The Report explained:

[W]e believe one integral part of a Postal Service request under the four-year cycle plan must be a presentation by a senior policy-making officer of the Postal Service—appearing as a "policy witness"—to make clear the policies to which the filing responds and, in general terms, the reasons the Postal Service believes the filing will advance them. This witness, who would be an officer having the position and information to speak authoritatively (possibly the Postmaster General), would not have the same function as the witnesses who testify to aspects of the asserted facts of the case. A "policy witness" at this level would combine the roles of a witness presenting facts and a recognized policy-maker authoritatively describing the policies of the organization. We see the emphasis as falling on the latter function—one for which the ordinary trial-type hearing, including discovery and cross-examination, is not generally appropriate.

Postal Ratemaking in a Time of Change: A Report by the Joint Task Force on Postal Ratemaking, at 20–21 (June 1, 1992)(emphasis and footnote omitted).

addressed these matters.⁵ While not specifically designated as a "policy witness," Mr. McBride explained the historical development and the general economic and operating environment that gave rise to the perceived need for the classification reform policies embodied in the Postal Service's proposals.⁶ He outlined the key classification guidelines that shaped the proposed classification reforms. He further explained the basis for the "contribution neutrality" approach to the financial foundation of the case.

In the most recently litigated general rate proceeding, Docket No. R94-1, the Postal Service proposed an unconventional "across-the-board" pricing approach, as well as moderate overall revenue objectives, that had significant implications for most rates and fees. These departures from previous pricing proposals were justified on the basis of the Postal Service's view of its current and future financial situation and its commitment to and plans for particular reclassification proposals in the upcoming classification reform case. In that proceeding, the Postal Service presented the testimony of its Chief Operating Officer, William Henderson. Mr. Henderson was not

⁵The Postal Service's Request also summarized the context of reclassification and the basic approach that gave rise to the specific proposals. This description included the principles that guided the structure of the proposed classes, the financial basis for the case, and the design of a reorganized DMCS. The Request also outlined the relationship of the Postal Service's case to the ratemaking policies contained in the Postal Reorganization Act. Taken together, these elements created the foundation for the classification reform policy goals embodied in the Postal Service's proposals. See Request of the United States Postal Service for a Recommended Decision on Classification Reform of First-, Second-, and Third-Class Mail, Docket No. MC95-1 (March 24, 1995).

⁶See Direct Testimony of Charles C. McBride on Behalf of the United States Postal Service, Docket No. MC95-1 (March 24, 1995).

designated as a "policy witness," but his testimony did provide the policy context of the Postal Service's novel rate case proposals.⁷ These were characterized as having been motivated by unique circumstances, modest financial goals calculated to produce rate changes that would nurture further growth yet not dramatically alter existing relationships, and a decision to defer classification changes pending introduction of comprehensive reform proposals. Tr. 23/9871-77.

Unlike these two cases, the instant general rate proceeding takes a more conventional approach to omnibus rate cases. Such cases result from requests by the Postal Service for a recommended decision on changes in most rates and fees, pursuant to the authority in 39 U.S.C. § 3622(a), and for classification changes, pursuant to 39 U.S.C. § 3623(b). The policy context, furthermore, is provided by the statute. Section 3622(a) refers only to a Postal Service determination to seek general rate changes based on its assessment of the public interest and the ratemaking policies embodied in the Postal Reorganization Act, as codified in title 39, United States Code. Of particular importance in this respect are the considerations mentioned in 39 U.S.C. § 3621, which creates the Postal Service Governors' authority

⁷Technically, Mr. Henderson was presented as part of the Postal Service's rebuttal case. His testimony was described as intended to "rebut specific assertions made by several intervenor witnesses who have taken issue with Postal Service witness Foster's general across-the-board approach to the pricing of postal services in this proceeding." Rebuttal Testimony of William J. Henderson on Behalf of the United States Postal Service, USPS-RT-1, Docket No. R94-1 (Sept. 7, 1994), contained in Tr. 23/9867-77. Nevertheless, his appearance was widely reported as responsive to requests from members of the mailing community that the Postal Service provide a policy witness to justify its ratemaking proposals. Furthermore, during his cross-examination, the Presiding Officer specifically characterized him as a "policy witness." Tr. 23/9878.

to establish classifications and rates, and in 39 U.S.C. § 3622(b) and § 3623(c), which provide guidance in the form of specific rate and classification policy and design factors applicable to both the Postal Service's proposals and the Commission's recommendations. Taken together, these and the other provisions in title 39, particularly those pertaining to rates and classifications,⁸ provide the policy framework in which Postal Service rate and classification proposals are formulated and reviewed.

Undeniably, every Postal Service proposal for rate and classification change also incorporates a variety of particular "policy" choices pertaining to the Postal Service's public responsibilities and its institutional and business prerogatives. Typically these form the context out of which particular proposals are developed and presented. These policy determinations vary widely as to type, such as financial, operational, labor relations, or service policies. Furthermore, they range in scale and scope from major policy goals, for example, the financial policies that dictate when rate cases are filed, to relatively minor procurement policies that determine the standards for purchasing supplies, which in turn influence the costs incurred in processing mail and the rates of the mail to which those costs are allocated.

Obviously, it would be impractical to attempt to catalog this disparate collection of management objectives or choices, or to subsume them under general principles that would have utility these proceedings. Nor do we believe that these are what the Presiding Officer meant when he referred to a "picture of the whole" that would be

⁸See, e.g., 39 U.S.C. § 403(c) and § 3623(d).

consistent with "a particular public policy." After all, it is not the purpose of Commission ratemaking and classification proceedings, nor is it the Commission's authorized function, to scrutinize and evaluate Postal Service policy choices. Rather, we understand the purpose of the trial briefs to be to illuminate the specific testimonies by explaining any unifying policies or goals, by which consistency might be measured, or to further explain the specific proposals, in light of the policies contained in the statute. In this respect, by and large, the testimonies directly supporting the Postal Service's proposals explain the specific policies involved in developing the proposals. Alternatively, they can be identified in the course of the discovery and hearing processes. The witnesses and counsel, furthermore, are responsible for explaining how the specific proposals conform to the statutory ratemaking policies encompassed by the Act.

Notwithstanding these limitations, every general rate case is founded on elements of a financial policy that determines when rate changes are sought and the overall magnitudes of revenue increases. Furthermore, specific rate proposals are generally encompassed by economic and other principles that influence the allocation of costs, price levels by subclass and special service, and inter-class relationships. With this in mind, the remainder of this brief will outline the Postal Service's case in three parts. First, it will very briefly discuss the financial policy contours of the case. By their nature, these are very general. Next, we will describe a dimension of the Postal Service's testimony that comes closest to being a "theory of the case." Namely, the Postal Service's approaches to costing and pricing have been guided by

adherence to certain economic principles, and it has employed particular forms of analysis that have been integrated comprehensively for the first time in this case. We describe these as improved economic tools for postal ratemaking. Finally, we will provide an overview that summarizes Postal Service testimonies and proposals.

II. Postal Service Policy and the Revenue Requirement

Fundamentally, general rate cases are initiated for the purpose of increasing revenues in order to cover future and past expenses. The instant case is no exception. The Postal Service's Request and testimony are founded on identification of a "revenue requirement" of close to \$62 billion in the chosen test period of Fiscal Year 1998. In this regard, the decision to seek revenue at this time in the form of rate and fee changes, rather than choosing another course, such as incurring future operating deficits or borrowing, constitutes the fundamental policy choice embodied in the Postal Service's Request. As indicated in Postal Service witness Tayman's revenue requirement testimony, furthermore, this decision was influenced by the goals of seeking moderate rate increases below the general rate of inflation in the economy.⁹ These objectives affected the choice of Fiscal Year 1998 as the test period on which to base the Postal Service's estimates of accrued costs, and the timing of the case. This was supplemented by a few basic policy choices embodied in the estimation of the revenue requirement, including the determination of a reasonable amount reserved for contingencies, based on knowledge and projections when the case was formulated, and the Board of Governors' policy regarding the restoration of equity, which established an amount for recovery of prior years' losses. Finally, the goals of moderate, below-inflation increases were qualified by the specific

⁹Direct Testimony of William P. Tayman on Behalf of the United States Postal Service, USPS-T-9, Docket No. R97-1, at 9 (July 10, 1997).

objectives that shaped the rate, fee, and classification proposals, and the Postal Service's assessment of the proper balance of rate adjustments across all classes and services, in accordance with the statutory ratemaking criteria. The results of this final consideration are contained in the testimony of Postal Service witness O'Hara.

Courts have held that whether to change rates to seek new revenue, and when to initiate that process, are matters committed to the discretion of the Postal Service and its Board of Governors.¹⁰ Subject to the requirements of the Act, the amount of new revenue to seek is also largely a matter determined judgmentally by the Board of Governors, with regard to certain elements of the revenue requirement, and by the Postal Service in exercising its various authorities to manage its finances and to operate. The composition and overall levels of accrued costs might be influenced by a variety of practical and legal constraints and circumstances, such as the terms of the Postal Service's collective bargaining agreements, its contractual obligations, interest rates, and the presence or absence of Congressionally-determined appropriations or liabilities. Furthermore, the Commission's rules of practice create requirements for the presentation of estimates supporting particular proposals. Fundamentally, however, the size of the revenue requirement is a product of the exercise of the Postal Service's authority to make numerous policy choices with regard to the incurrence of costs and financial management. In this important sense,

¹⁰*Newsweek, Inc. v. United States Postal Service*, 663 F.2d 1186, at 1203-06 (2d Cir. 1981), *affirmed sub nom National Association of Greeting Card Publishers v. United States Postal Service*, 462 U.S. 810 (1983).

- 12 -

the public policy furthered in this case is the provision of postal and other services in accordance with the exercise of the Postal Service's statutory authority to operate.

III. The Postal Service Has Devoted Substantial Effort to Providing the Commission With Improved Economic Tools for Postal Ratemaking

In developing this case, one focus of the Postal Service has been on improving the economic tools available to help guide the ratemaking process. Given the broad array of considerations that the Act requires ratemakers to address, economic analysis by no means provides the exclusive answer to all ratemaking issues. Nevertheless, from the beginning, the economic perspective has provided much of the framework upon which the postal ratemaking process before this Commission has been erected.

Consequently, the Commission over the years has been exposed to a wide variety of economic concepts, theories, and analyses. There is probably very little, if any, of the Postal Service's economic testimony in this case that presents ideas or concepts that have not been addressed in one fashion or another in previous Commission proceedings. There are, however, two means by which the Postal Service hopes in this case to advance the state of knowledge regarding such matters. First, some concepts that have been merely theoretical in the past are actually applied in this case. Second, efforts have been made, particularly in the costing arena, to standardize methodologies in an attempt to achieve a much more uniform transition from theory to practice. The objective is to insure that, to the maximum extent practical, costing procedures produce results that are consistent with what economic theory suggests are the relevant cost measurement concepts.

Specifically, the two conceptual tools which have been greatly refined in this case are incremental costs and Ramsey pricing. As witness Panzar testifies (USPS-T-11), incremental costs provide the information necessary to insure that each subclass covers all of its costs and is not a burden on other subclasses. While the concept of incremental costs is certainly not novel, either in regulatory economics in general or before this Commission, what is new is the Postal Service's ability to present estimates of such costs for each subclass and service.

The availability of incremental costs for each subclass is a major step forward in postal ratemaking for several reasons. First, it improves our previous ability to test for cross-subsidy. Second, it allows us to move beyond a situation in which one cost measurement was being called upon to perform two distinct and conflicting functions. Having incremental costs available to guard against cross-subsidy allows us to focus better on developing true marginal costs. As Prof. Panzar suggests, having one cost measure to perform two separate functions virtually guarantees that neither function will be fulfilled properly. See USPS-T-11 at 27-28. Third, at a perhaps less lofty level of concern, it may allow the Postal Service and the Commission to reach some consensus on an issue that has been a point of contention for nearly a decade — single subclass access costs in city carrier delivery operations. Moreover, the marginal/ incremental framework may provide the same opportunity with regard to other costing topics where consensus has similarly been elusive.

Unlike incremental costs, Ramsey pricing is a theory which various witnesses have actually applied in past postal ratemaking proceedings. In earlier cases, some

of these witnesses, like the late Nobel laureate William Vickery, were witnesses for the Postal Service. More recently, witnesses presenting Ramsey models have appeared on behalf of other parties. (In Docket No. R94-1, postal witness Foster included some Ramsey analysis in his rate policy testimony, but did not present a complete Ramsey model.) In this case, witness Bernstein (USPS-T-31) provides a comprehensive discussion of what Ramsey pricing is, why it applies to the Postal Service, and how Ramsey pricing can be used in postal ratemaking. His testimony includes development of Ramsey prices for each subclass, and an illustrative comparison of his results with those suggested by markup indices relating to the Docket No. R94-1 rate levels.

The Postal Service believes that Ramsey pricing is properly characterized as an economic tool that can assist in the ratemaking process. Ratemaking involves trade-offs, and Ramsey pricing is a means of measuring, as rate burdens are shifted among subclasses, what is being given up, and what is being gained. To some extent, the logic behind Ramsey pricing has always been incorporated into postal ratemaking under the Act in the evaluation of the "value of service" criterion of section 3622(b)(2). (Therefore, no one should be surprised that presentation by the Postal Service of a complete Ramsey model has not been accompanied by any proposal to initiate massive shifts in relative institutional cost burdens.) A formal Ramsey model, however, allows more objective, quantitative analysis to supplement and inform the more subjective, qualitative analyses sometimes used.

At the same time, as the Postal Service has emphasized repeatedly in the past, no Ramsey model will ever obviate the need for careful consideration of all of the statutory ratemaking factors. No one advocates that running a Ramsey model should begin and end the ratemaking process. Ramsey pricing is but one of many tools available to guide postal ratemaking. It is, moreover, a tool with substantial flexibility. As witness Bernstein has noted, while Ramsey pricing is often thought of as a means of identifying optimal "Ramsey" prices, it can also serve as a tool to measure the relative economic efficiency of any two alternative sets of prices, however derived. Therefore, the Postal Service believes that the Ramsey analysis presented by witness Bernstein constitutes a tangible advancement in the ratemaking process.

Incremental costing and Ramsey pricing are by no means the only notable improvements in the quality of the economic analysis offered by the Postal Service in this case. As will be discussed more fully below in the context of the overview of the costing testimony, the Postal Service has undertaken a massive effort to revise substantially the allocation procedures for the largest single category of postal costs—mail processing costs. The results of this effort are new procedures that should better position the Postal Service to accurately measure and distribute costs even as substantial evolution continues in the mail processing operating environment. Great care has been taken, moreover, to insure that the costs produced by these studies are consistent with the marginal cost information that is necessary for any rational ratemaking process, whatever the ratemakers' goals might be. See USPS-T-11 at 6–

7. Slowly, perhaps, but surely, the Postal Service is striving to make the component analyses of its costing presentation compatible with the conceptual framework developed by the economics profession.

IV. Overview of the Postal Service's Testimony

The sections that follow present overviews of the Postal Service's testimony, organized by general subject matter. The first section discusses the revenue requirement, and is followed by sections on volume forecasting, costing, cost studies (used in rate design), rate policy, rate design, and classification changes.

A. Revenue Requirement

The Postal Service's revenue requirement is presented in the testimony of witness Tayman, USPS-T-9. Mr. Tayman begins by summarizing the Postal Service's financial and operating results for the most recent ten-year period, and by describing its current financial condition. Referring to several conventional indicators of financial health, he observes that the Postal Service's financial condition has been improving. Nevertheless, he notes that future cost increases are anticipated to adversely impact finances in Fiscal Year 1998, leading to a revenue deficiency in this Test Year of approximately \$2.4 billion. He concludes that as a result of increased costs and other factors, the most responsible course of action would be to increase revenues through a moderate general increase in rates.

Mr. Tayman next explains the components of the revenue requirement and summarizes the procedures for estimating it. He describes in detail the contents of each category of accrued costs, indicating the major influences on changes in the cost segments and components in the Test Year. He then explains the rationale for

selecting a one-percent provision for contingencies, and describes and justifies the inclusion of an amount for the recovery of prior years' losses of approximately \$446.9 million.

In estimating the proposed test year revenue deficiency, witness Tayman projects a before rates revenue requirement of approximately \$59.4 billion, and an after-rates revenue requirement of approximately \$61.6 billion. Assessing projections for revenue from mail and special services, appropriations, and interest income, he concludes that the Postal Service's test year revenue deficiency at current rates would be approximately \$2.442 billion.

Also providing testimony on the revenue requirement is witness Macdonald. His testimony, USPS-T-10, relates to the estimation of workers' compensation expenses in the test year.

B. Volume Forecasting

As the Postal Service's operating environment has evolved, and the classification and rate structures have been refined to allow recognition of new and expanded opportunities for mailer worksharing, the task of forecasting mail volumes has gotten significantly more complicated. The Postal Service has responded with substantial improvements in its forecasting methodologies, relative to the last general rate case, Docket No. R94-1. Many of the new features, however, were developed for classification reform purposes in Docket Nos. MC95-1 and MC96-2, and thus should not be unfamiliar to the Commission.

Forecasts for most subclasses of mail are provided in this case by Dr. Tolley (USPS-T-6), as they have been in every omnibus rate case since Docket No. R80-1. Dr. Tolley uses the same basic approach to forecasting that has been employed in all recent cases. In this case, however, the econometric analysis upon which the forecasts are based is presented by his colleague, Thomas Thress (USPS-T-7). Most prominent among the improvements incorporated by Mr. Thress is a somewhat different approach to modeling demand for Standard A (formerly bulk third-class) mail.

Forecasts for Express Mail and Priority Mail are once again provided by Dr. Musgrave (USPS-T-8). Dr. Musgrave uses the same basic approach to forecasting that he has used in past omnibus rate cases. Although no fundamental changes were made to either the Priority or Express Mail models, some improvements were incorporated. For example, for Priority Mail, a "mixed estimation" econometric technique was used for the permanent income elasticity. As another example, for Express Mail, the measure of permanent income was changed from the measure of long-run income from expenditures on services to expenditures on nondurables.

C. Costing Testimony

In this case, the Postal Service presents new costing studies that advance the science of accurately identifying the costs that are relevant for postal ratemaking. The costing presentation is thoroughly integrated, starting with a sound theoretical

economic framework, and then continuing with the development of Postal Service costs in accord with this framework.

Renowned economist, John Panzar, provides the correct theoretical framework for the Postal Service's cost development, in testimony which is consistent with, yet extends beyond, that provided by Dr. William Baumol in previous cases. Dr. Panzar (USPS-T-11) goes beyond textbook definitions, and demonstrates how Postal Service procedures for developing volume variable costs yield the relevant marginal cost information for postal pricing. He also reiterates the need to develop incremental costs to test for cross subsidy, and describes how Postal Service cost data may be used to measure incremental costs.

In this case, for the first time, the Postal Service is able to fully implement the theoretical prescriptions of Dr. Baumol and Dr. Panzar. Joseph Alexandrovich (USPS-T-5) provides base-year volume variable (marginal) costs, Richard Patelunas (USPS-T-15) provides test-year volume variable (marginal) costs, and William Takis (USPS-T-41) provides base-year and test-year incremental costs.

The new studies of mail processing costs presented by Michael Bradley and Carl Degen, moreover, represent major advances in the allocation of huge categories of cost. Dr. Bradley (USPS-T-14) replaces simplistic and inaccurate assumptions about the volume variability of mail processing activities with estimates based upon empirical data. For the first time, the Postal Service has measured how time spent in each of these activities actually varies with changes in mail volume. Mr. Degen (USPS-T-12) builds upon Dr. Bradley's work with innovative new applications of the

In-Office Cost System (IOCS). By organizing IOCS and payroll data into categories that correspond to the activities analyzed by Dr. Bradley, Mr. Degen is able to allocate volume variable mail processing costs to categories of mail in a manner that yields the relevant marginal costs. One product of this analysis is marginal mail processing costs that can be added to other marginal transportation, delivery and administrative costs to yield the total marginal cost data, by subclass, needed for rational ratesetting. Another product of this work is cost equations for each major mail processing activity that can be employed (and are employed by Mr. Takis in USPS-T-41) to estimate incremental costs.

The Postal Service has invested heavily in addressing costing issues. A large number of our 42 witnesses provide testimony relating to cost systems or cost allocation studies. The testimonies of Bradley and Degen provide new data and new approaches to treating controversial "mixed mail" and "overhead" mail processing costs. New or updated volume variability studies of purchased transportation (Michael Bradley, USPS-T-13), window service (Christopher Brehm, USPS-T-21), vehicle service drivers (Steven Wade, USPS-T-20), city and rural carriers (Don Baron, USPS-T-17 and Michael Nelson, USPS-T-19, together with Peter Hume, USPS-T-18) address long-standing Commission concerns about the age of previous work in some of these areas, and provide useful refinements of prior analyses. The provision of incremental cost tests and the testimonies of witnesses Panzar and Takis, moreover, address past Commission concerns about the attribution of "single subclass" and other nonmarginal costs. The Postal Service's costing witnesses also provide useful

testimony regarding the nonmodeled cost factors which became an issue in Docket No. MC95-1. The new mail processing cost study has produced important new insights into these factors, insights that are reflected in the testimonies of witnesses Daniel (USPS-T-29), Hatfield (USPS-T-25), and Seckar (USPS-T-26). (See section III.D, below, for a summary of the testimony of these three witnesses)

The Postal Service recognizes that gaining a clear understanding of the major features of a case as complex as this one is a difficult process. To facilitate this process, the Postal Service has provided more documentation of its studies and data systems than is required by the Commission's filing rules. For example, the Postal Service provided statistical measures of reliability and electronic versions of data files together with its Request, so that such additional documentation would be available from the first day of the proceeding. The Postal Service also complied with the Commission's new rule regarding the filing of a version of base year, interim year, and test year attributable costs computed in accord with the costing methodologies most recently employed by the Commission.

The testimonies of witnesses Alexandrovich (USPS-T-5), Panzar (USPS-T-11), Degen (USPS-T-12), Bradley (USPS-T-14), Patelunas (USPS-T-15), and Takis (USPS-T-41) have been discussed above. A short discussion of the other witnesses whose testimony relates to subclass costing issues (as opposed to rate design costing issues, discussed below in section IV.D) follows:

(USPS-T-2)¹¹ The testimony of Norma Nieto describes the Postal Service's Transportation Cost System (TRACS), which generates distribution keys used to estimate various purchased transportation costs by rate category. Witness Nieto discusses the general design of TRACS, including the sample designs and estimation methodology for each mode of purchased transportation, and describes a new methodology used to calculate the distribution key for the Christmas Air Network (CNET).

(USPS-T-3)¹² The testimony of Thomas Harahush describes the rural and city Carrier Cost Systems, used to distribute to categories of mail the street costs associated with city carrier and rural carrier routes. His testimony includes the general design of the systems, as well as the types of estimates that each system produces, and presents tables showing the reliability of the major estimates.

(USPS-T-13) The testimony of Michael Bradley regarding purchased highway transportation updates and refines the Commission's Docket No. R87-1 analysis of volume variable purchased highway costs in Cost Segment 14. Dr. Bradley used a much more extensive database than in the past. He used data from virtually all

¹¹ In USPS-T-1, Bradley Pafford describes the Revenue, Pieces and Weight (RPW) data system. The RPW system is not primarily a data system for costs.

¹² USPS-T-4 is the testimony of Ralph Moden. Mr. Moden is an operations witness, rather than a costing witness. His testimony provides operational background on a variety of postal rate and costing proposals.

contracts in force in August, 1995 rather than a sample. In addition, Dr. Bradley enhanced the econometric equations used by the Commission by incorporating region-specific, non-volume cost characteristics. Also, Dr. Bradley disaggregated his analysis for intra-SCF and inter-SCF by truck type. Further, for the first time, Dr. Bradley was able to present a variability analysis for plant-load contracts.

(USPS-T-17) The testimony of Don Baron provides a new and refined approach to the estimation of volume-variable load-time costs generated on city carrier letter routes, and demonstrates how these refinements lead to improved accuracy in estimation over prior approaches. Witness Baron also evaluates alternative methods of splitting accrued letter route running-time cost into variable access costs and fixed route time costs, and demonstrates that a basic quadratic model produces the most accurate and sound results. Finally, Mr. Baron shows how the accuracy of estimation of the volume variability of rural carrier labor costs may be improved through modification of previously-used estimation procedures.

(USPS-T-19) The testimony of Michael Nelson presents a series of methodological refinements and analyses of newly collected data pertaining to the development of certain cost components within Cost Segments 6, 7, and 9. Among the new data analyzed by Mr. Nelson are four new field surveys of carrier and messenger activities: the Motorized Letter Route Survey, the Special Purpose Route Survey, the Expedited Mail Survey, and the LDC 24 Survey. As a result of this newly

available data and the analytical refinements employed, Mr. Nelson is able to develop more accurate estimates of volume variable costs and other cost information.

(USPS-T-20) The testimony of Steven Wade discusses the estimation of a volume variability for the costs of Vehicle Service Drivers (VSD), Cost Segment 8. Dr. Wade uses as the basis for his analysis data collected from VSD units in 1993. He uses this data to estimate a relationship between hours and mail volume. His analysis yields a volume variability that is somewhat higher than that used in previous proceedings.

(USPS-T-21) The testimony of Christopher Brehm updates the variability estimates for window clerk costs. He adopts the framework developed in Docket No. R90-1. A new window service transaction time study is used to estimate new variability factors, which are generally lower than those used in Dockets No. R90-1 and R94-1.

D. Cost Studies

The testimonies of Postal Service witnesses Hatfield, Hume, Treworgy, Miller, Lion, Seckar, Schenk, Crum and Daniel present updated cost estimates for existing rate categories and provide cost support for new worksharing proposals and other rate design advancements. Studies describing the detailed characteristics of bulk mail subclasses in a post-reclassification environment are used along with updated

productivity and mail flow data in these witnesses' cost models. These models calculate cost avoidances resulting from the many types of existing mailer worksharing.

(USPS-T-16) This testimony of Phillip Hatfield revises and improves the *method of allocating transportation costs among parcel post rate categories and zones*. New transportation cost allocation methodologies correct long held misconceptions concerning the effects of zone and distance on parcel post costs. Witness Hatfield's testimony in USPS-T-16 presents a new method for separating total parcel post purchased transportation costs into component rate categories, provides a more precise determination of distance relation and a more explicit method of estimating the relationship between cubic volume and weight in parcel post, incorporates the transportation costs related to postal owned vehicles, and recognizes the different treatment of terminal and line-haul costs in commercial air transportation.

(USPS-T-18) The testimony of Peter Hume develops reclassified test-year unit city carrier and rural carrier delivery costs by shape and rate category. This testimony essentially updates, and in some cases refines, the approach originally advanced by Mr. Hume and used by the Commission in Docket Nos. MC95-1 and MC96-2.

(USPS-T-22) The testimony of David Treworgy presents cost information relating to the Postal Service's delivery confirmation proposals.

(USPS-T-23) The testimony of Michael Miller provides relevant cost information to supports witness Fronk's reply mail proposal.

(USPS-T-24) The testimony of P. Michael Lion provides cost information regarding post office boxes.

(USPS-T-25) This testimony of Phillip Hatfield provides cost avoidance information relating to various types of mailer worksharing of First-Class Mail.

(USPS-T-26) The testimony of Paul Seckar presents flats mailflow models which form the basis for rate proposals for Periodicals and Standard Mail (A) subclasses. Witness Seckar makes use of a constant mail makeup scenario to construct flats cost differentials that primarily reflect worksharing differences. Unlike the actual mail makeup scenario that generates cost differences reflecting worksharing differences, eligibility requirement differences, and density makeup differences, the constant mail makeup scenario isolates the effect of mailer-applied barcodes. The models in both scenarios make use of the new FSM-OCR to fully reflect the Test Year processing environment of flats mail.

(USPS-T-27) The testimony of Leslie Schenk provides information on the costs associated with BRMAS.

(USPS-T-28) The testimony of witness Crum presents a thorough analysis of the costs of Standard (A) non-flat size nonletters to address the Commission's concerns expressed in Docket No. MC95-1 that cost information be developed in order to form the basis for improving the relationship between costs and rates for these pieces. *Cf.* PRC Op. & Rec. Dec. MC95-1, & 5569. Witness Crum presents a comprehensive analysis of the additional costs incurred by pieces that are neither letter- nor flat-shaped. The results of witness Crum's analysis demonstrate that the costs of nonletter non-flat shaped Standard (A) pieces exceed those for flat-size pieces significantly, thereby supporting the establishment of the proposed residual shape surcharge for these pieces.

Witness Crum employs new analyses to calculate cost avoidances for Standard (B) subclasses which would accrue from proposed forms of mailer worksharing, including new options for mail entry and drop shipping (OBMC, DSCF, DDU) and presorting to BMC. Witness Crum also updates DBMC mail processing cost avoidances with up-to-date inputs.

(USPS-T-29) The testimony of Sharon Daniel presents Standard (A) mailflow models which form the basis for rate proposals for Standard Mail (A) subclasses. For Standard (A) Regular and Nonprofit subclasses, witness Daniel updates the models

adopted by the Commission in Docket Nos. MC95-1 and MC96-2 with new inputs, including mail characteristics, productivities, coverage factors, piggyback factors, and wage rates. In addition, witness Daniel's Standard (A) models refine the methodology for determining the CRA adjustment, which represents an improvement to the "nonmodel cost factor" introduced by witnesses Takis and Smith in Docket No. MC95-1. Witness Daniel explains that, in this docket, the Postal Service has undertaken to disaggregate shape-specific costs taken from the CRA into worksharing- and nonworksharing-related cost pools, thereby enabling cost differentials based on modeled costs to be adjusted only by those that are in fact worksharing related.

A significant advancement in the analysis of carrier route costs is also presented in witness Daniel's exhibits. A new analysis of IOCS tallies divides carrier route mail processing costs into two components: Basic carrier route and combined High Density and Saturation. The results of this analysis, combined with witness Daniel's adjustment for different dropshipping profiles, confirm that the handling costs of denser carrier route mailings are lower than those for Basic categories. These differences in mail processing, along with differences in delivery costs, now form the basis for witness Moeller's rate design for carrier route categories.

Witness Daniel's testimony updates the Parcel Post mailflow models presented in prior dockets to estimate the mail processing cost difference between inter-BMC machinable and nonmachinable outside (NMO) parcels, which serves as the basis for the inter-BMC nonmachinable surcharge, as well as the costs avoided in mail

processing by intra-BMC parcels and the additional mail processing costs of handling oversized parcels. Witness Daniel also estimates the cost savings associated with customer barcoded Standard (B) parcels, thereby establishing a sound basis for the new prebarcoding discount proposed by witnesses Mayes and Adra for Standard (B) subclasses. The mailflow models incorporate recent operational improvements, including the package barcoding system, the Postal Pak network, and direct-to-secondary induction capability. Recently commissioned studies of Bulk Mail Center operations serve as rich sources for productivity and arrival and dispatch mail profiles. These new inputs enable witness Daniel to present up-to-date information about the paths parcels take through the postal system and the attendant costs of mail processing operations. Witness Daniel's testimony also provides a more comprehensive analysis of parcel costs by estimating the cost of mail processing operations at facilities up- and down-stream from BMCs. Witness Daniel's cost models also demonstrate the significant role cube plays in influencing mail processing cost.

E. Rate Policy

The Postal Reorganization Act, in § 3622(b), establishes nine pricing criteria which are applied to establish postal rate and fee levels. These criteria list the factors to be considered in determining how institutional costs¹³ are to be distributed

¹³ Traditionally thought of as those costs not determined to be volume-variable or specific fixed.

among the various classes and subclasses of mail and postal services, in order to ensure that rates and fees generate sufficient revenues to cover total costs, as required by § 3621. On behalf of the Postal Service, Dr. O'Hara (USPS-T-30) has applied the statutory criteria to allocate institutional costs among the various subclasses of mail and postal services. Dr. O'Hara's comprehensive application of the criteria satisfies the policies of the Act and represents a significant improvement over traditional pricing analysis.

The criteria in § 3622(b) to be considered in determining postal rate and fee levels are :

- (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 or subclass of mail bear the direct and indirect costs attributed to that class plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;
- (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 and its effects upon reducing costs to the Postal Service;
- (7) simplicity in structure for the entire schedule and simple, identifiable relationships between rates or fees charged the various classes of mail for the postal services;

- (8) the educational, cultural, scientific, and informational value to the recipient of mail matter, and;
- (9) such other factors as the Commission may deem appropriate.

The Postal Rate Commission's practice has been to assess rate levels by comparing revenue to attributable cost.¹⁴ The Commission has evaluated the resulting "cost coverage" ratio against the nine criteria of § 3622(b). In order to prevent any cross-subsidy between subclasses and postal services, the Commission has interpreted subsection 3622(b)(3) as establishing a test year attributable cost "floor" and requiring that the test year revenue generated by each subclass or postal service must at least equal this floor. Then the Commission has applied the nine criteria of 3622(b) to determine how much institutional cost burden should be borne by each subclass or postal service in the test year to meet the overall break-even requirement of § 3621.

The testimony of Dr. Panzar (USPS-T-11) establishes that these purposes would be better served if an incremental cost test were applied to ensure against cross-subsidy¹⁵, and if a ratio of revenue to volume-variable costs were used in allocating institutional cost burden instead of the traditional ratio of revenue to attributable costs. Dr. O'Hara follows this prescription by taking into account the incremental cost estimates developed by witness Takis (USPS-T-41).

As the starting point in determining test year rate levels, Dr. O'Hara uses the estimates of test year volume-variable costs presented by witness Patelunas (USPS-

¹⁴ Attributable cost have generally been defined by the Commission in recent years as the sum of volume-variable and specific-fixed cost.

¹⁵ As suggested by the Commission at PRC Op. R94-1, Appendix F, at ¶ 170. See also, PRC Op. R87-1, at pages 102-103.

T-15) for each subclass of mail. Those estimates incorporate the volume variability analyses of witnesses Bradley (USPS-T-14) and Brehm (USPS-T-21) and other cost measurement improvements. Dr. O'Hara (USPS-T-30) then applies the criteria of § 3622(b) to distribute the remaining costs among the various subclasses and postal services.¹⁶

Taking into account the resulting uneven reductions in the volume-variable costs measured for various subclasses which result from application of the volume variability analysis, Dr. O'Hara softens the consequences for subclasses which experience lower-than-average reductions in their measured volume-variable costs by proposing cost coverages that result in lower than average percentage rate increases.

A significant result of replacing assumptions about volume variability with actual empirical analysis is the reduction in the percentage of postal costs determined to be volume variable and an increase in the institutional cost pool to be allocated by Dr. O'Hara in accordance with statutory pricing criteria. The obvious consequence is a material increase in the systemwide cost coverage. USPS-T-30, at 17.

Examining the institutional cost pool, Dr. O'Hara has proposed mark-ups over costs (cost coverages) for each subclass which, after adjustments are made for the volume (and subsequent cost) consequences of new rate levels, ensure that total

¹⁶ Determination of the institutional cost burden to be borne by the preferred rate subclasses is governed by the six-year phasing schedule reflected in the Revenue Forgone Reform Act (RFRA) of 1993. Under that 6-step phasing schedule, the mark-up for each preferred subclasses is required to be equal to one-half of the mark-up for the most closely corresponding regular or commercial subclass in Fiscal Year 1999. Dr. O'Hara proposes Step 6 or "full" preferred subclass rates, with mark-ups equal to one-half of the corresponding commercial mark-ups. However, because the test year in this proceeding corresponds to Step 5 of the phasing schedule, the Postal Service's test year financial analysis uses the Step 5 rates.

proposed revenue will cover total costs. Exhibit USPS-T30-B. Although the Commission has traditionally used historical mark-up indices as a starting point for evaluating proposed omnibus rate and fee changes, Dr. O'Hara demonstrates that a cost coverage index provides a better starting point, in light of the improved costing analysis presented by the Postal Service. USPS-T-30, at 16–20.

The testimony of Postal Service witness Bernstein presents an analysis of the application of Ramsey pricing to postal ratemaking (USPS-T-31). Although Dr. O'Hara recognizes that a mechanistic application Ramsey pricing principles would not be consistent with the mandate that all nine criteria of section 3622(b) be considered, he finds witness Bernstein's economic efficiency analysis meaningful for two reasons. First, it provides a useful framework for demonstrating the effects of different pricing decisions. Second, because Dr. O'Hara views the movement of rates in the direction of Ramsey prices to be beneficial, the Bernstein analysis serves as a guidepost for evaluating his own rate proposals. USPS-T-30, at 20–21.

Dr. O'Hara's proposed cost coverages (Exhibit USPS-30B) reflect a judicious application of the applicable statutory pricing criteria. In keeping with the Postal Service's modest revenue requirement objectives, Dr. O'Hara applies the criteria to propose relatively modest percentage rate increases for the various subclasses. See Exhibit USPS-T30C.

F. Rate Design

The testimony of the following witnesses discuss the specific rate and fee proposals for subclasses and special services:

(USPS-T-32) The testimony of David Fronk, proposes rates for First-Class Mail letter and cards. Witness Fronk proposes to increase the basic first-ounce letter

rate to 33 cents. The basic post card rate is also proposed to increase by one penny, to 21 cents. Rates for workshared mail are proposed in accordance with updated estimates of cost avoidances. Witness Fronk also proposes two new rate categories, Prepaid Reply Mail (PRM) and Qualified Business Reply Mail (QBRM). PRM provides an opportunity for the senders of remittance mail or other reply mail to share in the rate reductions made possible by automation. QBRM is proposed in order to recognize the automation cost savings generated by prebarcoded, automation-compatible, Business Reply Mail pieces.

(USPS-T-33) The testimony of Thomas Sharkey proposes rates for Express Mail and Priority Mail. The proposed rates for Express Mail meet the cost coverage requirement of 204 percent proposed by witness O'Hara. There are no classification changes proposed for Express Mail. Along with a moderate increase in Priority Mail rates, in keeping with the 198 percent cost coverage proposed by witness O'Hara, Mr. Sharkey proposes the elimination of Priority Mail presort, describes the adjustments needed to reflect new delivery confirmation service features to be offered as part of basic Priority Mail. Finally, Mr. Sharkey proposes an increased pickup charge for Express Mail, Priority Mail, and Standard (B).

(USPS-T-34) The testimony of Altaf Taufique presents the Postal Service's rate and classification proposals for the Regular Rate and Within County Periodicals subclasses. The proposed rate changes average a 3.4 percent increase for Regular Rate, and a 2.2 percent increase for Within County. The proposed classification change, for both subclasses, consists of splitting the existing 3/5-digit rate category into 3-digit and 5-digit rate categories.

(USPS-T-35) The testimony of Kirk Kaneer proposes Nonprofit and Classroom rate design that follows that of Regular Periodicals. The rate design adopts the improved methodology introduced by witness Taufique in this docket for establishing the Nonprofit editorial pound and piece rate discounts, and also extends to Nonprofit and Classroom the proposed Regular Periodicals classification changes, including the division of the 3/5-digit category into separate presort tiers and the extension of the availability of the 3-digit rate category to nonunique city destinations. Witness Kaneer acknowledges that continuation of the Nonprofit rate design in Classroom results in a low cost coverage for that subclass, but maintains using the Nonprofit rate schedule is appropriate while uncertainty exists regarding Classroom costs.

(USPS-T-36) The testimony of Joseph Moeller proposes classification and rate changes for Standard (A) subclasses that are reasonable and consistent with the pricing criteria of the Act. The Postal Service proposes a modest increase of 4.1 percent for Regular and 3.2 percent for Enhanced Carrier Route. Cost coverages resulting for Nonprofit and Nonprofit Enhanced Carrier Route subclasses are consistent with the Revenue Forgone Reform Act. This filing also proposes the elimination of the Standard (A) Single Piece subclass to avoid the introduction of anomalous rate relationships. Witness Moeller explains that, if the Postal Service retained this subclass, its rates would exceed those for First-Class, despite the superior service offered by First-Class.

Witness Moeller's Standard (A) rate design achieves multiple objectives. First, the rate design preserves recently adopted incentives for worksharing while accounting for changes in cost data. Second, the rate design remains sensitive to the need to moderate the impact of price changes of individual categories, so that no single rate category receives a disproportionately high rate increase. Third, by

minimizing the shape passthrough in ECR Basic, the Postal Service is able to create appropriate incentives for nonbarcoded mail to migrate to Regular Automation 5-Digit. This measure properly balances the Postal Service's automation objectives with the appropriate recognition of shape-related costs in Enhanced Carrier Route.

Fourth, witness Moeller responds to the Commission's concerns raised in Docket No. MC95-1 that the Postal Service expeditiously propose a "comprehensive parcels proposal with supporting information." PRC Op. & Rec. Dec. MC95-1 ¶ 5569. The Postal Service proposes a 10 cent surcharge on nonflat nonletters in *Standard (A)* in recognition of new cost data confirming that these shapes exhibit substantially higher costs than flat-size pieces. This measure promotes fairness and equity by lessening the rate averaging that occurs between these shapes and flat- and letter-size advertising pieces. By setting a low passthrough for the surcharge, witness Moeller properly balances the need to recognize costs in rates while retaining sensitivity to the impact of the effective rate change on mailers. In addition, the low passthrough is sensitive to the concern that different types of nonflat shapes within the nonletters categories exhibit different cost characteristics.

Finally, witness Moeller preserves the Commission's rate design formula to set the basic rate elements. In this case, however, in recognition of information demonstrating that weight does not influence cost to the extent that is implied by the current pound rate, witness Moeller selects a lower pound rate for the *Standard (A)* subclasses, and instead uses the Commission's formula to solve for the piece rate for pound rated pieces. Using the Commission's formula to solve for the piece rate for pound rate pieces avoids the illogical outcome that would otherwise result from selecting that rate element. Currently, the rate relationship that results from the current application of the formula implies that weight alone varies directly with, and is

the sole driving factor of, cost for saturation pound-rated pieces. This outcome does not have logical appeal, for it implies that the Postal Service is indifferent between handling a single saturation pound rated piece and two saturation pound rated pieces, each of which weighs half the former. This is unlikely to be the case, however, because intuitively, the Postal Service likely incurs piece-related costs in handling pound-rated saturation pieces. Witness Moeller's selection of the pound rate avoids this outcome and instead generates a piece rate for pound-rated saturation mail that is greater than zero.

(USPS-T-37) The testimony of Virginia Mayes proposes new rates and classifications for Parcel Post. As in Docket No. MC95-1, the proposed rates for Parcel Post were intended to "align the rates more closely with the degree of preparation of mail for entry into the mailstream and the cost-causing characteristics of mail overall," and "provide strong incentives to drive costs out of the system by linking postage rates more closely with cost characteristics."¹⁷ The proposed rate design for Parcel Post in this docket further extends the benefits of worksharing to Parcel Post. In addition, new service enhancements are proposed to make parcel products more convenient and useful for customers. Extensive new studies of the processing and transportation of Parcel Post provide the most complete picture to date of the costs associated with handling parcels, and permit a rate design which more fully reflects these costs.

(USPS-T-38) The testimony of Mohammed Adra presents proposals regarding Bound Printed Matter, Special Rate, and Library Rate Standard Mail. For Bound Printed Matter, the Postal Service proposes to increase existing rates by an average

¹⁷ Request of the United States Postal Service For Recommended Decision on the Classification Reform of First-, Second and Third-Class Mail, Docket No. MC95-1, at 12.

of 5 percent. Based on an updated cost study, the current 6.3 cents for the carrier route presort discount would be increased to 6.7 cents. The Postal Service is also proposing to increase the weight limit from 10 pounds to 15 pounds. The Postal Service proposes that Special Standard rates be unchanged at \$1.24 for the first pound, increased to 51 cents from the current rate of 50 cents for each additional pound through the seventh pound, and decreased to 21 cents from the current rate of 31 cents for each additional pound in excess of seven pounds. Based on updated cost studies, the proposal decreases the 5-digit presort discount to 34 cents from the current 54 cents, and the Bulk Mailing Center (BMC) presort discount to 12 cents from the current 20 cents. The Postal Service proposes that Library Rate mail rates (i.e., full rates for step 6) be increased to \$1.44 from the current rate of \$1.12 for the first pound, to 52 cents from the current rate of 42 cents for each additional pound through the seventh pound, and to 25 cents from the current rate of 22 cents for each additional pound in excess of seven pounds. These increases would be phased in over the remainder of the statutory 6-step phasing period. To better reflect costs, the underlying rate elements have been recalculated, based on test year cost data to ensure that rate elements comport well with cost causation. For all three subclasses, the Postal Service is also proposing a 4 cent barcode discount, and delivery confirmation service.

(USPS-T-39) The testimony of Susan Needham proposes fees for the following special services: address changes for election boards, address correction, business reply mail, carrier sequencing of address cards, certified mail, collect-on-delivery, correction of mailing lists, money orders, on-site meter settings, parcel airlift, post office boxes, caller service, reserved call numbers, prepaid reply mail permits, registered mail, special handling, stamped cards, stamped envelopes, and ZIP

Coding of mailing lists. Witness Needham proposes classification changes for registered mail (limiting uninsured registered mail to items with no value), business reply mail (changing the name of the "prebarcoded" category to "qualified"), and the newly-proposed prepaid reply mail (adding an annual permit fee and a monthly accounting fee). She also proposes to amend the fee schedule for post office box and caller service by specifying a \$0 fee for all box sizes in Group E. Finally, she sponsors a proposed reorganization of the special service section of the Domestic Mail Classification Schedule, as the Commission suggested in its Notice of Inquiry No. 1 in Docket No. MC96-3.

(USPS-T-40) The testimony of Michael Plunkett proposes fees for the following special services: certificates of mailing, insurance, restricted delivery, return receipts, delivery confirmation, merchandise return, permit fees, and Periodicals application fees. He proposes a new classification for delivery confirmation service, and classification changes for insurance (adding a bulk insurance option), and return receipts (making them available in conjunction with the proposed delivery confirmation service).

(USPS-T-42) The testimony of witness Currie discusses the proposed treatment of mail which requires the handling of hazardous material.

G. Classification Changes

This filing also responds to the Commission's suggestion, initially raised in Docket No. MC96-3, that "broader improvements in the organization, format, and editorial presentation of the underlying DMCS, similar to those considered in the previous reclassification cases" be introduced. Docket No. MC96-3, Notice of Inquiry No. 1 Regarding Potential Improvements in the Organization and Structure of DMCS

Provisions Related to Various Special Services (hereinafter "Notice"). In its response to the Notice in Docket No. MC96-3, the Postal Service responded favorably to the Commission's suggestions for improvement, but recommended deferring consideration of such proposals in order to avoid being hastened by the procedural deadlines of that proceeding.

After the conclusion of Docket No. MC96-3, the Postal Service undertook to develop a comprehensive review of the organization and diction of the DMCS. The proposed classification changes address the Commission's suggestions for improvement. The special services schedules are reorganized into subject matter groupings, which represents an improvement over the existing sequence. The Postal Service has also introduced organizational headings¹⁸ to identify the logical relationships among the special service products. To facilitate ease of reference, the special services sections are also proposed to be renumbered in a 900 series. The prior numbering system, which consisted of a combination of the acronym "SS" followed by numbers, was cumbersome. By contrast, the new proposed 900 series extends the numbering system of the remainder of the DMCS to the special services provisions.

The proposed classification changes also serve to promote clarity, consistency, and conciseness. Specifically, the Postal Service has proposed numerous editorial improvements and changes in diction to remove internal inconsistencies as well as foster consistency with the Domestic Mail Manual. Gender-specific references are also proposed for elimination in the text of the DMCS. Separate rate schedules are developed for Parcel Post Rate categories to promote simplicity and ease of use,

¹⁸ These include: Addressing, Delivery Alternatives, Payment Alternatives, Accountability & Receipts, Parcel Handling, Stamped Paper, and Postal Money Orders.

particularly since discounts for intra-BMC and DDU and SCF entry are not uniform across all rate cells. Repetition of the definition of stamped cards is eliminated, consistent with the classification for stamped envelopes, and the Postal Service proposes a new name for the cards subclass to replace its current, unwieldy name.

V. CONCLUSION

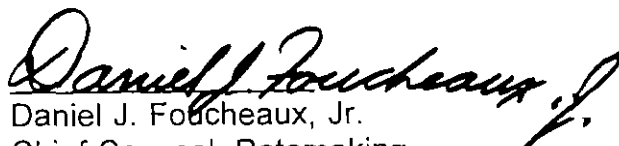
The Postal Service submits that the testimony and supporting documentation that it has filed in this case support its request for a recommended decision, and its proposed rates, fees, and classification changes.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

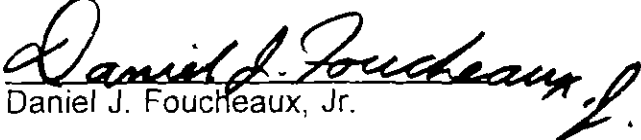
Anthony Alverno
Richard T. Cooper
Susan M. Duchek
Kenneth Hollies
Eric Koetting
Anne B. Reynolds
Scott L. Reiter
David H. Rubin
Michael T. Tidwell


Daniel J. Fouchaux, Jr.
Chief Counsel, Ratemaking

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2989; Fax -5402
September 29, 1997

CERTIFICATE OF SERVICE

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


Daniel J. Foucheaux, Jr.

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2989; Fax -5402
September 29, 1997