

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

RESPONSES OF POSTAL SERVICE WITNESS TANG
TO INTERROGATORIES OF THE MCGRAW-HILL COMPANIES, INC.
(MH/USPS-T35-1-5)

The United States Postal Service hereby files the responses of Witness Tang to the above listed interrogatories, filed on July 11, 2006.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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MH/USPS-T35-1. With respect to the container rate addressed at pp. 4-6 of your testimony and in USPS-LR-L-126, worksheet "Container":

- (a) Please explain fully how you arrived at a proposed container rate of 85¢ per container, as opposed to some other amount, and provide all calculations and references to any relevant portions of the record in this proceeding.
- (b) Given the estimate that an average pallet contains 1641.64 pieces, please confirm that on average, each palletized piece would effectively incur \$0.00052 (0.05176¢) as a result of the proposed container charge. If you do not confirm, please explain fully.
- (c) In worksheet "Container", please reconcile the 71,188, 563 figure in cell B7 with the 72,056,006 figure in cell B11.
- (d) In worksheet "Container", please explain fully the derivation of the 50,963,695 figure in cell H7.

RESPONSE:

- (a) The 85-cent container rate was developed to send an appropriate price signal to encourage better mail preparation and improve Periodicals efficiency, without imposing an overwhelming burden on those smaller publications which may not have the volume or density to fully take advantage of the price incentives. However, smaller publications would still have an incentive to use fewer containers. The revenue generated from the 85-cent container rate allows other rate elements to be lower. The container cost analysis in USPS-LR-L-85, Table 1 (specifically, the unit costs of \$1.1592 per sack, and \$19.5660 per pallet) was used as a reference but not as the primary basis for the 85-cent container rate.
- (b) Confirmed that 85 cents, divided by 1641.64 pieces, yields a result of \$0.00052 per piece (0.05178¢). While some might view that as an additional charge and compare it to the existing "pallet discount", that would be incorrect. As noted above, the container rate also serves to reduce the proposed charges for other components in

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Periodicals rate design. The appropriate comparison is to examine the absolute differences in postage for the same mailing, when it is sacked versus palletized.

(c) In worksheet "Container", the 71,188,563 figure in cell B7 is the total count of containers with Outside-County flats. To account for the letter and parcel shaped Periodicals pieces, I multiplied the number of flats containers, which is 71,188,563, by the ratio of total Outside-County volume (8,307,329,578 in cell D13) to flats volume (8,207,322,096 in cell D7). This is how the 72,056,006 figure in cell B11 is derived.

(d) Based on the assumption that about 65 percent of the "skin" sacks (cell F6) would be eliminated as a result of the minimum 24 pieces per sack rule, the remaining number of sacks is calculated in cell H6 by subtracting the eliminated skin sacks from the total number of sacks that contains flats (cell B6). The 50,963,695 figure in cell H7 is derived by applying the ratio explained above in (c) to the sum of the remaining flats containers (pallets in cell B5 + sacks in cell H6).

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MH/USPS-T35-2. With respect to the statements at page 6 of your testimony that the proposed container rate “would encourage customers to move toward more efficient containerization, such as from sacks to pallets”, and “would encourage better use of existing containers” (i.e., fuller, and therefore fewer, sacks and pallets):

(a) Please confirm that the proposed container rate is designed to foster a substantial reduction in the number of containers used for Outside-County Periodicals mail, and a corresponding reduction in costs incurred by the Postal Service, above and beyond the elimination of 65% of “skin” sacks projected to result from the minimum 24 pieces per sack rule that became effective for Periodicals mail on May 11, 2006. If you do not confirm, please explain fully.

(b) Please confirm that apart from the elimination of 65% of skin sacks, you nevertheless project in worksheet “Container” that the same number of containers (50,963,695) will be used for Outside-County Periodicals mail in TY 2008 as was used for Outside-County Periodicals mail in FY 2005 (even though the TYAR volume of Outside-County Periodicals mail forecast for TY 2008 is 210,102,987 pieces less than the corresponding FY 2005 volume). If you do not confirm, please explain fully.

(c) Please confirm that you likewise project in worksheet “Container” and your TYAR worksheets for Outside-County Periodicals mail that (i) the number of pallets used for Outside-County Periodicals mail in TY 2008 will be the same as in FY 2005 and (ii) pallets for Outside-County Periodicals mail will average the same number of pieces in TY 2008 as in FY 2005. If you do not confirm, please explain fully.

(d) Please provide your best estimate of the degree of impact (or range of impact) that the proposed container charge would likely have through TY 2008 on (i) the number of Outside-County Periodicals sacks and pallets, respectively, and (ii) the average number of pieces per pallet and per sack, respectively.

(e) Assuming that the proposed container rate in fact fosters a substantial reduction in the number of containers used for Outside-County Periodicals mail, please explain fully whether and to what extent it is likely that the corresponding reduction in costs incurred by the Postal Service may substantially exceed the resultant reduction in container charge revenues, resulting in a commensurately higher cost coverage for Outside-County Periodicals mail.

(f) Please provide your best estimate of the reduction in costs to the Postal Service that would likely be fostered by the proposed container charge through TY 2008.

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RESPONSE:

- (a) Confirmed that the pricing is intended to encourage more efficient use of containers beyond that which may result from the 24-piece sack rule.
- (b) Confirmed that, apart from the elimination of 65 percent of skin sacks, I assume that test year 2008 will have the same number of containers calculated based on the FY 2005 data. There are several reasons that I use this assumption. The proposed container rate is a completely new rate category for test year 2008. There are no existing data to forecast how mailers will react to this new incentive, combined with the other price, rate structure, and any resulting changes in standards. There is also no significant change in volume forecast -- the total outside county volume forecast for test year after-rates is about 97 percent of the FY 2005 volume. The effect of the recently implemented 24-piece per sack rule has been estimated and reflected in the presort-level adjustment to Periodicals volume as well as the 65 percent elimination of skin sacks. Given that Periodicals volume is relatively stable in total, but mailer preparation practices change, and the makeup of the Periodicals classification, itself, changes as publications are launched and others become defunct, the safest assumption appeared to be to hold the number of containers constant.
- (c) Confirmed. Please see my response to part (b).
- (d) I cannot make such an estimate. See my response to part (b).
- (e) As I said in my response to parts (b) and (d), I do not know how substantial the reduction in the number of containers used for Outside-County Periodicals mail will be. Even if the scenario posited in the question proved correct, the likely outcome would be

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that Periodical cost coverages would move in the direction of the historical figures during the late 1980s and early 1990s. I do not think that it would be entirely out of line for Periodicals to begin making a slightly more substantive contribution to institutional costs. And I would note that recent history seems to suggest that Periodicals cost coverages tend to move in the opposite direction from what is projected in the rate case. Perhaps the scenario laid out in the question would tend to offset such a movement.

(f) I cannot provide the estimate of the reduction in costs likely be fostered by the proposed container rate through TY 2008. As I mention in my response to part (b), the container rate is a completely new rate category for test year 2008. There are no existing data to forecast how mailers will react to a combination of rate, rate structure, and rule changes.

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MH/USPS-T35-3. With respect to your testimony at page 4 lines 20-23, page 5 lines 2-3 and page 6 lines 9-12 that the proposed container rate is designed to achieve greater progress, and would send a better price signal, for purposes of encouraging Periodicals mailers to shift from sacks to pallets and to use fewer (fuller) containers:

(a) Please explain fully all reasons for the decision that for such purposes, the proposed container charge would send a better price signal, and likely achieve greater progress, than the current pallet discounts or enhanced versions of those discounts.

(b) Please compare, with as much quantitative specificity as possible, the incentives for Outside-County Periodicals mailers to shift from sacks to pallets under the proposed rate structure (including, without limitation, the container charge) with any such similar incentives under the current rate structure (including, without limitation, the effect of pallet discounts on the level of the piece rates generally).

(c) To the extent that Outside-County Periodicals mailers already use pallets, please compare, with as much quantitative specificity as possible, any rate benefits to such mailers for continued use of pallets under the current rate structure (including, without limitation, the pallet discounts that you propose to eliminate) with any similar such rate benefits under the proposed rate structure (including, without limitation, the effect of the container charge and other proposed rate design changes on the level of piece rates generally).

(d) For the purpose of gauging the impact of the proposed rate structure on Outside-County Periodicals mailers, please provide alternative (non-binding) piece rates designed to recover the same revenue as the proposed piece and container rates but substituting the current pallet discounts (with any adjustments that might be warranted) for the container charge.

(e) For the purpose of gauging the impact of the proposed rate design on Outside-County Periodicals mailers, please provide alternative (non-binding) piece rates designed to recover 60% (rather than 63% or 62.5%) of the aggregate piece, pound and container revenues for Outside-County Periodicals mail in TY 2008, both (i) under the proposed rate structure and (ii) under the alternative rate structure described in subpart (d) above.

RESPONSE:

(a) The incentive the container rate offers is not limited to pallets. It also encourages better preparation and efficient use of other containers, including sacks.

(b) The complex rate structure makes it difficult to compare the incentives to palletize today versus the incentives to palletize under the proposed rates. Each mailer

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will have to consider his particular circumstances to determine whether creating more efficient containers is worth it. Also, please see my response to MPA/USPS-T35-13.

(c) See my response to part (b). Also, the increased dropship discounts enhance the potential savings that could come with palletization. Under the proposed Periodicals rates, the dropship per-piece discounts have been increased from \$0.002 to \$0.003 for DADC entry, and from \$0.008 to \$0.011 for DSCF entry. Moreover, editorial pound dropship rates have been introduced to offer additional incentives: a DDU editorial pound rate of \$0.154, and a DSCF rate of \$0.193, comparing with the current rate of \$0.203.

(d-e) Developing prices involves a balancing of a number of rate design objectives. I cannot develop any hypothetical alternative prices that necessarily would have met those objectives.

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MH/USPS-T35-4. With respect to your testimony at page 5 line 21 through page 6 line 8, noting data indicating for Periodicals mail an average of about 1642 pieces per pallet and 42 pieces per sack, and stating that if the proposed 85¢ container charge “were allocated to each mail piece within an average sack or pallet, each piece on a pallet would bear \$0.001, while each piece within a sack would bear \$0.02”, a differential of \$0.019:

(a) Please confirm that the proposed container charge would impose an added per piece rate burden on sacks that contain relatively few pieces (for example, an aggregate \$0.040 per piece for a sack containing only one-half the average pieces per sack) that is approximately 40 times higher than the per-piece rate burden that the proposed container charge would impose on pallets that similarly contain relatively few pieces (for example, an aggregate \$0.0010 per piece for a pallet containing only one-half the average pieces per pallet). If you do not confirm, please explain fully.

(b) Please confirm that under the current rate structure, there are no rate disincentives to mailing relatively few pieces per sack or pallet (*vis-à-vis* the average number of pieces per sack or pallet, respectively), putting aside Postal Service rules specifying minimum pieces per sack or minimum weight per pallet. If you do not confirm, please explain fully.

(c) Please set forth and explain your view of the relative advantages and disadvantages of encouraging greater container utilization through such rules, as opposed to rate incentives such as the proposed container charge.

RESPONSE:

(a) Confirmed that varying the number of pieces per sack or per pallet results in a change in the relative per-piece effect of the container rate.

(b) Confirmed.

(c) I have not prepared an exhaustive review of the relative merit of price incentives versus rule imposition. In general, it seems that the use of prices, rather than rules, allows for greater flexibility.

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MH/USPS-T35-5. Please refer to *Postal Bulletin* 22156 (6-9-05), pages 17 and 23, which announced revisions to the Domestic Mail Manual, including part 707.28.4.6 (entry of Periodicals mail at the destination delivery unit), and explained those revisions in part as follows:

The Postal Service is finding ways to make it easier for customers to enter mail. One way is by offering optional entry of unsacked bundles for specified flat-size mail. This will help reduce dependency on sacks and also help us increase efficiency and reduce costs. . . .

When entering mail at DDU facilities, mailers (or their drivers) must unload the mail within 1 hour of arrival and place the mail into containers that entry facility employees specify. DDU facility employees may also require drivers to keep bundles separated by individual 5-digit ZIP Codes or by 5-digit schemes.

(a) Please state whether the proposed container charge would apply to uncontainerized bundles of Periodicals mail that are entered at DDU facilities, where the bundles are unloaded by mailers, separated by mailers by 5-digit zip codes or 5-digit schemes or as otherwise specified by DDU personnel, and placed by mailers into corresponding rolling containers as specified by DDU personnel. Please explain your rationale fully.

(b) Please state whether the proposed container charge would apply to bundles of Periodicals mail that are entered at DDU facilities that cannot handle pallets, where the bundles are unloaded by mailers from pallets, separated by mailers by 5-digit zip codes or 5-digit schemes or as otherwise specified by DDU personnel, and placed by mailers into corresponding rolling containers as specified by DDU personnel, in accordance with DMM 707.28.4.6d. Please explain your rationale fully.

(c) Please state whether the proposed container charge would apply to bundles of Periodicals mail that are entered at DDU facilities, where the bundles are removed by mailers from sacks unloaded by mailers, are separated by mailers by 5-digit zip codes or 5-digit schemes or as otherwise specified by DDU personnel, and placed by mailers into corresponding rolling containers as specified by DDU personnel. Please explain your rationale fully.

RESPONSE:

(a) The proposed container charge is an integral part of the rate structure. Its existence allows for other rate elements to be lower than they otherwise would be, so it must apply to all mailings. The proposed container rate would therefore apply to

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mailings comprised of uncontainerized bundles of Periodicals mail that are entered at DDU facilities. The relatively rare situations where pallets or sacks are not used, as in this example, require alternative means for assessing the charge. These means will be the subject of specific standards that will be published in the Federal Register for comment. In this instance, one possibility would be to assess the container rate for each 5-digit ZIP Code or 5-digit scheme that is serviced by the DDU when the mailer presents carrier route bundles destined for those 5-digit ZIP Codes or 5-digit schemes.

(b) The proposed container rate would apply to Periodicals mail that is entered at DDU facilities as described. Please see my response to (a) as to how the container rate could be assessed.

(c) The proposed container rate would apply to Periodicals mail that is entered at DDU facilities as described. Please see my response to (a) as to how the container rate is to be assessed.