

**BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0111**

Before Commissioners:

George Omas, Chairman
Dawn A. Tisdale, Vice Chairman
Ruth Goldway; and
Tony Hammond

POSTAL RATE AND FEES CHANGES, 2006

Docket No. R2006-1

**PARCEL SHIPPERS ASSOCIATION (PSA)
RESPONSE TO PRC's NOTICE OF INQUIRY NO. 2
(July 26, 2006)**

The Parcel Shippers Association (PSA) responds herein to the Commission's Notice of Inquiry No. 2, issued on July 21, 2006.

Respectfully submitted,

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RESPONSE OF PARCEL SHIPPERS ASSOCIATION TO NOTICE OF INQUIRY NO. 2

The Parcel Shippers Association (PSA) appreciates the opportunity to comment on Notice of Inquiry No. 2, which solicits comments on the method to design rates for the Standard Mail subclasses. PSA respectfully submits that the appropriate framework for analyzing Standard Mail shape-based rate differentials is comparing the *entire* revenue difference between shapes with the respective cost differences, rather than through the development and analysis of shape-based passthroughs by rate category (e.g., comparing the rate for Mixed BMC machinable parcels with the rate for Mixed ADC Automated flats). The “presort tree” approach remains appropriate for evaluating worksharing discounts within a mail shape.

Table 1 below calculates shape-based passthroughs in this manner. As it shows, the passthrough of the parcel cost differential relative to both letters and flats underlying the Postal Service’s proposed rates exceeds 100%.¹

Table 1. Calculation of Standard Regular Shape-Based Passthroughs for Parcels

Shape	Costs		Parcel Cost Diff		TYAR Revenue	Parcel Rev Diff	Passthrough	
	MP+D	Total	MP+D	Total			MP+D	Total
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]
Letters	7.86	8.57	84.41	90.55	20.9	93.7	111.0%	103.5%
Flats	24.5	27.36	67.77	71.76	34.2	80.4	118.6%	112.0%
Parcels	92.27	99.12	n/a	n/a	114.6	n/a	n/a	n/a

[1],[2] USPS-LR-L-135. MP+D = Mail Processing and Delivery.

[3],[4] Calculated by subtracting letter and flat costs from parcel costs.

[5] Calculated from USPS-LR-L-36, 'Revenues @ TYAR Vols.' and 'TYAR Commercial Pieces & Pounds'

[6] Calculated by subtracting letter and flat revenues from parcel revenues.

[7]=[6]/[3]

[8]=[6]/[4]

¹ This response focuses on the appropriate approach to evaluate Standard Mail shape-based rate differentials and worksharing discounts. We, however, would note that, given the magnitude of the proposed rate increase for Standard Mail parcels – which averages about 50% (PSA/USPS-T36-2) with some increases in excess of 80% (USPS-LR-L-36, 'Percent Rate Changes') – and the uncertainty in Standard Mail parcel cost and mail characteristics data, a passthrough of less than 100% (not a passthrough in excess of it) seems more appropriate.

RESPONSE OF PARCEL SHIPPERS ASSOCIATION TO NOTICE OF INQUIRY NO. 2

Evaluating shape-based rate differentials in this manner has two primary benefits as compared to the traditional “presort tree” approach.²

- As the Commission accurately noted in its NOI, “it is often difficult to separate the cost effects of shape from weight.” Comparing the *entire* shape-based revenue difference with the *entire* shape-based cost difference does not require these two effects to be disentangled. The comparison we recommend simply ensures that the combined effect of differences in shape and weight are appropriately reflected in the combination of shape-based and weight-based rates.
- Ensuring the proper relationships between shapes by analyzing passthroughs at the aggregate level provides significant flexibility to design shape-specific rates that are appropriate for the particular shape at a more detailed level.

Importance of Comparing the Entire Revenue and Cost Differences

The traditional “presort tree” approach can be misleading when used to calculate passthroughs for parcels relative to letters and flats. This is because the traditional approach assumes that the pieces being compared weigh the exact same amount.³ Of course, this assumption is wrong – on average, Standard Mail parcels weigh about 5 ounces more than flats and 8 ounces more than letters and thus contribute much more in “weight-based” revenues than letters and flats. Since the cost difference between parcels and other shapes is caused by a combination of differences in weight and shape⁴, it is only appropriate to compare this cost difference to a revenue difference that also reflects both of these factors.

² A third benefit is that, in most instances, the quality of CRA unit cost by shape data will be higher than the quality of more detailed unit cost by shape and rate category data. This, however, may not be the case for Standard Regular parcels given the inconsistencies in how RPW and CRA systems define flats and parcels. See, e.g., PSA/USPS-T36-7; POIR No. 5, Question 16(b). As Harahush notes in response to POIR No. 5, Question 16(b) in the context of Periodicals, “[a] very small error in classification from major shape (flat) to one of the minor shapes (parcels) would be magnified in the small shape estimate.”

³ See, e.g., Taufique’s calculation for First-Class Mail. USPS-T-32 at 23.

⁴ As well as other cost causing characteristics

RESPONSE OF PARCEL SHIPPERS ASSOCIATION TO NOTICE OF INQUIRY NO. 2

Furthermore, the Postal Service's weight-based rates (Standard Mail pound rates and First-Class Mail additional ounce rates) have traditionally been designed to recover at least a portion of shape-related costs as well as weight-related costs. Witness Taufique describes this approach in the context of First-Class Mail, stating:

For pieces weighing more than an ounce, additional ounce postage is charged. The additional postage is presumed to reflect the transition from letters to flats and parcels, as weight increases, along with other factors. USPS-T-32 at 17.

As long as the Postal Service recovers some shape-based costs through weight-based revenues, it is important to ensure that the shape-based rate does not "double charge" parcels. For example, consider the following hypothetical situation –

- The parcel-flat cost differential (which reflects both differences in shape and weight) is 10 cents.
- All parcels weigh two ounces and all flats weigh one ounce.
- There is currently an additional-ounce rate of 10 cents per piece.

In this hypothetical, the ten-cent cost difference between flats and parcels is entirely recovered through the additional-ounce rate. Thus, introducing a ten-cent "parcel surcharge" on top of the additional-ounce rate would be inappropriate. Comparing the *entire* revenue difference with the *entire* cost difference would protect against this situation.

Rate Design Flexibility Within Shape

In its notice, the Postal Rate Commission points out that if passthroughs were set at 100% in all instances, then "the organization of a presort tree would not matter, because the differences in rates between the two categories would equal the difference in avoidable cost between the two categories. Any presort tree scheme would produce the same discounts and rates." Notice at 4.

It also notes that, for a multitude of reasons – including "rate simplification, the need for rational rate relationships, and avoidance of rate shock," (Notice at 2) – the Commission has recommended rates that depart from 100% passthroughs. In these instances, altering one passthrough can affect others – for example, passing through more than 100% of a presort discount

RESPONSE OF PARCEL SHIPPERS ASSOCIATION TO NOTICE OF INQUIRY NO. 2

in one shape alters the passthrough between presorted pieces in that shape and those in other shapes.

The question of which presort tree should be used at a more detailed level boils down to which passthroughs should be given precedence (and explicitly chosen) -- the passthroughs that govern worksharing discounts within a shape or the passthroughs that govern the rate relationships between pieces of different shapes at the same “workshare level.”

Maintaining the appropriate aggregate relationship between rates for different shapes is addressed by the framework discussed above. Having addressed the relationship between shapes at the aggregate level allows precedence (at the more detailed level) to be given to passthroughs of worksharing cost avoidances within a shape.⁵

This is also the appropriate result from a productive efficiency perspective because setting worksharing discounts equal to worksharing costs avoided (where appropriate given other policy considerations) will likely have a much larger impact on how mail is prepared and entered than doing the same for shape-based cost differences. The long history of worksharing shows that mailers respond to discounts by changing how they prepare and where they enter their mailings. It is much less clear whether mailers will change the shape of pieces that they send in response to postage incentives.

⁵ This, of course, is not absolute. There may be some situations where the passthroughs of worksharing cost avoidances need to be altered to ensure that, for example, the rate for a parcel is not less than the rate for a similarly-workshared flat.