

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

Postal Rate Commission
Submitted 9/6/2006 2:43 pm
Filing ID: 53185
Accepted 9/6/2006

PSA/POSTCOM-T-1

POSTAL RATE AND FEES CHANGES, 2006

Docket No. R2006-1

**DIRECT TESTIMONY
OF
SANDER GLICK
ON BEHALF OF
PARCEL SHIPPERS ASSOCIATION (PSA)
&
ASSOCIATION FOR POSTAL COMMERCE (POSTCOM)
&
MAIL FULLFILMENT SERVICES ASSOCIATION (MFSA)**

Respectfully submitted,

Timothy J. May
Patton Boggs, LLP
2550 M Street, NW
Washington, DC 20037
Tel: 202 457 6050
Fax: 202 457 6315
tmay@pattonboggs.com
Counsel for PSA

Ian D. Volner
Venable, LLP
575 7th Street NW
Washington, DC 20004-1601
Phone: (202) 344-4814
Fax: 202-344-8300
idvolner@venable.com

Counsel for PostCom & MFSA

Dated: September 6, 2006

TABLE OF CONTENTS

Autobiographical Sketch.....1

I. Purpose and Scope of Testimony.....2

II. The Postal Service has not justified such large rate increases for Standard Regular parcels.....2

a. The Postal Service proposal passes through more than 100 percent of the cost difference between Standard Regular flats and parcels.....3

b. The impact of the USPS Proposal is large and may be even more severe than estimated by the Postal Service.....4

c. The Postal Service’s data are insufficient to justify such large increases.5

III. The average rate increase for Standard Regular parcels should be limited to thirty percent to reflect impact and data imprecision and the DBMC discount should be increased. The increase for First-Class Mail parcels also should be reduced.8

IV. The data quality and impact issues discussed above also apply to Standard Mail NFM’s.11

V. Per the Commission’s recommendation in Docket No. MC2006-1, the PRS passthroughs should be increased.13

VI. Conclusion14

1 **Autobiographical Sketch**

2

3 My name is Sander A. Glick. I am a Vice-President and co-founder of SLS Consulting, Inc.,
4 a Washington, D.C. consulting firm specializing in postal economics. I have testified before the
5 Postal Rate Commission in two previous cases.

6

7 In Docket No. R97-1, I testified on behalf of the Magazine Publishers of
8 America (MPA). In Docket No. R2000-1, I submitted direct testimony on behalf of the Association
9 of Postal Commerce, the Recording Industry Association of America, and the Magazine Publishers
10 of America. I also submitted rebuttal testimony in that case on behalf of the Parcel Shippers
11 Association.

12

13 I have also participated on multiple Mailers' Technical Advisory Committee (MTAC) work
14 groups, including the Package Integrity Work Group and the Presort Optimization Work Group.

15

16 I attended the Maxwell School of Citizenship and Public Affairs at Syracuse University,
17 where I received a Masters of Public Administration in 1994, and Carleton College, where I received
18 a Bachelors Degree, magna cum laude, in Physics in 1993.

19

20

1 **I. Purpose and Scope of Testimony**
2

3 This testimony concerns the proposed rates for Standard Regular and First-Class Mail
4 parcels; Standard Mail not flat-machinables (NFMs); and Parcel Return Service.
5

6 Section 1 of my testimony explains why the dramatic rate increases proposed for Standard
7 Mail parcels are inappropriate. Given the impact of the USPS proposal on parcel shippers and the
8 imprecision of Postal Service data regarding Standard Regular parcels, a better approach is to
9 implement the proposed classification changes, but based upon less-than-full passthroughs.
10

11 Section 2 of my testimony recommends specific changes to the USPS proposals for Standard
12 Mail and First-Class Mail parcels that will make them more tolerable.
13

14 Section 3 of my testimony addresses the Postal Service's proposed rates for Standard Mail
15 NFMs.
16

17 Section 4 recommends that the Postal Service, consistent with the Commission's
18 recommendation in Docket No. MC2006-1, increase the Parcel Return Service (PRS) discounts by
19 passing through a larger percentage of the PRS cost avoidance.
20

21 **II. The Postal Service has not justified such large rate increases for Standard Regular**
22 **parcels.**
23

24 In this case, the Postal Service proposes to dramatically increase rates for Standard Regular
25 parcels. The increase is unjustified for three primary reasons.

1 The proposal passes through more than 100 percent of the cost difference between Standard
2 Mail flats and parcels.

3
4 Even if the passthrough did not exceed 100 percent, the rate increase should be reduced
5 simply to avoid “rate shock.”

6
7 The data that the Postal Service uses to support its proposal are insufficient to support such
8 dramatic increases.

9
10 The remainder of this section expands on each of these points.

11
12 ***a. The Postal Service proposal passes through more than 100 percent of the cost***
13 ***difference between Standard Regular flats and parcels.***
14

15 As discussed in PSA’s response to NOI No. 2, the passthroughs of shape-based rates should
16 be calculated by dividing the entire revenue difference between shapes by the entire cost difference
17 between shapes. This approach has two primary benefits.

18
19 As the Commission accurately noted in its NOI, “it is often difficult to separate the
20 cost effects of shape from weight.” Comparing the *entire* shape-based revenue
21 difference with the *entire* shape-based cost difference does not require these two
22 effects to be disentangled. The comparison we recommend simply ensures that the
23 combined effect of cost differences in shape and weight are appropriately reflected in
24 the combination of shape-based and weight-based rates.

25
26 Ensuring the proper relationships between shapes by analyzing passthroughs at the
27 aggregate level provides significant flexibility to design shape-specific rates that are
28 appropriate for the particular shape at a more detailed level. PSA Response to NOI
29 No. 2 at 3.
30

1 Calculated in this manner, the shape-based passthrough between Standard Regular flats and
2 parcels is 112 percent.¹

3

4 ***b. The impact of the USPS Proposal is large and may be even more severe than***
5 ***estimated by the Postal Service.***
6

7 The average rate increase proposed for Standard Regular parcels is nearly fifty percent.
8 Response to PSA/USPS-T36-2 (Tr. 5/949). The increase faced by many shippers will be even
9 higher. Most Standard Regular parcels are machinable, entered at origin facilities or at the DBMC
10 and are Mixed BMC or BMC presort. The proposed rate increases for these parcels are huge as
11 Table 1, below, shows. Further, as shown in Kiefer’s workpapers, the rate increases for some
12 Standard Mail parcels exceed 80 percent. USPS-LR-L-36, WP-STDREG-27.

13

14 **Table 1. Sample Rate Increases for Standard Regular Parcels²**

| Presort | Origin | DBMC |
|-----------------|---------------|-------------|
| 5-Ounce | | |
| Mixed BMC | 62.7% | n/a |
| BMC | 59.1% | 59.4% |
| 8-Ounce | | |
| Mixed BMC | 57.8% | n/a |
| BMC | 54.6% | 54.5% |
| 14-Ounce | | |
| Mixed BMC | 51.8% | n/a |
| BMC | 49.1% | 39.9% |

15 Source: USPS-LR-L-36, WP-STDREG-27

16

1 Calculated as a percentage of mail processing and delivery costs, this passthrough is approximately 119 percent.
PSA Response to NOI No. 2 at 2

2 Note that the percentage rate increase will actually be higher than shown in this table because, in developing these
figures, Kiefer compared the proposed rates for barcoded parcels with the current rates for non-barcoded parcels.
USPS-LR-L-36, WP-STDREG-27.

1 The impact on parcel shippers that enter parcels at the DBMC is likely to be even larger than
2 estimated by the Postal Service. As discussed by Mr. Finley, due to the Postal Service’s Evolutionary
3 Network Development (END) initiative, parcel shippers will likely be required to enter their parcels
4 at a larger number of facilities and thereby incur additional costs to qualify for DBMC rates. This is
5 because shippers will have to enter parcels at the destination facility where parcel distribution is
6 performed to qualify for DBMC rates. Institutional Response to PSA/USPS-T42-1.

7
8 In the Test Year, there are likely to be more of these destination facilities. In addition to
9 DBMCs, parcels will likely have to be entered at some destination regional distribution centers
10 (DRDC). As the Commission stated in POIR No. 10, Question 6, “[USPS] Management reported
11 that by next February, it expects to convert all HASPS to Surface Transportation Centers, and to
12 have 22 to 24 RDCs in place.” Emphasis added.

13
14 ***c. The Postal Service’s data are insufficient to justify such large increases.***
15

16 The data quality “bar” should be set much higher in support of huge rate increases than for
17 those that are in line with the overall average increase. Due to concerns about rate shock, it should
18 be undeniably clear that the data used to justify huge rate increases support the proposal. In the case
19 of Standard Mail parcels, however, the data quality does not meet this “high bar.” As argued by
20 Kiefer, the classification change itself will allow better data to be collected in the future. USPS-T-36
21 at 17. However, the present case must be decided based on the data that currently exist.

1 The record indicates that there is substantial uncertainty in the cost data for parcels in
2 subclasses where they comprise only a small percentage of the mail volume.³ On their face, the test
3 year unit attributable mail processing costs for parcels are clearly anomalous for at least some
4 subclasses, with unit costs for First-Class Presort Parcels at \$3 and for Standard ECR Parcels at
5 more than \$24. USPS-T-13, Attachment 14. Such results make it impossible to have complete
6 confidence in the unit costs provided for parcels.

7
8 Without an adequate and verified explanation of these parcel unit cost anomalies, there is no
9 way to know how the anomalies may have infected the other mail classes in which the estimated unit
10 costs seem to have the right order of magnitude. As stated by Smith, such an explanation will not
11 likely be available for this rate case.

12
13 As I indicate above, the source of the Standard ECR parcels cost anomaly is unclear.
14 In addition, I am not able to say when the actual cause of this anomaly can be
15 determined. I am told that the Postal Service has been investigating this issue in
16 response to the questions raised in POIR No. 5, question 16, and is considering
17 collecting additional data. The result of this work is not likely to be available for this
18 rate case.

19
20 Response to POIR No. 10, Question 2(e) (Tr. 14/4245).

21
22 While it is comforting that the parcel unit costs in some of the other subclasses are not
23 clearly wrong—as they are for First-Class Presort and Standard ECR—being “not clearly wrong” is

³ There is also uncertainty in the mail preparation and entry data used to calculate Standard Regular parcel revenue. Because it does not have data on FY 2005 volumes in each of the new rate categories, the Postal Service estimated parcel volumes for each of the new rate categories based upon a long series of assumptions. Response to PSA/USPS-T28-1 (Tr. 7/1501-3). Further, preparation and entry is likely to change in response to the enhanced worksharing incentives being offered. Because the presort discounts for parcels are based upon passthroughs of less than 100 percent, this could increase the contribution of Standard Regular parcels relative to USPS projections. Tr. 5/1110.

1 not a sufficiently high standard. To date, USPS has not conducted a formal review of the reliability
2 of CRA cost by shape data. Response to POSTCOM/USPS-1.

3

4 In his response to PSA, USPS witness Kiefer describes a disconnect between the volume
5 and costing systems that is likely to give rise to at least some of the anomalous parcel unit costs:

6

7 An unknown number of Standard Mail pieces that have parcel characteristics are not
8 identified as such in the RPW by Shape Report totals. In contrast, the principal
9 source of mail processing information, the IOCS, identifies the shape of Standard
10 Mail based on its physical characteristics so there are cases where IOCS would
11 identify a Standard Mail item as a parcel when the RPW would report it as a flat.

12

13 Response to PSA/USPS-T36-7 (Tr. 5/956).

14

15 With this disconnect, it is possible for mail pieces that have the physical characteristics of
16 parcels, but are mailed as flats, to have their costs included with other parcels by IOCS and their
17 volume included with other flats by RPW. As described by USPS witness Harahush in the context
18 of Periodicals, this could lead to anomalous results for shape categories that comprise small
19 percentages of subclass volume: “A very small error in classification from major shape (flat) to one
20 of the minor shapes (parcels) would be magnified in the small shape estimate.” Response to POIR
21 No. 5, Question 16b (Tr. 13/3631).

22

23 USPS witness Smith (USPS-T-13) uses available data to fix the inconsistency in the Standard
24 Regular subclass, but his adjusted numbers should be used with caution. Using an adjustment based
25 on the ratio of Standard Regular parcel volumes to RPW controlled ODIS-RPW volumes, Smith
26 lowers the Standard Regular unit cost for parcels by 23 percent (USPS-T-13, Attachment 13).
27 However, there are other ways to perform the adjustment.

1 Another approach – shifting IOCS costs for Standard Regular parcels with Postnet barcodes
2 (the barcodes used for flats) from parcel costs to flats costs – would have resulted in a 43 percent
3 downward adjustment to Standard Regular parcel costs. Response to PSA/USPS-T13-10(f) (Tr.
4 14/4284). While Smith provides a reasonable explanation for why this larger adjustment is not quite
5 right – some parcel-rated pieces have Postnet barcodes on them – he does not have sufficient data
6 to conclude that this explains the entire difference between these two adjustments. Response to
7 PSA/USPS-T13-14(a) (Tr. 14/4290-1).

8
9 **III. The average rate increase for Standard Regular parcels should be limited to thirty**
10 **percent to reflect impact and data imprecision and the DBMC discount should be**
11 **increased. The increase for First-Class Mail parcels also should be reduced.**
12

13 As discussed in Section 1 of my testimony, rate shock combined with data imprecision
14 suggests that the passthrough of the Standard Regular parcel-flat cost difference should be less than
15 100 percent. As the Postal Service “gains visibility for... parcels in the Postal Service’s cost and
16 volume reporting systems” through the new parcel classification (USPS-T-36 at 17) and as data
17 quality improves, the passthrough can be increased in future cases.

18
19 As shown in PSA’s response to NOI No. 2 (at 2), the Postal Service proposal results in an
20 80-cent unit Test Year After Rates (TYAR) revenue difference between Standard Regular parcels
21 and flats even though the Test Year Standard Regular flat-parcel cost difference is only 72 cents.
22 Limiting the average rate increase for Standard Regular parcels to 30 percent, which would yield an
23 average Standard Mail parcel revenue per piece of approximately \$1, will produce a more
24 appropriate aggregate rate relationship (i.e., a less-than-full passthrough) between flats and parcels.
25

1 It will also reduce, but not eliminate, the significant impact of the Postal Service proposal on
2 parcel shippers. Kiefer proposes a similar constraint on rate increases in Parcel Post. In fact, he
3 goes further, limiting the rate increase in every rate cell, rather than the average increase, to 30
4 percent because “[i]f I had not constrained the preliminary rates, many Parcel Post rate cells would
5 have experienced unacceptably large rate increases.” USPS-T-37 at 17.

6
7 Given the broad impact of the USPS proposal on Standard Regular parcel shippers, a
8 significant portion of the reduction from the proposed rates should be used to shift the proposed
9 rates for all Standard Regular parcels downward. A portion, however, should be dedicated to
10 increasing the DBMC dropship discount.

11
12 I agree with Kiefer’s approach of offering enhanced dropship discounts for Standard
13 Mail parcels to “offset some of the increases.” USPS-T-36 at 5. In addition to providing an
14 opportunity for shippers to avoid some of the increase, the increased worksharing may yield a
15 larger-than-estimated contribution from Standard Regular parcels (Tr. 5/1110), hopefully
16 reducing the need for such dramatic rate increases in the future.

17
18 Kiefer, however, did not significantly “enhance” the dropship discounts for DBMC-entered
19 parcels. Kiefer increases the dropship discounts for parcels through the use of multipliers (1.2 for
20 DBMC entry, 2.2 for DSCF entry, and 2.7 for DDU entry) on the “normal” Standard Mail dropship
21 discounts for Standard Mail letters and flats. USPS-LR-L-36, WP-STDREG-26. Consistent with
22 the multipliers for DDU and DSCF entry, I recommend increasing the multiplier for DBMC parcels
23 to 2.2.

1 Enhancing the DBMC discount is particularly important for two reasons. Currently, about
2 half of Standard Regular parcels are origin-entered. USPS-LR-L-36, WP-STDREG-30. These
3 parcels are much more likely (in the short term) to be able to “offset some of the increases” by
4 converting to DBMC entry. Second, as discussed above, shippers will likely incur more costs to
5 enter parcels at the DBMC in the Test Year.

6
7 The rate increase for First-Class Mail parcels also should be reduced. The Postal Service is
8 proposing a very large overall increase for these parcels – an average rate increase of 30 percent –
9 with astronomical increases for some. The proposed rate increase for nearly 20 percent of First-
10 Class Mail parcels is nearly 100 percent. Almost half of First-Class Mail parcels would receive a rate
11 increase above 40 percent under the USPS proposal. Response to PSA/USPS-T32-1(c), 4 (Tr.
12 16/4867-8, 4874).

13
14 As calculated in PSA’s response to Notice of Inquiry (NOI) No. 3, these increases are based
15 upon a 100 percent passthrough of the entire First-Class Mail letter-parcel cost difference, not a
16 50% passthrough of the mail processing and delivery cost difference as suggested by Taufique.
17 USPS-T-32 at 23.

18
19 I would note that the Commission could reduce the proposed first-ounce rate for First-Class
20 Mail parcels by ten cents and still generate more revenue than the Postal Service originally projected
21 from these pieces. This is because Taufique recently filed errata shifting First-Class Mail Business
22 Parcel volumes back to higher-revenue categories. This change, which increased TYAR parcel

1 revenue by nearly \$50 million⁴, was necessary to ensure that the mail mix assumptions underlying
2 his revenue forecast are consistent with those underlying the USPS TYAR cost estimate. Response
3 to PSA/USPS-T32-20 (Tr. 16/4897).

4

5 **IV. The data quality and impact issues discussed above also apply to Standard Mail**
6 **NFMs.**
7

8 In this case, the Postal Service proposes a new Standard Mail classification for not flat-
9 machinables (NFMs). This category will consist primarily of pieces that are “rigid” or are between
10 ¾” and 1¼” thick. USPS-T-36 at 21-22. Most of these pieces are currently mailed as automation
11 flats. While the Postal Service has proposed lower rates for these pieces than for parcels, the issues
12 described in Section 1 regarding parcels also apply to NFMs.

13

14 A reduction from the Postal Service’s proposed rates for these pieces also seems reasonable.
15 To encourage efficient entry of NFMs and merging of these pieces into the Standard Mail parcel
16 mailstream⁵, I also recommend extending the enhanced dropship discounts to these pieces.

17

18 The Postal Service has even less data regarding the unit cost and mail characteristics of
19 Standard Mail NFMs than for parcels. The Postal Service has no CRA unit cost data at all for these
20 pieces. Rather, as discussed above, these pieces are often counted as parcels by IOCS and flats by
21 RPW. USPS-T-36 at 22. Also, while witness Miller (USPS-T-21) modeled the mail processing costs
22 for these pieces, the accuracy of these cost estimates is questionable given that, according to

4 Tr. 16/4991. Alternatively, if the migration into the First-Class Mail Business Parcels category that Taufique originally projected does occur, the resulting savings (which were not included in the Postal Service’s original TYAR cost estimate) could be used to reduce the huge rate increases for parcels.

5 According to McCrery, there is value to combining hybrid flats and parcels with other parcels that will be sorted on the same equipment. Tr. 11/3241-2.

1 McCrery, “the [mail] flows [for these pieces] can not be mapped out until the preparation is
2 finalized.” Response to POIR No. 5, Question 1(e)-(l) (Tr. 11/3009).

3
4 Further, as noted by Loetscher (USPS-T-28), USPS does not have much data on the
5 characteristics of NFMs either -- “we don't know much about how the pieces that will be hybrid will
6 shake out and how large the mailings are, what type of entry.” Tr. 7/1569. Thus, for revenue
7 estimation purposes, the Postal Service simply assumed that the distribution of NFMs by presort
8 level would be similar to the current distribution for UFSM 1000 flats and that the distribution by
9 entry would be similar to parcels. Response to POSTCOM/USPS-T28-1 (Tr. 7/1496).

10
11 The assumption regarding presort level is particularly problematic since the preparation
12 requirements may be similar to those for parcels, not those for UFSM 1000 flats. Tr. 11/3235-41.
13 Higher presort minimums, for example, would result in some NFMs being entered at lower presort
14 levels and thus paying higher rates than estimated by USPS.⁶ Also, just like for machinable parcels
15 (USPS-LR-L-36, WP-STDREG-26), 3-Digit Presort may not be an option for NFMs that USPS will
16 process on parcel sorting machines.

17
18 The Postal Service’s estimate of the volume of NFMs is also quite uncertain. The Postal
19 Service’s NFM volume estimate is based upon a study of only 1,743 Standard Mail non-letter pieces.
20 Consequently, the confidence intervals around the NFM volume estimates are large. Responses of
21 USPS witness Loetscher to Questions by Commission During Oral Testimony, Questions 1 and 2.

22

⁶ Note that presort minimums for Standard Mail machinable parcels (ten pounds) are higher than for UFSM 1000 automation flats (ten pieces). DMM Quick Service Guides 340b and 440a.

1 Despite the scarcity of data regarding NFMs, the rate increases being proposed for these
2 pieces (relative to automation flat rates) are enormous. USPS-LR-L-36, WP-STDREG-27.

3
4 For pieces weighing 3.3 ounces or less, the proposed rate increase ranges from 77.8 percent
5 to 215.6 percent.

6
7 For pieces weighing 5 ounces, the proposed rate increase ranges from 68.2 percent to 181.6
8 percent.

9
10 For pieces weighing 8 ounces, the proposed rate increase ranges from 58.6 percent to 145.1
11 percent.

12
13 The rate increases will be even higher if the NFM preparation standards cause pieces to fall
14 back by one presort level.

15
16 **V. Per the Commission’s recommendation in Docket No. MC2006-1, the PRS**
17 **passthroughs should be increased.**
18

19 In Docket No. MC2006-1, the Postal Service proposed basing the passthroughs for Parcel
20 Return Service (PRS) rates on passthroughs of roughly 50 percent. Given the circumstances of the
21 case, PSA acquiesced to these low passthroughs, but noted that they should be increased in the next
22 omnibus case.

23
24 The Parcel Shippers Association comments that with the recent approval of an
25 “across-the-board” rate increase for Parcel Return Service and most other postal

1 rates and the expectation that the Postal Service will soon be filing another omnibus
2 rate case, it is appropriate for the Settlement Agreement to maintain the discounted
3 Parcel Return Service rates that were approved in Docket No. R2005-1. The Parcel
4 Shippers Association acquiesces in passthroughs of roughly 50 percent as
5 “[c]onsistent with the longstanding practice of steadily increasing passthroughs as
6 new worksharing discounts mature[.]” The Parcel Shippers Association, however,
7 advocates increasing these passthroughs in the next omnibus rate case to better
8 comport with the principle of efficient component pricing.
9

10 Docket No. MC2006-1 Op. at 14.

11
12 The Commission concurred with PSA’s position. Ibid. While the Postal Service has
13 proposed larger passthroughs in this case, the increase was only marginal -- from roughly 50 percent
14 in Docket No. MC2006-1 to about 61 percent for RDU parcels and about 54 percent for RBMC
15 parcels in this case. USPS-LR-L-82, WP-PP-39.

16
17 Based upon these low passthroughs, the Postal Service proposes a 9.1 percent rate increase
18 for RDU parcels and a twelve percent rate increase for RBMC parcels. USPS-T-37 at 22. I
19 recommend a 20-cent reduction from the Postal Service’s proposed PRS rates. This will yield rates
20 that better comport with the Commission’s longstanding practice of steadily increasing passthroughs
21 as worksharing discounts mature while still guarding against a potential overstatement of cost
22 savings, USPS-T-37 at 13, and would comport with the Commission’s Opinion in Docket No.
23 MC2006-1. Op at 14.

24 25 **VI. Conclusion**

26
27 The Postal Service’s shape-based rate design proposals have gone too far. The Postal
28 Service is proposing enormous rate increases based upon inadequate data, without giving any due

1 consideration to impact. The proposed rate increases for Standard Regular parcels and NFMs and
2 First-Class Mail parcels should be reduced. In marked contrast, the Postal Service has not gone far
3 enough in reflecting PRS cost avoidances in rates. Consistent with the Commission's
4 recommendation in Docket No. MC2006-1, the Postal Service should increase the passthroughs
5 underlying the PRS rates more than just marginally.

6