

POSTCOM-T-5

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

POSTAL RATE AND FEE CHANGES, 2006

DOCKET NO. R2006-1

**DIRECT TESTIMONY
OF PETER A. ANGELIDES, Ph.D.
ON BEHALF OF
THE ASSOCIATION FOR POSTAL COMMERCE AND
THE MAILING AND FULFILLMENT SERVICE ASSOCIATION**

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Direct Testimony

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I. Autobiographical Sketch

My name is Peter A. Angelides. I am a Manager at PricewaterhouseCoopers (PwC), where I have worked since 2001. Prior to PwC, I worked at Putnam, Hayes & Bartlett (later PHB Hagler Bailley) from 1997-1999 and Charles River Associates from 1999-2001. I am located at PwC's office in Philadelphia. I also teach a master's level course in urban economics at the University of Pennsylvania.

I have over nine years of economic consulting experience, including extensive experience with regulatory proceedings and commercial litigation. My work often involves the preparation of testimony, as well as the economic analysis of markets and companies.

In Docket R97-1 I analyzed the system-wide cost coverages and modeled the impact of alternative pricing theories on rates for the various classes of mail. This resulted in the preparation of testimony by witness J. Stephen Henderson. In addition, I analyzed the incremental cost estimates of Postal Service witness Takis for consistency with the pricing criteria in the Postal Reorganization Act.

I have also conducted analyses and prepared testimony in a number of other regulatory proceedings in the electricity and natural gas industries, as well as other regulatory actions involving firms in the media, consumer products and software industries. Pricing was a major issue in all of the regulatory proceedings and actions, and each involved a pricing analysis. Furthermore, I have prepared analyses in a

1 number of litigation cases involving regulated industries, including telecommunications
2 and energy.

3 I completed my Ph.D. in Economics in 1998 and my M.A. in Economics in 1996,
4 both at the University of Minnesota. I received a B.A. in Urban Studies in 1987 and a
5 Master of City Planning in 1988, both from the University of Pennsylvania.

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7 **II. Purpose of Testimony**

8 PricewaterhouseCoopers LLP ("PwC") has been retained by Venable, LLP on
9 behalf of the Association of Postal Commerce ("PostCom") and the Mailing and
10 Fulfillment Service Association ("MFSA") (hereinafter, collectively "PostCom") in
11 connection with the omnibus rate case R2006-1, which was filed by The United States
12 Postal Service ("Postal Service" or "USPS") with the Postal Rate Commission
13 ("Commission")

14 I have been asked to examine rate design issues for Bound Printed Matter and
15 Media Mail / Library Mail.

16 My work was limited to the specific procedures and analysis described herein
17 and was based only on the information made available to us through September 6,
18 2006. Accordingly, to the extent additional relevant information becomes available, I
19 may amend or supplement my opinions as necessary.

20 This report has been prepared in connection with the above-referenced matter. It
21 is to be used for the specific purposes of this matter and is not to be used for any other
22 purpose without the express written consent of PwC. This report was prepared under
23 the AICPA Standards of Consulting.

1 III. Media Mail and Library Mail

2 I have created a new rate design for the Media Mail¹ subclass of mail. This new
3 rate design employs

- 4 • A cost coverage reduced from that proposed by the Postal Service; and
- 5 • Half-pound pricing increments instead of full pound pricing increments for
6 packages weighing more than one pound and less than five pounds.

7 A. Current Rates and USPS Proposed Rates

8 Mailers pay a rate for the first pound and an additional rate for each additional
9 pound or portion thereof. There are three categories of media mail, Single Piece, Basic
10 Presort, and 5-Digit Presort, which differ in the rate for the first pound. Library Mail has
11 the same rate structure, but slightly lower rates. Media Mail's rate structure is unzoned.
12 The current and USPS proposed rates are shown in Table 1 below.

13 **Table 1 - Current and USPS Proposed Media Mail and Library Mail Rates**

Weight Not Over	Media Mail			Library Mail		
	Single Piece	Basic Presort	5-Digit Presort	Single Piece	Basic Presort	5-Digit Presort
Current Rate						
0.0 - 1.0 Pounds	1.59	1.26	0.90	1.51	1.20	0.86
Per pound, 1.0 - 7.0 pounds	0.48	0.48	0.48	0.46	0.46	0.46
Per pound, 7.0 - 70.0 pounds	0.34	0.34	0.34	0.32	0.32	0.32
USPS Proposed Rate						
0.0 - 1.0 Pounds	2.09	1.69	1.30	1.99	1.61	1.24
Per pound, 1.0 - 7.0 pounds	0.38	0.38	0.38	0.36	0.36	0.36
Per pound, 7.0 - 70.0 pounds	0.38	0.38	0.38	0.36	0.36	0.36

14 Source: USPS-T-38, Attachment C

¹ Because the rates for Media Mail and Library Mail are directly linked, the term "Media Mail" is sometimes used as shorthand for "Media Mail and Library Mail."

1 According to witness O'Hara, the Postal Service's proposal will result in an
2 average rate increase for Media Mail of 18 percent.²

3 **B. Cost Coverage**

4 The Postal Service's proposed cost coverage for the Media Mail and Library Mail
5 subclass is 109.0 percent.

6 The Postal Service states that it has evaluated this cost coverage in light of the
7 nine pricing criteria in the Postal Reorganization Act. 39 USC § 3622(b). However, the
8 Postal Service's discussion with regard to Media Mail is not sufficiently detailed to
9 understand what attention was given to the factors discussed below. These additional
10 considerations indicate a lower cost coverage than that proposed by the Postal Service.

11 **1. Average Cost per Unit Is Historically Variable**

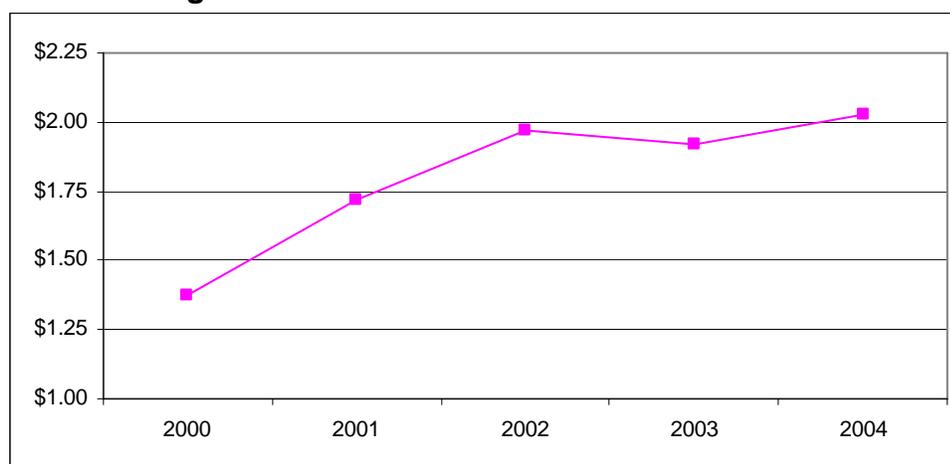
12 The Postal Service's cost data for Media Mail and Library Mail has demonstrated
13 substantial variability in the last several years. For example, between 2000 and 2001,
14 the average cost increased from \$1.376 per unit to \$1.717 per unit, a one year increase
15 of 25 percent. Just two years later, from 2002 to 2003, the average cost decreased
16 from \$1.972 per unit to \$1.918 per unit, a one year decrease of three percent. This
17 variability suggests that the Postal Service's cost data collection system might not be
18 accurately or consistently measuring the costs attributable to Media Mail. The
19 Commission has expressed concern regarding this fluctuation, and cited it as a reason
20 to recommend a 100.2 percent cost coverage for Media Mail in R2005-1.³

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² Testimony of Donald J. O'Hara, USPS-T-31, page 33.

³ Postal Rate Commission, "Opinion And Recommended Decision," Docket No. R2005-1, November 1, 2005, page 162.

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Figure 1 - Media Mail Unit Costs: 2000-2004

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Source: Postal Rate Commission, "Opinion And Recommended Decision," Docket No. R2005-1, November 1, 2005,

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2. The Cost Coverage Was Set to 100.2 Percent in the R2005-1 Rate Case

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In the R2005-1 rate case, the Postal Service proposed an "across the board" increase for all subclasses of mail, which would have yielded a 5.4 percent rate increase for Media Mail and a 5.7 percent rate increase for Library Mail.⁴ According to the Commission, this proposed rate structure would have resulted in a combined cost coverage of 89.1 percent for Media Mail and Library Mail. The Commission increased the cost coverage to 100.2 percent to ensure that these subclasses covered their attributable costs. Thus, 100.2 percent is the most recent cost coverage for Media Mail specifically set by the Commission.

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3. PostCom's Price Proposal Provides a Small Margin Above Costs

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Witness O'Hara states in his testimony regarding the Media Mail rates that:

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"The 18 percent increases will clearly have some adverse effect on current users of Media and Library Rate mail (criterion 4), but the rate

⁴ Direct Testimony of Altaf H. Taufique on Behalf of United States Postal Service, PRC Docket No. R2005-1, April 8, 2005, page 17.

1 increases reflect cost increases and the revenue they generate provides
2 only a small margin above costs."
3

4 However, the Before Rates cost coverage of Media Mail is 92.7 percent, while the cost
5 coverage proposed by the Postal Service for Media Mail is 109.0 percent. Therefore, of
6 the 18 percent increase, more than half is to increase the cost coverage above 100
7 percent. A set of rates with a cost coverage of only a few tenths of a percent greater
8 than 100.0 percent would more appropriately be described as a rates that "reflect cost
9 increases and the revenue they generate provides only a small margin above costs."

10 Therefore, I have prepared a rate design with a cost coverage of 100.2 percent.

11 **C. Rate Design**

12 I am proposing a new rate design for Media Mail and Library Mail. The new rate
13 design includes the use of one half pound price increments for presorted parcels that
14 weigh over 1.0 pound and less than 5.0 pounds, and it includes first pound rates and
15 additional pound rates that are less than the current Postal Service proposal.

16 **1. Half-pound Increments**

17 The current Media Mail rate structure is priced in full-pound increments. For
18 lighter-weighted parcels, this structure can result in dissimilar packages paying the
19 same rate.

20 Table 2 illustrates this effect. In each row, Parcel A and Parcel B pay the same
21 postage, and yet Parcel A can weigh significantly less than Parcel B. A 1.1 pound
22 package, for example, weighs 45 percent less than a 2.0 pound package, and yet it
23 pays the same postage.

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Table 2 - Full Pound Increment Examples**Examples of Packages with Different Weights Paying the Same Postage - Full Pound Increments**

Parcel A Weight (lbs.)	Parcel B Weight* (lbs.)	Parcel A Percentage Decrease from Greatest Weight in Band
1.1	2.0	45%
1.4	2.0	30%
2.1	3.0	30%
3.1	4.0	23%
4.1	5.0	18%

* - Greatest weight in Parcel A's weight band

2 By moving to half pound increments in the first few pounds, the new rate design
3 diminishes this effect. For example, the weight band for a 1.1 pound package is 1.0 -
4 2.0 pounds under a full-pound increment structure, and 1.0 - 1.5 pounds under a half-
5 pound structure. A change to half-pound bands reduces the percentage difference
6 between a 1.1 pound package and the greatest weight in the weight band (1.5 pounds).
7 Under full-pound increments, the price difference is 45 percent, whereas under half-
8 pound increments, it is 27 percent.

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Table 3 - Half Pound Increment Examples**Examples of Packages with Different Weights Paying the Same Postage - Half Pound Increments**

Parcel A Weight (lbs.)	Parcel B Weight* (lbs.)	Parcel A Percentage Decrease from Greatest Weight in Band
1.1	1.5	27%
1.4	1.5	7%
2.1	2.5	16%
3.1	3.5	11%
4.1	4.5	9%

* - Greatest weight in Parcel A's weight band

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1 **2. Individual Rates**

2 I have also adjusted the rates proposed in witness Yeh's testimony for Media
3 Mail and Library Mail. I have done this by selecting rates for the first pound and for
4 additional pounds that are based on "First Pound Total" costs and "Additional Pounds
5 Total Per Pound" costs in witness Yeh's testimony. This method leaves witness Yeh's
6 model rate design largely intact, but at a reduced cost coverage.

7 To calculate the new cost coverage, I used witness Yeh's model, modified as
8 described above and also modified to account for half-pound increments, to calculate
9 revenue per piece. Because the prices are lower than in the USPS proposal, I used
10 witness Thress's volume model at the new price to generate a new volume for Media
11 Mail. Based on the new volume, I used witness Yeh's model to calculate revenue, cost,
12 and cost coverage.⁵ Table 4 summarizes the proposed rates for Media Mail and Library
13 Mail.

14 **Table 4 - PostCom's Proposed Media Mail and Library Mail Rates**
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Weight Not Over	Media Mail			Library Mail		
	Single Piece	Basic Presort	5-Digit Presort	Single Piece	Basic Presort	5-Digit Presort
Proposed Rates						
0.0 - 1.0 pound	1.95	1.55	1.16	1.85	1.47	1.10
Per half pound, 1.0 - 5.0 pounds	0.17*	0.17	0.17	0.16*	0.16	0.16
Per pound, 5.0 - 70.0 pounds	0.34	0.34	0.34	0.32	0.32	0.32

* Single piece remains billed in single pound increments at a rate of \$0.34 per pound for Media Mail and \$0.32 per pound for Library Mail

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⁵ The Postal Service's estimates of elasticity and volume treat Media Mail and Bound Printed Matter as partial substitutes for one another. I have incorporated the Postal Service's substitution factors into my calculations. I have not conducted an independent evaluation of this substitutability.

1 **IV. Bound Printed Matter**

2 I have created a new rate design for the Bound Printer Matter subclass that
3 results in a cost coverage reduced from that proposed by the Postal Service.

4 **A. Current Rates**

5 The Bound Printed Matter subclass's rate structure has eight zones in addition to
6 local delivery. The presorted categories pay based on a piece rate and a pound rate.
7 The number of pieces in the shipment is multiplied by the rate per piece, and this
8 amount is added to the rate per pound multiplied by the total number of pounds in the
9 shipment. The presorted per piece rate contains different rates based on the amount of
10 worksharing done by the mailer. The presorted pound rate is also distance sensitive, so
11 that the pieces traveling longer distances pay a greater rate per pound.

12 The current rate structure also provides for a single piece BPM rate, which is
13 based on weight bands. There is a weight band for the first pound, weight bands in
14 half-pound increments for packages greater than 1.0 pound and less than 5.0 pounds,
15 and weight bands in full-pound increments for packages weighing more than 5.0
16 pounds.

17 **B. Cost Coverage**

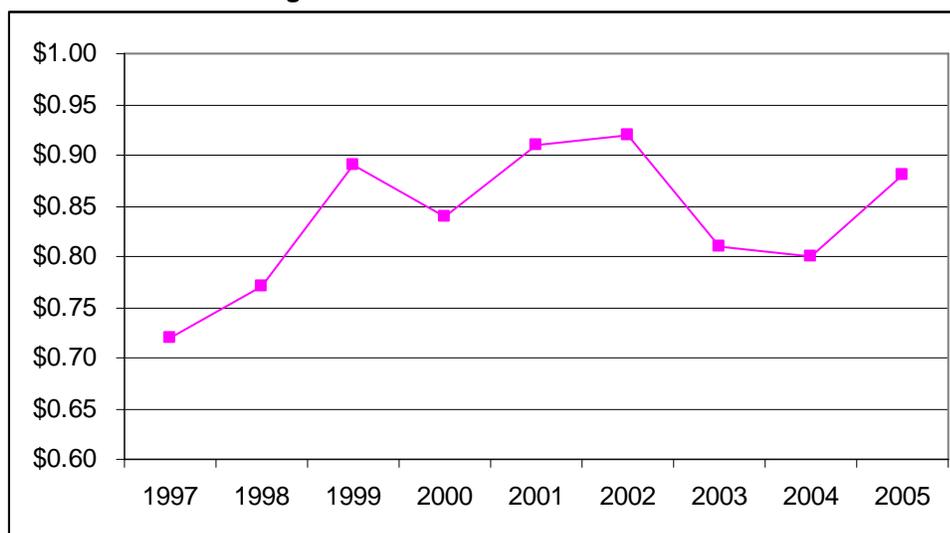
18 The Postal Service's proposed cost coverage for this subclass is 124.9 percent.

19 The Postal Service states that it has evaluated this cost coverage in light of the
20 nine pricing criteria in the Postal Reorganization Act. 39 USC § 3622(b). However, the
21 Postal Service's discussion with regard to BPM is not sufficiently detailed to understand
22 what attention was given to the factors discussed below. These additional
23 considerations indicate a lower cost coverage than that proposed by the Postal Service.

1 1. **Average Cost per Unit is Historically Variable**

2 As with Media Mail, the Postal Service's cost data for BPM has demonstrated
 3 substantial variability in the last several years. For example, between 2002 and 2003,
 4 the average cost decreased from \$0.917 per unit to \$0.809 per unit, a one year decline
 5 of 12 percent. Just two years later, from 2004 to 2005, the average cost increased from
 6 \$0.804 per unit to \$0.876 per unit, a one year increase of 9 percent. This variability
 7 suggests that the Postal Service's cost data collection system might not be accurately or
 8 consistently measuring the costs attributable to BPM. As with regard to the Media Mail
 9 costs, the Commission has expressed concern in the past about fluctuating BPM cost
 10 data, and cited cost fluctuation as a reason to reduce cost coverage.⁶

11 **Figure 2 - BPM Unit Cost: 1997-2005**



12 *Source: Response of the USPS to Interrogatory of Amazon.com, Inc. (AMZ/USPS-T38-*
 13 *25(c)&(d)) Redirected from Witness Yeh. July 31, 2006*

14 ⁶ Postal Rate Commission, "Opinion And Recommended Decision," Docket No. R2000-1, November
 15 13, 2000, page 207.

1 **2. Historically, the Cost Coverage Has Been Below 124.9%**

2 The cost coverage approved in R-2005 was 121.8 percent.⁷ In R-2001 the
3 approved cost coverage was 124.1 percent.⁸ However, both of these rate cases took
4 place under special circumstances.

- 5 • The R-2001 case took place in the aftermath of the September 11, 2001 World
6 Trade Center Attacks and the Anthrax found in several Postal Service facilities.
7 The R-2001 case was brought to conclusion by a settlement among the
8 interested parties.
- 9 • The R-2005 case arose from the need to fully fund the Postal Service's pension
10 obligations. The Postal Service's proposal called for an across the board
11 increase in rates, which was largely accepted by the Commission. There was
12 limited intervention in the case because the Postal Service intentionally treated
13 all subclasses equivalently for the purpose of minimizing disputes about relative
14 cost coverage.

15 Therefore, neither of these cases were fully-litigated rate cases.

16 The last time the Commission ruled on BPM cost coverage in a fully litigated case
17 was in the R-2000 case. In that case, the Postal Service proposed a cost coverage of
18 117.6 percent. The Commission lowered the Postal Service's request to 114.0
19 percent.⁹

20 Therefore, I have prepared a rate design with a cost coverage of 114.1 percent.

⁷ Postal Rate Commission, "Opinion And Recommended Decision," Docket No. R2005-1, November 1, 2005, page 161.

⁸ Postal Rate Commission, "Opinion And Recommended Decision," Docket No. R2001-1, March 22, 2002, page 116.

⁹ Postal Rate Commission, "Opinion And Recommended Decision," Docket No. R2000-1, November 13, 2000, page 207.

1 **C. Rate Design**

2 I have adjusted the rates proposed in Witness Yeh's testimony for BPM. I have
3 done this by altering the "Cost Coverage Markup Factor (Including Contingency)" in
4 witness Yeh's rate design model. This results in lowered Cost Markup percentages for
5 both per-piece and per-pound for Single Piece, Non-Drop-Shipped Presort, and DBMC
6 across all zones. This modification to witness Yeh's model keeps her rate design
7 largely intact, but at a reduced cost coverage.

8 To calculate the new cost coverage, I used witness Yeh's model, modified as
9 described above, to calculate revenue per piece. Because the prices are lower than in
10 the USPS proposal, I used witness Thress's volume model at the new price to generate
11 a new volume for BPM. Based on the new volume, I used witness Yeh's model to
12 calculate revenue, cost, and cost coverage.¹⁰

13 Table 5 summarizes the proposed rates for BPM.

¹⁰ The Postal Service's estimates of elasticity and volume treat Media Mail and Bound Printed Matter as partial substitutes for one another. I have incorporated the Postal Service's substitution factors into my calculations. I have not conducted an independent evaluation of this substitutability.

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2**Table 5 - PostCom's Proposed Bound Printed Matter Rates****Postcom BPM Proposed Rates Single Piece Parcels**

Weight Not Over (lbs.)	Zones 1 & 2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
1.0	\$1.94	\$1.98	\$2.03	\$2.10	\$2.19	\$2.27	\$2.42
1.5	\$1.94	\$1.98	\$2.03	\$2.10	\$2.19	\$2.27	\$2.42
2.0	\$2.02	\$2.08	\$2.14	\$2.24	\$2.36	\$2.46	\$2.66
2.5	\$2.11	\$2.18	\$2.26	\$2.38	\$2.53	\$2.66	\$2.91
3.0	\$2.19	\$2.28	\$2.37	\$2.52	\$2.70	\$2.85	\$3.15
3.5	\$2.28	\$2.38	\$2.49	\$2.66	\$2.87	\$3.05	\$3.40
4.0	\$2.36	\$2.48	\$2.60	\$2.80	\$3.04	\$3.24	\$3.64
4.5	\$2.45	\$2.58	\$2.72	\$2.94	\$3.21	\$3.44	\$3.89
5.0	\$2.53	\$2.68	\$2.83	\$3.08	\$3.38	\$3.63	\$4.13
6.0	\$2.70	\$2.88	\$3.06	\$3.36	\$3.72	\$4.02	\$4.62
7.0	\$2.87	\$3.08	\$3.29	\$3.64	\$4.06	\$4.41	\$5.11
8.0	\$3.04	\$3.28	\$3.52	\$3.92	\$4.40	\$4.80	\$5.60
9.0	\$3.21	\$3.48	\$3.75	\$4.20	\$4.74	\$5.19	\$6.09
10.0	\$3.38	\$3.68	\$3.98	\$4.48	\$5.08	\$5.58	\$6.58
11.0	\$3.55	\$3.88	\$4.21	\$4.76	\$5.42	\$5.97	\$7.07
12.0	\$3.72	\$4.08	\$4.44	\$5.04	\$5.76	\$6.36	\$7.56
13.0	\$3.89	\$4.28	\$4.67	\$5.32	\$6.10	\$6.75	\$8.05
14.0	\$4.06	\$4.48	\$4.90	\$5.60	\$6.44	\$7.14	\$8.54
15.0	\$4.23	\$4.68	\$5.13	\$5.88	\$6.78	\$7.53	\$9.03

Barcode discount:

Automatable flats: \$ 0.03

Machinable parcels: \$ 0.03

Flats differential:

\$ 0.16

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Postcom Proposed BPM Basic Presort Rates

	Zones 1 & 2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
Per piece rate	\$1.442	\$1.466	\$1.513	\$1.566	\$1.626	\$1.673	\$1.789
Per pound rate	\$0.114	\$0.138	\$0.185	\$0.238	\$0.298	\$0.345	\$0.461

Barcode discount:

Automatable flats: \$ 0.03

Machinable parcels: \$ 0.03

Flats differential:

\$ 0.156

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Postcom Proposed BPM Basic Presort Destination Entry Rates

Weight Not Over (lbs.)	DBMC/ASF Zone				DSCF	DDU
	Zones 1 & 2	Zone 3	Zone 4	Zone 5		
Per piece rate	\$1.103	\$1.139	\$1.177	\$1.230	\$0.760	\$0.649
Per pound rate	\$0.081	\$0.117	\$0.155	\$0.208	\$0.079	\$0.039

Barcode discount:

Automatable flats: \$ 0.03

Machinable parcels: \$ 0.03

Flats differential: \$ 0.156

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Postcom Proposed BPM Carrier Route Presort Rates

Weight Not Over (lbs.)	Zones 1 & 2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
Per piece rate	\$1.346	\$1.370	\$1.417	\$1.470	\$1.530	\$1.577	\$1.693
Per pound rate	\$0.114	\$0.138	\$0.185	\$0.238	\$0.298	\$0.345	\$0.461

Flats differential: \$ 0.156

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Postcom Proposed BPM Carrier Route Presort Destination Entry Rates

Weight Not Over (lbs.)	DBMC/ASF Zone				DSCF	DDU
	Zones 1 & 2	Zone 3	Zone 4	Zone 5		
Per piece rate	\$1.007	\$1.043	\$1.081	\$1.134	\$0.664	\$0.553
Per pound rate	\$0.081	\$0.117	\$0.155	\$0.208	\$0.079	\$0.039
Flats differential:		\$ 0.156				

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