

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 14

2. In the response to Presiding Officer's Information Request No. 7, Question 1, witness Taufique explains that he assumes that mailers of business parcels weighing less than one ounce will pay the nonmachinable parcel surcharge. The response goes on to state that, "[m]ailers of pieces weighing between 1 and 2 ounces would likely prepare a heavier weight piece than pay the nonmachinable surcharge."

- a. Please describe and identify the location of the additional ounce revenue adjustment that accounts for this change in mailer behavior.
- b. If no adjustment is made, please explain the rationale for assuming that parcels weighing between 1 and 2 ounces will pay neither the nonmachinable surcharge nor the additional ounce revenue that would be consistent with an increase in weight to avoid the surcharge.

RESPONSE

a-b. I used the base year assumptions regarding additional ounces and made no adjustments. Senders of mail pieces between 1 and 2 ounces would try to avoid the additional ounce postage and the nonmachinable surcharge to the extent practicable. Since the proposed additional ounce rate is 20 cents and the proposed nonmachinable surcharge is only 5 cents, there would be an incentive to keep the pieces at exactly 2 ounces or lighter than 2 ounces rather than exceed 2 ounces. There are no data to make an adjustment for changes in behavior to avoid either the nonmachinable surcharge or the additional ounce postage.

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3. Please refer to the response to Presiding Officer's Information Request No. 7, Question 2.c. Does the use of presort parcel costs to estimate the additional cost (above letter costs) imply that parcels in the proposed Business Parcel categories will have costs similar to presort parcels, regardless of the category from which they migrate? If not, please explain the rationale for utilizing presort parcel costs to estimate the additional cost (above letter costs) of these pieces.

RESPONSE

I am not certain that I understand what is meant by the phrase "regardless of the category from which they migrate." When they shift to presort parcels, the pieces will have options regarding their presort level, but there are no subcategories within the single-piece parcel category. In developing the rate differentials between letters and parcels, I used the mail processing and delivery costs as a starting point and used a low passthrough (15%). This approach was intended to mitigate the impact on parcel mailers, while establishing a price signal regarding shape costs and setting the stage for the classification of and measurement of the costs of parcels. Because there are so few Presort parcels, it is difficult to gauge what the presort profile of the 150 million parcels that I predict will shift from single-piece to presort will be. Because the ability to presort depends partly or largely on density, I cannot predict what the geographic density of the shifting parcels will be, and hence, what their presort level will be once they have shifted to presort. So, I used the profile of auto flats as a proxy. However, I have no reason to believe that the costs of the pieces shifting from single-piece will remain as they were in single-piece. In the absence of additional information, it is usually deemed reasonable to assume that the pieces entering a mail

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RESPONSE to Question 3 (continued):

classification will have cost characteristics similar to the pieces already in existence in that classification, so that is what I have done. Admittedly, as witness Smith acknowledged (Tr. 14/ 4266), there is some doubt about the reliability of the cost estimate for presort parcels. However, I would note that the number of pieces that I am predicting will shift from single-piece to presort parcels is a fairly small number and the potential financial impact of those shifted pieces is relatively small in comparison to the total of Presort.

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4. During oral cross-examination, witness Taufique stated that the Postal Service still anticipates that single-piece parcels will migrate to the proposed Business Parcel categories, despite the revision to USPS-LR-L-129 (revised August 24, 2006). Tr. 16/4993, 5042-43.
 - a. Please confirm that as a result of this revision, the TYAR unit contribution of single-piece increases from \$0.235 to \$0.242 and the TYAR unit contribution of workshared decreases from \$0.234 to \$0.230. If not confirmed, please provide the amounts and sources of the correct figures.
 - b. Please explain why the Postal Service elected to undo the revenue adjustment associated with this migration, as opposed to developing and presenting a corresponding cost adjustment.
 - c. If the answer to b. is that it is not feasible to develop an appropriate cost adjustment, please explain why it is not feasible.
 - d. If it is feasible, please develop and present an appropriate cost adjustment (e.g., a final adjustment), showing all calculations and identifying all data sources.

RESPONSE

- a. Confirmed. Please note that the change in the TYAR unit contribution is not caused solely by the reversion of the First-Class Mail business/presort parcel volume to single-piece and nonautomation presort. Other factors that minimally affect these revised figures are the additional revenue associated with nonmachinable letter-shaped pieces paying flat prices, and a small revision in fee revenues.
- b. The decision to make the revenue adjustment rather than the cost adjustment was based on the following reasons.
 1. As stated by witness Smith (Tr. 14/ 4266), the mail processing cost numbers for First-Class Mail presort parcels were anomalously high, so it would be difficult to make a cost adjustment.
 2. Even if reliable costs were available for the basic shape difference, it would be difficult to gauge the presort profile of the 150 million

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RESPONSE to Question 4 (continued):

parcels that might shift from single-piece to presort. In any event, the purpose of the adjustment was to put the revenue and costs on an equal footing. Given the limited availability of extensive cost data on parcels, the more prudent course was to undo the revenue assumption. Using this assumption to estimate the cost impact, once again, would not provide a reliable estimate.

As a shape category, parcels are a small portion of First-Class Mail stream both for single-piece and presort categories. The Postal Service has proposed the shape based classification to recognize the role of shape in cost causation but also wants to provide an alternative for parcel mailers who can prepare automation compatible parcels and presort them to finer levels. The lack of detailed cost data did not warrant forgoing this addition of price incentives for presorting parcels. The simplifying assumption that was ultimately followed (putting the revenue and cost on an equal footing) has little impact on the overall First-Class Mail financial analysis.

c. & d. Please see my response to subpart b, above.

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5. Please refer to the response to Presiding Officer's Information Request No. 10, Question 2.f. (revised August 22, 2006). Is the rationale offered for this adjustment method also valid for First-Class presort parcels? If so, please provide an analysis similar to Attachment 4 to the response that calculates a parallel adjustment for First-Class presort parcels. If not, please explain why the adjustment method could not be reasonably applied to First-Class presort parcels.

RESPONSE:

The rationale provided in my response to POIR No. 10, Question 2.f is valid for First-Class presort parcels. Applying this adjustment method to First-Class presort parcels, however, is more uncertain than applying it to Standard Regular (non-ECR) parcels. It is not as supportable, and the adjustment for First-Class presort parcels is much larger than for Standard Regular parcels. Below I explain my reasoning for this statement and I supply the adjustment for First-Class presort parcels as requested.

The rationale provided in my response to POIR No. 10, Question 2.f for applying the adjustment method contained in my testimony, USPS-T-13, Attachment 13, to Standard ECR also is valid for First-Class presort parcels.

This rationale was (TR 14/4248-9):

“Even without knowing the source for the cost anomaly, one can support the use of this method [contained in USPS-T-13, Attachment 13] to adjust Standard ECR parcel costs on the basis that ODIS-RPW and the cost systems are both sample based and have the same definition of shape and, therefore, both may well diverge from RPW by shape data in a parallel way.”

As for Standard ECR parcels, the unit costs for First-Class presort parcels appear anomalous, as noted in POIR No. 10, Question 2 itself, TR 14/ 4243. As in the case of Standard ECR, I do not know the source of this anomaly (see my

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response to parts a and e of POIR no. 10, question 2, TR 14/ 4243-53). Finally, the consistency of ODIS-RPW and the costs systems in defining shape applies to First-Class presort parcels in just the same way it applies to Standard ECR parcels, providing a basis for the same kind of adjustment.

But, there is significant uncertainty in applying this method to First-Class presort parcels for two important reasons.¹ First, applying this adjustment method to First-Class presort parcels is not supported as fully as its application to Standard Regular (non-ECR) parcels, as done in my testimony. In the case of Standard Regular parcels, as indicated in my testimony, there appears to be a mismatch between volume and cost data, since some parcel-shaped pieces could qualify for automation flats rates based on DMM 301.3.4.2 (Criteria for UFSM 1000 Flats) and classified as flats, rather than parcels. Costs for Standard Regular parcels would include these parcel-shaped pieces, which qualified for automation flats rates, while the reported volumes would not include them. In addition, the Standard parcel rate surcharge incentivizes parcel mailers to qualify for automation flats rates. The Standard parcel rate surcharge and rules allowing some parcel-shaped pieces to qualify for automation flats rates were first implemented in early FY 1999. The decline in the ratio of RPW by Shape volumes to ODIS-RPW volumes for Standard Regular parcels began in FY 1999 and is consistent with the rise in the Standard Regular parcels unit costs, thus

¹ This same uncertainty also applies to the use of this adjustment for Standard ECR parcels. Some of the concerns expressed here on First-Class presort parcels were also discussed for Standard ECR parcels in my response to POIR No. 10, Question 2 (See TR 14/ 4243-53).

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showing the value of the ratio as a measure of the cost and volumes inconsistency, and the use of this ratio as an adjustment method for Standard Regular parcels.²

This explanation does not account for the rise in First-Class presort parcels unit costs. Attachment 1 of this response shows that the ratio of RPW volumes to ODIS-RPW volumes for First-Class presort parcels declined markedly in FY 1998. Attachment 1 of my response to POIR No. 10, Question 2 (TR 14/ 4250) shows the unit costs for First-Class presort parcels also jumped in FY 1998. While there might be comfort in seeing the consistency of the timing in these changes, these changes (and the process leading to cost anomalies) began the year before the implementation of the rules allowing some parcel-shaped pieces to qualify for automation flats rates based on DMM 301.3.4.2 (Criteria for UFSM 1000 Flats). This suggests there is a different source for the cost anomaly for First-Class presort parcels than for Standard Regular parcels.

Second, the adjustment is much larger for First-Class presort parcels (and for Standard ECR parcels) as compared to Standard Regular parcels. As a result, it is more uncertain or less reliable to use this adjustment for First-Class presort parcels. This is shown by the following algebraic interpretation of the adjustment method. The adjustment process, applied to parcels mail processing unit costs, can be represented as:

² See Attachment 2 of my response to POIR No. 10, Question 2 (TR 14/ 4251) ratio of RPW by Shape volumes to ODIS-RPW volumes for Standard Regular parcels for 1996 to 2005. Also, see Attachment 1 of this same response (TR 14/ 4250) to see the trend of unit labor costs for Standard Regular parcels.

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$$\text{Unit Cost}_A = \text{Unit Cost}_U * \text{AR}$$

where subscript A is “adjusted” and subscript U is “unadjusted” and AR is “adjustment ratio.” In addition, we can say:

$$\text{Unit Cost}_U = \text{Cost}_{\text{IOCS}} / \text{Volume}_{\text{RPW}} \quad \text{and}$$

$$\text{AR} = \text{Volume}_{\text{RPW}} / \text{Volume}_{\text{RPW-ODIS}}$$

where $\text{Cost}_{\text{IOCS}}$ is the costs per IOCS, $\text{Volume}_{\text{RPW}}$ is the RPW by Shape volumes and $\text{Volume}_{\text{RPW-ODIS}}$ is the ODIS-RPW volumes (controlled to RPW). If we substitute the latter two formulas into the formula for Unit Cost_A we get the following:

$$\text{Unit Cost}_A = \text{Cost}_{\text{IOCS}} / \text{Volume}_{\text{RPW-ODIS}}$$

This unit cost has consistent costs and volumes, as discussed previously, since both IOCS and ODIS-RPW sample based system use the same dimension based definitions for shape.

What the algebra also shows is that the adjusted parcel unit cost is the unit cost for the parcels as defined by ODIS-RPW volumes, rather than the RPW by shape volumes. In the case of Standard Regular parcels, the adjusted unit cost for the 600.3 million RPW based Standard Regular parcels is premised on the unit cost for the 784.0 million ODIS-RPW based Standard Regular parcels.³ The 600.3 million RPW based Standard Regular parcels and the 784.0 million ODIS-RPW based Standard Regular parcels are mostly the same mail pieces, but the latter also likely contains parcel-shaped pieces that qualify for automation

³ See my testimony, USPS-T-13, Attachment 13 for the RPW and ODIS-RPW volumes for Standard Regular parcels.

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flats rates. Thus we can comfortably use the unit costs of the 784.0 million ODIS-RPW based Standard Regular parcels as a proxy for the 600.3 million RPW based Standard Regular parcels.⁴

The case is different for First-Class presort parcels (and for Standard ECR as well). In the case of First-Class presort parcels, the adjusted unit cost for the 8.4 million RPW based First-Class presort parcels is premised on the unit cost for the 26.9 million ODIS-RPW based First-Class presort parcels.⁵ The 8.4 million RPW based First-Class presort parcels and the 26.9 million ODIS-RPW based First-Class presort parcels are possibly two very different groups of mail pieces, with the differences between the two groups unknown. Thus, there are significant unknowns and uncertainty in using the unit costs of the 26.9 million ODIS-RPW based First-Class presort parcels as a proxy for the 8.4 million RPW based First-Class presort parcels. These same reservations certainly apply to using the adjustment method for Standard ECR parcels as provided in my response to POIR No. 10, Question 2, given the great disparity between the RPW by Shape volumes to ODIS-RPW volumes for Standard ECR parcels.

In Attachment 2 of this response, I provide for First-Class presort parcels a version of my testimony Attachment 13. This shows the adjustment to be made to both First-Class presort flats and parcels, as done for Standard Regular flats and parcels in USPS-T-13, Attachment 13. The test year First-Class presort

⁴ A discussion of the approximation involved in using the adjustment method for Standard Regular parcels is provided in my responses to PSA/USPS-T13-8 and 14 (TR 14/4280, 4290-4292).

⁵ See Attachment 1 of this response for the RPW and ODIS-RPW volumes for First-Class presort parcels.

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parcels unit cost of 303.81 cents as reported in USPS-T-13, Attachment 14, would be 94.77 cents, if adjusted as shown in Attachment 2 of this response. In addition, First-Class presort flats processing unit costs would rise by 7.1 percent, from 27.15 cents to 29.08 cents.

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COMPARISON OF FIRST-CLASS LETTERS PRESORT (CARRIER ROUTE INCLUDED) RPW AND ODIS VOLUMES BY SHAPE
FOR FY1996 TO FY2005

FY	RPW SHAPE REPORT VOLUME BY CLASS & SHAPE Volume In Thousands				ORIGIN-DESTINATION INFORMATION SYSTEM DESTINATING VOLUME BY CLASS & SHAPE Volume In Thousands Controlled to RPW				RATIO OF RPW TO ODIS FOR PARCELS/IPPS VOLUMES
	Letters	Flats	Parcels/IPPs	All Shapes	Letters	Flats	Parcels/IPPs	All Shapes	
1996	38,399,756	615,318	42,119	39,057,193	38,402,520	615,521	39,152	39,057,193	1.076
1997	39,421,809	610,213	30,595	40,062,616	39,416,726	614,326	31,565	40,062,616	0.969
1998	40,117,142	506,305	10,805	40,634,252	39,989,570	611,232	33,451	40,634,252	0.323
1999	42,282,156	562,570	14,393	42,859,119	42,133,188	688,544	37,387	42,859,119	0.385
2000	44,931,629	733,863	9,980	45,675,472	44,850,693	796,573	28,205	45,675,472	0.354
2001	46,418,387	789,239	6,585	47,214,210	46,272,848	910,721	30,642	47,214,210	0.215
2002	46,841,607	807,594	8,876	47,658,076	46,666,118	956,127	35,831	47,658,076	0.248
2003	46,415,198	862,863	9,727	47,287,788	46,277,264	976,874	33,650	47,287,788	0.289
2004	46,509,242	816,967	7,610	47,333,818	46,339,584	966,103	28,132	47,333,818	0.271
2005	48,147,533	909,626	8,394	49,065,552	47,977,533	1,061,112	26,907	49,065,552	0.312

Source: LR-L-87 Shape GFY 2005rV.xls and predecessors.

Source: ODIS-RPW UDS file and predecessors.

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FIRST-CLASS MAIL PRESORT FLATS-PARCEL COST ADJUSTMENT FOR COSTS BY SHAPE

PART I: CALCULATION OF RPW/RPW-ODIS RATIO FOR FIRST-CLASS PRESORT PARCELS

Source, ODIS-RPW UDS file
Produced by Revenue & Volume Reporting
Volumes in 000s

ODIS		Letters	Flats	IPPS/Parcels	Total
FIRST-CLASS	<i>PRESORT</i>	52,635,596	1,164,134	29,519	53,829,249

ODIS		Letters	Flats	IPPS/Parcels	Total
Distribution Key %		97.8%	2.2%	0.1%	1

RPW Volumes with ODIS Shape Shares

		Letters	Flats	IPPS/Parcels	Total
FIRST-CLASS	<i>PRESORT</i>	47,977,533	1,061,112	26,907	49,065,552

RPW Volumes by Shape

FIRST-CLASS	<i>PRESORT</i>	48,147,533	909,626	8,394	49,065,552
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Source: USPS LR-L-87

RPW/RPW-ODIS: FIRST-CLASS PRESORT 0.311948282

PART II: CALCULATION OF ADJUSTMENT

		Unadjusted Costs		Unit Costs With Final Reconciliation Factor	
		Flats	IPPS/Parcels	Flats	IPPS/Parcels
First-Class Presort Unit Costs	n/a	26.96	301.63	27.15	303.81
First-Class Presort Total Costs		245,235	25,317		
Split of Parcel Costs to Flats & Parcels		17,420	7,898	25,317	
		Adjusted Costs			
First-Class Presort Total Costs		262,654	7,898		
First-Class Presort Unit Costs		28.87	94.09	29.08	94.77
Adjustment Ratios		1.071	0.311948282	1.071	0.311948282

Based on USPS LR-L-53, shp08usps.xls