

CAP COMPLIANCE FOR FIRST-CLASS MAIL PRICE CHANGES

I. PREFACE

The overall percent increase for First-Class Mail is 2.889 percent, slightly below the 2.9 percent cap. Attachment USPS R2008-1/1 contains the workpapers necessary to demonstrate that the percentage change in First-Class Mail prices complies with the annual price cap limitation. The Attachment consists of this summary document and two sets of Excel workpapers described in detail below.

II. ORGANIZATION

For purposes of calculating the percentage change in prices, First-Class Mail includes both domestic First-Class Mail and Single-Piece First-Class Mail International. The Excel file labeled CAPCALC-FCM-FY2008.xls in this Attachment contains the billing determinants, current prices, adjusted prices and revenue calculations for First-Class Mail. The percentage rate change calculations in that file include total revenue and pieces from Single-Piece First-Class Mail International (FCMI) derived from the sources below.

The billing determinants, current prices, adjusted prices, and the revenue calculations for Outbound Single-Piece FCMI can be found in this Attachment in the Excel file labeled CAPCALC-FCMI-FY2008.xls.

Inbound Single-Piece First-Class Mail International – Letter-Post (Inbound FCMI) is a service that the Postal Service is required to offer as a member of the Universal Post Union (UPU). The rates for this service, with the exception of Inbound FCMI received from Canada Post, are set by the UPU. Rates for Inbound FCMI received from Canada Post are set through a bilateral agreement between the Postal Service and Canada Post. The rates for all Inbound FCMI provide compensation for the cost of delivering inbound mail from foreign countries. Rates are adjusted on a calendar basis, with the most recent rate change taking place on January 1, 2008. Since Inbound FCMI is included in the First-Class Mail grouping, and therefore part of the “cap,” this price change is incorporated into the cap-compliance measurement. The billing determinants, rates and detailed cap calculations for Inbound FCMI are available in a nonpublic annex, Attachment USPS-R2008-1/NP1, because these data reveal confidential information concerning Canada Post’s inbound Letter-Post items, which are handled under a negotiated agreement between the Postal Service and Canada Post.

In separate sections below, the remainder of this Attachment describes the contents of the above-referenced workpapers: CAPCALC-FCM-FY2008.xls and CAPCALC-FCMI-FY2008.xls.

III. First-Class Mail

A. Adjustments to the Billing Determinants

As described in detail below, the workpapers in CAPCALC-FCM-FY2008.xls are based upon the FY2007 billing determinants from Docket No. ACR2007, USPS FY2007 Annual Compliance Report, USPS-FY07-4 (December 28, 2007), but reflect the following adjustments:

- The first tab (“FY07 BD”) has the annual billing determinants for FY2007, as reported in the ACR.
- The second tab (“FCM SP Nonauto Shp. & Wt. Incr.”) provides the ounce increment data by shape and by Revenue, Pieces & Weight (RPW) categories for FY 2007 for both single-piece and nonautomation presort. These data are differentiated to reflect the Docket No. R2005-1 and R2006-1 rate regimes.
- In the next tab, labeled “FCM SP Nonauto addl Ozs,” all of the data are converted into additional ounces.
- The above-referenced second and third tabs provide the basic data used to split single-piece and nonautomation by shapes and to estimate the additional ounces by shapes. The parcel split between single-piece and the category of business parcels is also performed using these data. These splits are estimated in the tab labeled “Adjustments.”
- The estimation of nonmachinable pieces for business parcels (tab “Adjustments”) utilizes the quarterly billing determinants data.
- The estimation of nonmachinable letter-shaped pieces for both single-piece and nonautomation is performed (in tab “Adjustments”) using the 4th quarter numbers that are provided in the First-Class Mail billing determinants in Docket No. ACR2007, USPS FY2007 Annual Compliance Report, USPS-FY07-4, and the R2006-1 regime 3rd quarter data that are also provided in this tab labeled Adjustments. This tab includes all the adjustments that are made to derive the weighting for cap compliance.

B. Revenue and Percentage Rate Change Calculations

The prices for each First-Class Mail rate cell are presented in USPS Notice of Market-Dominant Price Adjustment, Appendix A.

In CAPCALC-FCM-FY2008.xls., subject to the adjustments in the areas identified below, the Docket No. ACR2007 billing determinants for FY2007, were used as the basis for the weighting to calculate the percentage rate changes for domestic First-Class Mail:

- a. Estimation of letter, flat and parcel-shaped pieces for single-piece.
- b. Estimation of letter and flat-shaped pieces for nonautomation presort.
- c. Distribution of parcel-shaped pieces between single-piece and the new category of Business Parcels.
- d. Estimation of nonmachinable letter-shaped pieces for both single-piece and nonautomation presort and nonmachinable parcels for the Business Parcels category.

The CAPCALC-FCM-FY2008.xls tab labeled “FCM SP Nonauto Shp & Wt. Incr.” provides the detailed data by shapes, RPW category and weight increments and by rate regimes (R2005-1 and R2006-1) for both Single-Piece and Nonautomation presort.

In the “FCM SP Nonauto Addl Ozs.” tab, letter and flat-shaped pieces and the corresponding additional ounce estimates are derived for the adjusted year using these data without any further manipulations or adjustments. The distribution of parcels for the first two quarters and the first part of third quarter is performed using the distribution after the implementation of the Docket No. R2006-1 rates. This is a reasonable methodology because the After Rates distribution of parcels is significantly different than the distribution assumed by the Postal Service in its Docket R2006-1 request and by the Commission in its opinion and recommended decision in that docket. See, Docket No. R2006-1, USPS Library Reference L-129, REV 11-17-06 LR-L-129.xls. tab “Shp. & Addl Ozs Distribution” (revised November 17, 12006); PRC Op. R2006-1, Appendix G and PRC Library Reference 20, First-Class Mail rate design workpaper tab “Shape and Wgt.” The parcel adjustments in CAPCALC-FCM-FY2008.xls tab “FCM SP Nonauto Shp & Wt. Incr.” provide the simple calculations that were performed to derive parcel shaped pieces for both single-piece and the new Business Parcels category by the three presort levels. The same distribution was used for parcel-related additional ounces.

In the Adjustments tab, nonmachinable pieces for both single-piece and nonautomation presort categories, for letter-shaped pieces, were derived using once again the relationship that emerged after the implementation of Docket R2006-1 rates. After the removal of lightweight flat and parcel shaped pieces from this category, and the extension of nonmachinable surcharge to letter-shaped pieces weighing up to 3 ounces, it is appropriate to use the actual post

Docket No. R2006-1 After Rates data (the last part of FY2007 Quarter 3 and all of Quarter 4) to estimate the annual volume of nonmachinable pieces.

The volume of nonmachinable pieces for the Business Parcels category was estimated using the same methodology as for letter-shaped nonmachinable pieces. The following pair of CAPCALC-FCM-FY2008.xls tabs, *ADJ. FY07-Current Rates* and *ADJ. FY07 New Rates*, provide the adjusted volume multiplied by current and adjusted rates. All of the volume cells are linked to the previous tabs. Revenue is calculated by multiplying the same volume by the current and adjusted rates. A row is added for Single-Piece First-Class Mail International in both of these tabs. The source data for Single-Piece First-Class Mail International are from the CAPCALC-FCMI-FY2008.xls tab labeled *Cap Calculation*.

The next four tabs in CAPCALC-FCM-FY2008.xls., provide the same information for each of the following:

- *SP [Single-Piece] Letters and Cards;*
- *Presort Letters & Cards;*
- *First-Class Flats; and*
- *First-Class Parcels.*

These tabs provide the Before and After Rates postage using the same volume and calculate the percent increase for each product.

The next two tabs in CAPCALC-FCM-FY2008.xls (see “Workshare Passthroughs L, F & P” and “Workshare Passthroughs Cards”) replicate the First-Class Mail workshare passthrough tabs from ACR-FY07-03, but with one significant difference. The discounts in these tabs are calculated on the basis of the adjusted Docket No. R2008-1 rates, as opposed to the rates implemented as a result of Docket R2006-1.

Each one of the passthrough deviations from 100 percent are discussed in USPS Notice of Market-Dominant Price Adjustment, at 26-27, and Appendix 2.

The final tab in CAPCALC-FCM-FY2008.xls (appropriately labeled “Summary”) provides a summary of percentage price changes by products.

IV. Outbound Single-Piece First-Class Mail International

Below are step-by-step descriptions of how the revenue cap calculation was made for Outbound Single Piece First-Class Mail International (FCMI) letters,

large envelopes (flats), and packages (small packets);¹ for the FCMI nonmachinable surcharge; and for FCMI cards. The results of these calculations, along with the results of the comparable calculation for Inbound FCMI, are consolidated in the “Cap Calculation” tab of the workpaper in this Attachment designated as CAPCALC–FCMI–FY2008.xls. The collective rate increase for all components of FCMI is 3.09 percent.

A. FCMI Letters, Flats and Parcels

1. Starting Point

In the Excel worksheet entitled CAPCALC–FCMI–FY2008.xls, the FY 2007 Outbound Single-Piece First-Class Mail International (FCMI) billing determinants appear in the following tabs: “Orig FCMI_Grp1” through “Orig FCMI_Grp5.” The Airmail Letter-Post billing determinants appear in tab “Orig Airmail Letter-Post.” Both sets of billing determinants are subdivided into five rate groups. The Marshall Islands and Micronesia (Rate Group 6 from January 8, 2006, to November 19, 2007), for which mail from the U.S. is now treated as domestic, were not included in either set. In the FCMI billing determinants, the Vatican was mistakenly placed in rate group 5; it has been moved to rate group 3 for the cap calculation. In the Airmail Letter-Post billing determinants, the Vatican was correctly grouped in rate group 3.

For FCMI, the billing determinants were broken out by weight step for each individual country; for Airmail Letter-Post, the billing determinants were broken out by weight step for each rate group (but not by country). Prior to the May 14, 2007, international service offering and price change, FCMI was classified as Airmail Letter-Post.

2. Calculating Revenue under the May 2007 Rates

The first step toward establishing the benchmark against which the increase in revenue under adjusted rates would be calculated involved the FCMI billing determinants. For each of the five rate groups (see CAPCALC–FCMI–FY2008.xls tabs “FCMI_Grp1” through “FCMI_Grp 5”), the data were sorted by step weight, then an overall piece volume for each one-ounce weight increment was calculated. Because the rate schedule provides rates for mail pieces in one-ounce increments up to 8 ounces and then every 4 ounces (12,16,20,24, etc.) up to four pounds, the billing determinant volumes were organized along the same lines. This step put the FCMI data into the same format as the Airmail Letter-Post billing determinants: five rate groups with each rate group’s total piece volume broken out into the same 22 weight increments. These total billing

¹ For ease of reference, these categories will simply be referred to as letters, flats and parcels throughout the rest of this document and in the spreadsheets showing the calculations.

determinant volumes were calculated in CAPCALC–FCMI–FY2008.xls tabs “Airmail Letter-Post_Grp 1-5” and “FCMI_Grp 1-5.”

The next step was to adjust the FCMI and Airmail Letter-Post billing determinant volumes so that they matched up with the total volumes reported in the FY 2007 Revenue, Pieces, and Weight (RPW) report. For FCMI, this was accomplished by multiplying the volume for each weight increment in each rate group by 0.99527116. For Airmail Letter-Post, an adjustment factor of 0.99357546 was used. These adjustment factors were derived by dividing total RPW volumes by total billing determinant volumes. These calculations, as well as the calculations involved in the following two steps, were made in cells A1 – M200 of the tab “Combined_Grp 1-5.”

Total volume for FCMI and Airmail Letter-Post in FY 2007 was then calculated by summing the adjusted volumes by weight increment for each of the five rate groups.

The last step entailed multiplying the appropriate May 14, 2007 rate for each weight increment by the adjusted volume for that weight increment to derive the revenue for that weight increment. Summing the revenue for each weight increment in each rate group derives total revenue of \$666,035,672. This is the benchmark against which revenue generated by the adjusted rates must be measured.

3. Calculating Revenue under the Adjusted Rates

This task was complicated by the fact that the rate changes in 2008 will be accompanied by two major changes in the structure of FCMI: the expansion of rate groups from five to nine and the introduction of shape-based rates.

Conversion to nine rate groups (FCMI): Canada and Mexico were unaffected by this conversion as they are the only countries in Rate Groups 1 and 2, respectively. However, it was necessary to reallocate the countries in the current rate groups 3 – 5 into the new rate groups 3 – 9. To effect this reallocation, all the countries in rate groups 3 – 5 in the FCMI billing determinants were consolidated in one spreadsheet (see the CAPCALC–FCMI–FY2008.xls tab “FCMI RGs 3-5”), assigned their new rate group number, and sorted first by rate group number and then by weight step. After total volume per weight step was calculated for each of the new rate groups (see the tab “FCMI RGs 3-9”), the overall volume for the new nine rate groups was calculated in cells AA7 – AW63 of tab “FCMI_Grp 1-9,” and the volume figures in cells AA7 – AW63 were multiplied by the adjustment factor of 0.99527116 to create adjusted volume cells within cells B7 – X63. Total FCMI volume – 121,215,120 - in cell V63 in tab “FCMI_Grp 1-9” was found to equal the overall volume of the original five rate groups (cell C191 in tab “Combined_Grp 1-5”).

Conversion to nine rate groups (Airmail Letter-Post): Because Canada and Mexico were unaffected by this conversion, it was necessary (as with FCMI) to reallocate the countries in the current rate groups 3 – 5 into the new rate groups 3 – 9. However, unlike the FCMI billing determinants, the Airmail Letter-Post billing determinants are not broken out by individual country. Thus, to create rate groups 3 – 9 for Airmail Letter-Post, the first step was to group all the data in the billing determinants' rate groups 3 – 5 into one consolidated rate group (see cells G164 – J190 in tab “Airmail Letter-Post_Grp 1-5” of CAPCALC–FCMI–FY2008.xls). Next, Airmail Letter-Post billing determinants (see cells BJ1 – DF31 in tab “Airmail Letter-Post_Grp 1-9”) extracted from the FY2007 System for International Revenue and Volume Outbound (SIRVO) database were employed as a distribution key to (1) subdivide the SIRVO data into rate groups mirroring the rate groups created for FCMI as explained above (Conversion to nine rate groups (FCMI)) and (2) calculate the proportions of volume by weight step for each of rate groups 3 – 9. Next, these proportions were multiplied by the billing determinants' consolidated totals for rate groups 3 – 5 to derive volumes for the new rate groups 3 – 9 (cells Z1 – BC63 in tab “Airmail Letter-Post_Grp 1-9”). Finally, the figures in cells AA7 – AW63 were multiplied by the volume adjustment factor of 0.99357546 to create the table in cells A7 – X63. As a check, it was confirmed that the overall volume for the new nine rate groups in cell V63 – 246,986,831 - equaled the total volume of the original five rate groups (cell K191 in tab “Combined_Grp 1-5”).

Subdivision of the piece volume by shape (FCMI and Airmail Letter-Post): The billing determinants did not break out either FCMI or Airmail Letter-Post by shape. Thus, in order to split each of the nine rate groups' volumes into letters, flats, and parcels, shape-differentiated FCMI and Airmail Letter-Post billing determinants extracted from the FY2007 SIRVO database were employed as distribution keys. Three adjustments were made to the SIRVO billing determinants: all letter-shaped items over four ounces were reclassified as flats; all items weighing more than 64 ounces were discarded; and items designated as either air packets or parcels were included as parcels.

After the SIRVO data were subdivided into nine rate groups mirroring the rate groups created in the previous step for FCMI and Airmail Letter-Post and placed in cells BL104 – CD1028 of tabs “FCMI_Grp 1-9” and “Airmail Letter-Post_Grp 1-9”, respectively, the proportions of letters, flats, and parcels were calculated by weight step for each rate group for each service (see cells AT107 – BH1028 in each tab). These proportions were then multiplied by the appropriate weight-step totals obtained as described above (Conversion to nine rate groups (FCMI) and (Airmail Letter – Post)) to produce separate letter, flat, and parcel break-outs for FCMI and Airmail Letter-Post by weight step and rate group (cells AA107 – AO1028); these figures were then multiplied by the appropriate volume adjustment factors to create the totals found in cells A107 – P1028. As a check, total letters, flats, and parcels were summed separately for FCMI and Airmail Letter-Post in cells B1034 of the two “Grp_1-9” tabs to ensure that the overall

number of pieces matched the totals used to generate the benchmark revenue (see cells C191 and K191 in tab “Combined_Grp 1-5.”)

After the FCMI and Airmail Letter-Post volume data used to set the benchmark was subdivided into nine groups and then disaggregated by shape, total FY 2007 volume was calculated by summing the adjusted volumes for FCMI and Airmail Letter-Post by weight increment for each of the nine rate groups (see cells B1 – E284 of tab “Overall Vol & Rev_Grp 1-9” of CAPCALC–FCMI–FY2008.xls). Overall volume (368,201,951) matched the benchmark volume calculated in cell C200 of the tab “Combined_Grp1-5.”

The last step entailed multiplying the adjusted rate for each shape in each weight increment in each rate group by the appropriate volume (these calculations occur in cells B1 – R290 in tab “Overall Vol & Rev_Grp 1-9.”) Summing the revenue for each weight increment in each rate group results in total revenue of \$685,213,281 under the adjusted rates. This represents a 2.88 percent increase over the benchmark revenue of \$666,035,672, which was calculated in cell E200 of the CAPCALC–FCMI–FY2008.xls tab “Combined_Grp1-5.” It should be noted that multiplying the volumes for the nine rate groups by the May 14, 2007, rates, yields total revenue of \$666,065,549 (see cell R281 in the “Overall Vol & Rev_Grp 1-9” tab); this increase of approximately \$30,000 over the benchmark is due to the fact that certain countries such as Israel, Malta, Slovenia, Slovakia, Solomon Islands, and Afghanistan end up paying different rates under the 9-Rate-Group format than they would under the 5-Rate-Group format.

4. Cap Calculation for the Nonmachinable Surcharge

A \$0.17 per-piece surcharge is currently applied to any FCMI item weighing one ounce or less and exhibiting one of a number of characteristics that render it nonmachinable. The adjusted FCMI surcharge - \$0.20 – will mirror its domestic counterpart. For cap-calculation purposes, the volume of FCMI mailpieces that incurred the surcharge in FY 2007 was estimated using Quarter 1, FY 2008, data; these data showed that 0.004569 of FCMI was nonmachinable. Applying this proportion to the benchmark volume for FCMI and Airmail Letter-Post (368,201,951 – see step 5 above) yields 1,682,315 total pieces that incurred the surcharge in FY 2007. Multiplying this volume times \$0.17 and \$0.20 produces total revenue of \$285,994 and \$336,463, respectively, for the old and adjusted surcharges. This represents a 17.65 percent increase above the benchmark.

B. FCMI Cards

1. Starting Point

The billing determinants for First-Class Mail International (FCMI) Cards are shown in tabs “Orig FCMI Cards_Grp1” through “Orig FCMI Cards_Grp5” in the Excel worksheet entitled CAPCALC–FCMI–FY2008.xls. The billing

determinants for Postcards and Postal Cards appear in the tab “Postal Cards – Billing Dets.” The FCMI Cards billing determinants were subdivided into five rate groups whereas those for Postcards and Postal Cards were separated into three groupings. The Marshall Islands and Micronesia (Rate Group 6 from January 8, 2006, to November 19, 2007), for which mail from the U.S. is now treated as domestic, were not included in either set of billing determinants. Unlike the situation with the FCMI, the placement of the Vatican was not an issue in the FCMI Cards billing determinants because it did not appear in either rate group 5 or rate group 3.

For FCMI Cards, the billing determinants were broken out by weight step for each individual country; for Postcards and Postal Cards, the billing determinants were broken out by weight step for Canada, Mexico, and Other (rest of world). Prior to the May 14, 2007, international service offering and price change, FCMI Cards were classified as Postcards and Postal Cards (Postcards).

2. Calculating Revenue under the May 2007 Rates

The first step entailed subtracting those cards weighing more than one ounce from the FCMI Card billing determinants (see tabs “_FirstCard_Grp1” through “_FirstCard_Grp5”) as they were assumed not to be cards. This adjustment to each of the five rate groups appears in tab “Summary FirstCard_Grp1-5.” 7,370 pieces, weighing more than one ounce and representing .07 percent of total cards, were subtracted out.

In the next step the adjusted volumes for FCMI rate groups 3 – 5 were combined into one, rest-of-the-world rate group. This step produced three rate groups (Canada, Mexico, and Rest of World) for FCMI Cards, mirroring the format of the Postcards billing determinants. The volumes for the three FCMI Card rate groups appear in cells G18 – G22 in the tab “Cap Calculation (Cards),” and the volumes the three Postcards rate groups appear in cells E18-E22 in the same tab. All the cell references in the following steps apply to this tab as well.

Adjusting the FCMI Card and the Postcards volumes so that they match up with the total volumes reported in the FY 2007 RPW report required multiplying the volumes for the former by an adjustment factor of 0.98922265, and the latter by an adjustment factor of 1.0007602 (cells I18 – K22).

The consolidated volume for FCMI Cards and Postcards in FY 2007 was then calculated by summing the adjusted volumes for each of the three rate groups (cells M18 – M22).

The final step involved multiplying the appropriate May 14, 2007 rate for each rate group (cells O18-O22) by the consolidated volume for that rate group to obtain each rate group's revenue under those rates (cells Q18 – Q22). Summing the revenue for each rate group derives total revenue of \$23,507,826. This is the benchmark against which revenue generated by the adjusted rates is measured.

3. Calculating Revenue under the Adjusted Rates

The adjusted rates for FCMI Cards in 2008 (cells S18-S22) were then multiplied by the same rate-group volumes (cells M18-M22) to produce revenue under adjusted rates (cells U18 – U22). This resulted in total revenue of \$23,504,616, a 4.43 percent increase over the revenue obtained from the May 2007 rates.