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POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

POSTAL RATE AND FEE CHANGES, 1997

DOCKET NO. R97-1

# DIRECT TESTIMONY

# OF

# JAMES V. JELLISON

# ON BEHALF OF

# PARCEL SHIPPERS ASSOCIATION

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## AUTOBIOGRAPHICAL SKETCH

My name is James V. Jellison. I am the Executive Vice President of the Parcel Shippers Association, and offer this testimony in that capacity. As a former USPS Officer and employee, mailing industry consultant, and as the resident manager of this Association, I have worked in the mailing industry since 1956. I retired from the USPS in 1986 from the position of Senior Assistant Postmaster General, Operations. In that position I had exposure to the processing and transportation requirements for all classes and types of mail. I also had opportunities to discuss these issues with mailers who would likely be impacted by the decisions we were making within our internal operations. Since retiring, I employed that same knowledge and background in counseling individual mailers and mailers associations, either as a consultant or, as I am now, an active manager of an association.

Throughout that 41 year experience, I have served on industry work groups, panel discussions, Postal Forums, and postal issue gatherings of all types representing both the USPS perspective and the industry perspective as I understood them.

The Parcel Shippers Association is an organization of approximately 200 members, most of whom advertise their products through the U.S. Mails and by other media, who ship their products to the market place using the Standard A, Standard B, Priority Mail, and Express Mail package services of the USPS as well as UPS, FedEx, RPS, and other carriers. Our members also rely on the USPS to deliver their mail orders for merchandise and to send bills and receive payment for that merchandise.

**INTRODUCTION.**

The primary reason these companies band together as an association is because they have a common interest in the need for effective delivery to the business and residential consumers of the world. Effective is defined to be dependable service at a reasonable price, service which constantly evolves to take advantage of technological advances in our field. While there is fairly effective competition in the expedited package market and some in the business to business market, there is not in the residential delivery market. Over the past nearly four years that I have been with this Association, the primary concern expressed by our members has been the dominance of UPS in this residential delivery market. The testimony of PSA member Dale A. Mullin, Avon Products, Inc., describes the difficulties that confront mailers because of this market dominance by one carrier. We feel very strongly that only the USPS is, for the short term, positioned to provide meaningful competition in this area of residential delivery.

My testimony will examine why our members feel the USPS rates and classification proposals are crucial to their long term interests and their ability to select their carriers in a more competitive environment.

As my testimony will develop, the overall 10.2% rate increase proposed for parcel post is unwarranted, excessive, contrary to USPS' own stated policy on cost coverage and unjustifiably out of line with other proposed increases. And the 10¢ Standard (A) parcel surcharge is discriminatory, unnecessarily large, and will have very damaging impact on users. On the other hand, other Postal Service proposals in this case are very positive moves in making the USPS more competitive in the market place, although we do have some concerns that we need to address.

## I. SURVEY OF MEMBERSHIP

As PSA has customarily done, I caused a survey to be taken of our members to ascertain their reaction to USPS rate and classification proposals. The survey questions are also designed to provide basic information about the parcel shipping market and the carriers who deliver our members' parcels. The survey questionnaire is attached to my testimony as Appendix A. Responses were also returned by three (3) members of the Mail Order Association of America, two (2) of whom are also members of PSA. Thus, there were thirty-five (35) respondents. Five (5) of those respondents do not ship Standard (B) parcel post-type parcels.

Following is a summary of the results:

- Respondents shipped 348,610,000 Standard (A) parcels by USPS, and 8,405,000 by UPS.
- Members shipped 124,522,000 Standard (B) Parcel Post by USPS, and 127,596,000 of that type parcel with UPS.
- In addition, respondents also shipped 58,000,000 pieces of bound printed matter and records that weighed one (1) or more pounds.
- Fifty-five percent (55%) of those responding commingled their Standard (A) and Standard (B) parcels when shipping by USPS, but only seventeen (17%) of those using UPS commingled their Standard (A) and Standard (B) parcels.

- Twenty-four (24) respondents used both USPS and UPS for their Standard (B) parcel post to some extent.

- Of the thirty (30) who reported using UPS, fifteen (15) reported having special contract rates for their shipments.

- Sixteen (16) respondents reported shipping 8,043,000 parcels by a carrier other than USPS and UPS. This represents almost three percent (3%) of the total category of over one (1) pound parcels, which is up from the results of previous surveys conducted over the years, which typically reported less than one percent (1%) of total parcels shipped by a carrier other than USPS or UPS.

## A. Degree Of Presorting And Mail Preparation

The survey also asked a series of questions attempting to ascertain the current degree of presorting and preparation, and the willingness of members to do more worksharing or to use a consolidator in order to qualify for the Postal Service's proposed drop shipping discounts. Those results show the following:

### 1. OMBC Discount

- Of twenty-six (26) who responded to whether they are currently eligible for the OMBC discount, seventeen (17), or sixty-five percent (65%) ,responded that they were.

- Of the ten (10) who responded that they were not eligible, four (4) stated that they would do the work in order to qualify for the discount and six (6) said they would not. In addition, there were four (4) respondents who report that they currently qualify for a part of their shipments and who would do the necessary work to qualify the remainder of their shipments in order to earn the discount.

2. <u>DBMC Discount</u>

- Of twenty-eight (28) respondents, eighteen (18), or sixty-four (64%) reported that they are currently eligible for the DBMC discount. Of the ten (10) who said they were not currently eligible, four (4) said they would do the work to qualify and six (6) said they would not. Four (4) of the eighteen (18) who responded that they currently qualified for part of their shipments said that they would do the necessary work to qualify the remainder of their shipments for the discount.

3. <u>DSC Discount</u>

- Of the thirty (30) who responded, only four (4) said that they currently would qualify for the DSC discount. And of the twenty-six (26) reporting they did not currently qualify, eleven (11) said that they would do the work to qualify and fifteen (15) said they would not.

(There were two (2) respondents who already use consolidators and therefore they were not counted as respondents to this series of questions.)

- Another twenty (20) respondents stated that they would use a consolidator in order to qualify; this included ten (10) of those who had already responded that they would do the work in order to qualify. This is a fairly significant number because it suggests that twenty (20) of the twenty-seven (27) respondents, or seventy-four percent (74%) would do what is necessary, including using a consolidator, in order to earn the Destination Sectional Center discount.

4. DDU Discount

Of thirty (30) respondents, only four (4) indicated that they would currently qualify for the DDU rates. These are the same four (4) who also indicated they would currently qualify for the DSCF rates. Of the twenty-six (26) who do not currently qualify, seven (7) said that they would do the work to become eligible and nineteen (19) said they would not. Also, twelve (12) of the twenty-six (26) said that they would be willing to use a consolidator. Thus, out of a total of thirty (30) respondents, twenty-one (21), or two-thirds, either currently qualify or would do whatever is necessary, including using a consolidator to qualify.

## B. Use Of Delivery Confirmation

The survey also queried respondents whether they would use the manual and electronic delivery confirmation service being offered. Only three (3) of thirty-one (31) respondents said that they would use the manual service; however, twenty-four (24) of thirty-three (33), almost seventy-three percent (73%), said they would use the electronic confirmation service.

## C. Size Increase and Balloon Surcharge

The survey also questioned members about the impact of the increase in length and girth over 108", with the ten percent (10%) restriction, and the balloon parcel surcharge.

Sixteen (16) of the thirty-three (33) respondents said that they did have parcels that exceeded 108" in length and girth and that, if the size expansion is approved, thirteen (13) of the sixteen (16) would switch their parcel business to USPS. About 4.4% of their parcels are reported to exceed the current 108" limit.

Also, sixteen (16) out of the thirty-two (32) respondents indicated that they would be impacted by the proposal to charge a minimum rate for balloon parcels. Also, five (5) of those sixteen (16) report that they would switch their business away from USPS to a competitor if this balloon charge is approved.

Of more than passing interest, this survey does show a significant shift in the two carriers' market shares for these respondents. In prior surveys UPS always emerged as the overwhelmingly dominant carrier of our members' parcels. As can now be seen, at least for these respondents, while UPS is still the major carrier, USPS has a forty-nine percent (49%) share. This must be attributed in part to improved parcel post service, and, more particularly, to the competitive prices that USPS offers for residential delivery compared to UPS residential delivery rates, which are substantially higher, for those who do not have special contract rates, than the commercial rates. This does not mean that USPS is in a position to challenge UPS for a more significant market share. It merely means that many of those who responded to the survey, and who are predominantly residential shippers, have switched their patronage away from UPS to the Postal Service. Nevertheless, UPS remains, for most of the market, the overwhelmingly dominant carrier.

It is also significant to note that the thirty-five (35) respondents report that their current total volume of parcel post shipped by USPS is 124,522,000[1] . That would

[1] We have excluded the parcel post volumes reported by CTC, a consolidator, on the supposition that they have been largely double counted by being included in the report of other respondents.

constitue almost fifty-four percent (54%) of the total parcel post volume of 230 million Standard (B) parcel post parcels for FY 1997. Thus, while this survey makes no pretense at being a scientifically drawn sample, nevertheless the actual volume of reported parcels constitutes such a significant percentage of total parcel post volume that the survey results themselves, and the information the survey reports are of great significance as indicators of the probable behavior and responses of volume parcel shippers.

Before ending this section of my testimony, I would like to comment on a so-called market study conducted by the USPS that has been the subject of discovery by UPS. While the survey was not sponsored and is, therefore, not in evidence, we are concerned that its reported findings may be believed. The survey respondents indicated that 96% of parcels are already barcoded. The problem is that not all those parcels are barcoded with a code that can be read by an OCR. The application of a discount will make readability a requirement! The survey results have other incredible conclusions that none of our members are able to verify based on their personal experiences. I know of no one that is now drop shipping OBMC mail in a 3/4 full Gaylord; that is a different issue than what percent is now drop shipping to an OBMC. The most incredible figure is the survey finding that 59% of parcel volume is now being drop shipped to a DSCF. The question is fifty-nine (59%) of what? According to the wording in the interrogatories, it would be fifty-nine (59%) of the volume that the USPS conservatively expects to be drop shipped to the DSCF under the proposed rates. The question not posed is what percentage is that volume of the total volume. Members with similar experience in the industry as I have found the survey results frankly to be a joke.

## II. FURTHER DROP SHIP DISCOUNTS

I would like first to discuss those parts of the filing that have very strong support among our members and some of the reasons for that support. In Docket No. R90-1, the Commission recommended the DBMC proposal, correctly perceiving the critical role that DBMC would play in allowing the USPS to provide innovative and competitive service. The implementation of DBMC rates has clearly allowed the USPS to become a more competitive factor in the home delivery market. We support the new SCF and DDU pricing proposals as a further development that will allow the USPS to offer competitive services.

What must be understood about the parcel post drop shipping discounts that are being proposed for the first time in this proceeding is that, unlike other classes and subclasses of mail, there is currently relatively little existing activity in parcel post drop shipping to SCFs and DDUs. For that reason, it will require a substantial investment on the part of our members if they are to expand their drop shipping from the twenty-one (21) BMCs to which they currently ship to hundreds of SCFs and thousands of DDUs. The testimony of PSA member Steve Zwieg, Parcel/Direct Quad Graphics, makes clear that shippers will not make the costly investments DSC drop-shipping requires if the discounts are reduced. Small incentives will not provide sufficient return on our members' infrastructure investments. We strongly urge the Commission not to dilute this opportunity by watering down the amount of the discounts the Postal Service proposes to offer for drop shipping in this proceeding.

The cost of parcel presorting and drop shipping is quite a different order of magnitude than it is for other types of mail. Parcel mailers must physically sort parcels during the process of fulfilling orders as opposed to the automated sequencing of letters and flats that occurs with mailing lists. Also, the required containerization results in a loss of cube utilization in mailer trucks as opposed to sacking. The size of the discounts must be sufficient to make up for the additional transportation costs incurred by our members, or they just won't do it.

We trust that the Commission understands there is nothing radical about SCF and DDU discounts. Those have been available to other business mailers for years; first class, Standard (A), and periodical mailers have for some time had a variety of worksharing options, whereas Standard (B) parcel mailers have had only DBMC or the single piece rate as their options. Parcel reform is long overdue and must be achieved in this case, a reform which will merely place business parcel post customers on an equal basis with other business mailers.

It is not yet clear how many of our members will be able to use these new services because of the densities required, but we can report that nearly all of our members are analyzing their operations to see what they must do to take advantage of them. It is very important to members making this analysis that UPS not succeed in having the implementing rules imposed by a regulatory body, instead of being left as an operational decision at the lowest level possible. The most innovative service is of no value if it cannot be implemented using good operational sense. Our members are doing more outsourcing of their transportation requirements than in the past, and these new service proposals will allow them to become even more aggressive in this outsourcing, which, in turn, allows them more time and resources to manage their base business.

Our members are also very aware of the improvement in delivery times that will be accomplished by depositing their packages at a point as close as possible to the USPS delivery office. Our members report that the elapsed time for delivery is becoming more and more important to their customers; even of more importance, they have found that delivery in accordance with the customers' expectations is absolutely critical. These new drop shipment options should allow more consistency in elapsed time to delivery as well.

## III. BAR CODE DISCOUNTS

We support bar code discounts for all packages, including Standard A parcels, for all the reasons stated above, but also because we believe that information capture technology is going to continue to develop in ways that will allow both the carriers and the mailing industry to improve their operations and their products' value added features. As an example, the standardized bar code concept the USPS has been working with industry on will allow mailers to pack enough information in the bar code to offer valuable advance operational volume data to the USPS, and will give mailers the information needed to track their packages and to reenter return orders into inventory and credit transactions with much less labor than is now being used. The argument against discounts because mailers are already using bar codes in large numbers really misses the point. First, the use of a bar code reader to sort packages instead of humans has obvious operational savings; but, beyond this cost avoidance argument, it sets up a perfect marketing opportunity for the USPS to get its customers to think about the value of standardized bar codes and standardized element locations within the bar codes. One only needs to look at the rest of the materials handling industry to know that the world is moving in this direction. Our one concern is that the USPS recognizes the value of this bar code discount to Standard B parcels but not to Standard A parcels. That, frankly, bewilders us because the obvious opportunities are equally applicable to both!

## IV. DELIVERY CONFIRMATION SERVICE

Delivery confirmation is also a must if the USPS is to be on the same competitive level as other carriers. We strongly support the concept of delivery confirmation and the pricing proposals the USPS has advanced including the free confirmation service for Priority Mail. The very nature of the expedited package market calls for confirmation services being offered as part of the basic price. Many of our members ship parts of their product line by expedited mail, and, for Priority Mail to be an alternative, they would expect it to include delivery confirmation as an integral part of the service.

We are told by our members that all of the worksharing discounts will be very important in their consideration of what carriers to use for their shipping needs. I do need to mention that, since the UPS strike this summer, more and more of our members are considering alternatives to their current shipping practices than ever before. The interest of shippers to lower their dependency on UPS as a carrier is very high and, we believe, will be persistent. It's no secret that the only alternative to UPS in the home delivery market is the USPS. There can be no doubt the USPS can increase its market share if it can offer these worksharing opportunities.

## V. COMPETITIVE FACTORS IN THE PARCEL SHIPMENT MARKET

There is another consideration, seldom discussed or quantified, that the Postal Rate Commission must be aware of when it is weighing the relative competitive positions of UPS and USPS parcel service. As the Commission is well aware, and has been often documented in these proceedings, it is not possible to make a direct comparison of the parcel post rates schedule and the UPS rates schedule because a very substantial number of major parcel shippers with UPS have secret contract rates that are substantially less than the published tariff. What the Commission may not be aware of, however, is that, for a variety of reasons including a more efficient UPS, it is more expensive to use USPS parcel post service than it is to use UPS, apart from whatever the applicable rates might be. I will describe a list of factors which cause a USPS parcel shipper to incur more expense than they would were they to use UPS:

1. Returned postage costs on nondeliverable parcels;
2. Reshipment of returned parcels;
3. Product costs due to lost parcels;
4. Reshipment costs of lost parcels;
5. Loss of savings on inventory reduction that would have occurred due to better service from UPS;

6. Space costs due to more inventory requirements;

7. Customer service labor costs because of problem delivery;

8. Costs incurred because of manifest complexity and system support;

9. Increased telephone costs due to a greater number of delivery problems for USPS than when using UPS;

10. The costs of internal postal audits;

11. The costs of sorting equipment and labor; and

12. The cost of maintenance on sorting equipment.

We have made no attempt to assess an industry-wide cost for these various factors, although I am told that some of our more sophisticated members have made that assessment for purposes of determining the actual relative costs of using one service rather the other. However, I am told by our members that these costs are significant and, more often than not, they erase whatever actual rate advantage the Postal Service Parcel Post schedule may have over the UPS actual rates, particularly when speed and reliability of delivery are also important factors in making these decisions. We recite these factors not to criticize the Postal Service, although these factors do suggest there is a lot of room for improvement; rather, we point these factors out because the Commission needs to be aware of them in fixing parcel post rates if it wishes to maintain competition in this market, particularly the residential small parcel delivery market. Merely maintaining a parity in the relative rates charged by these two competitors (the only two in the market) does not guarantee at all that there will be effective competition. Parcel post rates must be very competitively set for there to be any realistic choices offered to the market.

## VI. INCREASED STANDARD B PARCEL SIZE

The USPS proposal to raise the current length and girth requirement of 108" to 130" makes good sense. All other carriers are at least 130". The proposal also has operational advantages to the mailers and the USPS. It is clear that USPS prefers its customers to drop ship as close to the delivery point as possible, leaving the USPS infrastructure more capable of providing better service to the small mailer, who must, of necessity, use USPS end to end processing. This increase in size limit will increase the volumes mailers will have available to fill out otherwise marginal vans for direct shipments and drops to points deeper in the USPS operational chain. This means better service, not only for these larger parcels, but for all parcels that have now become qualified, in terms of density, to drop ship. It also simplifies the mailers' operations; in the past they have had to split their operations between loads for USPS and the alternate carrier who would accept these larger parcels.

Frankly, PSA is disappointed that the Postal Service felt it had to limit the number of parcels in a mailing which could exceed the 108" limit. Such a proposal does not go as far as our members need. However, we do support the Postal Service proposal because, if it is recommended and adopted, and the Postal Service's experience with the larger parcels goes smoothly, then we hope we would be able to make the case in the future that the restriction should be removed.

## VII. STANDARD B PARCEL INCREASES AND COST COVERAGE

As valuable as the new service proposals are to the competitive delivery situation in residential areas, overall rate increases proposed for parcels in this case will cancel that advantage. Increases of 20% to 30% in the majority of the weight and zone cells are excessive in a case where the overall revenue increase that is needed is so much lower than would justify asking mailers to increase the rates they pay by 20% to 30%! Part of this increase is due to trying to obtain a coverage level that USPS believes would be acceptable to the Commission. Obviously, that is an important consideration; but then USPS refuses to attribute costs to parcels as directed by the PRC in the last several proceedings. I refer, of course, to the handling of the Alaska air costs by the USPS. These costs should not be charged to parcel post, but the USPS refuses to exclude them, thereby giving the false impression that parcel post is not covering its costs.

Postal Service witness O'Hara is the Postal Service policy witness that proposes the appropriate amount of cost coverage for each subclass of mail. He has proposed coverage of 104% for parcel post, and acknowledges that the overall 10.2% increase for parcel post that is necessitated by his coverage objective is one of the highest proposed. (USPS T-30, p. 37) Witness O'Hara also testified, however, that he regretted that the increase had to be that large (Tr. 2/478) and also stated that if the attributable and incremental costs had been less than they were for parcel post, he would have proposed the average 4% increase, "depending on what coverage that would have resulted in," (Tr. 2/479) meaning, presumably, that it would yield 104%

coverage, since he was firm in his judgment that 104% was the proper coverage, and equally certain that had he been able to do so, the increases he would have proposed would be "much lower than the 10.2%." (Tr. 2/481) We agree that 104% is a proper coverage for parcel post.

The reason that the Postal Service has had to propose an overall 10.2% increase in this case for parcel post is because it has once again defied the Postal Rate Commission's consistent ruling that nonpriority Alaska air costs are not properly attributable to parcel post. There is not one line of testimony offered by the Postal Service to justify its continuing defiance of the Commission's decision on this matter; not one change cited that would merit a reconsideration of the Commission's decision; in fact, there is simply no discussion whatsoever. Postal Service witness Mayes, who designed parcel post rates, asserts that it was not her decision to reject the Commission's treatment of Alaska air costs. She stated that it was Postal Service witness Patelunas who assigned these costs to parcel post. (Tr. 8/4265) One will search witness Patelunas' testimony in vain for any basis for his decision, if he is the one who made it, to reject the Commission's treatment of Alaska air costs and to attribute them to parcel post.

What exactly is the impact on parcel post costs? By stringing together various responses from the Postal Service, we have calculated the impact in this proceeding of that decision. The intra-Alaska nonpreferential air transportation after rate cost adjustment, utilizing the Commission's methodology, causes a reduction of $75,609,000.00 in parcel post costs. (The source for this number is Attachment 1 to the USPS response to PSA/USPS-1.) According to Postal Service Exhibit USPS-30B, revised 9/19/97, line 29, the Parcel Postal TYAR Revenue is $782,916,000.00. According to that same Exhibit, Parcel Post TYAR costs are $753,327,000.00. A reduction of $75,609,000.00, utilizing the Commission's adjustment for intra-Alaska nonpreferential air, produces a TYAR Parcel Post cost of $677,718,000.00. Thus, the Postal Service's proposed 10.2% rate increase is estimated to yield $782,916,000.00 of revenue with costs of $677,718,000.00, yielding a cost coverage of 115.52%. These calculations are reflected in the following table:

**TABLE 1**

**PARCEL POST TYAR COVERAGE AT PROPOSED RATES**

| | | |
|---|---|---|
| 1. | Parcel Post TYAR Revenue (Exhibit USPS-30B, revised 9/19/97, line 29 | $782,916,000 |
| 2. | Parcel Post TYAR Costs (Exhibit USPS-30B, revised 9/19/97, line 29 | $753,327,000 |
| 3. | Intra-Alaska Nonpreferential Air Transportation After Rate Cost Adjustment (Attachment 1 to Response to PSA/USPS-1) | ($75,609,000.00) |
| 4. | Total TYAR Costs After PRC Adjustment for Alaska Air Costs (line 2 plus line 3) | $677,718,000.00 |
| 5. | TYAR Revenues in Excess of Costs (line 1 minus line 4) | $105,198,000.00 |
| 6. | Percent of Cost, or "Cost Coverage" (line 1÷ line 4) | 115.52% |

A coverage of 104%, which Postal Service witness O'Hara testified repeatedly was the appropriate coverage for parcel post, would have required revenues of only $704,827,000.00. That is $78,089,000.00 less than the revenue that will be yielded by the Postal Service's 10.2% increase. In other words, a 10% reduction in the amount of revenue that is produced will still yield the desired 104% cost coverage; and that 10% reduction is precisely equal to the entire 10.2% rate increase proposed by the Postal Service in this case. In other words, if there had been a zero increase in the overall rates for parcel post, test year after rates revenues would have equaled $710,450,000.00, ($710,450,000.00 x 110.2% = $782,916,000.00). That means, that with no rate increase at all, parcel post would still have had coverage of 104%.[2] Consequently, utilizing the Commission's adjustment for Alaska air costs, the Postal Service will achieve its stated policy objective of 104% cost coverage for parcel post with a zero increase in rates overall.

We realize, of course, that all of these calculations make several unrealistic assumptions: that at lower rates the volumes would not change and therefore the costs and revenues would not change; and that the Postal Service's stated policy objective of 104% cost coverage would not have changed even though such a position yielded a zero increase in rates. Nevertheless, the numbers amply demonstrate that the Postal Service's increases are greatly out of line with all other increases and are unnecessarily so because they are not needed in order to meet the Postal Service's 104% coverage factor, the justification they advanced for proposing such high rate increases.

Taking the Postal Service at its word, that is, that, had it been able, it would have proposed no more than the average 4% increase for parcel post, it is useful to examine

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[2] This result is also in accord with the coverage for parcel post in the Test Year Before Rates, with the PRC modification on Alaska air. According to USPS Exhibit 30A Parcel Post Costs will be $786,812,000.00 TYBR, and revenues will be $737,970,000.00. Reducing the TYBR costs by the $75,609,000.00 of Alaska air yields TYBR costs of $711,203,000.00. That revenue cost relationship produces cost coverage of 103.8% in the TYBR ($737,970,000.00 ÷ $711,203,000.00).

what coverage that would produce in this case. Again assuming that there are no volume changes because the rates are less than proposed, a 4% increase in revenues would equal revenues after rates of $738, 868,000.00 ($710,450,000.00 x 104%). After rates revenues of that amount would produce coverage of 109%. ($738,868,000.00 ÷ $677,718,000.00, the TYAR costs.) At the most, bearing in mind the high price elasticity of parcel post, and bearing in mind the Postal Service's own sworn testimony that, were the costs to have permitted it, they would have proposed no more than an overall 4% increase, it is clear that the proposed parcel post rates are excessively high, and that the Commission should recommend overall increases no greater than the average 4% rate increases proposed in this case.

We urge the Commission to carefully consider the competitive position of this sub-class of mail and the impact on competition of 30% increases at a time when overall rates need to be increased only 4% to meet the revenue requirement.

## VIII. <u>STANDARD A RESIDUAL SHAPE SURCHARGE</u>

The Standard A parcel surcharge is of great importance to our members. With the regular Standard A increases plus the surcharge, these concerned members face huge percentage increases in both Standard A and Standard B parcels. As best I can understand this proposal by the Postal Service, it was motivated by a finding (unsupported by evidence of record) of the PRC that this small percentage of Standard A mail is more expensive to handle than Standard A flats, and a further directive from the PRC to do something about it or else. I have never heard the so-called "victims" of this inequity complain about it. This additional cost is presumed to be caused predominantly by the shape of the article and not the weight of the article. In the now-aborted Parcel Classification Case, the "cost study" presented by the USPS essentially said USPS was able to isolate the cost difference caused by shape by comparing the costs of ECR parcels and flats, where the weight of the average parcel was nearly the same as the average flat; the presumption, therefore, was any cost difference must be due to shape. I could not find a single member that mails Standard A parcels at the enhanced carrier route rate! So where did this volume come from and how much of it was there? I don't know, but supposedly the USPS knows, and its witnesses now say the ECR cost differential is no longer 20 cents, as it was in March, but it is now around 40 cents.

USPS witness Moeller had to concede that witness Crum's cost study merely identified the cost differences between Standard (A) flats and parcels, but did not offer any explanation to account for these cost differences; in other words, even though Mr. Moeller calls this10¢ surcharge a shape-based surcharge, witness Crum's study does not establish shape as the cost causing factor. (Tr. 6/3055-56)

The Postal Service defines parcels in this proceeding as they are in the IOCS Field Operating Instructions Handbook F-45 (this is reproduced beginning at Tr. 5/2202). The volumes of Standard (A) parcels are entered into the Permit system based on the shape determination that is placed on the mailing statement, and the mailing statements give directions that they should be filled out as referenced in DMM C050. However, the actual costs of handling parcels and flats is based upon a sampling system that has no reference to the mailing statements filed by the mailers.

USPS witness Crum was asked how a tally clerk would record parcels that were less than 3/4" thick that were combined with those that were more than 3/4" thick. He stated that it was his understanding that the proportions were heavily weighted one way or the other and that the clerk would select the category of "parcel" or "flat" depending upon the majority of the volume the mailing. (Tr. 5/2219)

The fragility of the cost data is perfectly illustrated by witness Crum's own testimony which finds that the cost difference between ECR flats and parcels is $0.391, which was almost twice as high as the cost difference that witness Crum presented in Docket No. MC97-2, just a few months prior to filing this testimony. (Tr. 5/2242)

The actual mail processing costs differences for flats and parcels are derived from the sampling data accumulated and reflected in Library Reference 146. Witness Crum stated that those collecting that data based their definition of a parcel and a flat on the IOCS shape tally referred to in Handbook F-45. (Tr. 5/2383) But witness Crum did have to concede that, "An individual tally-taker certainly could have, in an instance, picked the improper shape designation for the reasons you suggest." (Tr. 5/2384)

USPS witness Crum claims that postal employees were able to distinguish between a Standard A parcel and a flat because they were given 120 hours of training, or at least mail classification specialists were. (Tr. 5/2341) He claimed that, based on his understanding in speaking with the people involved in training, one of the items discussed as part of the training was how to distinguish between a Standard (A) flat and a parcel. (Tr. 5/2341) However, he had to admit that, where the dimensions were roughly close between a flat and a parcel, it would be difficult for the unaided eye to correctly distinguish between the two. (Tr. 5/2342) Finally, the Postal Service made no effort to factor in the influence of weight on the cost of a parcel nor the amount of revenue that that parcel produced. Since the average parcel weighed 8 ounces, the Service conceded this necessarily meant there were hundreds of millions of parcels that weighed more than 8 ounces. (Tr. 5/2344-45)

The Postal Service has not even bothered to estimate the effect of the 10¢ surcharge on the cost coverage of Standard (A) parcels. The Postal Service dismisses this as unimportant because there are no cost coverage targets separately for parcels as distinguished from flats in Standard (A). Thus, the Postal Service admits that it does not even know whether the surcharge might create a higher cost coverage for Standard (A) parcels than for Standard (A) flats. At the same time the Postal Service agrees that it is possible that, and would not be surprising if, the average cost difference between letters and nonletters was greater than the average cost difference between flats and residual shape pieces. In other words, there could be an even more serious cross-subsidization problem between letters and nonletters than there are alleged to be between flats and parcels. This raises the question of why the Postal Service felt it was necessary to address the potentially less serious amount of cross-subsidization between flats and an insignificant portion of Standard (A), that is, parcels, which are not even separate rate categories, but at the same time ignore what could be a potentially more serious cross-subsidization issue between letters and nonletters, which are in fact two separate rate categories. (Tr. 6/2885)

We have to ask again: why has USPS singled out this insignificant portion of a rate category that is, in turn, only part of one of several subclasses of Standard (A). What about First Class?

### A. FIRST CLASS SHAPE COSTS: FLATS VERSUS PARCELS

According to Exhibit USPS-43C, there are a total of 758.4 million non-standard pieces of First Class Mail; of this total there are 145.4 million letters; 558.8 million flats; and 54.2 million parcels. The parcels comprise 7.14% of the total. In light of the USPS proposal for a parcel surcharge in Standard (A), the question that raises itself immediately is why there is a uniform surcharge for non-standard FMC letters, flats, and parcels when there are such great cost discrepancies in their mail processing. More particularly, why is it that first class parcels, which according to the study cost 16¢ more per piece to handle than flats, do not pay any more than the flats? And, why don't the flats pay more than lettres? This is certainly a significant enough segment of mail volume, 758.4 million pieces, to warrant discrete treatment. After all, the 10¢ in Standard (A) is being visited on a category of mail, the 900 odd million pieces of Standard (A) parcels, that is not much larger than this category. In fact, the First Class mail parcels constitute 9.7% of the total of nonstandard first class flats and parcels; whereas Standard (A) parcels constitute only 3.5% of all commercial nonletter Standard (A) mail. If such an insignificant percentage of a category of mail as Standard (A) parcels can be singled out for special rate treatment to cover its cost differentials, why isn't the larger percentage of parcels in First Class mail singled out for a special surcharge to cover its cost differential?

## B. STANDARD (A) PARCEL COVERAGE

Postal Service witnesses have stated that they do not know, and are unable to project, what the cost coverage either before or after rates would be in the Test Year for Standard (A) Parcels; what the average cost per parcel will be in the Test Year; nor what the average revenue per piece will be for Standard (A) Parcels. In fact, the Postal Service has admitted they do not know whether the average revenue per piece that will be yielded for Standard (A) Parcels, in the absence of a surcharge, would be equal to or greater than the average per piece cost. Despite this lack of knowledge the Postal Service nevertheless is asking the Commission to make Standard (A) Parcels pay a 10¢ surcharge, not because Standard (A) Parcels will not cover their costs; not because there is something particularly burdensome about a Standard (A) Parcel; but simply because the Postal Service's base year cost estimates show that Standard (A) Parcels are considerably more costly to process than Standard (A) Flats.

While the data is not available to make Test-Year comparisons of the revenue contributions and coverages of Standard (A) parcels and flats, we believe we can use USPS data to make these comparisons for the Base Year. Utilizing data contained in USPS witness Crum's Exhibit K, we have calculated the Base Year per piece costs, the average weight per piece, and the revenue per piece, separately for letters, flats, and parcels, for the ECR, the Regular, the Non-Profit ECR, and the Non-Profit Regular categories. We have made the assumption, which should be a roughly close approximation, that the average costs per piece that are derived from this Postal

Service data are costs that can be applied to each one of the pieces listed in Tables 1 and 2 of Mr. Crum's Exhibit K. This information is presented in the following Exhibit A.

EXHIBIT A

## BASE YEAR DATA FOR STANDARD A LETTERS, FLATS, AND PARCELS

| ECR | Cost/Piece[1] $ | Vol.[2] (000) | Wgt.[2] (000) | Rev.[2] (000) | Rev./Piece[3] | Coverage[4] (%) | Wgt./Piece[5] (lbs.) | Wgt./Piece (oz.) |
|---|---|---|---|---|---|---|---|---|
| Letters | .058 | 12,808,617 | 863,349 | 1,722,628 | 13.45¢ | 232.00% | .0674 | 1.08 |
| Flats | .064 | 16,303,000 | 3,236,038 | 2,564,898 | 15.73¢ | 246.00% | .1985 | 3.175 |
| Parcels | .455 | 69,464 | 12,029 | 10,992 | 15.80¢ | 35.00% | .173 | 2.77 |
| All | .062 | 29,180,700 | 4,111,416 | 4,298,518 | 14.73¢ | 237.60% | .1408 | 2.25 |
| **Regular** | | | | | | | | |
| Letters | .097 | 19,075,362 | 1,177,288 | 3,438,281 | 18.02¢ | 186.00% | .0617 | 0.987 |
| Flats | .182 | 10,205,710 | 2,387,896 | 2,481,505 | 24.30¢ | 133.00% | 0.234 | 3.74 |
| Parcels | .513 | 868,434 | 483,659 | 403,812 | 46.45¢ | 91.00% | 0.5563 | 8.9 |
| All | .138 | 30,150,506 | 4,048,843 | 6,323,598 | 20.97¢ | 152.00% | 0.1342 | 2.14 |
| **Nonprofit ECR** | | | | | | | | |
| Letters | .040 | 2,294,416 | 107,479 | 168,863 | 7.35¢ | 184.00% | 0.0468 | 0.75 |
| Flats | .070 | 612,812 | 84,658 | 72,586 | 11.80¢ | 169.00% | 0.138 | 2.2 |
| Parcels | 1.382 | 1,389 | 266 | 178 | 12.80¢ | 9.20% | 0.1915 | 3.1 |
| All | .047 | 2,908,617 | 192,403 | 241,627 | 8.30¢ | 176.75% | 0.0838 | 1.34 |
| **Nonprofit Regular** | | | | | | | | |
| Letters | .083 | 7,687,399 | 361,813 | 807,094 | 10.49¢ | 126.50% | 0.0471 | 0.75 |
| Flats | .191 | 1,570,708 | 251,682 | 255,922 | 16.93¢ | 88.60% | 0.16 | 2.56 |
| Parcels | .659 | 42,360 | 16,933 | 11,232 | 26.50¢ | 40.20% | 0.3997 | 6.4 |
| All | .104 | 9,300,467 | 630,428 | 1,074,248 | 11.55¢ | 111.00% | 0.0677 | 1.08 |

1 USPS-T-28, Exhibit K, Table 3

2 USPS-T-28, Exhibit K, Tables 1 and 2

3 Col. 4 ÷ Col. 2

4 Col. 5 ÷ Col. 1

5 Col. 3 ÷ Col. 2

Out of a total of 982,647,000 Standard (A) Parcels, 869,434,000, or 88-1/2%, of all the categories of parcels are regular for-profit. This category of parcels shows per piece costs of 51.3¢, compared to 18.2¢ for flats, or 33.1¢ per piece more, not the 40¢ per piece differential the Postal Service testimony speaks about. Witness Crum further adjusts parcel costs by reducing them by 7.3¢ per piece (Exhibit K, Table 7.) This represents .3¢ due to the deeper entry of flats and 7.0¢ because of the finer presort of flats. Thus, the actual commercial regular parcel cost would be 51.3¢ less 7.3¢, or 44¢. The parcel/flat cost difference would then be 25.8¢ (44¢ minus 18.2¢).

The Table also shows that the average per piece revenue from a flat is only 24.3¢ per piece, whereas the average revenue per piece for a parcel is 46.45¢, almost twice as much revenue. Thus, while a parcel may cost 25.8¢ more per piece, according to these numbers, it also earns 22.15¢ more per piece revenue for the Postal Service. The Table also shows that the average flat weights 3.74 ounces and the average parcel weights 8.9 ounces. Despite the Postal Service's contention, that there is no evidence that weight in Standard (A) is a significant cost causing factor, we suggest the opposite is obviously the case: that weight is every bit as distinct a cost causing factor as shape. We would also point out, however, that the Postal Service's rate structure takes account of that additional cost by charging more for that average parcel, in this case almost twice as much.

Thus, if we accept, for the sake of argument, that there is some common sense to the Postal Service's claimed cost numbers derived from Library Reference 146, when seen in the perspective of the actual cost revenue relationships between Regular Rate Flats and Regular Rate Standard (A) Commercial Parcels, one is left with an actual discrepancy of around 2.65¢, a number far less than 10¢ the Postal Service is proposing in this case. The Postal Service, however, would have you believe that they are being inordinately generous in only passing through in the form of a surcharge one-quarter of the cost difference. In fact, the Postal Service is exacting seven cents (7¢) more than the actual difference in the cost revenue relationships of regular rate flats and commercial parcels.

The lumping together in this case of all categories, for-profit and not-for-profit, ECR as well as Regular, obfuscates the true picture of what the numbers demonstrate are cost/revenue discrepancies for the overwhelmingly predominant volume in Standard (A). Viewed from another aspect, if, for the base year, one adds in the 10¢ surcharge to the average revenues yielded on a commercial Standard (A) Regular Parcel, according to Postal Service data, that revenue yield would be 56.45¢ per piece versus an average cost of 44¢ per piece. In other words, a zero surcharge, would still allow these parcels to cover their costs with 2.45¢ per peice to spare (46.45¢ minus 44¢).

We would make the point that, while we object to separating out parcels from flats in Regular Standard (A) when there is no existing sub-class or rate category distinction, we most emphatically object to lumping together Regular Parcels with Parcels in three other rate categories and subclasses, that is, ECR Parcels, Non-Profit ECR Parcels, and Non-Profit Regular Parcels. These are all separate rate categories or subclasses, with separate and distinct costs and revenue yields. They should be treated differently with respect to any surcharge. There is no more justification for visiting a surcharge on Regular Standard (A) Parcels because First Class Parcels are not covering their costs than there is for imposing a surcharge on Standard (A) Parcels because the parcels of another separate subclass, for example, ECR Parcels, are not covering their costs.

We have already pointed out the fragility of the Service's cost estimates for Standard (A) Parcels and Flats; and all the reasons why they should be viewed with great skepticism. Nevertheless, giving full credit to the mail processing costs reported in Library Reference H-146, there is no case for any surcharge on Commercial Standard (A) Regular parcels.

## CONCLUSION

I can only repeat what representatives of our Association have always said to the Commission: what our members want is real competition between carriers for the business of delivering our products to the market place. I don't believe anyone can deny that in the home delivery market there are only two players in the ground delivery portion of this market. UPS and USPS! I also don't believe anyone can deny that UPS is so dominant in this market that they can dictate to the customers what kind of service they can expect and what price they will be expected to pay. Our PSA member, Dave Mullen presents the harm this situation has caused and will continue to cause until there is more effective competition in this market. The USPS' totally out of line increases for parcel post will harm not help competititon.

And finally, we do not think that the damage that will be caused by a 10¢ surcharge to that group of less than 1 billion Standard (A) parcels just so that some tiny relief be accorded to the over 26 billion pieces of Standard (A) flats is worth it. The estimated $93.9 million in revenues that will be derived from the 10¢ residual shape surcharge could have benefited the average commercial flat in Base Year FY '96 by only .35¢ per piece. (Tr. 6/2739) In other words, we do not see how the Post Office justifies visiting rate increases in excess of 50% on certain Standard (A) parcel mailers, in order to have a reduction for Standard (A) flat mailers of an average of 1/3 of a cent per piece. (Tr. 6/2720) Again, the Service's own data show that no surcharge is needed in order to cover the costs of Standard (A) commercial parcels.

## PARCEL SHIPPERS ASSOCIATION - QUESTIONNAIRE

It will be helpful in the presentation of PSA's position in the current rate proceeding at the Postal Rate Commission if we can present our members' reactions to and likely usage of new Standard B parcel products proposed by the Postal Service. The following questionnaire is relatively simple to complete and does not require extensive technical knowledge.

1. Please supply the total volume of Standard (A) parcels (less than one pound) you estimate you will ship during Calendar Year 1997 by:

USPS ________
United Parcel Service ________
Other ________

2. Please supply the total volume of Standard (B) parcels (one pound or more) you estimate you will ship during Calendar Year 1997 by:

USPS ________
United Parcel Service ________
Other ________

3. What percentage of your parcels delivered to residential addresses do you ship:

by USPS ________%
by UPS ________%
by other ________%

4. What percentage of your parcels delivered to nonresidential addresses do you ship:

by USPS ________%
by UPS ________%
by other ________%

5. If you ship both Standard (A) and Standard (B) parcels by USPS, do you commingle them in one mailing?

____ Yes ____ No

6. If you use UPS, do you have Special Contract Rates, rather than pay the regular published rates?

____ Yes ____ No

7. If you use UPS to ship your Standard (B) parcels, do you also use UPS to ship your Standard (A) parcels?

____ Yes ____ No

8. The Postal Service has proposed new parcel discounts for worksharing. Please indicate which discounts you would already qualify for, and if you would prepare your mail as required to earn the discounts for the following:

(a) Origin BMC Discount of 57¢ (parcels are entered at a BMC and presorted to Destination BMC):

i. Parcels currently qualify ____ Yes ____ No

ii. Parcels do not currently qualify, but would prepare parcels to qualify ____ Yes ____ No

(b) DBMC presort discount of 12¢ (parcels are not entered at the Origin BMC, but are presorted to Destination BMC):

i. Parcels currently qualify ____ Yes ____ No

ii. Parcels do not currently qualify, but would prepare to qualify ____ Yes ____ No

(c) DSCF Rates (Dropshipped to the Destination SCF and prepared so that at least 50 pieces are sorted to the 5 digit level):

i. Parcels currently qualify ____ Yes ____ No

ii. Parcels do not currently qualify, but would prepare to qualify ____ Yes ____ No

iii. Would use a consolidator in order to qualify ____ Yes ____ No

(d) DDU Rates (Dropshipped to the Destination Delivery Unit, and prepared so that at least 50 pieces are sorted to the 5 digit level):

i. Parcels currently qualify ____ Yes ____ No

ii. Parcels do not currently qualify, but would prepare to qualify

Yes No

iii. Would use a consolidator in order to qualify

Yes No

9. Delivery Confirmation Service:

a. I would use the manual service for a fee of 60¢

Yes No

b. I would use the electronic service for a fee of 25¢

Yes No

10. The USPS proposes to increase the maximum parcel size from 108" to 130". However, the rate would be at 70 lbs. irrespective of the actual weight. Also, no more than 10% of the mailing could exceed 108" in size.

(a) The percentage of my parcels that exceed 108" is ________%

(b) I would switch parcels to USPS from another carrier if this proposal were adopted

Yes No

11. Balloon parcel penalty. The USPS proposes to charge the 15 lb. rate to parcels in excess of 84" in size, even if the parcel weighs less than 15 pounds.

(a) I will be affected by this change

Yes No

(b) If affected, I will switch my business away from USPS to another carrier

Yes No

______________________________
NAME OF COMPANY

______________________________
CONTACT AT COMPANY

## CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing upon all participants of record in this proceeding in accordance with Section 12 of the Rules of Practice.

Timothy J. May

Dated: December 29, 1997