

Before The
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

RATE ADJUSTMENT DUE TO EXTRAORDINARY
OR EXCEPTIONAL CIRCUMSTANCES

Docket No. R2010-4

RESPONSES OF THE UNITED STATES POSTAL SERVICE
TO QUESTIONS 1-8, AND 10 OF PRESIDING OFFICER'S
INFORMATION REQUEST NO. 4
(August 10, 2010)

The United States Postal Service hereby provides its responses to Questions 1-8, and 10 of Presiding Officer's Information Request No. 4, dated August 5, 2010. Answers were sought no later than today. A response to Question 9 is forthcoming. The Postal Service intends to file its response to Question 9 later this afternoon. Each question is stated verbatim and is followed by the response.

The responses are sponsored by officials in this docket as follows:

Questions 1, 6-8 -- Kiefer
Questions 2-4, 10 -- Masse
Questions 5 -- Institutional

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorney:

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August 10, 2010

**RESPONSE OF JAMES KIEFER
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 4**

1. Please refer to the Statement of James M. Kiefer at 53, which states the "offering of Stamped Envelopes bearing a Standard Mail stamp will be eliminated." Please provide the FY 2009 volume of Stamped Envelopes bearing a Standard Mail stamp.

RESPONSE:

13,500 stamped envelopes bore a Standard Mail stamp in FY 2009.

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6. Please refer to page 7 of USPS-LR-2, Standard Mail Preface R2010-4.doc where it states, “[b]ased on its experience and judgment, Postal Service management has estimated that 61 percent of NFM volume will migrate to Fulfillment Parcels.” Please explain in detail the rationale underlying the judgment of Postal Service management that 61 percent of NFMs will migrate to Fulfillment Parcels and the remaining 39 percent will be Marketing Parcels.

RESPONSE:

The Postal Service examined volume data for the top 200 customers of its NFMs/Parcels product and assigned the volume of each customer to either the Marketing Parcels or Fulfillment Parcels category. The decision as to which category a customer was to be assigned was based upon the Postal Service's knowledge and understanding of the type of business each customer engages in and the kind of parcels it mails. The volumes in each category were summed and the resulting 61-39 percent split was based on the relative proportions of the volumes assigned to each category. In performing this analysis, the Postal Service assumed that if a customer currently mailed fulfillment parcels, it would continue to mail fulfillment parcels and if a customer currently mailed marketing parcels, it would continue to mail marketing parcels.

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7. Please confirm that the Postal Service proposal in this proceeding will result in rate increases as large as 79 percent for Standard Mail NFMs—the proposed rate increase for 3.3-ounce SCF presorted, DSCF-entered irregular NFMs that will fall into the fulfillment parcel category under the proposed classification—and as large as 35 percent for Standard Mail Parcels (the proposed rate increase for 3.3-ounce SCF presorted, DNDC-entered irregular parcels). If not confirmed, please provide the correct figures.

RESPONSE:

Confirmed. After the proposed price adjustments, the DSCF-entered former NFM would pay 98.0 cents and the DNDC-entered irregular parcel would pay 105.7 cents per piece.

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8. In the file “SPParcelPost Worksheets R2010-4.xls,” The Alaska Bypass Volume for the Hybrid year FY2009 Q3 – FY2010 Q2 is calculated to be 1,391,219 in the tab “Inputs” at cell c22. The Revenue for the hybrid year is calculated to be \$30,203,196 in the tab “New SPP Prices” at cell AA87. These values are used in the file “Package_Services_Worksheets_R2010-4.xls,” which contains the calculation of the R2010-4 proposed price increase for Package Services. On July 28, 2010, the Postal Service filed Quarterly Billing Determinants for the Hybrid year. The following questions concern Alaska Bypass Volume and Revenue in the file “Parcel Post Hybrid BD Q309-Q210 R2010-4.xls.”

- a. Please confirm that the Alaska Bypass Volume in file “Parcel Post Hybrid BD Q309-Q210 R2010-4.xls” tab “BD Total Q3FY09-Q2FY10” cell L87 is 1,482,963.
- b. Please confirm the following Alaska Bypass Volumes match the volume listed in a text note at the bottom of each quarterly Billing Determinant page in the file “Parcel Post Hybrid BD Q309-Q210 R2010-4.xls.”

Tab	Volume
BD Q309	433,440
BD Q409	335,432
BD Q110	307,571
BD Q210	314,776
Total	1,391,219

- c. Please reconcile the discrepancy between the volume figures in “Parcel Post Hybrid BD Q309-Q210 R2010-4.xls” and the file “SPParcelPost Worksheets R2010-4.xls.”
- d. Please Confirm that the Alaska Bypass Revenue in tab “BD Total Q3FY09-Q2FY10” cell L87 is \$27,931,604.
- e. Please confirm the following Alaska Bypass Revenues match the revenue listed in a text note at the bottom of each quarterly Billing Determinant page in the file “Parcel Post Hybrid BD Q309-Q210 R2010-4.xls.”

Tab	Revenue
BD Q309	\$ 6,901,597
BD Q409	\$ 7,863,038
BD Q110	\$ 7,439,562
BD Q210	\$ 7,297,697
Total	\$ 29,501,894

- f. Please reconcile the discrepancy between the revenue figures in “Parcel Post Hybrid BD Q309-Q210 R2010-4.xls” and the file “SPParcelPost Worksheets R2010-4.xls.”

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RESPONSE:

- a. The text note reference in cell L87 is in error, and 1,482,963 should read 1,391,219. The entire text note reference should read, "*Excludes 1,391,219 Alaska Bypass Pieces (\$29,501,894).*" This correction does not affect any of the computations in the spreadsheet.
- b. Confirmed. The text notes at the bottom of each quarterly Billing Determinant page in the file "*Parcel Post Hybrid BD Q309-Q210 R2010-4.xls*" correctly match the referenced Alaska Bypass volumes.
- c. The volume figures in "*Parcel Post Hybrid BD Q309-Q210 R2010-4.xls*" and the file "*SPParcelPost Worksheets R2010-4.xls*" match. The only volume discrepancy is in the file "*Parcel Post Hybrid BD Q309-Q210 R2010-4.xls*" in the tab "*BD Total Q3FY09-Q2FY10*" at cell L87. The text note at cell L87 should read, "*Excludes 1,391,219 Alaska Bypass Pieces (\$29,501,894),*" not "*Excludes 1,482,963 Alaska Bypass Pieces (\$27,931,604).*" Additionally, the text note at cell B87 in this tab should read, "*Excludes 1,391,219 Alaska Bypass Pieces.*" These corrections do not affect any of the computations in the spreadsheet.
- d. The text note reference in cell L87 is in error, and \$27,931,604 should read 29,501,894. The entire text note reference should read, "*Excludes 1,391,219 Alaska Bypass Pieces (\$29,501,894).*" This correction does not affect any of the computations in the spreadsheet.
- e. Confirmed. The text notes at the bottom of each quarterly Billing Determinant page in the file "*Parcel Post Hybrid BD Q309-Q210 R2010-4.xls*" correctly match the referenced Alaska Bypass revenues.

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- f. The revenue figures in "Parcel Post Hybrid BD Q309-Q210 R2010-4.xls" and the file "*SPParcelPost Worksheets R2010-4.xls*" differ because of the following methodology, which was used for the "*Before Rates*" computations associated with the file "*SPParcelPost Worksheets R2010-4.xls*" in tab "*New SPPP Prices*," in columns "T" through "AA" (the *Before Rates* part of the "*Fixed-Weight Average Price Change Calculation*" matrix).

The "*Before Rates*" computations apply current prices (May 2009) to the hybrid billing determinant volumes, and the "*After Rates*" (proposed prices) apply the proposed prices to the same (fixed) hybrid billing determinant volumes, creating a fixed-weight (by volume) methodology. This controls for factors other than the change in prices.

Hybrid billing determinant volumes are used in the before and after price change computation, but hybrid billing determinant revenues are not. Using hybrid billing determinant revenues introduces bias, because factors other than the change in price are not controlled. Additionally, the percentage price change computation is overstated if hybrid billing determinant revenues are used, because of the integration with the May 2008 price change associated with Q3 FY 2009. Using the fixed weight average price change calculation methodology correctly determines total revenue to be \$631,205,279.

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2. In USPS LR-R2010-4/6, the file RFIInputTable.xls lists the values for the cost effects used in the PCCEM model. In that file there are five different cost reductions for component 165, Segment 15 Rents, which are distributed to products using two different distribution keys. Component 1467 is used for one cost reduction and component 1452 for the four other cost reductions. The effect of using these distribution keys is to allocate cost reductions to zero balances in component 165, resulting in negative balances in the component before distribution of rental costs in the FY 2010BR "B" report. Component 165 generally has zero variable costs in the short run and the distribution of rental costs in this component is handled within the development of the "B" report, the distribution of PESSA costs. The result of the "B" report distribution is reflected in the FY 2010 "C" report, but the results of the cost reductions distribution to products are not reflected in the distribution of costs in the "C" report. Should the distribution key components 1467 and 1452 be used to distribute the cost reductions for component 165, Segment 15 Rents, or should the cost reductions affect only the other costs and total costs of component 165? If the use of components 1467 and 1452 is correct, please explain how the cost reduction distribution to products is reflected in the FY 2010BR "C" report.

RESPONSE:

The distribution key used for cost reductions in component 165 is immaterial because only total costs will ultimately be impacted. As the question states, the component will be distributed again in the "B" report.

The distribution for component 165 in the "B" report is based on the rental value distribution key, which is developed in the Factor report. For FY 2010 the rental factors used to develop the rental value distribution key were the same as FY 2009, while in FY 2011 new factors were developed. Therefore the cost reduction distribution to products for this component is better represented in the FY 2011BR "C" report.

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3. Please refer to the FY 2009 Cost and Revenue Analysis reports (posted at www.usps.com/financials), Attachments 9-12 of the Masse Statement, and PRC Order No. 191, at 43.

- a. Please confirm that the Postal Service increased Standard Mail Not FlatMachinables (NFM)/Parcels rates by an average of 16.4 percent in May 2009. If not confirmed, please explain.
- b. Please confirm that the FY 2010 Standard Mail NFM/Parcel revenue per piece (94.5 cents) presented in Attachment 9 of the Masse Statement is 1.5 percent higher than FY 2009 Standard Mail NFM/Parcel revenue per piece (93.1 cents). If not confirmed, please provide correct figures.
- c. Please explain why the Standard Mail NFM/Parcel average revenue per piece is forecasted to grow by 1.5 percent in FY 2010 despite the significant May 2009 price increase. In particular, please address whether the mail mix (e.g., percentage destination entered) implicit in the FY 2010 revenue forecast is a lower-revenue, lower-cost mail mix than the FY 2009 Standard Mail NFM/Parcel mail mix.
- d. Please confirm that neither the forecasted FY 2010 nor the forecasted FY 2011 Standard Mail NFM/Parcel costs presented in Attachments 9 through 12 include any adjustments to reflect differences in mail mix between the forecasted years and FY 2009. If not confirmed, please identify and explain all adjustments.

RESPONSE:

- a. Confirmed that, using a fixed weight index approach for cap compliance calculations that employed FY08 billing determinants, the measure of the price increase implemented in May of 2009 for NFM/Parcels was 16.4 percent. See page 14 of the Notice of Price Adjustment in Docket No. R2009-2 (Feb. 10, 2009). Using FY09 billing determinants instead of FY08 billing determinants, however, would suggest that the May 2009 price increase for NFM/Parcels was only about 3 percent, rather than 16 percent.
- b. Confirmed.
- c. It is clear that the mail mix implicit in the FY10 revenue forecast is different from the FY08 mail mix which was employed in Docket No. R2009-2 for cap

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compliance purposes. In the 2009 price change, the Postal Service forced migrations by eliminating some price cells. So the shift to lower revenue per piece represents, in part, the elimination of some higher priced options.

Migrations from these May 2009 classification changes, as well as from the May 2009 changes in the relative prices between the remaining rate categories, would have started in the second half of FY09, and therefore would have had an effect on FY09 unit revenues, with the effect intensified in FY10. Note, however, that the FY10 forecasted revenues included in the Masse exhibits use a base period that differs from FY09 by only one quarter. The forecasting base period drops Q1 of FY09, and adds Q1 of FY10. In any event, as indicated in the response to part a. of this question, using the FY09 billing determinants to evaluate the May 2009 price changes explains why the forecasted revenue increase in FY10 is much less than one might imagine when focusing on the results using FY08 billing determinants.

d. Confirmed.

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4. Please refer to the FY 2008 and FY 2009 Cost and Revenue Analysis reports, Cost Segments and Component reports, and Revenue, Pieces, and Weight reports (posted on www.usps.com/financials).

a. Please confirm that the unit cost of Standard Mail NFM/Parcels increased by 11.6 percent from FY 2008 to FY 2009. If confirmed, please explain why Standard Mail NFM/Parcel unit costs increased by such a large amount between FY 2008 and FY 2009. If not confirmed, please provide the correct figure.

b. Please confirm the following FY 2009 (vs. FY 2008) cost segment-specific percentage changes in Standard Mail NFM/Parcel unit costs and explain why Standard Mail NFM/Parcel unit costs in each listed cost segment increased so rapidly from FY 2008 to FY 2009. If not confirmed, please provide the correct figure.

- i. C/S 3 Clerks and Mailhandlers (CAG A-J) – 11.6%
- ii. C/S 6 City Carriers Office Activity – 36.5%
- iii. C/S 7 City Carriers Street Activity – 24.5%
- iv. C/S 8 Vehicle Service Drivers – 72.2%

RESPONSE:

a. Confirmed. The unit costs for Standard Mail NFM/Parcels rose 13 cents from \$1.11 in FY 2008 to \$1.24 in FY 2009, an 11.6 percent increase. The increase is driven by the increases in cost segments 3, and 6 to 8 as discussed below in part b, which accounts for nearly 10 cents of the increase in unit costs. These same factors, as discussed below, also led to increases in cost segments 2 (Supervisors and Technicians), 11 (Custodial and Maintenance Services), 15 (Building Occupancy) and 18 (for Service-Wide Benefits). There was a decline in cost segment 14 (Purchased Transportation) as well. A common thread of the explanations in part b, is the shift in mail mix toward a higher share of parcels vs. NFMs. In addition, many postal products had significant increases in these same cost segments for FY 2009.

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b. i. Confirmed. Cost segment 3 costs rose 11.6 percent, going from 41.5 cents in FY 2008 to 46.3 cents in FY 2009, an increase of 4.8 cents. The entire increase was in mail processing, cost segment 3.1, a 12.3 percent increase. Several factors are relevant. First, clerk and mail handler cost per work hour rose by about 7 percent. Second, the share of NFMs declined in FY 2009, likely raising unit processing costs. RPW data show the FY 2008 share was 28.1 percent and in FY 2009 it was only 20.9 percent. Finally, variance could also be part of the increase, as there was a decline in cost segment 3 unit costs from FY 2007 to FY 2008 as large as the increase between FY 2008 and FY 2009. These factors outweighed the increase in dropshipping for this product in FY 2009 as compared to FY 2008.

ii. Confirmed. Standard Parcels/NFM unit costs for city carriers in-office activities increased approximately 1.8 cents in FY09 (from 4.7 cents in FY08 to 6.5 cents in FY09). Standard Parcels/NFMs are often cased by city carriers after they have cased their other mail, made up of non-DPS letters and flats. Two mail-mix changes for Standard Parcels/NFMs occurred in FY09, both of which resulted in an increase in C/S6 unit costs.

First, the City Carrier Cost System (CCCS) shows that NFM volume dropped approximately 26 percent while Standard Parcel volume decreased by two percent. This means that the proportion of Standard Parcels rose in FY2009. NFM pieces because of their small size and uniform dimension (rectangular) can be cased by the carrier quickly and efficiently. Standard Parcels, conversely, may require the carrier additional time to put them in the case. An increase in

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the proportion of Standard Parcels thus leads to higher unit casing costs for the aggregate product.

Second, a higher percentage of Standard Parcels in FY09 were irregular in shape (source billing determinants – 51 percent irregular in FY09 and 47 percent in FY08). This also increases the unit casing time relative to regular shaped Standard Parcels and results in an increase in C/S6 unit costs. These two factors largely explain the CS/6 unit cost increase for Standard Parcels/NFMs in FY09.

Moreover, it is quite possible that the sharp decline in volume was accompanied by a decline in casing productivity. Such a productivity decline would lead to higher unit costs.

iii. Confirmed. Standard Parcels/NFM unit costs for city carrier street activities increased approximately 2.4 cents in FY09 (from 9.9 cents in FY08 to 12.3 cents in FY09). Two factors largely explain the increase in unit costs in FY09. First there was a methodology change that introduced a new and current distribution key for special purpose route carriers. The dated distribution key that was previously used was replaced with a current one obtained through CCCS-SPR (City Carrier Cost System – Special Purpose Route). Second an environment with declining volumes and a stable number of delivery points reduces the number of pieces per delivery point which, in turn reduces, carrier street time productivity. This fall in productivity resulted in an average unit cost increase of sixteen percent for all products in CS/7 in FY09.

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The Service's introduction of a new distribution key for mail delivered by special purpose route carriers¹ was expected to cause about a one cent unit cost change, based upon FY08 data. This anticipated increase represents about forty percent of the actual increase. After accounting for this methodology change, the Standard Parcels/NFM unit cost change for city carrier street activities was approximately the same as the average change in unit costs for all products (sixteen percent) in C/S7.² This unit cost change in FY09 was largely a function of working in an environment in which there was declining volume and constant delivery points.

iv. Confirmed. Standard Parcels/NFM unit costs for Vehicle Service Drivers increased 0.6 cent in FY09 (1.4 cents in FY09 and 0.8 cent in FY08). CS/8 costs encompass less than 1.2 percent of the total unit cost for Standard Parcels/NFMs (\$1.24 unit cost in FY09). Two factors largely explain the increase in unit costs in FY09, 1) a methodology change in surface densities and 2) statistical variance in the distribution factor used to assign relevant costs.

The Service's proposal of a methodology change³ which introduced new surface densities was expected to result in a 0.3 cent unit cost increase, based on FY08 data. This accounts for approximately 50 percent of 0.6 unit cost change. The remaining 0.3 cent increase in unit costs is likely

¹ Filed July 28, 2009 in Docket No. RM2009-10, Proposal Eight – accepted by the Commission in Order No. 339, dated November 13, 2009.

² In other words, approximately 10 points of the 24.5 percentage point increase were due to the methodology change and the other 14.5 points were due to the effects of the decline in volume.

³ Filed October 6, 2009 in Docket No. RM2009-10, Proposal Twenty, accepted by the Commission in Order No. 393, dated January 14, 2010.

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accounted for by statistical variation from the estimate used to assign the relevant costs. The estimate comes from sampled data collected as part of the Transportation Cost System (TRACS). The distribution factor derived from Intra-SCF transportation data is used to assign relevant VSD costs. Standard Parcels/NFMs have an approximate coefficient of variation (CVs) of 14 percent⁴. The point estimate and CV result in a 95 percent confidence interval with a lower bound cost of \$6.9 million and an upper bound of \$12.2 million.⁵ In terms of unit costs, this translates into a margin of error of 0.4 cent. In sum, the combination of incorporating updated surface densities and statistical variation likely accounted for the 0.6 cent unit cost increase for Standard Parcels/NFMs in CS/8 in FY09.

⁴ TRACS CVs are filed with ACR in USPS-FY09-NP24, dated December 29, 2009

⁵ A 95 percent confidence interval is formed by taking
Annual Estimate – $\$9,519 \pm (1.96 \times 0.14 \times \$9,519)$

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10. Please: (a) explain how you have modeled the negative volume impact of the Internet and other electronic alternatives in the demand equation for First-Class workshared letters; and (b) describe any differences in modeling the Internet impact on First-Class workshared letters between the July 1, 2010 periodic reports filings (Narrative Explanation of Econometric Demand Equations for Market Dominant Products as of November, 2009) and the Docket No. R2010-4 filing.

RESPONSE:

(a) The negative impact of the Internet and other electronic alternatives on First-Class workshared letters volume in recent years is modeled by including the number of Broadband subscribers in the First-Class workshared letters equation.

Prior to 2002 or so, there was little, if any, apparent Internet diversion of First-Class workshared letters (or, to the extent such diversion existed, its presence was offset by other factors). Over the past decade, electronic diversion of First-Class workshared mail has increased because of the growth in broadband internet access. In addition, it appears that diversion has increased further during the most recent recession, suggesting an interaction between the growth in broadband and the decline in the economy. This is modeled by interacting the coefficient on the Broadband variable with the cumulative negative trend on Employment (EMPL_TN_L). The Broadband variable, as well as the interaction term, is lagged eight quarters (two years) in the First-Class workshared letters equation in recognition of the observed lag between people's acquisition of Internet access and the extent to which they begin to divert mail. Prior to the growth in EMPL_TN_L tied to the 2001 recession, the modeled impact of Broadband usage on First-Class workshared letters volume is set equal to zero here.

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(b) The only differences between the First-Class workshared letters equations filed in Docket No. R2010-4 and those described in the July 1, 2010, periodic reports filing with the Commission is that the former are estimated using one additional quarter of data (2010PQ1, which ran from October 1, 2009 through December 31, 2009) and the elimination of a dummy variable equal to one in quarters during which Federal general elections occur.

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5. Please refer to the Flats Strategies described in USPS-LR-9. Please confirm that in addition to reducing costs for flat-shaped mail, the USPS-LR-9 strategies in the areas listed below will, if implemented, reduce the costs of parcels in general and the costs of Standard Mail NFM/Parcels in particular. If not confirmed, please identify which of the listed strategies will, if implemented, reduce parcel costs.
- a. Transportation
 - i. Improve Handling Unit/Container Density
 - ii. Eliminate Periodical and Standard Mail Flown
 - iii. Transportation Utilization
 - iv. Network Optimization
 - b. Mail Processing
 - i. Facility Optimization
 - ii. Equipment Optimization – APPS Utilization
 - iii. Automated Package and Bundle Sorter
 - iv. Material Handling
 - v. Electronic Condition-Based Maintenance
 - vi. Distribution Compression
 - vii. Realign Operating and Transportation Plan to Improve Utilization
 - viii. Refine Work Methods to Improve Business Mail Entry Unit (BMEU)/Plant Load Handoff to Mail Processing
 - ix. Continuous Improvement
 - c. Post Office and Delivery Operations
 - i. Business Plan Staffing and Scheduling Reviews;
 - ii. Shifting distribution from Post Office Operations (Function 4) to Mail Processing Operations (Function 1);
 - iii. Customer Service Unit Optimization
 - iv. Route Adjustments Joint Alternate Route Assessment Process (JARAP) / Carrier Optimal Routing (COR)
 - v. Route Optimization 100 Percent Street Routes
 - vi. Facility Optimization

RESPONSE:

Confirmed. The strategies listed above would be expected to generate savings for parcels. Most of them, with the exception of APPS utilization and the automated package and bundle sorter, would be expected to generate savings for letters as well.

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

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August 10, 2010