

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

TRANSFERRING COMMERCIAL STANDARD MAIL
PARCELS TO THE COMPETITIVE PRODUCT LIST

Docket No. MC2010-36

RESPONSES OF THE UNITED STATES POSTAL SERVICE
TO CHAIRMAN'S INFORMATION REQUEST NO. 1
(September 13, 2010)

The United States Postal Service hereby provides its responses to Questions 1, 2(b), 3-6, 7(b)-(c), and 8-17 of Chairman's Information Request No. 1, dated September 13, 2010. Answers were sought no later than today. Each question is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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Question 1

Page 2 of the Statement of Supporting Justification in Docket No. MC2010-36 (Statement) states, “[i]n fiscal year 2009, commercial Standard Mail Fulfillment Parcels and the other Standard Mail parcel categories had a collective cost coverage of 75.23 percent.”

- a. Please provide the FY 2009, FY 2010, FY 2011 (At Current Rates), and FY 2011 (At R2010-4 Proposed Rates) cost coverage for commercial Standard Mail Fulfillment Parcels and provide all underlying calculations.
- b. Please reconcile, if different, the FY 2009 cost coverage provided in response to subpart a. of this question with the 109 percent cost coverage for Standard Mail Parcels calculated in the attachment to witness Kiefer’s response to POIR No. 3, question 7, in Docket No. R2010-4.

RESPONSE:

(a) The Postal Service does not have FY 2009, FY 2010 or FY 2011 cost estimates for commercial Standard Mail Fulfillment Parcels, or even for all Standard Mail Parcels, that could be used to develop a separate cost coverage estimate for Standard Mail Parcels independent of the estimate for Not-Flat Machinables (NFMs). On September 8, 2010, the Postal Service filed a petition requesting the initiation of a proceeding to consider several proposals for changes in analytic principles in Docket RM2010-12. Proposal Seven in that petition describes the development of a mail processing cost model for Standard Mail Parcels and NFMs that was created using FY 2009 input data. The rationale supporting Proposal Seven states that “the results may not necessarily be meaningful due to the price changes that took place” during FY 2009. The rationale further states that, “[a]t this time, the Postal Service therefore asks for the Commission’s approval concerning the *methodology* used to develop the Standard Mail parcel / NFM mail processing cost model, and requests that the Postal Service be authorized to

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populate this version of the model with 2010 input data and file it in ACR document USPS-FY10-12, in lieu of the USPS-LR-L-45 analysis” [emphasis added].

Thus, although Proposal Seven presents estimates of unit costs, those estimates are the results obtained by making assumptions regarding the classifications to which mail volumes from the portion of the year prior to the May 11, 2009 implementation of the rate and classification changes (price structure changes) should be assigned. For that reason, the Postal Service is seeking approval of the methodology, not of the results per se. Furthermore, Proposal Seven only addresses mail processing cost estimates; the results from that model cannot be used as a means to develop accurate FY 2009 cost coverage estimates for commercial Standard Mail fulfillment parcels.

The Postal Service has provided calculations of cost coverages for the aggregate Standard Not-Flat Machinables and Parcels category in Docket No. R2010-4. Those calculations are reproduced below:

	Revenue (in millions)	Volume (in millions)	Attributable Cost (in millions)	Revenue (per piece)	Attributable Cost (per piece)	Contribution (per piece)	Cost Coverage
FY 2009	\$632	679	\$840	\$0.931	\$1.237	-\$0.306	75.2%
FY 2010	\$648	656	\$797	\$0.988	\$1.215	-\$0.227	81.3%
FY 2011 ¹	\$696	705	\$856	\$0.987	\$1.214	-\$0.227	81.3%
FY 2011 ²	\$778	686	\$834	\$1.134	\$1.215	-\$0.081	93.3%

¹ At current rates.

² At rates proposed in Docket No. R2010-4, based on an implementation date of January 2, 2011.

(b) See the response to part (a). Further, the cost coverage percentages above are not comparable to the cost coverages provided in response to Question 7 of POIR No. 3. The 109 percent cost coverage provided in response to Question 7 of POIR No. 3 was calculated using the average parcel revenue received from the Postal Service's top 600 catalog mailers, rather than the average revenue for the product category as a whole,

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which is significantly lower. The purpose of the response was to provide an estimate of cost coverage of mail sent specifically by catalog mailers, not of mail generally.

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Question 2

Page 5 of the Statement shows that the Postal Service's CY 2008 Share of Revenue for Parcels Under One Pound was 79.2 percent.

- a. Please provide the Postal Service's CY 2008 Share of Volume for Parcels Under One Pound.
- b. Please confirm that the 79.2 percent share of revenue is for ground parcels. If not, please provide the volume share and revenue share for Under One Pound ground parcels.

RESPONSE:

- (b) Confirmed.

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Question 3

Please provide the Postal Service's CY 2008, FY 2009, and CY 2009 Shares of Revenue and Volume for the following categories of ground parcels and all underlying calculations.

- a. Under One Pound, Business-To-Consumer (B-to-C) Parcels;
- b. Under One Pound, B-to-C Parcels Delivered to Residential Addresses;
- c. Under One Pound, B-to-C Parcels Delivered to Rural Addresses;
- d. 1-to-2 Pound Parcels;
- e. 1-to-2 Pound, B-to-C Parcels;
- f. 1-to-2 Pound, B-to-C Parcels Delivered to Residential Addresses;
- g. 1-to-2 Pound, B-to-C Parcels Delivered to Rural Addresses;
- h. 2-to-5 Pounds;
- i. 2-to-5 Pound, B-to-C Parcels;
- j. 2-to-5 Pound, B-to-C Parcels Delivered to Residential Addresses; and
- k. 2-to-5 Pound, B-to-C Parcels Delivered to Rural Addresses.

RESPONSE:

(a)-(k) The Postal Service does not possess the requested information.

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Question 4

Please provide the percentage of Standard Mail commercial Fulfillment Parcels that fall into each of the following categories and all underlying calculations.

- a. B-to-C Parcels;
- b. B-to-C Parcels Delivered to Residential Addresses; and
- c. B-to-C Parcels Delivered to Rural Addresses.

RESPONSE:

(a)-(c) The Postal Service does not possess the requested information.

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Question 5

Please confirm that, all else being equal, delivery costs for (a) the Postal Service and (b) the Postal Service's competitors comprise a higher percentage of total cost for lightweight parcels than for heavier parcels. If not confirmed, please explain fully.

RESPONSE:

(a) Not confirmed. As posed, the question is ambiguous and admits several interpretations. In this response, we answer the two most likely ones.

In the first interpretation, the question seeks a comparison between actual subsets of parcels, lightweight parcels and heavier parcels, and it asks for a comparison of the share of actual total costs that delivery costs represent. A number of difficulties arise responding to such a question. First, because the subsets reflect actual experience, they are not likely to be "equal" in many key respects. This means the non-delivery costs will be determined by a variety of factors and are unlikely to be equal across the subsets. This makes the requested comparison difficult to calculate and interpret.

Also, the delivery cost for a parcel involves several factors other than weight, including the dimensions of the parcel, the level of service required, the distance to the delivery point, and mode of delivery. Thus, it is not obvious that the delivery cost of a lightweight parcel is materially different from the delivery cost of a heavyweight parcel. For example, on city routes, a critical cost driver for the Postal Service is whether a parcel causes the carrier to leave the vehicle to deliver it. Shape is much more important than weight in causing a deviation, as a larger but lightweight parcel may not fit in the mailbox, when a smaller but heavier one would. This means that the actual

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relative delivery costs of heavyweight and lightweight parcels cannot be determined theoretically and must be measured empirically. This example raises another problem with this approach to the question – its failure to define exactly where the line between lightweight and heavyweight parcels categories should be drawn. Finally, the Postal Service has neither delivery costs nor non-delivery costs for any two sets of parcels based on weight, so no determination can be made regarding the ratio of actual delivery costs to actual total costs for any categories of lightweight versus heavier parcels.

The second way to interpret the question is to focus on the “all else being equal” phrase, and view the question as a purely theoretical inquiry regarding two hypothetical parcels that are identical in all respects except weight. Conceptually, this requested comparison is easier because it requires estimating the delivery and non-delivery costs for two parcels that are otherwise equal except for their weight and then calculating the ratio of delivery costs to total costs.¹ Unfortunately, it is not possible to give an unambiguous response to this question. Depending upon the weight of the heavier parcel, there are circumstances in which the delivery cost of the heavier parcel might be greater than a lightweight parcel and circumstances when it might not be greater. Similarly, depending how heavy the “heavier” parcel is, as well as other factors, there are circumstances in which the non-delivery cost of the heavier parcel might be greater and circumstances when it might not. Because both numerator and denominator could or could not be greater, it is not possible to unambiguously determine whether the ratio

¹ For purposes of simplicity in this exercise, total costs will be considered to be the sum of mail processing costs, transportation costs and delivery costs.

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of the numerator to the denominator is greater or lesser for heavier parcels.

(b) Not confirmed. The Postal Service does not know its competitors' parcel costs, so the requested comparison cannot be done.

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Question 6

Please confirm that due to its universal delivery network and mailbox monopoly, the Postal Service's marginal delivery cost, particularly for residential and rural addresses, is substantially less than that of its competitors. If not confirmed, please explain fully.

RESPONSE:

Not confirmed. The Postal Service does not have the information necessary to perform such a comparison. The Postal Service does not know the marginal delivery costs for its competitors. Assuming the question is referring to the marginal delivery costs of parcels, one might reasonably speculate that the Postal Service's costs are *not* substantially less than its competitors', given the Postal Service's small share of the parcel delivery market and the fact that several parcel delivery competitors currently exist. However, since the relevant data are not available from competitors, no valid comparison can currently be made by the Postal Service between the marginal delivery cost for the Postal Service and the marginal delivery cost for its competitors.

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Question 7

Page 6 of the Statement provides the Postal Service's FY 2009 Share of Revenue For All Air and Ground Parcels Up to 70 Pounds and states, "[t]his [information] provides a more realistic view of a parcel shipping marketplace where the Postal Service's products cover their costs."

- a. Please provide the Postal Service's FY 2009 Share of Revenue and Volume For Ground Parcels Up to 70 Pounds.
- b. Please provide all studies and analyses, whether formal or informal, performed by the Postal Service or on its behalf in support of the statement that "[t]his [information] provides a more realistic view of a [ground] parcel shipping marketplace where the Postal Service's products cover their costs."
- c. Does the Postal Service believe that "[t]his [information] provides a more realistic view of a[n] [under one pound ground] parcel shipping marketplace where the Postal Service's products cover their costs[?]" If so, please provide all studies and analyses, whether formal or informal, performed by the Postal Service or on its behalf in support of this belief.

RESPONSE:

(b) The Postal Service has not performed any such studies. In stating that the table on page 6 provides a "more realistic view of a parcel shipping marketplace where the Postal Service's products cover their costs," the Statement was comparing the table on page 6 to the table on page 5, which shows the Postal Service and its competitors' shares of revenue for under one pound parcels. Because the table on page 6 is largely based on Postal Service products that cover their costs, the table provides a more realistic view of a parcel shipping marketplace where the Postal Service's products cover their costs than the table on page 5.

(c) The table on page 6 demonstrates that, where the Postal Service's parcel products largely cover their costs, there is significant competition among the Postal Service and its competitors for market share. Therefore, although it is impossible

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without a formal study to state exactly how the market share would be divided among the Postal Service and its competitors, the table certainly provides a more realistic view than does the table on page 5 of what the under one pound parcel shipping marketplace would look like if the Postal Service's under one pound parcels covered their costs.

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Question 8

Page 11 of the Statement says, “[a]t least one large customer has informally expressed support for a transfer of commercial Standard Mail Fulfillment Parcels to the competitive product list because such a transfer would open up the possibility of the Postal Service entering into contract pricing for the product.... Currently, because of the segmented structure of the Postal Service’s parcel offerings, customers cannot enter into contracts for complete shipping solutions.”

- a. Is it the Postal Service’s belief that it currently cannot offer contract prices for under one-pound parcels?
- b. If so, please explain fully all reasons for this belief and provide relevant citations to the Postal Accountability and Enhancement Act of 2006 and Commission rules.
- c. Page 11 of the Statement says that customers’ main concern with the transfer is that it will lead to price increases. This is tempered by the assertion that nevertheless there was one customer who “has informally expressed support....” Does this mean that only one customer supports the transfer, so far as you know?

RESPONSE:

(a, b) The Postal Service can enter into contracts for under one pound parcels through the negotiated service agreement process. However, customers generally prefer the more streamlined contract process available for competitive products. The Postal Service’s ability to enter into contracts that combine competitive parcels and under one pound parcels is addressed in the response to Question 12.

(c) No. Multiple customers have informally expressed support for the transfer. The Postal Service has not formally polled its customers, so it does not know what proportions support, oppose, or are neutral concerning the transfer.

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Question 9

Page 6 of the Statement says, "it is unlikely that the Postal Service can set the price of commercial Standard Mail Fulfillment Parcels substantially above costs or raise prices significantly without losing a significant level of business to other firms." Please provide all studies and analyses, whether formal or informal, performed by the Postal Service or on its behalf that support this statement.

RESPONSE:

The Postal Service has not performed any such studies. It is a basic business reality that, where other high quality providers are ready and willing to take on the Postal Service's business, significantly raising the Postal Service's prices or raising them substantially above costs carries the risk of losing business share to such providers.

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Question 10

Page 7 of the Statement says, "it is unlikely that the Postal Service can decrease the quality or output of commercial Standard Mail Fulfillment Parcels without risk of losing a significant level of business to other firms."

- a. Please provide all studies and analyses, whether formal or informal, performed by the Postal Service or on its behalf that support this statement.
- b. Given the substantial price advantage enjoyed by the Postal Service, even if the increases proposed in Docket No. R2010-4 are approved, how much debasement of service would be required to cause the Postal Service a loss of business? Please explain what evidence supports your answer.

RESPONSE:

- (a) The Postal Service has not performed any such studies. As in the response to Question 9, it is a basic business reality that, where high quality competitors exist, decreasing quality or output carries with it the risk of losing business share to such competitors.
- (b) The Postal Service has not quantified the level of service debasement that would cause a loss of business. Further, the Postal Service questions whether it "enjoys" a price advantage where its current prices mean that it cannot cover its costs.

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Question 11

The Postal Service's proposal does not include non-profit Standard Mail Fulfillment Parcels.

- a. Why are they excluded from the transfer to the competitive class?
- b. If the answer is that they are market dominant, please explain why they meet that definition and For Profit Fulfillment Parcels do not?
- c. If the transfer is approved, please explain how prices for non-profit Standard Mail Fulfillment Parcels would be determined.

RESPONSE:

- (a) Section 3626(a)(1) of title 39, U.S. Code, states:

"Except as otherwise provided in this section, rates of postage for a class of mail or kind of mailer under former section 4358, 4452, 4451(b), 4452(c), 4554(b), or 4554(c) of this title shall be established in accordance with section 3622."

Nonprofit Standard Mail Parcels are encompassed by this provision through its reference to former section 4452(c). Therefore, rates for nonprofit Standard Mail Parcels must be established in accordance with section 3622, the section of law that governs pricing for market dominant products. In other words, there is a statutory obligation that nonprofit Standard Mail Parcels remain on the market dominant product list.

- (b) Commercial Standard Mail Fulfillment Parcels are not covered by the statutory provision cited above.
- (c) As required under section 3626(a)(A), prices for nonprofit Standard Mail Fulfillment Parcels will be set such that the estimated average revenue per piece for nonprofit Standard Mail Fulfillment Parcels will be equal, as nearly as

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practicable, to 60 percent of the estimated average revenue per piece to be received from the most closely corresponding regular-rate subclass of mail. The Postal Service has not yet determined which subclass of mail on the market dominant product list would be the most closely corresponding regular-rate subclass of mail.

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Question 12

On page 4, the Statement claims that the Postal Service parcel products' structure complicates its ability to negotiate with certain customers. Can the Postal Service enter into a negotiated service agreement (NSA) that combines both market dominant parcels and competitive parcels? If not, why not?

RESPONSE:

Yes, and it has done so in the context of the bilateral agreement with Canada Post Corporation. See, e.g., Docket Nos. R2009-1 (inbound Letter Post and Xpresspost) and CP2009-9 (inbound surface parcels). As was demonstrated in those dockets, however, different review periods apply to market dominant and competitive streams. In the context of the comprehensive negotiated bilateral agreement with Canada Post, the differing advance notice requirements is less consequential because the bilateral is negotiated on regular cycles, and expectations regarding review can be factored into both parties' planning purposes. By contrast, in the context of Postal Service's customer agreements, time to market is more critical, particularly with new customers. Hence, the USPS and its customers prefer the more abbreviated advance notice period of 15 days available for competitive products, as compared to the longer, 45-day advance notice period required for market dominant products.

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Question 13

On page 5, the Statement refers to the Postal Service's "dominance in the under one-pound category."

- a. Is that not a concession that, at least at present, these parcels are market dominant?
- b. Is it not the case that the Postal Service could convert any non-monopoly market dominant product into a competitive product through the simple device of very large rate increases?

RESPONSE:

- (a) No. The Statement uses the word "dominance" in its normal sense.
- (b) No. Section 3642(b)(1) of title 39 states:

The market-dominant category of products shall consist of each product in the sale of which the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products. The competitive category of products shall consist of all other products.

Based on the statutory language above, market-dominant products are products whose prices the Postal Service can raise significantly without risking the loss of a significant level of business to other firms. Thus, very large rate increases for non-monopoly products that are properly classified on the market-dominant list result in declining volume, rather than volume shifting to other firms. On the other hand, if a very large rate increase for a particular non-monopoly market-dominant product would result in the Postal Service risking the loss of a significant level of business to other firms offering similar products, then that product would be properly classified on the

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competitive product list.

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Question 14

Page 6 of the Statement avers that UPS and FedEx “need to have their under-one-pound parcels cover their costs.” The cited footnote admits this statement presumes that they do not consider such parcels as “loss leaders.” What evidence do you have to support this presumption?

RESPONSE:

The Statement specifically points out this presumption, rather than leaving it unstated, to be open about the fact that Postal Service does not have evidence to support the presumption.

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Question 15

On page 10, the Statement speaks of the “distortionary effect” of low Standard Parcel rates as causing failure “to structure profitable contracts with large shippers for lightweight parcels.” Please provide concrete examples that demonstrate this failure.

RESPONSE:

The Postal Service discussed with one customer the possibility of negotiating a contract with favorable pricing along with certain preparation and entry considerations for Standard Mail Parcels. However, even with the cost savings considerations, it was not possible to envision a profitable arrangement with favorable pricing because the base prices are so far below product costs. The Postal Service has had similar discussions with certain consolidators, but the same complicating factors inhibited any real possibilities. The Postal Service is willing to provide the names of these customers under seal.

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Question 16

Please refer to the tables entitled "UPS Standard Ground Rates for Customers Shipping 100+ Parcels/Week" and "FedEx Standard Ground Rates for Customers Shipping 100+ Parcels/Week" on page 5 of the Statement.

- a. Please identify the source of the rates in these tables. If the source is not publicly available, please provide all documents from which the Postal Service extracted these rates.
- b. Please list and identify the size of all surcharges that are included in the rates shown in these tables.
- c. Please list and identify the size of all potential surcharges to which under-one-pound ground parcels could be subject that are not included in the rates shown in these tables.

RESPONSE:

(a-c) The UPS/FedEx rates listed in the table on page 5 were provided by a private eBay seller and are not publicly available. The seller is one of eBay's highest volume sellers. In July of 2009, the Postal Service discussed with eBay the possibility of offering a discount to eBay's highest volume sellers. Such discounts are already offered to this class of eBay sellers by UPS and FedEx. eBay put the Postal Service in contact with one of its highest volume sellers; the Postal Service consulted with the seller on structuring a potential discount program. In the course of these consultations, the seller provided the rate charts listed on page 5 as a reference for what the competition was offering. The information provided by the seller did not include surcharges. The seller indicated that while it paid surcharges, the surcharges were at a reduced rate compared to the competitors' standard surcharges.

The Statement includes the table used on page 5, rather using UPS and FedEx's publicly listed prices, in order to show the difference between the Postal Service's

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commercial Standard Mail Fulfillment Parcel prices and UPS and FedEx's prices as accurately as possible. It would have been less accurate to use the publicly available UPS and FedEx prices because those prices are higher and do not include the volume discounts that UPS and FedEx provide to high volume customers. Unfortunately, UPS and FedEx's volume discounts are not publicly available, as the discounts are individually negotiated with their customers. The table on page 5 is the Postal Service's best attempt at accurately representing UPS and FedEx's discounted prices.

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Question 17

Please refer to the table entitled "Postal Service Commercial Standard Mail Fulfillment Parcel Rate" on page 5 of the Statement.

- a. In FY 2009, what percentage of Standard Mail machinable parcels were entered at the Origin-Entered, Mixed NDC Presort Rate? Please provide all underlying calculations in a Microsoft Excel spreadsheet.
- b. In FY 2009, what percentage of Standard Mail NFMs/Parcels were entered at the Origin-Entered, Mixed NDC Presort Rate? Please provide all underlying calculations in a Microsoft Excel spreadsheet.
- c. Under the rates proposed in Docket No. R2010-4, what is the average postage for a Standard Mail commercial Fulfillment Parcel expected to be? Please provide all underlying calculations in a Microsoft Excel spreadsheet.

RESPONSE:

- (a) In FY 2009, the percentage of Standard Mail machinable parcels that were entered at the Origin-Entered, Mixed NDC Presort Rate is 4.06%. Please see the Microsoft Excel file Q17ab.xls, which is being filed with this response, for the underlying calculations.
- (b) In FY 2009, the percentage of Standard Mail NFMs/Parcels that were entered at the Origin-Entered, Mixed NDC Presort Rate was 4.96%. Please see the Microsoft Excel file Q17ab.xls, which is being filed with this response, for the underlying calculations.
- (c) The Postal Service does not have specific projections of volumes for fulfillment parcels at Docket No. R2010-4 prices. Therefore this response calculates the weighted average postage for a fulfillment parcel using the hybrid year parcels and NFMs billing determinants volumes (i.e. historic volumes) that were employed in Docket No. R2010-4 to calculate the percentage price changes in that docket. Under the rates proposed in

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Docket No. R2010-4, the average postage for a Standard Mail commercial Fulfillment Parcel is expected to be \$1.1391. Please see the Microsoft Excel file Q17c.xls, which is being filed with this response, for the underlying calculations.