Postal Rate Commission
Submitted 10/12/2006 2:33 pm
Filing ID: 54038
Accepted 10/12/2006

APWU-T-1

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

POSTAL RATE AND FEE CHANGES, 2006 **Docket No. R2006-1**

REVISED DIRECT TESTIMONY OF KATHRYN L. KOBE ON BEHALF OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

Revised October 12, 2006

Table of Contents

Autobiographical Sketch

My name is Kathryn Kobe. I am the Director of Price, Wage and Productivity Analysis for Economic Consulting Services, LLC (ECS), a position I have held since October 2003. ECS is an economic consulting company based in Washington DC that has been in business for more than 25 years. Prior to joining ECS, I was Vice President and Chief Economist of Joel Popkin and Company (JPC), also a Washington DC-based economic consulting firm. I worked for JPC for more than 20 years. Prior to working for JPC, I was an economist for the Department of Agriculture and a research assistant for Evans Economics. I graduated *summa cum laude* with a bachelor's degree in economics from the University of Maryland and have a master's degree in economics from the George Washington University.

My areas of research include the forecasting of wage and price trends, both national and company specific. For more than 20 years I have been the principal researcher and co-author for JPC's economic newsletter *The CPI's Future*. I have analyzed Postal finances for more than 20 years and have analyzed postal rate cases and provided economic consultation and advice on postal rate matters for approximately 10 years. I have prepared price trends and analyses for telephone rate proceedings.

I have also done research relating to the state of manufacturing and manufacturing R&D in the United States and recently co-authored a white paper

published by the National Association of Manufacturers.[1] I have also researched several aspects of the economics of small businesses including the calculation of the costs of employee benefits to large and small businesses and the share of GDP attributable to small businesses.

I have not testified before the Postal Rate Commission prior to this proceeding. I have testified in arbitration cases related to the Postal Service and have provided expert opinions in litigation.

[1] "U.S. Manufacturing Innovation at Risk," by J. Popkin and K. Kobe published by The Council of Manufacturing Associations and The Manufacturing Institute of the National Association of Manufacturers, February 2006.

I. Purpose and Scope

The purpose of this testimony is to calculate First Class letter rates using the concept and general methodology that has been used by the Postal Service and the Postal Rate Commission for many years. Mr. Taufique describes that concept in his testimony.

> Since classification reform in Docket No. MC95-1, the structure of and approach to the relationship between the Single-Piece and Workshare rate categories in First-Class Mail have remained relatively constant. Workshare rates are determined by applying discounts to Single-Piece rates. These rate differentials (discounts) are based on estimates of costs avoided through each type of worksharing activity (e.g. prebarcoding and/or various levels of presortation). The cost differentials are developed by estimating avoidance of postal mail processing and related operations costs in comparison to a representative benchmark for workshare mail generally. [2]

In calculating costs avoided, the bulk metered mail letter (BMM) will be used as the benchmark piece, as it has been since R97-1.

In this testimony I will present the critical information the Postal Service omitted from its calculations in the current docket--the costs associated with the First Class benchmark letter and the unit cost savings between that benchmark letter and each of the First Class Presort letter categories. I will then present rates that could result if discounts equal to those costs avoided were used to determine the First Class Presort letter rates, and present an alternative set of First Class rates for the consideration of the Commission in this proceeding. Library References APWU-LR-1 and APWU-LR-2 are also submitted to show the calculations made.

[2] USPS T-32, p. 12.

II. Background

In the instant proceeding the Postal Service has proposed de-linking the rates of Presort First Class letters from those of Single Piece First Class letters. Mr. Taufique, the Postal Service's First Class rate design witness, states

> [t]he Postal Service de-links the cost and rate development for Single-Piece Letters from the cost and rate development for Presort Letters. Accordingly, the Postal Service proposes that the rates for Single-Piece Letters and for Presort Letters be developed independently of each other. No longer should the rates for Presort Letters look to the cost base of Single-Piece Letters...[3]

Mr. Taufique has proposed a change in rate design methodology. This change, if accepted by the Commission, would change the policies of the Postal Service and the Commission. It would also change the rate relationships between Single Piece First Class letters and Presort First Class letters and would create a template for further change. In stating that the Presort letter rates would no longer look to the cost base of Single Piece letters, the Postal Service is deaveraging Presort letters and Single Piece letters. From the inception of First Class workshare discounts, there has been an understanding by both the Postal Service and the Commission that discounts must be justified by costs avoided so that similar letters being provided First Class service bear the same amount of the institutional costs of the Postal network.[4] The process is to set a single uniform rate for First Class letters and validate discounts provided to Presort

[3] USPS-T-32, p. 15 at 5-10.

[4] On page 16 of its *Opinion and Recommended Decision* for MC73-1, the Commission states "Although the Postal Service admits to lack of experience with presorting, their best information suggests that the one-cent discount will, on the average, be the equivalent of the clearly capturable cost avoidance[footnote omitted]. Thus contributions to institutional costs will be maintained."

letters by the determining cost savings due to worksharing activities that allow the Postal Service to skip certain steps in processing that mail. The costs associated with the wide array of characteristics in the First Class mail stream have been averaged among all the First Class letter mailers because everything has been tied back to the overall Single Piece first ounce rate.

The Postal Service and the PRC adopted this concept explicitly in the choice of BMM as the benchmark piece. In its R97-1 decision, the Commission states that it "accepts the Service's proposed use of BMM as the benchmark for calculating First-Class worksharing discounts. Fronk's use of BMM responds to the Commission's concern that the current benchmark—all nonpresorted single-piece mail—captures more costs than warranted." It then quotes witness Fronk's testimony:

> [n]onpresorted mail includes everything from 'clean' mail (uniform pieces featuring typewritten or pre-printed addresses and often mailed in bulk) to 'dirty' mail (pieces featuring handwritten and incorrect or incomplete addresses) and all the mail in between. Using all nonpresort letters as a benchmark results in a larger discount than using a benchmark which tends to have all the attributes of presort/automated mail, except for the actual presortation or application of the barcode.[5]

In the instant docket the Postal Service seems to be moving back toward the concept that was rejected in R97-1 and in doing so produces the larger discounts predicted by Mr. Fronk. Mr. Taufique states that the Postal Service's objective is to move toward a new rate design paradigm without conceding any of the past differences of opinion on the subject of workshare cost differentials. However, the Postal Service has failed to

[5] *Opinion and Recommended Decision* R97-1, p.292 at 5092.

provide any convincing rationale for this change in methodology or for the change in its policies on cost averaging.

On average, standard-sized, typed business mail is, and always has been, some of the cheapest for the Postal Service to handle because of its “cleaner” characteristics. Consequently, it tends to provide a larger contribution to overhead than does the average First Class piece. A very large percentage of business mail also has discounts associated with it that have been justified by cost savings due to the presorting and prebarcoding mailers do that reduce the number of mail processing steps the Postal Service must provide. However, there are equally clean pieces of Single-Piece mail that also provide a larger than average contribution to overhead. Those pieces pay the full Single Piece rates because their mailers do not or can not presort or prebarcode their mail. The First Class bulk metered mail letter is chosen as the benchmark because it is most like the workshared piece in its general characteristics. Thus, the Postal Service’s cost savings due to the worksharing activities are more clearly isolated because the comparison is being made between mail pieces that have very similar characteristics. The discounts based on those cost avoided savings mean that both mailers provide the same per piece contribution to overhead. Both of these mailers of “cleaner” mail also cover some of the costs of the First Class letters that have “less clean” characteristics. Differences in per unit costs based on a difference in the total CRA costs for Presort mail and Single Piece mail may reflect a whole

range of characteristics that do not relate to the cost avoidances for workshare activities. Thus, the proposed methodology which essentially applies equal contributions to the straight CRA costs would result in the mailer of the Single Piece "clean" letter paying a larger contribution to overhead than the mailer of the Presort "clean" letter and would constitute a change in an important postal policy. The Commission confirmed its understanding of the current policy in its R2000-1 Opinion when it confirmed the use of BMM letters as the appropriate benchmark [at 5089] and stated:

> This may mean that the institutional cost burden of First-Class workshare mail is increasing. However, when discounts pass through 100 percent of avoided costs to the workshare mailer, the contribution made by that mailer to institutional costs is the same as the mailer would have made without worksharing. Thus, workshare mailers and non-workshare mailers provide the same contribution, which is fair and equitable. [6]

Because of the de-linked rate design it has presented in this case, the Postal Service has not provided the calculations for comparing the cost of the presort pieces to the nearly identical non-presort benchmark BMM letter piece. However, the Postal Service's de-linking can:

> easily result in identical First Class letters making different contributions to overhead depending solely on whether or not the piece is workshared;

[6] *Opinion and Recommended Decision* R2000-1, at 5060, page 234 and 5089 at p. 241.

recommend rates that provide discounts that exceed the costs saved by the Postal Service for the presorting and prebarcoding of the letters; and

violate the policy of uniform rates for First Class letter mail.

Consequently, it is important to look at the results of the cost avoided comparisons based on current policies and consider the rates that would result from applying that concept.

III. Findings and Recommended Rates

Table 1 presents my calculations of costs avoided by the Postal Service when compared to the bulk metered mail letter benchmark. The calculations themselves will be discussed in Section IV of this testimony.

Table 1: Workshare Related Unit Costs and Workshare Related Unit Cost Savings for First Class Letter Mail Compared with Proposed Discounts (cents per piece)

Letter category	Total Workshare Related Unit Cost	Total Workshare Related Unit Cost Savings	Proposed USPS Discounts from Single Piece Letter Rate R2006-1	Amount by Which USPS Proposed Discount differs from Unit Cost Savings
Bulk Metered Mail (BMM)	14.280			
Nonauto Presort	10.360	3.920	2.0	-1.92
Auto Mixed AADC	10.080	4.200	7.4	3.20
Auto AADC	8.871	5.409	8.5	3.09
3-Digit Presort	8.442	5.838	8.9	3.06
5-Digit Presort	6.960	7.320	10.8	3.48

Source: APWU-LR-1, “Letter Sum”

The last column of Table 1 shows the amount by which the discounts for Presort letters proposed by the Postal Service in this case differ from the costs the Postal Service avoids due to the worksharing activities of the mailers. This shows that the discounts proposed for most of the Presort letter categories in this case are not justified by costs avoided. [7]

The first column of numbers in Table 2 shows what the rates would be if the currently proposed Single Piece letter rate of 42 cents was used as a starting point and then discounted by the costs avoided in Table 1 to produce rates for each Presort letter rate category. [8]

Table 2: Comparison of Single Piece and Presort First Class Letter Rates (cents per piece)

Letter Categories	Presort rates based on costs avoided (cents)	Percent increase from current rates	Current USPS proposal R2006-1 (cents)	Percent increase from current rates	Proposed rates based on partial adjustment (cents)	Percent increase from current rates
Single Piece	42.0	7.7%	42.0	7.7%	41.0	5.1%
Nonauto Presort	38.1	2.7%	40.0	7.8%	37.1	0.0%
Mixed AADC	37.8	16.0%	34.6	6.1%	35.1	7.7%
AADC	36.6	15.5%	33.5	5.7%	34.0	7.3%
3-digit	36.2	17.5%	33.1	7.5%	33.6	9.1%
5-digit	34.7	18.4%	31.2	6.5%	32.1	9.6%

[7] The one exception would be First Class Nonautomation Presort letters which have a higher calculated cost avoidance than its implied discount.

[8] This proposal follows the proposal of the Postal Service in this case to no longer have a separate rate for First Class Carrier Route Presort. That mail is assumed to migrate to the First Class 5-digit automation category.

The percentage increases that would result from these rate increases are shown in the next column of Table 2. Those can be compared to the Postal Service's proposed rates and percentage changes shown in the middle columns of the table. To fully adjust the discounts to the costs avoided levels would require Presort rates to increase an additional 10 percentage points or more beyond the Postal Service's current proposal.

In my opinion, the rates that would be achieved from such an adjustment are not a viable alternative for this case. With the costs avoided several cents out of alignment, a "one step" adjustment is likely to result in rate shock that probably would cause undue disruption to both mailers and the Postal Service. Additionally, raising the workshare rates by this amount, with no other adjustments, would exceed the revenue requirement in this case.

Consequently, the rates being proposed for the Commission's consideration, shown in the next to last column of Table 2, show only a partial adjustment of the discounts toward the costs avoided levels but do keep the Presort letter rate increases down to single-digit levels; the remaining adjustment should be phased in during a subsequent proceeding or proceedings.

Any change in the Single Piece letter rate and in the relationships between the letter rates can have many impacts. The USPS proposal in this case already presents new Single Piece flat and parcel rates that are partially dependent on the Single Piece letter rate since they are calculated using costs avoided from the Single Piece letter first ounce rate. These are newly introduced flat and parcel rates and are in a transitional phase where the rates are not based on a

full pass through of costs differences. This provides a basis to change the relationships slightly.

Since the Single Piece letter rate has been lowered by 1 cent, the Single Piece flat has also been lowered by 1 cent to maintain the 20 cent differential between flats and letters that the Postal Service originally proposed in this case. The Single Piece parcel rate has been lowered by 5 cents. That was done mostly to mitigate the large rate shock that Single Piece parcel mailers will experience under the Postal Service's rate proposal. The First Class Presort flats rates have also been changed slightly, adding half a cent to each of the Postal Service's proposed rates. The Postal Service proposed a relatively small pass-through of the cost differentials between the Presort letter rates and the Presort flat rates, of around 40 percent.[9] An increase in the proposed Presort letter rates with no adjustment to the Presort flats rates would reduce the rate difference between them and reduce the cost pass through percentages to less than the Postal Service proposal. Thus, the proposed increase in the flats rate partially readjusts those pass-throughs. The First Class Mail Business Parcels rates were not changed from those proposed by the Postal Service even though the increase in the Presort letter rates also narrows the pass-throughs for those rates.

Changes in the First Class letter rates and the Presort letter discounts will have an impact on Standard mail volumes even though no changes in Standard rates are being proposed at this time. These changes in the rates will also have a

[9] USPS-T-32, p. 34. The Postal Service's Single Piece letter to flat rate differential represents approximately a 55 percent pass through of the cost differential (p.23).

minor impact on the volume of cards. All of these changes can result in differences in the revenues generated by each rate category when compared with the current Postal Service proposal.

The revenue impact of these changes has been estimated by using Mr. Thress' worksheets to estimate the volume impacts on all classes of mail from the proposed rate changes in First Class and then recalculating the resulting revenues for First Class and Standard based on the new proposed rates (if applicable) and the revised volumes generated from those rates.[10] The only changes made to Mr. Thress' worksheets were those required by the proposed changes in the First Class rates. That change in rates impacted First Class letter volumes, First Class card volumes, and Standard Regular volumes.[11] Priority,

[10] In the description of USPS LR-L-66, Mr. Thress describes the process for estimating new volumes using a different set of prices. The steps are to enter the new prices in the USPS LR-L-63 Prices.xls worksheet and then to copy selected portions of that worksheet to the LR-L-66 vf_ar.xls worksheet. The new volumes for the test year can then be read from Attachment A of the latter workbook. These were the steps that were followed to determine the volume impacts of the proposed rate changes.

[11] Based on Mr. Thress' equations, there will be a smaller decline in the First Class Single Piece volumes (letters, flats and parcels combined) under this proposal than under the USPS rate proposal. There are some reasons to think Mr. Thress' equations may not provide an ideal forecast of Single Piece volumes by shape, in fact Mr. Thress does not produce separate forecasts of the three shapes. Mr. Taufique simply shares the Single Piece volumes out among Single Piece shape groups using the base year distribution. Those distributions were also used in predicting the volumes by shape in these calculations; however, the result may overstate the parcel and flat volumes that will result (under either the original USPS proposal or this revised proposal) since those two categories have much larger price increases than do letters. However, Mr. Thress does not calculate price elasticities for each of the three shapes, only for the three shapes combined so there is no alternative information on which to base alternative estimates of the Single Piece volume distirbution by shape. Mr. Thress' equations also estimate a relatively large increase in nonauto presort mail because it will not experience any increase in price under this rate proposal, and

Express, Periodical, and Package volumes were not impacted by the change in First Class rates proposed here. The other assumptions that Mr. Thress used to produce his original after rates volumes have remained unchanged. Mr. Thress' original after rates GFY2008 volumes are shown in Appendix Table A-1 of this testimony where they are compared with the after rates GFY2008 volumes produced from the new rate assumptions described above.

Table 3 shows the changes in the revenues produced from the changes in volumes that are the result of the different rates. First Class Single Piece revenues are virtually unchanged. First Class cards revenues decline very slightly despite an increase in the cards volume produced by Mr. Thress' worksheets; that happens because the cards sent at letter rates produce less revenue due to the lower First Class Single Piece letter rate. The First Class Presort revenues increase slightly because an increase in the volume of Nonautomated Presort letters and flats offsets the volume declines experienced by the Automated Presort letters and flats. There is also a further shift from Single Piece to Presort parcels. Overall, revenues are virtually unchanged from the estimates made by Mr. Taufique in USPS LR-L-129 and by Mr. Kiefer in USPS LR-L-36.

---

its price, relative to the other letters categories becomes more attractive. It is unclear that this category will react quite the way that Mr. Thress' equations anticipate given that this set of circumstances has not happened during the historical time period that has been used to estimate the coefficients. This may imply somewhat more uncertainty than usual surrounding some of the volume outcomes.

Table 3: Comparison of Revenues Before and After Rate Change (Thousands of Dollars)			
	TY Revenues After Rates as Calculated by USPS Witnesses	TY Revenues After Rates Based on Volumes from Proposed Rates	Percent Difference
First Class Single Piece Letters, Flats & Parcels	18,934,871	18,938,022	0.02%
First Class Presort Letters, Flats & Parcels	16,610,324	16,625,827	0.09%
First Class Cards	1,357,052	1,356,089	-0.07%
Standard Mail Regular	17,357,926	17,422,759	0.37%
Total of Listed Revenues	54,260,173	54,342,697	0.15%
Sources: First Class as Calculated by Mr. Taufique, USPS-LR-L-129,REV 8-24-06 LR-L-129.xls (Rev. FY08BR &FY08AR) Standard as Calculated by Mr. Kiefer, USPS-LR-L-36,WP STDREGR0621.xls (Revenues @ TYAR Vols.) Revised Revenues APWU-LR-2 (Includes the same Revenue adjustment factors used in the Postal Service witnesses' worksheets.)			

IV. Calculation of Unit Costs

To link together the Single Piece and Presort letter rates requires the calculation of the costs avoided by the Postal Service. That requires calculating the costs associated with the benchmark piece of mail. In every rate case since the creation of Automation Presort rates during MC95-1, the benchmark piece that has been used for this purpose is the First Class bulk metered mail letter (BMM). There have been many discussions about the use of BMM as the benchmark for cost avoided calculations. Some of those discussions have revolved around which mail is most likely to convert to presort and others have focused on the mail that presort mail would most likely covert back to if it left the workshare category. Mr. Taufique, in his oral testimony, seemed to indicate that part of his de-linking of the single piece rates from the workshared rates stemmed from his perception that there has been a change in the type of mail

that is now converting to presort. This was not discussed in his written testimony and he provided no studies on this topic. However, it seems highly unlikely that the mail that is converting to presort mail is equivalent to the average collection mail that is coming from individual households, nonprofit organizations, and small businesses, which seems to be the concept that Mr. Taufique was suggesting to support his use of the Single Piece CRA as the base for his de-linked Single Piece calculations.[12]

Regardless, there is another reason for using the BMM letter as the benchmark. When looking at a very heterogeneous pool of mail, such as that of First Class letters, it is the only way to make certain that two mailers with identical pieces of mail are paying the same contribution to overhead costs, irrespective of whether they workshare. The Commission put this slightly differently in its R2000-1 Opinion, quoted earlier, when it stated "the contribution made by that mailer to institutional costs is the same as that mailer would have made without worksharing."[13] Once worksharing discounts are introduced and mailers pay different rates based on their worksharing activities, it is necessary to make this comparison to determine if the letter rates are uniform across mailers.

In R2005-1 witness Abdirahman defined the benchmark piece: "BMM letters are generally considered to be machinable, homogeneous, non-barcoded pieces with machine printed addresses that are properly faced and entered in trays."[14] The Postal Service has never directly calculated a cost for just this

[12] Tr. Vol. 16 at 4937.
[13] *Opinion and Recommended Decision R2000-1,* p. 234 at 5060.
[14] R2005-1, APWU/USPS-T21-8, R2005-1 Tr. Vol. 4 at 952.

benchmark piece. The unit costs for BMM letters must be approximated based on a broader category of letters, all First Class letter-shaped mail with metered postage.

The general steps followed by the Postal Service to calculate the unit cost savings between the benchmark piece and the presort pieces in previous cases were followed to produce the unit costs and cost savings shown in Table 1. The R2005-1 methodology (USPS version) of witness Eliane Van-Ty-Smith was followed to produce the costs by cost pools of all first class metered letter-shaped mail for the 2005 base period from the IOCS file provided in USPS LR-L-9.[15] Those costs by cost pool are adjusted to the test year and are converted into per unit costs for all First Class metered mail letters as per the methodology used by witness Marc Smith.[16]

These unit mail processing costs by shape and indicia, produced using witness Smith's methodology and confirmed by him, become the starting point for the First Class bulk metered mail letter proxy. From that starting point adjustments to the metered letter mail processing costs can be made to approximate the workshared-related unit mail processing costs for the bulk metered mail letter benchmark piece. Those adjustments follow the past practice of allocating each cost pool into one of three groupings: workshare-related proportional, workshare-related fixed, or non-workshare related. See Appendix Table A-2 and A-3 for the detailed cost pool allocations.

[15] Witness Van Ty Smith confirms these numbers in APWU/USPS-T11-2, Tr. Vol. 10 at 2446-2452.
[16] Witness Smith confirms these numbers in APWU/USPS-T13-2, Tr. Vol. 14 at 4222-4228.

In addition to making a calculation of unit costs for the benchmark piece, the distribution of the CRA totals for the First Class Presort letter mail produced by witness Abdirahman for this case must also be reconsidered. It is not possible to directly use the CRA cost allocations calculated by witness Abdirahman and shown in USPS LR-L-48 FCM.xls. That is because he allocates the cost pools into only two groups rather than the three used previously and he only uses mail processing costs in his final cost comparisons by rate category. The CRA totals for Presort letter mail must be reallocated to the same three groupings listed above and the distribution of the revised Presort workshare-related costs among the different rate classes of Presort letter mail recalculated. I have used the model costs provided by witness Abdirahman in USPS LR-L-48 FCM.xls to distribute the presort mail processing costs among the different rate categories of Presort letter mail. The calculations are shown in APWU-LR-1.

In allocating the cost pools to the three groupings of cost categories: workshare-related proportional, workshare-related fixed, and non-workshare related, I have examined the allocations in the most recent three rate cases, R2000-1, R2001-1 and R2005-1. In its R2000-1 decision, the PRC relied on cost data produced from allocating 11 cost pools to the workshare-related proportional category, and 10 cost pools and one partial cost pool to the workshare-related fixed category. The remaining cost pools were allocated to the non-workshare related category.[17] Since that time, there have been changes to the cost pools

[17] In PRC-LR-9 from R2000-1, the following MODS cost pools were allocated to worksharing related proportional: BCS, OCR, LSM, MANL, LD15, LD41, LD42, LD43,LD44 and the NONMODS (Stations and branches) cost pools

produced by witness Van-Ty-Smith and they no longer exactly match the cost pools used in the R2000-1 decision.

The LSM cost pool has been discontinued since the letter-sorting machines have been taken out of service. Witness Van-Ty-Smith now combines the costs from LD41, LD42, LD43 and LD44 cost pools with the other station and branch data and does not produce separate MODS cost pools for those categories but does allocate those costs based on the allocation of the other station and branch data. The BCS cost pool has been renamed to BCS/DBCS. The workshare fixed category of 1BULKPR has been renamed 1PRESORT but witness Van-Ty-Smith states that the two cost pools have the same definition.[18] Consequently, it is still treated as a workshare fixed category. Abdirahman treats the other new categories 1TRAYSORT, 1DISPATCH, 1FLTPREP, and 1OPTRANS as non-workshare related because they are not related to "piece distribution or package distribution of letters or cards." 1TRAYSORT is a new cost pool introduced in FY2002 and is defined as mechanized tray sorter and robotics gantry. This is clearly not a piece distribution activity but since, by definition, the BMM is entered in trays and much of the Presort letter mail is entered in trays, there is some possibility that there are worksharing-related differences in these costs. Consequently, while I consider this a borderline case,

---

AUTO/MECH and MANL. The following cost pools were allocated to the worksharing-related fixed category: 1BULKPR, a third of 1CANCMMP, 1OPBULK, 1OPPREF, 1PLATFRM, 1POUCHING, LD49, LD79, 1SUPP F1 and 1SUPP F4 and the NONMODS (Stations and branches) cost pool ALLIED. The remaining cost pools were allocated to the non-worksharing related category.

[18] See Response of Van-Ty-Smith to Interrogatory TW/USPS-T11-9 in R2005-1 (May 5, 2005).

I did include it in the worksharing related fixed category. The others, following witness Abdirahman's practice, were allocated to non-workshare related. The cost pool 1CANCMMP, a third of which the PRC used in the fixed workshare-related category, was split after R2000-1 and became two cost pools: the cancellation activities and the meter prep activities (1CANCEL and 1MTRPREP).

In R2005-1, the two cost pools that resulted from the separation of 1CANCMMP were both included, in full, in the workshare-related fixed category.[19] However, in R2000-1 the Postal Service did not include any of these activities in its original proposals and the PRC included only some of the activities (using an arbitrarily assigned value of 1/3 of that cost pool in its final calculations). In these calculations the 1CANCEL has been placed in the non-workshare related category since the BMM letters skip the cancellation activities that non-metered, non-trayed mail would undergo and presort mail also skips the cancellation activities. While Postal witnesses Abdirahman and McCrery have both indicated that BMM goes straight to the MLOCRs for barcoding, it is less clear that all the presort mail would skip the meter preparation operations. Consequently 1MTRPREP remains in the workshare fixed category.

In the past three rate cases, it has been the practice of the Postal Service to develop the cost basis for Nonautomation Presort letters separately from the costs for Automation Presort letters. However, in R2005-1, a problem with accurately dividing the costs between Nonautomation Presort and Automation Presort letters was identified. Consequently, the Postal Service has now

[19] LR-L-141 also includes the 1CANCEL cost pool in the workshare related category but is not clear as to why it is included there.

combined the costs for those two types of letters and reallocates the costs based on models for each category of presort mail. I have followed that methodology in my calculations. Thus, the per unit costs for all First Class Presort letter mail is used as the starting point for the Presort letter cost calculations. I have used the models provided by Mr. Abdirahman in his library reference USPS LR-L-48 to allocate the proportional costs to each of the different categories of Presort letters and then add on the fixed per unit worksharing related costs to each.

The unit delivery cost of BMM letters was proxied by the Nonautomation Presort letter unit delivery costs until the R2001-1 rate case. In that case witness Miller proposed changing the unit delivery cost to that of only machinable, Nonautomation Presort letters. That suggested change had merit since, by definition, BMM consists only of machinable letters and only machinable letters can be delivery point sequenced. However, in this case, the unit delivery costs of machinable Nonautomation Presort letters have not been calculated separately from the nonmachinable Nonautomation Presort letters. Consequently, the unit delivery costs of all Nonautomation Presort letters again has been used as the proxy for BMM unit delivery costs.[20]

The resulting unit cost calculations and the per unit savings they generate (which are also shown in Table 1) are presented in Table 4.

[20] Based on the volume distribution of the Nonautomation Presort letters in USPS LR-L-48 only about 1.3% of Nonautomation Presort letters are nonmachinable compared with the distribution in R2001-1 (USPS LR-J-60) when over 40% of the letters were considered to be nonmachinable.

Table 4: R2006-1 FIRST-CLASS MAIL PRESORT LETTERS AND BMM LETTERS—SUMMARY (in cents)

BENCHMARK RATE CATEGORY	Mail Processing Total Unit Cost (1)	Mail Processing Worksharing Related Unit Cost (2)	Delivery Worksharing Related Unit Cost (3)	Total Worksharing Related Unit Cost (4)	Total Worksharing Related Unit Cost Savings (5)
Bulk Metered Mail (BMM) Letters		9.584	4.696	14.280	
Nonautomation Presort Letters		5.664	4.696	10.360	3.920
Nonautomation Nonmachinable Mixed ADC	23.708	23.200			
Nonautomation Nonmachinable ADC	18.871	18.363			
Nonautomation Nonmachinable 3-Digit	16.503	15.995			
Nonautomation Nonmachinable 5-Digit	8.853	8.345			
Nonautomation Machinable Mixed AADC	6.224	5.715			
Nonautomation Machinable AADC	6.224	5.715			
Nonautomation Machinable 3-Digit	5.706	5.197			
Nonautomation Machinable 5-Digit	5.706	5.197			
Automation Mixed AADC Letters	6.328	5.820	4.260	10.080	4.200
Automation AADC Letters	5.269	4.761	4.110	8.871	5.409
Automation 3-Digit Presort Letters	4.900	4.392	4.050	8.442	5.838
Automation 5-Digit Presort Letters	3.698	3.190	3.770	6.960	7.320

Sources

(1) APWU-LR-1 Worksheet "Presort Letter Sum"

(2) APWU-LR-1 Worksheets "CRA- Metered Letters", "Presort Letter Sum"

(3) USPS-LR-L-67 UDCModel.USPS.xls "1. Table 1" , witness Kelley response to ABA/NAPM T-22-2(b) revised 8/15/2006

(4) Column (2) + Column (3)

(5) Each cost number in column (4) is subtracted from the BMM Letter estimate in the first row of (4).

V. Conclusion

The Postal Service has moved away from its long-followed methodology in this case, de-linking the rates of First Class Single Piece letters from rates of the First Class Presort letters. This testimony focuses on the policy change inherent in that methodological change and proposes rates that adhere to the policy that ties Presort First Class letter rates to those of Single-Piece First Class letter rates through costs avoided. Because of the significant possibility of rate shock if the full adjustment were to be implemented, the rates proposed here would be only a partial adjustment toward the policy of using costs avoided to calculate the First Class Presort letter rates. However, the problems inherent with not beginning this readjustment process are obvious. It will become harder and harder to return to the policy of a uniform First Class letter rate with 100 percent pass-throughs of costs avoided if the Single Piece and Presort letter rates are allowed to drift further apart.

Appendix

Table A-1 : TY2008 Volume Forecast for Postal Service Proposal and Produced by New Rates R2006-1 Volume Forecast: After-Rates (millions of pieces)		
	2008GFY Postal Service Forecast from Thress T-	2008GFY Produced Using Rates Proposed in APWU-T-1
FIRST-CLASS MAIL		
First-Class Letters & Flats	85,633.639	85,495.596
-- Single-Piece	37,206.438	37,981.407
-- Workshared	48,427.200	47,514.189
(Nonautomated Presort)	929.256	1,252.072
(Automated)	47,497.945	46,262.118
(Mixed-ADC Letters)	2,918.778	2,840.361
(Mixed-ADC Flats)	46.774	45.938
(AADC Letters)	2,538.198	2,470.006
(AADC Flats)	111.845	109.847
(3-Digit Letters)	23,024.390	22,437.620
(5-Digit Letters)	18,233.989	17,744.756
(3-Digit Flats)	274.864	270.291
(5-Digit Flats)	349.107	343.298
(Carrier-Route Letters)	0.000	0.000
First-Class Cards	5,657.451	5,658.658
-- Single-Piece	2,358.960	2,360.167
-- Workshared	3,298.491	3,298.491
(Nonautomated Presort)	300.783	300.783
(Automated)	2,997.708	2,997.708
(Mixed-ADC)	320.788	320.788
(AADC)	244.322	244.322
(3-Digit)	1,281.495	1,281.495
(5-Digit)	1,151.102	1,151.102
(Carrier-Route)	0.000	0.000
TOTAL FIRST-CLASS MAIL	91,291.090	91,154.254
Priority Mail	829.079	829.079
Express Mail	42.683	42.683
Mailgrams	0.000	0.000
PERIODICAL MAIL		
Within County	700.140	700.140
Nonprofit	1,698.941	1,698.941
Classroom	60.068	60.068
Regular Rate	6,290.945	6,290.945
TOTAL PERIODICAL MAIL	8,750.094	8,750.094
STANDARD MAIL		
Regular Rate Bulk	92,273.062	92,538.627
Regular	62,926.250	63,191.815

Table A-1 : TY2008 Volume Forecast for Postal Service Proposal and Produced by New Rates R2006-1 Volume Forecast: After-Rates (millions of pieces)		
	2008GFY Postal Service Forecast from Thress T-	2008GFY Produced Using Rates Proposed in APWU-T-1
-- Nonautomated	2,859.038	2,871.459
(Basic Letters)	802.187	805.672
(Basic Nonletters)	375.386	377.017
(Presort Letters)	866.364	870.128
(Presort Nonletters)	815.101	818.642
-- Automated	60,067.212	60,320.356
(Mixed-ADC Letters)	2,318.382	2,328.454
(AADC Letters)	2,607.469	2,618.798
(Basic Flats)	394.477	396.191
(3-Digit Letters)	19,930.778	20,017.369
(5-Digit Letters)—includes ECR auto volume	23,193.899	23,286.843
(3/5-Digit Flats)	11,622.206	11,672.700
Enhanced Carrier-Route	29,346.811	29,346.811
-- Nonautomated	29,346.811	29,346.811
(Basic Letters)	1,689.402	1,689.402
(Basic Nonletters)	11,544.923	11,544.923
(High-Density Letters)	514.813	514.813
(High-Density Nonletters)	1,771.572	1,771.572
(Saturation Letters)	3,173.664	3,173.664
(Saturation Nonletters)	10,652.436	10,652.436
-- Automated	0.000	0.000
Nonprofit Rate Bulk	14,895.401	14,895.401
Nonprofit	12,372.554	12,372.554
-- Nonautomated	1,129.174	1,129.174
(Basic Letters)	405.240	405.240
(Basic Nonletters)	91.109	91.109
(Presort Letters)	471.358	471.358
(Presort Nonletters)	161.467	161.467
-- Automated	11,243.381	11,243.381
(Mixed-ADC Letters)	894.038	894.038
(AADC Letters)	851.568	851.568
(Basic Flats)	88.265	88.265
(3-Digit Letters)	4,367.566	4,367.566
(5-Digit Letters)	3,308.396	3,308.396
(3/5-Digit Flats)	1,733.548	1,733.548
Nonprofit ECR	2,522.847	2,522.847
-- Nonautomated	2,522.847	2,522.847
(Basic Letters)	264.091	264.091
(Basic Nonletters)	1,109.966	1,109.966
(High-Density Letters)	56.760	56.760
(High-Density Nonletters)	66.206	66.206
(Saturation Letters)	622.863	622.863
(Saturation Nonletters)	402.961	402.961

Table A-1 : TY2008 Volume Forecast for Postal Service Proposal and Produced by New Rates R2006-1 Volume Forecast: After-Rates (millions of pieces)		
	2008GFY Postal Service Forecast from Thress T-	2008GFY Produced Using Rates Proposed in APWU-T-1
-- Automated	0.000	0.000
TOTAL STANDARD MAIL	107,168.463	107,434.028
PACKAGE SERVICES		
Parcel Post	362.597	362.597
Non-Destination Entry	112.686	112.686
(Inter-BMC)	78.463	78.463
(Intra-BMC)	34.223	34.223
Destination Entry	249.911	249.911
(DBMC)	62.099	62.099
(DSCF)	1.732	1.732
(DDU)	186.081	186.081
Bound Printed Matter	654.853	654.853
Media Mail	153.731	153.731
Library Rate	12.253	12.253
TOTAL PACKAGE SERVICES MAIL	1,183.434	1,183.434
Postal Penalty	646.024	646.024
Free-for-the-Blind	87.514	87.514
TOTAL DOMESTIC MAIL	209,998.381	210,127.110
DOMESTIC SPECIAL SERVICES		
Registry	3.396	3.391
Insurance	41.636	41.636
Certified	263.719	263.348
Collect-on-Delivery	1.135	1.135
Return Receipts	237.633	237.358
Money Orders	151.879	151.879
Delivery Confirmation	811.319	811.319
Signature Confirmation	10.538	10.538
TOTAL SPECIAL SERVICES	1,521.254	1,520.604
Stamped Cards	111.951	112.012

TABLE A-2: FIRST CLASS MAIL BULK METERED LETTERS
CRA MAIL PROCESSING COSTS

Cost Pools		Total (Cents)1/	Proportional (Cents)	Fixed	
				Worksharing related (Cents)	Non Worksharing related (Cents)
MODS 11	BCS/				
MODS 11	BCS/DBCS	2.3607	2.3607		
MODS 11	OCR/	0.9641	0.9641		
MODS 12	FSM 100	0.0396			0.0396
MODS 12	FSM/				0.0000
MODS 12	FSM/1000	0.0186			0.0186
MODS 13	MECPARC	0.0001			0.0001
MODS 13	SPBS OTH	0.0151			0.0151
MODS 13	SPBSPRIO	0.0028			0.0028
MODS 13	1SACKS_M	0.0101			0.0101
MODS 13	1TRAYSRT	0.2115		0.2115	
MODS 14	MANF	0.0223			0.0223
MODS 14	MANL	1.3422	1.3422		
MODS 14	MANP	0.0038			0.0038
MODS 14	PRIORITY	0.0070			0.0070
MODS 15	LD15	0.3438	0.3438		
MODS 17	1CANCEL	0.3678			0.3678
MODS 17	1DISPATCH	0.2094			0.2094
MODS 17	1FLATPRP	0.0021			0.0021
MODS 17	1MTRPREP	0.0826		0.0826	
MODS 17	1OPBULK	0.0210		0.0210	
MODS 17	1OPPREF	0.2684		0.2684	
MODS 17	1OPTRANS	0.0810			0.0810
MODS 17	1PLATFRM	0.9080		0.9080	
MODS 17	1POUCHNG	0.0243		0.0243	
MODS 17	1PRESORT	0.0163		0.0163	
MODS 17	1SACKS_H	0.0156			0.0156
MODS 17	1SCAN	0.0544			0.0544
MODS 18	BUSREPLY	0.0156			0.0156
MODS 18	EXPRESS	0.0048			0.0048
MODS 18	MAILGRAM	0.0046			0.0046
MODS 18	REGISTRY	0.0098			0.0098
MODS 18	REWRAP	0.0124			0.0124
MODS 18	1EEQMT	0.0458			0.0458
MODS 19	INTL	0.0153			0.0153
MODS 19	PMPC				0.0000
MODS 49	LD49	0.2199		0.220	
MODS 79	LD79	0.0215		0.022	
MODS 99	1SUPP_F1	0.3611		0.361	

TABLE A-2: FIRST CLASS MAIL BULK METERED LETTERS
CRA MAIL PROCESSING COSTS

Cost Pools		Total (Cents)1/	Proportional (Cents)	Fixed	
				Worksharing related (Cents)	Non Worksharing related (Cents)
Mods Subtotal			**5.0107**	**2.1348**	**0.9578**
BMCS	NMO	0.0000			0.0000
BMCS	OTHR	0.0010			0.0010
BMCS	PLA	0.0007			0.0007
BMCS	PSM	0.0000			0.0000
BMCS	SPB	0.0017			0.0017
BMCS	SSM	0.0000			0.0000
BMC Subtotal			**0.0000**	**0.0000**	**0.0034**
NON MODS	ALLIED	0.4623		0.4623	
NON MODS	AUTO/MEC	0.3939	0.3939		
NON MODS	EXPRESS	0.0069			0.0069
NON MODS	MANF	0.0263			0.0263
NON MODS	MANL	1.5823	1.5823		
NON MODS	MANP	0.0026			0.0026
NON MODS	MISC	0.4861			0.4861
NON MODS	REGISTRY	0.1831			0.1831
Non Mods Subtotal			**1.9761**	**0.4623**	**0.7049**
Total		**11.25009**	**6.9869**	**2.5971**	**1.6662**

1/ Per unit costs of metered mail letters, confirmed by Witness Smith APWU/USPS-T13-2

TABLE A-3: FIRST CLASS MAIL PRESORT LETTERS
CRA MAIL PROCESSING COSTS

Cost Pools		Total (Cents) 1/	Proportional (Cents)	Fixed Worksharing related (Cents)	Fixed Non Worksharing related (Cents)
MODS 11	BCS/	0			
MODS 11	BCS/DBCS	1.324015	1.3240		
MODS 11	OCR/	0.136077	0.1361		
MODS 12	FSM 100	0.009759			0.0098
MODS 12	FSM/	0			0.0000
MODS 12	FSM/1000	0.006348			0.0063
MODS 13	MECPARC	0.000407			0.0004
MODS 13	SPBS OTH	0.006472			0.0065
MODS 13	SPBSPRIO	0			0.0000
MODS 13	1SACKS_M	0.010168			0.0102
MODS 13	1TRAYSRT	0.172956		0.1730	
MODS 14	MANF	0.004714			0.0047
MODS 14	MANL	0.262045	0.2620		
MODS 14	MANP	0.004394			0.0044
MODS 14	PRIORITY	0.001471			0.0015
MODS 15	LD15	0.069664	0.0697		
MODS 17	1CANCEL	0.018636			0.0186
MODS 17	1DISPATCH	0.076136			0.0761
MODS 17	1FLATPRP	0.004771			0.0048
MODS 17	1MTRPREP	0.011796		0.0118	
MODS 17	1OPBULK	0.021625		0.0216	
MODS 17	1OPPREF	0.179291		0.1793	
MODS 17	1OPTRANS	0.031105			0.0311
MODS 17	1PLATFRM	0.383728		0.3837	
MODS 17	1POUCHNG	0.009766		0.0098	
MODS 17	1PRESORT	0.028085		0.0281	
MODS 17	1SACKS_H	0.009943			0.0099
MODS 17	1SCAN	0.028803			0.0288
MODS 18	BUSREPLY	0.003179			0.0032
MODS 18	EXPRESS	0.001126			0.0011
MODS 18	MAILGRAM	0.001431			0.0014
MODS 18	REGISTRY	0.000996			0.0010
MODS 18	REWRAP	0.002818			0.0028
MODS 18	1EEQMT	0.013334			0.0133
MODS 19	INTL	0.00541			0.0054
MODS 19	PMPC	0			0.0000
MODS 49	LD49	0.177127		0.1771	
MODS 79	LD79	0.205337		0.2053	

MODS 99	1SUPP_F1	0.147386		0.1474	
		3.370323	**1.7918**	**1.3371**	**0.2414**
Mods Subtotal					
BMCS	NMO	0			0
BMCS	OTHR	0.000282			0.000282
BMCS	PLA	0.000291			0.000291
BMCS	PSM	0			0
BMCS	SPB	0			0
BMCS	SSM	0			0
BMC Subtotal		0.000573	0	0	0.000573
NON MODS	ALLIED	0.156942		0.156942	
NON MODS	AUTO/MEC	0.233175	0.233175		
NON MODS	EXPRESS	0.000862			0.000862
NON MODS	MANF	0.00118			0.00118
NON MODS	MANL	0.559354	0.559354		
NON MODS	MANP	0.005139			0.005139
NON MODS	MISC	0.251761			0.251761
NON MODS	REGISTRY	0.007438			0.007438
Non Mods Subtotal		1.215852	**0.7925**	**0.1569**	**0.2664**
Total		**4.587**	**2.584**	**1.494**	**0.508**
1/ Per unit costs from USPS-LR-L-53					