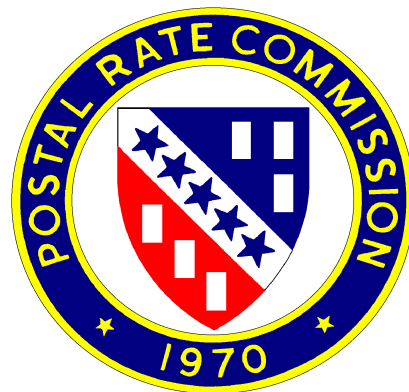


POSTAL RATE COMMISSION



PRESS BRIEFING

**POSTAL RATE AND FEE CHANGES
DOCKET NO, R2000-1**

NOVEMBER 13, 2000



POSTAL RATE COMMISSION

CONTENTS OF PRESS PACKET

PRESS BRIEFING ON THE R2000-1 OMNIBUS RATE PROCEEDING

**Commission Hearing Room
1333 H Street, N.W. Suite 300
Washington, D.C.
November 13, 2000
11:00 AM**

Press Release

Statement by Edward J. Gleiman, Chairman, Postal Rate Commission
Service Quality and Advertising

Charts On Display:

1. Contribution To Institutional Costs (Pie Chart)
2. Percentage Rate Increases
3. Selected Rates Used By Nonbulk Mailers

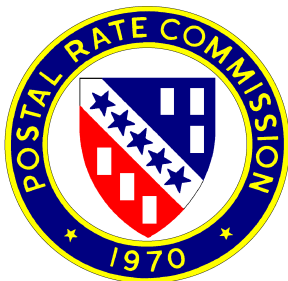
Other Charts in Press Package:

1. History of Postal Rate Increases
2. First-Class Stamp and Consumer Price Index
3. Selected Rates Used by Bulk/Business Mailers

Excerpts from Decision

Table of Contents
List of Appendices
Summary
Introduction

Biographies of Commissioners



POSTAL RATE COMMISSION

FOR IMMEDIATE RELEASE • NOVEMBER 13, 2000

EMBARGOED UNTIL 11:30 AM

Contact: Robert Cohen; Stephen Sharfman

POSTAL RATE COMMISSION ISSUES OPINION

Washington, D.C. November 13, 2000 — The independent Postal Rate Commission today approved the U.S. Postal Service request to increase the one ounce, First-Class stamp to 34 cents. Under the Commission's Decision, however, a post card would continue to cost 20 cents, and First-Class letters weighing more than one-ounce would have no rate increase. The Postal Service sought increases in both categories.

These First-Class rates are among hundreds of postal rates reviewed by the Commission since last January, when the Postal Service sought an overall average rate increase of 6 percent designed to raise \$2.8 billion annually. By law the Commission has 10 months after the Postal Service asks for rate increases to make its Decision, which now goes to the Postal Service Governors for final approval. The Board of Governors is not expected to implement the new rates until January, 2001.

Of the \$2.8 billion sought by the Postal Service in this case, only about \$800 million was needed to cover anticipated increases in the costs of collecting, processing, and delivering mail. The difference was split between a quarter billion dollars allocated to pay down outstanding accrued losses and \$1.7 billion allocated for a contingency to cushion unforeseen expenses.

The Commission made adjustments to the Postal Service request that recognized higher operating costs, but the Commission then concluded that the contingency cushion proposed by the Postal Service was unreasonably high. The impact of this decision on rates was to increase rates over-all by only 4.6 percent. The one-cent increase in the one-ounce, First-Class stamp represents a 3 percent increase and would generate about \$1 billion.

Other increases of note proposed by the Postal Service and approved by the Commission concern periodical publications and the heavily advertised Priority Mail. The cost of mailing one-pound Priority Mail would increase from the current \$3.20 to \$3.50, while the two-pound rate would go to \$3.95. According to the Commission, 33 percent of all Priority mail weighs one pound or less.

Periodical publications faced a 14.2 percent average increase under the Postal Service proposal, but the Commission reduced this increase to 9.9 percent after the Postal Service announced in mid-year a “break through productivity” program designed to reduce costs associated with processing magazines and newspapers. The Postal Service initiative followed testimony before the Commission that despite using new automated equipment, periodical costs continued to increase faster than inflation.

Rate increases for mail sent by nonprofit organizations and libraries also were reduced from the original Postal Service request after Congress passed legislation in October, 2000 that established a formula designed to restrain rate increases for mail sent by these groups.

Other Commission recommendations to the Postal Service included development of two new, discount rates for First-Class, the first to lower the rate for preprinted, barcoded courtesy reply envelopes used by consumers for bill payments, and the second to apply to letters bearing computer-generated postage.

The Commission reaches decisions on the basis of evidence developed in public hearings. Much of the evidence is complex technical cost analyses presented by organizations representing business mailers, but individuals and consumer representatives also participate actively. The Commission heard 122 expert witnesses during 40 days of hearings and reviewed more than 25,000 pages of evidence. Three Commissioners also joined in a separate concurring opinion urging the Postal Service to explore potential service improvements and cost reductions that might result from offering electronic capabilities to additional mail services.

The Rate Commission is composed of five presidentially-appointed Commissioners, each confirmed by the Senate for a six-year term. All five Commissioners participated in the R2000-1 decision: Chairman Edward J. Gleiman; Vice-Chairman George A. Omas, and Commissioners Dana B. Covington, Ruth Y. Goldway, and W.H. "Trey" LeBlanc III.

#



POSTAL RATE COMMISSION

STATEMENT OF THE CHAIRMAN

Good morning ladies and gentlemen.

I'm pleased that you could join us today.

I am Ed Gleiman, Chairman of the Postal Rate Commission. With me today are Vice Chairman George Omas and Commissioners Trey LeBlanc, Ruth Goldway and Dana Covington.

The press package distributed earlier contains the summary and selected excerpts from the Commission's Opinion and Recommended Decision for R2000-1, copies of the charts we have in the front of the room, plus some additional background material. Our Decision was transmitted to the Governors of the Postal Service and the Postmaster General a short while ago and has been posted on the Commission's web site, www.prc.gov.

We are very proud of our web site, which last year received one of 22 Government Technology Leadership awards. This year the site is even more comprehensive, as we added several new features, including programs that enable you to word-search not only today's Decision, but every rate and classification opinion dating back to the Commission's first-issued case in 1971.

The law that established the US Postal Service in 1970 provides that the Postal Service may, from time to time, request that the Postal Rate Commission recommend "rates and fees [that] shall provide sufficient revenue so that the total estimated income...to the Postal Service will equal as nearly as practicable the total estimated costs of the Postal Service."

In my almost seven years at the helm of the PRC, if I have learned nothing else, I've learned that each case presents a new challenge. In this case the challenge lay in evaluating the Service's request for additional funds over and above its expected operating expenses/needs.

Last January the Postal Service proposed an array of rate increases designed to generate an additional \$2.8 billion in revenue. This request is neither the largest nor the smallest amount of money sought in a rate case. What is unusual about this request is that roughly \$1.7 billion of these dollars (or 60 percent) is for a contingency, a cushion, a hedge against the unknown — to cover unforeseen events. Another quarter billion plus dollars (some \$250 million) are to pay down operating debt accrued in past years. You can do the math on how much of the \$2.8 billion the Service thought it needed to cover increases in operating costs. I make the amount to be a little more than \$800 million.

In most instances parties who intervene in a rate case focus almost exclusively on the justification the Postal Service presents for increasing rates for a particular type of mail. In the R2000-1 case, mailers did not ignore rate issues. However, many of them — representing a significant portion of the total mail volume, touching every class of mail — sponsored evidence challenging the need for a cushion so substantially above and beyond the Postal Service's own best estimate of future increases in the cost of collecting, processing and delivering the mail.

In presenting these estimates of its future needs, the Postal Service used financial and operational data from fiscal year 1998 as a benchmark. Unfortunately, by the time the Service filed its request, fiscal year 1999 had already come and gone.

The Commission and the parties agreed early in the process that if more recent data, reflecting actual events and requiring a shorter forecasting timeframe could be utilized, recommended rates would be more representative and fair.

At the request of the PRC, the Postal Service completed an update of its original cost projections. This updating process was no simple task. I commend the Service for undertaking and finishing the task in a timely manner. Doing so enabled the parties to the case to reassess their concerns in the context of the more recent data. The Service's

effort in this instance was consistent with the generally high level of cooperation we received during litigation of the R2000-1 case.

To give you a flavor of the impact of this updating effort, which allowed the Commission to use more recent information than was in the Service's initial package, let's look at a few of the changes:

- The USPS was able to factor in the increased costs of fueling its delivery fleet. A cost item we all can appreciate.
- It also was able to take account of the dollars associated with actual cost-of-living adjustments, health insurance and the like, which were higher than earlier projected figures.

But the update was not one-sided, only adding new costs. The Postal Service also presented additional revenue and costing-cutting initiatives, such as the billion-dollar-a-year “break through productivity plan” announced by the Postmaster General this past spring. Unfortunately for those who pay the bills — the mailing public — when it came to holding down rate increases, the Postal Service was only willing to commit to saving slightly more than one half the highly publicized, promised amount.

The one item that did not change materially in the Postal Service update was the \$1.7 billion rainy day contingency cushion to cover unforeseen expenses. The \$1.7 billion remained, despite the fact that the updated data also shortened the time line used to forecast future events.

Please understand, the law that the PRC operates under states that the Postal Service may include a “reasonable provision for contingencies” when calculating its revenue needs. As one might suspect, the parties arguing that a \$1.7 billion contingency was unreasonable before the update, felt even more strongly about this matter after the update. In their view new data and a shorter time frame for prognosticating were grounds for a much smaller contingency than \$1.7 billion. They argued that a cushion of this size was unreasonable and unjustified.

The evidence presented by the parties on the contingency issue was determinative. Consequently, while my colleagues and I, by and large, took into account the net cost changes presented by the Postal Service in its update, along with many adjustments proposed by the other parties to the case, we recommend a \$1 billion contingency and conclude that it more than meets the reasonableness standard of the law.

Before I get into specifics about the rates we are recommending, let me explain briefly what this now \$1 billion contingency really means.

- First and foremost, it enabled the Commission to recommend smaller rate increases for most types of mail than those proposed by the Postal Service.
- Second, if the Postal Service's best estimate of its future need for more money to cover expenses associated with the collection, processing and delivery of mail are on target — remember, this is a new, updated estimate that incorporates the impact of more recent actual events and which, by its very nature involves less uncertainty — if this estimate is correct, the Postal Service would still realize a \$1 billion surplus on an annualized basis.

If you hear doom and gloom projections about this Recommended Decision not providing the Postal Service with sufficient revenue to breakeven in the current fiscal year, remember this. If rate increases are implemented in January — which the Service has indicated is likely — and the Service's best estimate is on target, the Postal Service should be sitting on a sizable cushion. Put another way, in the absence of the occurrence of unforeseen events costing more than \$500 million, the Service should do quite well with the smaller rate increases we recommend.

Now let me turn to the specific rate recommendations made by the Commission.

As you can see on the chart entitled **SELECTED RATES USED BY NONBULK MAILERS**, the rate for a one-ounce First-Class letter will go up to 34 cents. However, the rates for heavier First-Class mail will not increase. The rate for each ounce above the

first ounce is currently 22 cents. That will decline to 21 cents. As a result, the rate for a 2-ounce piece will be 55 cents, the same as it is today. The rate for a 3-ounce piece actually goes down.

This is not an insignificant matter. Almost 15 percent of single piece First-Class Mail weighs more than one-ounce, and will have no rate increase as a result of this decision.

The Commission is also recommending that the post card remain at 20 cents.

This mix of rate changes in First-Class letters and cards reflects the fact that, while we operate under an integer constraint when it comes to the basic stamp rate, the Commission continues to be concerned about the institutional cost burden borne by these monopoly rate payers.

Next, let me ask you to focus on the section of the chart showing changes for Priority Mail. Currently there is a two-pound rate that applies to the vast majority of Priority Mail pieces. The Postal Service proposed that a one-pound rate be established and the Commission approves that request. However, this proposal did lead to a rate design problem.

The Postal Service currently distributes a so-called "flat rate" envelope. Mailers can put as much as they want into a flat rate envelope and send it at the minimum rate, currently the two-pound rate. Because the minimum rate will become the one-pound rate, it could become very confusing if flat rate envelopes are still charged the two-pound rate.

The Commission reviewed this issue carefully. Because more than three quarters of all flat rate envelopes contain less than a pound, the Commission has chosen to recommend that flat rate envelopes be charged a one-pound rate.

Now let me turn to the rate changes for some of the major bulk mail categories. It is easiest to discuss these rates by reference to the AVERAGE PERCENT RATE CHANGE chart.

Periodicals have been saddled with substantial rate increases in each of the last two cases because the cost of processing this mail increased dramatically. Following the last rate case the industry and the Postal Service put together a Joint Task Force to find the causes of the sharply increasing costs. The Task Force reviewed multiple Postal Service processing facilities and came up with a dozen or so specific recommendations for restraining costs.

The initial Postal Service request did not take into account the Task Force recommendations. Periodicals Mailers challenged Postal Service cost projections, arguing that the recommendations of the Task Force should be put into effect. The Postal Service has now accepted many of these suggestions. As you can see, the Commission has been able to recommend rate increases for Periodicals that are substantially smaller.

Many of these cost reduction measures identified by the Joint Task Force also will have the effect of restraining the cost increases that led to the proposed Standard Mail rate increases. As you can see, the recommended rates for Standard Mail are also below the rates initially proposed by the Postal Service.

I think a separate explanation is necessary for those five rates marked with an asterisk on the AVERAGE PERCENT RATE CHANGE chart. Each of those categories has traditionally paid low rates in recognition of the preferred status of Nonprofit mailers. As you can see from the left hand column, Nonprofit mailers would have been burdened with exceptionally high increases but for the fact that Congress passed legislation. That legislation not only restrained rate increases in this case, but it established a ratemaking formula for this mail that should moderate future increases.

During the course of this case, there have been a number of instances in which evidence was presented that the Postal Service was not delivering as promised on one or another of its offerings. I believe that all would agree on the importance now and in the future of quality service at an affordable price. Maintaining affordable rates will require considerable discipline on the part of the Postal Service to contain and, where possible, cut costs. Cost cutting need not be associated with a diminution in service.

One example of an opportunity for the Postal Service to provide a higher quality service at a lower price and still drive costs out of the system is discussed in a concurring opinion signed by me and my colleagues, Vice Chairman Omas and Commissioner Goldway. We propose that the Service consider extending its computer-based deliver confirmation service to First Class mail as a substitute for the more costly, paper-based certified mail service.

Delivery confirmation is less expensive, user-friendly and the switch could save the Postal Service hundreds of millions of dollars in costs.

That concludes my prepared remarks. My colleagues and I will now take questions for a few minutes, following which staff will be available to answer technical questions you may have.



POSTAL RATE COMMISSION

DOCKET NO. R2000-1 SERVICE QUALITY AND ADVERTISING

The Commission Decision expresses concern over poor or uneven service quality and confusing or misleading advertising in connection with a number of products and services, including Priority Mail, Express Mail, Certified Mail and Return Receipt Service. The following parts of the recommended decision specifically discuss these issues:

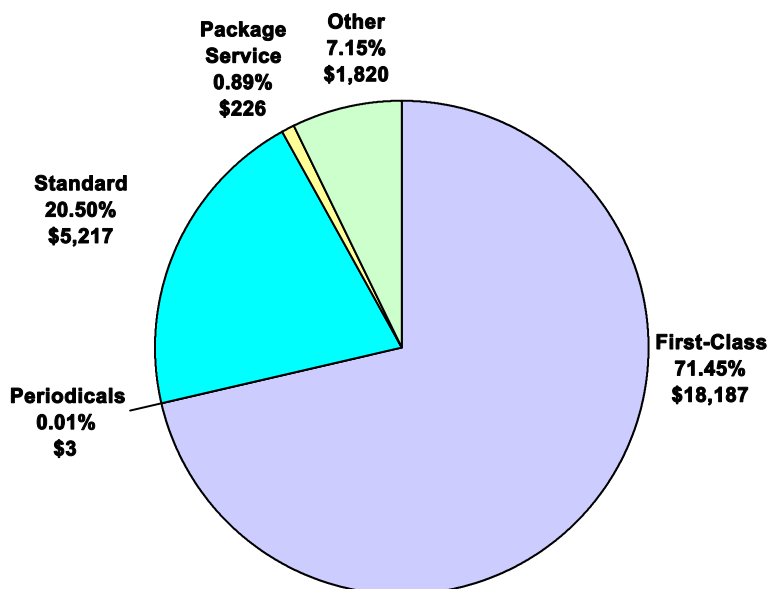
Priority Mail	Paras. 5297-5301 (pp. 306-08); Para. 5304 (p. 309); Para. 5317 (pp. 312-13)
Express Mail	Paras. 5009-10 (pp. 219-220); Para. 5013 (pp. 220-21)
Certified Mail	Paras. 6076-77 (p. 570); Paras. 6079-80 (pp. 570-71); Paras. 6082-84 (p. 572)
Return Receipt	Paras. 6104-05 (p. 578)

In addition, three Commissioners in a Concurring Statement attached to the Decision suggested that the Postal Service review the confusing array of services it offers for accountable mail services. These are services for which the consumer pays a premium for receiving information about delivery. These mail services include certified mail, return receipt, delivery confirmation, signature confirmation, and certificates of mailing. The Commissioners observed that if the Postal Service's electronically based delivery and signature confirmation services were extended to First-Class letters, the Postal Service might more easily be able to deal with the high-volume situations that at present are compromising the quality of these services. The Commissioners note that it should be possible to maximize electronically based services in a way that gives consumers better choices and quality of service at lower prices. According to Commission calculations, implementation of this change could save the Postal Service in excess of \$300 million annually.

Contribution to Institutional Costs PRC R2000-1

(Dollars in Millions)

Total Contribution to Institutional Costs: \$25,453



	Percent Volume	Percent Revenue	Percent Contribution to Institutional Cost
First-Class ¹	51.4%	61.7%	71.45%
Periodicals	5.0%	3.5%	0.01%
Standard	42.4%	23.3%	20.50%
Package Service	0.5%	3.1%	0.89%
Other Mail	0.7%	8.4%	7.15%
Total	100.0%	100.0%	100.00%

1/ Includes Priority Mail

Average Percent Rate Change

	USPS Proposed	PRC Recom- mended
First-Class Mail:		
Letters	3.5%	1.8%
Cards	5.2%	0.4%
Priority Mail	15.0%	16.0%
Express Mail	3.9%	3.6%
Periodicals:		
Within County	8.6%	6.8%
Regular Rate	14.2%	9.9%
Nonprofit	15.2%*	7.2%
Classroom	11.3%*	9.6%
Standard Mail:		
Regular Other	9.4%	8.8%
Regular ECR	4.9%	4.5%
Nonprofit Other	6.6%*	4.8%
Nonprofit ECR	41.9%*	18.3%
Package Services:		
Parcel Post	2.7%	2.7%
Bound Printed Matter	17.5%	17.6%
Media Mail	5.0%	6.3%
Library Rate	5.0%*	4.9%
Special Services:		
Certified Mail	50.0%	35.7%
Money Orders	8.3%	(4.1)%
Lock Boxes	9.0%	9.0%
Systemwide	6.0%	4.6%

* Estimated increase had 39 U.S.C. § 3626(a) formula not been amended by legislation enacted October 27, 2000.

SELECTED RATES USED BY NONBULK MAILERS

	<u>Current</u>	<u>USPS Proposed</u>	<u>PRC Recommended</u>
First-Class Letter			
One ounce letter	33¢	34¢	34¢
Two ounce letter	55¢	57¢	55¢
Three ounce letter	77¢	80¢	76¢
Post Card	20¢	21¢	20¢
Priority Mail			
One Pound	N/A	\$3.45	\$3.50
Two Pound	\$3.20	\$3.85	\$3.95
Five Pound	\$6.50	\$7.60	\$7.55
Express Mail			
(8 oz. P.O. to addressee)	\$11.75	\$12.30	\$12.25
(2 lb. P.O. to addressee)	\$15.75	\$16.05	\$16.00
Parcel Post - Inter BMC			
(2 lbs., zone 5)	\$3.15	\$3.47	\$3.45
Certified Mail	\$1.40	\$2.10	\$1.90
Money Orders	80¢	90¢	75¢

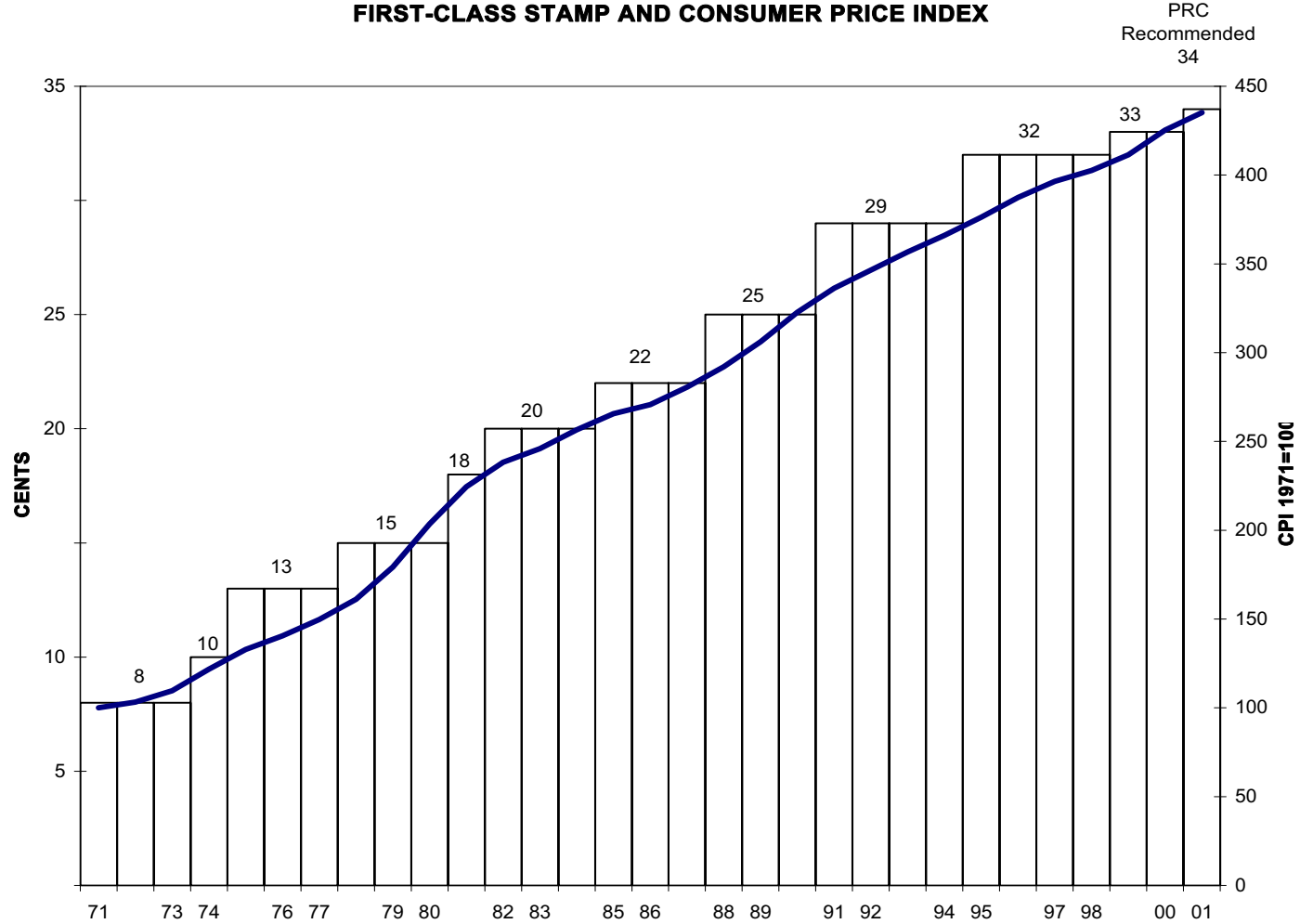
HISTORY OF FIRST-CLASS STAMP RATES

<u><i>Date</i></u> [*]	<u><i>Cost</i></u> [#]
1885-1917	.02
1917-1919	.03 (War Years)
1919	.02 (Dropped back by Congress)
July 6, 1932	.03
August 1, 1958	.04
January 7, 1963	.05
January 7, 1968	.06
May 16, 1971	.08
March 2, 1974	.10
December 31, 1975	.13
May 29, 1978	.15 ("A" Stamp used)
March 22, 1981	.18 ("B" Stamp used)
November 1, 1981	.20 ("C" Stamp used)
February 17, 1985	.22 ("D" Stamp used)
April 3, 1988	.25 ("E" Stamp used)
February 3, 1991	.29 ("F" Stamp used)
January 1, 1995	.32 ("G" Stamp used)
January 10, 1999	.33 ("H" Stamp used)

* The date specified is the first day on which the rate became applicable. In some instances, the rate introduced was temporary.

[#]The rate for the first ounce of a First-Class Letter. Beginning September 14, 1975, additional ounces have been charged rates lower than the applicable first-ounce rate.

FIRST-CLASS STAMP AND CONSUMER PRICE INDEX



NOTE: In 1981 the rate increased twice, once in March 1981 to 18 cents then in November 1981 to 20 cents

SELECTED RATES USED BY BULK/BUSINESS MAILERS

	<u>Current</u>	<u>USPS Proposed</u>	<u>PRC Recommended</u>
First-Class Letter			
Bank Statement (3 oz.)	77¢	80¢	76¢
Department Store Bill (Non-automation presort)	30.5¢	32¢	32¢
Utility Bill (Automation 5-Digit)	24.3¢	25.3¢	25.3¢
Post Card			
(Automation 3-Digit)	15.9¢	16.7¢	15.8¢
Priority Mail			
3 lbs.	\$4.30	\$5.10	\$5.15
10 lbs., Zone 4	\$8.50	\$9.70	\$10.30
Express Mail			
Legal Documents (2lbs.)	\$15.75	\$16.05	\$16.00
Regular Publications			
<i>Weekly News Magazine</i> 5.8oz. Drop shipped, CR presort	16.2¢	18.6¢	17.8¢
<i>Journal of Opinion</i> 3 oz., wide distribution, 5-Digit presort	20.1¢	22.6¢	21.8¢
<i>National Newspaper</i> 10 oz., drop shipped, 5-Digit presort	26.6¢	30.1¢	28.7¢
<i>Household Magazine</i> 13.8 oz., drop shipped, CR presort	27¢	31¢	29.36¢
<i>Trade Publication</i> 6.6 oz., wide distribuiton, 3-Digit presort	29.8¢	34.3¢	33.2¢
Within County Publication			
<i>In-County Newspaper</i> 4.5 oz., DDU Entry, CR presort	6.9¢	7.6¢	7.4¢
Nonprofit Publications			
<i>Small Publication</i> 4 oz., 20% adv, Zone 5, 3-Digit presort	19.6¢	23.8¢	23¢
<i>National Magazine</i> 14 oz., 60% adv, Zone 5, carrier route	31.6¢	36¢	34.1¢

SELECTED RATES USED BY BULK/BUSINESS MAILERS

	<u>Current</u>	<u>USPS Proposed</u>	<u>PRC Recommended</u>
Standard Regular Rate Mail			
Very Selective Advertising (Required presort, 2 oz. Letter, prebarcoded)	18.3¢	20.0¢	19.7¢
Selective Catalog (5-Digit presort, 9 oz. Flat)	43.9¢	45.3¢	45.9¢
Local Department Store Advertisement (5-Digit presort, 2 oz. Flat, SCF entry)	21.9¢	23.6¢	23.9¢
Saturation Local Mail (Carrier route walk sequence presort, 3 oz. Flat, delivery office entry)	11.4¢	12.0¢	11.8¢
Standard Nonprofit Mail			
Fund Raising Letter (Required presort, 1 oz.)	16.9¢	15.9¢	15.5¢
Church Bulletin (5-Digit presort, flat)	16.5¢	17.5¢	16.9¢
Package Service			
Parcel Post (2 lbs. To Zone 1, entered at DBMC)	\$2.23	\$2.39	\$2.10
Media Mail (2 lbs., presorted to BMC)	\$1.40	\$1.44	\$1.45
Bound Printed Matter (2.5 lbs., Zone 3, basic presort)	93.8¢	\$1.14	\$1.14
Library Rate (3 lbs.)	\$2.03	\$2.10	\$2.10

TABLE OF CONTENTS

	Page
SUMMARY	i
CHAPTER I: INTRODUCTION	1
CHAPTER II: REVENUE REQUIREMENT	15
A. Bases of Test Year Cost and Revenue Estimates	15
B. Volume Models and Forecasting Methodology.	18
1. The Service's Volumes Worksheets	18
2. The Postal Service's Econometric Models	27
3. The Postal Service's Forecasting Methodology.	28
4. The Postal Service's Forecasts During PFY 2000.	30
5. The Postal Service and Commission Forecasts for the Test Year	31
C. Changes and Adjustments to Test Year Costs and Revenues.	32
1. Supervisor Cost Reduction Program	32
2. Proposed Disallowance for Inefficient Processing of Flats	34
3. Summary of Non-Update Changes and Adjustments	37
D. Provision for Contingencies	38
CHAPTER III: COSTING	79
A. Mail Processing	79
1. Apportioning Segment 3 Costs to Components.	80
a. Migration of Window Service and Administrative Costs.	81
b. Development of New Cost Pools for Non-MODS Offices.	84
c. Consolidating Four MODS Mail Processing Cost Pools into Two.	84
2. Variability of Mail Processing Labor.	85
a. Summary	85
b. Operational Findings.	92
c. Econometric Findings	97
3. Distributing Mail Processing Labor Costs to Subclasses.	98
a. The Commission's Docket No. R97-1 Distribution..	98
b. Treatment of Allied Mixed Mail Costs.	101
c. Treatment of Allied Not Handling Costs..	104
d. Distributing Support Costs.	106
e. Drawing Inferences from IOCS Questions 18 and 19.	107

	Page
B. City Delivery Carrier Street Time Costs	109
1. Summary	109
2. Postal Service Engineered Standards (ES) Data Proposals	110
a. Use of Engineered Standards (ES) Data for Street Time Proportions	112
b. Use of Engineered Standards (ES) Data for Route-level Variabilities	120
3. The Established Load Time Variability Model	123
a. Stop-level Load Time Sub-model	124
b. System-level Load Time Sub-model	128
c. Relationship Between the Stop- and System-Level Sub-models	132
4. Postal Service Methodological Proposals	136
a. Fixed Load Time per Stop	137
b. The Deliveries Effect	142
c. Elemental Volume Variability and Other Issues	143
5. Elemental Load Parcel Distribution Key	147
a. UPS Proposal	148
b. Postal Service Opposition	149
c. Commission Analysis	149
6. Runtime Variability	150
7. Motorized Letter Route Volume Variable Costs	155
a. Witness Nelson's Proposal in R2000-1	156
b. Postal Service Rebuttal	157
c. Commission Analysis	158
8. Vehicle Loading Time Variability for Parcel Shaped Mail	159
a. UPS Proposal to Treat Parcel Handling as In-Office Time	160
b. Postal Service Rebuttal	161
c. Commission Analysis	161
9. Special Purpose Route Proposal	161
a. UPS Proposal	162
b. Postal Service Opposition	162
c. Commission Analysis	163
C. Rural Carriers	164
D. Purchased Transportation	167
1. Highway Transportation	167
a. A Note on Methods Used	168
b. Background for this Docket	170
c. Witness Bradley's Analysis	171
d. Witness Ball's Analysis	172
e. Witness Nelson's Analysis	173
2. Distribution of Transportation Costs	181
a. The Transportation Cost System	181
b. Alaska Air Adjustment	187
c. Air Transportation Network	187

	Page
CHAPTER IV: PRICING	193
A. Introduction	193
B. Pricing Overview	200
1. First Ounce Rate	200
2. Increasing Costs	205
3. Legislation	208
C. Ramsey Pricing	210
D. Incremental Cost	212
CHAPTER V: RATES AND RATE DESIGN	217
A. Express Mail	217
B. First-Class Mail	222
1. Letters and Sealed Parcels Rates and Classifications	226
a. Preliminary Considerations	226
b. Rates for Single-Piece (Nonpresorted) Letter Mail	228
c. Proposals Affecting Rates and Discounts for Workshared Mail (Letters and Flats)	235
d. Automation Flats	244
e. Additional-Ounce Rate Proposals	246
f. Heavyweight Discount Proposal	250
g. First-Class Mail Nonstandard Surcharge Proposals	252
h. Rate Summary	256
2. Letters and Sealed Parcels Classification Proposals	258
a. Single-Piece Automation Compatible Classification Proposals: CEM and IBIP	258
b. Meter Technology Discount Proposal	274
c. "P" Rate Proposal	282
d. Rates Working Group Proposal	285
e. First-Class Single Piece Rate Stability Proposal	286
f. Proposal to Provide Mailers with 10 One-Cent Make Up Stamps	291
3. Cards	292
4. Priority Mail	297
a. Introduction	297
b. Postal Service Proposal	299
c. Attributable Costs	300
d. Cost Coverage	300
e. Proposed Classification Changes	313
f. Rate Design	325
g. Consistency with Statutory Criteria	326
C. Standard A Mail	328
1. Introduction and Summary	328

	Page
2. Preliminary Considerations	336
a. Background.	336
b. Docket No. R2000-1 Rate Design Approach	338
c. Pricing and Cost Support	340
3. The Service's Classification Proposals	342
a. Automation-related Discount for Certain Prebarcoded Parcels	342
b. Eligibility of Automation Letters for Minimum Per Piece Rates.	344
c. The 3.3 Ounce Breakpoint	345
4. Rate Design for the Commercial Subclasses (Regular and ECR)	347
a. Introduction.	347
b. Regular Subclass Proposal	347
c. Proposed Changes Affecting the Residual Shape Surcharge	352
d. Standard A Enhanced Carrier Route Subclass	358
e. ECR Pound Rate Discussion	362
f. Witness Haldi's "Heavy Letter" Letter Adjustment in ECR	393
g. Witness Lubenow's Rate Design Suggestions	395
5. Impact of Legislation on Preferred Subclasses (Nonprofit and Nonprofit ECR) ...	396
a. Background.	396
b. Commission's Rate Design.	398
D. Periodicals	401
1. Introduction and Summary.	401
2. Preliminary Considerations	405
a. Background.	405
b. Mail Processing Cost Trends	407
c. Post-filing Adjustments	412
d. Cost Support.	426
3. Outside County Subclass	429
a. Merger Implementing New Legislation	429
b. Rate Design	433
c. Cost coverage.	443
4. Within County	446
a. Proposal and Recommendation	446
b. Eligibility for Destination Delivery Unit Discount	451
5. Other Matters.	453
a. Rate Grid Concept (MPA witness O'Brien).	453
b. Proposed Pallet Discount (TW witness Stralberg)	455
E. Package Services Mail (Standard Mail (B))	457
1. Parcel Post Subclass.	457
a. Introduction.	457
b. RPW Parcel Post Estimates	458
c. Postal Service Proposal	467
d. Cost Coverage	468
e. Rate Design	474

	Page
2. Bound Printed Matter	492
a. Introduction	492
b. Postal Service Proposal	492
c. Intervenor Proposals	495
d. Due Process Claims Are Without Substance	497
e. Cost Coverage	501
f. Rate Design	505
g. Recommendation	511
3. Media Mail	512
a. Introduction	512
b. Postal Service Proposal	512
c. Intervenor Proposals	514
d. Recommendation	515
e. Cost Coverage	517
f. Rate Design	518
4. Library Mail	519
a. Introduction	519
b. Postal Service Proposal	520
c. Intervenor Proposals	521
d. Recommendation	521
F. Special Services	522
1. Address Correction Service (Schedule 911)	526
2. Mailing List Services (Schedule 912)	527
a. ZIP Coding of Mailing Lists	527
b. Correction of Mailing Lists	528
c. Address Changes for Election Boards and Registration Commissions	529
d. Arrangement of Address Cards in Carrier Delivery Sequence	529
3. Post Office Boxes, Caller Service, and Reserve Call Numbers (Schedule 921)	530
4. Business Reply Mail (Schedule 931)	540
5. Merchandise Return (Schedule 932)	558
6. On-Site Meter Settings (Schedule 933)	559
7. Bulk Parcel Return Service (Schedule 935)	561
8. Shipper Paid Forwarding (Schedule 936)	568
9. Certified Mail (Schedule 941)	569
10. Registered Mail (Schedule 942)	573
11. Insurance (Schedule 943)	573
12. Collect on Delivery (Schedule 944)	576
13. Return Receipt (Schedule 945)	577
14. Restricted Delivery (Schedule 946)	579
15. Certificates of Mailing (Schedule 947)	580
16. Delivery Confirmation (Schedule 948)	582
17. Signature Confirmation (Schedule 949)	585
18. Parcel Airlift (Schedule 951)	587
19. Special Handling (Schedule 952)	587
20. Stamped Envelopes (Schedule 961)	588

	Page
21. Stamped Cards (Schedule 962)	591
22. Money Orders (Schedule 971).....	593
23. Mailing Online (Schedule 981).....	596
24. Annual Permit Fees (Schedule 1000)	596
25. Special Services DMCS Proposals	597

RECOMMENDED DECISION

CONCURRING OPINION OF CHAIRMAN GLEIMAN
COMMISSIONER GOLDWAY AND COMMISSIONER OMAS

APPENDIX ONE

APPENDIX TWO

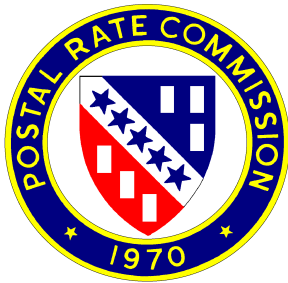
ABBREVIATIONS AND ACRONYMS

TECHNICAL APPENDICES

TECHNICAL APPENDICES

Appendix A, Part One	Participants and Counsel
Appendix A, Part Two	Participants
Appendix B, Part One	Witnesses' Testimony
Appendix B, Part Two	Witnesses' Biographies
Appendix C	Revenue Requirement for Test Year with Proposed Revenues and Costs
Appendix D	Development of Revenue Requirement and Cost Rollforward Adjustments
Appendix E	Comparison of Costs Attributed by Cost Segments and Components
Appendix F	The Variability of Mail Processing Operations
Appendix G	Schedule 1 – Test Year Revenues and Costs Schedule 2 – Revenue Calculation Schedule 3 – Mark-ups and Mark-Up Indices
Appendix H	Considerations for the Future Conduct of Recurring Sample Surveys and Observational Studies
Appendix I	Comparison of Volume Forecasts
Appendix J	Summary of Attributable Costs
Appendix K	Changes to TYAR Net Income: Postal Service Filing through PRC Recommended Decision
Appendix L	Correspondence

Docket No. R2000-1



POSTAL RATE COMMISSION

SUMMARY OF DECISION • R2000-1

In January, 2000, the Postal Service requested a general rate increase designed to raise \$2.788 billion per year. This request generated an unprecedented amount of opposition from mailer groups that questioned whether the Service accurately identified its revenue needs. The Postal Rate Commission reviewed both the detailed documentation provided by the Postal Service in support of its request, and the extensive evidence submitted by mail users. The Commission concludes that while the Postal Service does need additional rate revenues, some of the rate increases it sought were excessive.

The most important rate, in terms of postage revenue, is the single piece First-Class rate. The Postal Service asks to increase this rate from 33 cents to 34 cents. The Commission recommends this increase, which by itself will generate approximately \$1 billion. However, in order to assure that First-Class does not bear an unreasonably large share of the increase, other rates paid by ordinary citizens and small businesses, such as the postcard rate of 20 cents, and the extra ounce rate applicable to First-Class weighing more than one ounce, will not be increased. In fact, the Commission recommends that the extra ounce rate be reduced from 22 cents to 21 cents.

In this case a consortium of business mailer organizations and large individual business mail users presented wide ranging evidence that persuaded the Commission that some Postal Service expense projections were too high. As a result, the Commission recommends smaller increases for periodicals and other categories of bulk mail than the Postal Service originally requested.

The following table compares the rate increases recommended by the Commission with the increases proposed by the Postal Service.

Average Percent Rate Change

	USPS Proposed	PRC Recommended
First-Class Mail:		
Letters	3.5%	1.8%
Cards	5.2%	0.4%
Priority Mail	15.0%	16.0%
Express Mail	3.9%	3.6%
Periodicals:		
Within County	8.6%	6.8%
Regular Rate	14.2%	9.9%
Nonprofit	15.2%*	7.2%
Classroom	11.3%*	9.6%
Standard Mail:		
Regular Other	9.4%	8.8%
Regular ECR	4.9%	4.5%
Nonprofit Other	6.6%*	4.8%
Nonprofit ECR	41.9%*	18.3%
Package Services:		
Parcel Post	2.7%	2.7%
Bound Printed Matter	17.5%	17.6%
Media Mail	5.0%	6.3%
Library Rate	5.0%*	4.9%
Special Services:		
Certified Mail	50.0%	35.7%
Money Orders	8.3%	(4.1)%
Lock Boxes	9.0%	9.0%
Systemwide	6.0%	4.6%

* Estimated increase had 39 U.S.C. § 3626(a) formula not been amended by legislation enacted October 27, 2000.

The Commission's decision reflects several initiatives that warrant special mention. Although the Service filed the request in January, 2000, it based cost projections on fiscal year 1998 data. The Commission immediately asked participants whether fiscal year 1999 data should be substituted. There was broad agreement that projections would be more accurate if more recent data could be used. At the Commission's direction, the Postal Service successfully completed a basic update of its cost projections

that incorporated 1999 data while the case was in progress. Participants had an opportunity to offer supplementary evidence adjusting their presentations for this more recent data.

The use of actual 1999 costs had a number of salutary effects. The recommended rates reflect more recent actual operating results, and thus are fairer to both mailers and affected private businesses. Additionally, the update provided the Postal Service with the opportunity to correct earlier longer-range projections, identifying both underestimates and overestimates. The Service acknowledged that it should experience lower costs to process flat-shaped mail than it initially projected. The rates recommended by the Commission reflect these reductions. The Service also identified several recent events, such as increasing fuel prices, that should increase its overall revenue needs. The rates recommended by the Commission also take account of these cost increases.

One aspect of the rate request that generated substantial opposition was the claim that the Postal Service needed \$1.680 billion of additional revenue as a cushion against unforeseen events. The statute allows the Postal Service a reasonable provision for contingencies; however, many parties presented evidence that a sum of this size was not reasonable under current circumstances. The Commission has reduced the contingency amount, in part because it has been able to improve the reliability of Postal Service projections through the incorporation of more recent, up-to-date projections and actual cost data. The Commission lowered the contingency provision by \$.668 billion.

Another focus of concern was the high rate increases that would fall on mail sent by nonprofit organizations. These increases largely resulted from a statutory formula imposed in 1993. Efforts to amend this law were successfully completed with the signing by the President of new legislation on October 27, 2000. As a result of this legislation, the Commission applied a new formula to calculate rates for so-called preferred mail, reducing the increases that these mailers must pay. These differences are identified with an asterisk on the preceding table showing Average Percent Rate Changes.

The Commission believes that several issues raised during the case warrant Postal Service attention in the months ahead. The accuracy of the Service's data reporting systems is a major source of concern. Two subsystems of the Revenue, Pieces and Weight system produced markedly different Parcel Post volume estimates for the base year of this proceeding. In addition, data collection errors in the In-Office Cost System forced the Postal Service to substantially revise the costs of Media Mail (formerly the book rate). The Commission worries that these errors due to problems other than statistical variation in the basic data collection systems might not be isolated events. The Governors are urged to launch a study of "nonsample" error in the Service's data systems to complement the recent, joint (USPS/GAO/PRC) Data Quality Study that focused on potential sources of statistical error.

The Office of the Consumer Advocate suggested a number of ways to ease the inconvenience and expense associated with frequent adjustments of the rate used for sending correspondence and bill payments. These ideas merit consideration from postal management and consumer groups interested in exploring ways to make the nation's mails more attractive for business and personal correspondence.

Another continuing area of concern is service quality. The Commission heard evidence on poor or uneven quality of service and confusing or misleading advertising for Priority Mail, Express Mail, Certified Mail and Return Receipt Service. These problems affect the value of these services, and the Commission encourages the Service to take appropriate action.

Finally, the Commission notes that the Service provided the basic update along with extensive supporting explanatory materials in a timely fashion; participated in a joint USPS-Periodicals Industry Operations Review Team, and reduced its projected costs to reflect that group's findings; and devised a resolution to a rate eligibility problem raised during the case by In-County Periodicals. The Commission commends the Postal Service for its diligence and cooperative efforts during the course of this case.

I. INTRODUCTION

[1001] On January 12, 2000 the United States Postal Service submitted its request for a recommended decision on changes in rates and fees, and for certain mail classification changes.¹ The Request was docketed as R2000-1, and noticed in Order No. 1279. The Commission heard the case *en banc*, with Chairman Edward J. Gleiman serving as presiding officer. The 78 participants sponsored 178 pieces of testimony from 120 witnesses that was received during 40 days of hearings.

[1002] The Postal Service supports its Request with testimony that projects its costs forward from fiscal year 1998 (base year), and estimates that at existing rates, it will suffer an operating loss in fiscal year 2001 (test year) of \$1.719 billion. It requests rates that will allow it to generate \$2.788 billion additional revenues, of which \$0.268 billion will go to offsetting 1/9 of its accumulated prior years losses, \$1.680 billion will be used as a contingency against unforeseen events/costs.

[1003] During this case, the Commission issued four Notices of Inquiry, asking any interested party to comment or provide evidence on a specific issue, and 21 Presiding Officer Information Requests asking a particular participant (most frequently the Postal Service) to provide explanations or analyses to clarify its evidence. In several instances the Commission went further, and it issued five orders that resulted in the Postal Service providing evidence on a specific topic.

[1004] Order No. 1289, Requesting the Submission of Evidence on Periodicals Processing Costs, was issued March 28, 2000. This order presented analyses developed from information provided in response to a Presiding Officer's Information Request showing that the costs of processing Periodicals mail, even after adjusting for inflation, had been steadily rising since 1993, and that the cost of processing flat shaped

¹ Request of the United States Postal Service for Changes in Rates of Postage and Fees for Postal Services (Request).

pieces sharply rose in base year 1998. The order directed the Postal Service to provide evidence explaining these phenomena. Witnesses O'Tormey and Unger presented testimony on these topics.

[1005] Order No. 1291, Directing Witnesses to be Prepared to Answer Questions, was issued on April 6, 2000. It directed Postal Service witnesses who would be appearing to present the Service's direct case the following week to be prepared to respond to questions concerning the impact on test year results of eBillPay, a major new service initiative not mentioned in the Service's Request, that was launched by the Postal Service April 5, 2000. During hearings, witness Tayman responded to questions on this subject.

[1006] On May 26, 2000 Order No. 1294 on the Use of FY 1999 Data was issued. This order followed two notices of inquiry. It directed the Service to present through testimony and exhibits a "basic update" to its test year forecasts that incorporated actual, audited FY 1999 Cost and Revenue Analysis (CRA) data into the cost projection process. The Postal Service complied with this order submitting testimony from witnesses Patelunas, Kay, and Thress. The ramifications of this order have been somewhat controversial, and its justification and impact are discussed in more detail shortly, beginning at para. 1009.

[1007] Order No. 1299, Resolving Procedural Issues Arising from Notice of Inquiry No. 3, was issued July 31, 2000. That notice of inquiry had requested testimony or comments on the proper methodology for projecting revenue from First-Class Mail weighing more than one ounce. The presiding officer certified to the full Commission arguments offered opposing the admission of responsive testimony, and Order No. 1299 denied those objections. As a result, testimony on this topic from Postal Service witness Fronk and OCA witness Callow is part of the evidentiary record in this case.

[1008] Finally, Order No. 1300, Requesting the Designation of a Witness to Discuss an Institutional Response, was issued August 18, 2000. The Postal Service had undertaken to provide written responses to questions concerning the causes of the increased cost of processing Standard B Special Mail between FY 1998 and FY 1999.

The questions were initially posed to witness Patelunas, who had been unable to answer while on the witness stand. Following a practice allowed by the Commission, the Service submitted an “institutional” response; that is, a statement from the institution, rather than from a witness already under oath and available to respond to further clarifying questions. In this instance, further clarification was needed, and the Service was directed to identify a witness that could sponsor the written responses and answer additional questions on the subject. The Postal Service then undertook a further review of this issue, and provided additional testimony from witness Degen on this topic.

[1009] *The use of actual FY 1999 cost data.* The most significant procedural issue in this case involves the use of updated cost information. The Commission Rules require Postal Service rate requests to provide projections based on “the total actual accrued costs during the most recent fiscal year for which they are reasonably available.” Rule 54(f)(1). FY 1999 had been over for almost four months when the Request was filed, and a significant amount of 1999 data was available. Nevertheless, consistent with Rule 54(c)(1), Postal Service estimates of test year costs were based on the costs incurred in fiscal year (FY) 1998, since its final audited 1999 CRA costs had not yet been issued.

[1010] The Commission has a long-standing practice of updating to capture known and certain changes that have a significant impact on test year results. Therefore, at the earliest stage of this case, even before the initial prehearing conference, the Commission focused attention on the potential problems of developing rates based on FY 1998 costs; costs representing a period ending some sixteen months before the Request was filed. Notice of Inquiry No. 1 Concerning Base Year Data, issued February 2, 2000 described these problems and announced that participants should be prepared to discuss this issue at the prehearing conference scheduled for February 16, 2000. Written comments could be submitted one week later, on February 23, 2000. The notice suggested that participants focus on the potential obsolescence of the FY 1998 data, especially in light of the implementation in FY 1999 of the new rates and classifications established in Docket No. R97-1. At the same time, it cautioned participants to bear in mind that

substituting actual FY 1999 results for the Service's estimates would be a complex, large scale undertaking.

[1011] The general tenor of both the oral and written comments provided in response to Notice of Inquiry No. 1 was that theoretically it would be preferable to estimate test year costs using actual FY 1999 CRA costs, rather than the estimates of FY 1999 costs based on projections from FY 1998 results used by the Service. However, many of those commenting suggested that it would be wise to wait until the actual results were published so that potential disruption could be balanced against the likelihood of improved results.

[1012] On April 4, 2000, the Postal Service filed its FY 1999 CRA Report and the supporting Cost Segments and Components Report as USPS-LR-I-275 and 276.² The Commission promptly issued Notice of Inquiry No. 2 Concerning Base Year Data which provided participants with comparisons of these actual FY 1999 costs with the originally filed estimates of FY 1999 costs based on FY 1998 data. Notice of Inquiry No. 2 again asked participants to comment on the appropriate use of the actual FY 1999 cost data.

[1013] In Order No. 1294 the Commission reviewed both its own obligations under the law, and participants' comments in response to Notice of Inquiry No. 2. It then determined that at least to some degree, it should use actual FY 1999 CRA results in developing this Opinion and Recommended Decision.

[1014] The Commission identified its two primary obligations: To identify and analyze the most reliable evidence so that it could accurately estimate the Postal Service's revenue needs and develop the most fair rates to generate those revenues; and to provide all interested persons the opportunity to fully and fairly participate in the ratemaking process. No participant argued that the Postal Service's initial filing should be adopted with no use of actual 1999 cost data. All of the participants' comments espoused the use of actual FY 1999 CRA data to one degree or another, and only two,

² Supporting workpapers A and B were filed April 5, 2000, as USPS-LR--I-277 and 278. Most FY 1999 billing determinants had been submitted on March 31, 2000, as USPS-LR-I-259, and the remaining billing determinants, for Express Mail and parcel post, were filed on April 19, 2000.

the Coalition of Religious Press Associations and United Parcel Service, suggested that FY 1999 should be substituted as the base year for all analyses in the case.

[1015] The Commission noted that all of the participants responding to the notice of inquiry had recognized that actual costs are a more accurate representation of FY 1999 experience than estimates developed by rolling forward FY 1998 costs. It agreed that its decision would be improved to the extent it could use actual FY 1999 CRA cost results. It also agreed with the majority of those responding that it might not be feasible to completely revise the Postal Service request and other participant's evidence to make FY 1999 the base year for all estimates. It determined that the minimum appropriate improvement would be achieved by what has been called the "basic update" under which actual FY 1999 costs would be substituted for the estimates of FY 1999 presented by Postal Service witnesses Kashani and Tayman. The Service was directed to rollforward actual FY 1999 costs to the test year. In doing so, the Service was encouraged to update such other portions of its request as it choose. Order No. 1294, at 3-5.

[1016] The Commission directed the presiding officer to establish a revised procedural schedule that would allow the Postal Service six weeks to perform the basic update. The revised schedule provided for technical conferences and discovery on the basic update, and also afforded all participants, including the Postal Service, time to develop and present other changes to reflect actual FY 1999 results. P.O. Ruling R2000-1/71 at 1-2.

[1017] The Postal Service submitted a request for reconsideration of Order No. 1294 that restated two concerns it had raised in its responses to Notice of Inquiry No. 2. The Service contended that it would be unable to develop "a complete replacement of the base year and a subsequent roll-forward to produce new test year estimates." U.S. Postal Service Motion for Reconsideration of Order No. 1294 (June 2, 2000) at 6. The Commission had acknowledged that concern by demurring from establishing a new base year. The Service also predicted that it would not be able to provide the requested basic update using information on FY 99 costs, or refinements in its rollforward format, in the

time allotted. Furthermore, it characterized the practical effect of Order No. 1294 as nullifying much of its direct case and thereby denying it due process.

[1018] The Commission did not act on this request. If the production of actual FY 99 cost data in usable formats, the so-called basic update, had proved to be an insuperable task, and the schedule established in P. O. Ruling R2000-1/71 could not reasonably be adjusted to accommodate the needs of participants, then the concerns expressed by the Service would have been realized, and additional action would have been necessary.

[1019] To its credit, the Postal Service successfully responded to Order No. 1294. At the end of the six weeks allotted to prepare the basic update that would substitute actual FY 1999 CRA costs for the estimates used in its Request, it reported:³

As suggested, the Postal Service has been able to incorporate actual FY 1999 CRA and accounting data (“the basic update”), as well as to incorporate updates for as many other factors as practicable in the time available. These factors include inflation in labor and benefit expenses and non-personnel costs; changes in workers compensation costs, breakthrough productivity, Periodicals initiatives, e-commerce revenue and expenses, reductions in advertising expenses, and increases in expedited supplies.

[1020] In the following weeks, the Service provided appropriate supporting documentation for this update, made its witnesses available for technical conferences, and responded to written discovery. The Commission expresses its appreciation for the Postal Service’s ability both to complete the update, and to provide voluminous materials, under very tight deadlines, in response to questions from participants and the Commission. *See* Postal Service Brief at I-7, fn. 11. As a result, the Commission has been able to improve its test year projections by using actual FY 1999 cost data.

³ Notice of United States Postal Service of Filing of Supplemental Testimony in Response to Order No. 1294, July 7, 2000, at 1.

[1021] On brief, the Service again suggests that the use of actual FY 99 costs in preference to estimates of those costs based on FY 98 operating results would be a denial of its due process rights. *Id.* at I-13. This is an extremely important allegation. The Commission views providing due process to all participants as an absolute obligation, see § 3624, and the Postal Service's views on this issue are particularly important as it may be called upon to defend the Governors' acceptance of Commission recommendations in court. Therefore, the Service's contention has been thoroughly considered.

[1022] To correctly evaluate the Service's charge, it is important to understand what is, and what is not, involved in substituting actual FY 99 costs for estimates of those costs based on FY 98 operating results in the context of an omnibus rate case.

- To estimate the Postal Service's needs in a future test year, the Commission compares projected costs with projected revenues. This involves three types of actual data.
- Estimates of volumes in the test year are made using econometric models that forecast changes to actual volumes in a recent year. Those volume estimates are used to estimate costs and revenues.
- The actual costs in a recent year are "rolled forward" through each intermediate year to the test year, incorporating the annual effect of numerous change factors such as the estimated volumes, projected wage rates and other expenses, and the impact of planned management initiatives.
- Revenues are developed by applying actual billing determinants in a recent year to estimated volumes. Billing determinants are the distribution of volume to rate cells within each subclass.

[1023] From this it can be seen that changing the "actual costs in a recent year" that are rolled forward will almost certainly have an important impact. Notwithstanding that, it is only one of the many factors that goes into projecting Postal Service test year results. The Commission knew that it was making a major adjustment, and it did so only after carefully weighing whether the change was necessary to provide a recommended decision that would be accurate and fair to all those affected by changes in postal rates.

[1024] To project accurate results, the data that are rolled forward into the test year should, to the extent possible, reflect current operations. More importantly, they should

reflect existing rates and classifications. Rate and classification changes often lead to substantially altered relative shares of volumes, costs, and billing determinants in the mailstream, causing projections based on outdated historical results to be inaccurate. For example, a new discount that attracts a substantial volume of (relatively heavy, and therefore relatively expensive) parcel mail may significantly change both costs and billing determinants. Therefore, it is particularly important that when costs and volumes data from different years are used together, that a single set of rates and classifications be in place during both years, since volumes, costs and billing determinants all change to different degrees when rates and classifications are varied.

[1025] In an ideal world, test year projections in a rate case would reflect actual volumes, costs, and billing determinants from a single recent year, a year in which existing rates and classifications were in effect. A superficial reading of the Postal Service Brief might leave the impression that its initial filing in this case incorporates unified projections from such a consistent, reliable base. In fact, that is not the case.

[1026] The Postal Service Request submitted to the Commission in January is supported by projections of costs based primarily on cost data from FY 1998. However its volume projections are based on FY 1999 data. And finally, the Postal Service uses billing determinants taken from a hybrid year that includes two quarters of actual data from FY 1999, and two quarters of adjusted data from FY 1998.

[1027] This recitation should not be interpreted as criticism. The Service presented projections based on what it viewed as the best available data when it prepared its Request. Many Postal Service witnesses attempted to adjust the data to incorporate FY 1999 results into their presentations. *See, for example*, Tr. 12/4806 (Fronk) "I then needed to make adjustments to these 1998 estimates to account for the increase in the First-Class Mail maximum weight limit from 11 to 13 ounces that took place on January 10, 1999." *See also*, Tr. 2/395 (Tayman):

I utilized the latest data available to the extent that it made a material difference to the estimates and could be incorporated without compromising the filing date.

In particular, I used actual FY 99 volume and revenue, the November 1999 DRI forecast (which resulted in actual FY 99 inflation factors and COLA unit costs calculations), and actual FY 99 health benefit premium changes. This approach yielded an FY 99 estimate of expenses which was only \$8 million different than actual expenses.

I was unable to incorporate actual FY 99 expense data because it was not available in time to update the required models, testimony, and Library References.

[1028] While updating to reflect actual FY 1999 operating results might well have been justified absent extraordinary circumstances, updating was particularly appropriate in this case as the FY 1998 CRA cost data used by the Service was of seriously reduced validity as a base for projections because of one immutable fact. In January 1999, some 3½ months after the conclusion of FY 1998, and 3½ months into FY 1999, the Postal Service implemented sweeping, disproportionate changes in the rates for all classes of mail, as well as several important classification changes.

[1029] Thus, the Postal Service Request is premised on projections of costs incurred in FY 1998 that reflect expenses for processing, transporting and delivering the mix of mail volumes experienced before rates changed. Its volumes are projected from FY 1999, during which the new, generally higher rates were in effect for almost ¾ of the year. The billing determinants used by the Service include ½ year of data during which the new rates were in effect, and ½ year of data from the previous year adjusted in an attempt to reflect the new rates and classifications.

[1030] The current postal rate structure includes numerous rate categories within each subclass designed to pass through cost differences calculated by reference to CRA data. The FY 1998 CRA cost data used in the Service's Request did not reflect the impact of the new rates and classifications. The Commission knew that the FY 1999 cost data would become available at an early stage in the case, and it had to evaluate whether due process permits, or perhaps even requires, that the cost projections initially offered by the Service be adjusted to reflect this more recent, applicable data. *See, for example*, UPS Brief at 13. The Commission issued two Notices of Inquiry seeking comments from the participants on this question, the first at the earliest stage of

proceedings, and the second after the FY 1999 data had been published. As might have been expected, the unit costs actually experienced in FY 1999 by a number of subclasses of mail varied by meaningful amounts from those projected by the Postal Service using FY 1998 cost data.

[1031] Order No. 1294 considered the participants' advice on this question, and concluded that the Commission decision would be improved if actual FY 1999 CRA costs by class and subclass could be substituted for the estimates of 1999 costs included in the Postal Service Request, and rolled forward to the test year. It further held that the Postal Service, or any other participant, should be allowed to offer such additional updates as they deemed appropriate. As noted above, the Postal Service timely filed testimony and supporting library references providing test year cost projections using actual FY 1999 CRA costs.

[1032] The Postal Service suggests throughout its initial brief that it had to replace the base year for its request, and that it could not complete this task. This overstates the situation. Order No. 1294, at 4, specifically did not require that the Service revise its entire case.

[1033] The Service used the same roll-forward methodology that it used in its initial filing to develop FY 1999-based test year costs. Tr. 35/16772 (Patelunas). FY 1999 volumes were already used in the Postal Service request, and the Service filed testimony from witness Thress explaining why additional volume updates could be counter-productive. As a result, no updating of volume data was required. The Service also was relieved of any obligation to provide adjusted FY 1999 billing determinants since it had already filed billing determinants for a hybrid year ($\frac{1}{2}$ of 1999 and $\frac{1}{2}$ of 2000) during which the January 1999 rate changes were in effect.⁴

[1034] Order No. 1294 gave the Postal Service the opportunity to incorporate such other updates as it believed would more accurately predict test year results. In

⁴ See P O Ruling R2000-1/110, granting Motion of the United States Postal Service for Clarification or Reconsideration of Presiding Officer's Information Request No. 18. MPA witness Cohen provided supplemental testimony that calculated presortation-related cost differences using adjusted 1999 billing determinants for Periodicals that the Commission utilizes in projecting test year revenues for Periodicals.

response, the Postal Service presented testimony suggesting a number of updates to its initial revenue requirement estimates. Some of these changes reduce test year costs while others increase them. In total, the Service has offered testimony indicating that its test year before rates deficit will be more than \$450 million higher than it initially forecast. The Commission has evaluated the testimony justifying each new revenue and expense item, just as it evaluates all the other testimony presented in the case. The vast majority of these changes appear valid, and have been included in the Commission's projections of test year results.⁵

[1035] The Service suggests that there are other aspects of its original filing that it would have liked to revisit, and that it might have discovered other appropriate changes. Postal Service Brief at I-11. It then contends that because it did not have sufficient time or resources to review every conceivable change, the Commission should ignore both the actual FY 1999 cost data, and most of the other cost updates the Service has proposed. This argument is not persuasive. It is always true that in the limited time allowed to conduct postal rate cases there will be issues that could not be completely explored. However as a general rule, those corrections that can be made, should be made. Furthermore, the Service's initial filing included errors, many of which were corrected in the revised test year cost estimates. *See, for example*, Tr. 35/16794.

[1036] It is accepted practice for the Commission to incorporate known events that significantly effect test year projections. Actual FY 1999 cost data and most of the other revisions suggested by the Service and other participants fit this description.

[1037] The Postal Service argues that updating cost projections to reflect actual FY 1999 results eliminates the foundation for its integrated Request, and virtually

⁵ The Commission was particularly concerned about one adjusted expense item, an increase in test year labor expenses developed by assuming increased wage rates resulting from a yet-to-be negotiated labor contract. During hearings, the sponsoring Postal Service witness could not confirm that upper management had authorized that apparent wage policy shift. On August 9, 2000, the Commission wrote to the Postmaster General asking for verification that the testimony was consistent with Postal Service policy. An answer was provided by Richard Strasser, Acting Chief Financial Officer, on September 1, 2000, and the Commission has accepted this projection of increased test year costs. Copies of this correspondence appear in Appendix L.

nullifies its specific rate proposals. This simply is not the case. A review of Chapter V of this Opinion will show that the Service's proposals are the main focus of the Commission's analysis.

[1038] Omnibus rate cases normally include a number of participant challenges to the Service's cost attribution and allocation methodologies, and when one or more of these challenges are successful the estimates of attributable costs by subclass relied on by Postal Service rate design witnesses may become obsolete. The substitution of actual FY 1999 costs for the estimates initially provided by the Service is only one of several adjustments the Commission is making to the initial Postal Service filing in this case. Several proposals to change existing cost attribution and distribution methods advanced by Postal Service witnesses have been rejected in whole or in part. Nonetheless, the rate testimony sponsored by the Service is understood as being part of an integrated presentation, and it remains both relevant and material even when underlying premises change. For example, the policy reasons for limiting the size of rate increases within specific subclasses remain probative even when the levels of costs attributable to those subclasses are adjusted. As in every past omnibus rate case, all of the enunciated considerations that led to specific Postal Service rate proposals remain before the Commission, and have been carefully evaluated. This practice does not violate the due process rights of the Postal Service.

[1039] The Postal Service is entitled to file a rate request whenever it chooses, and it is entitled to a prompt response to every request for rate changes that it files. Section 3624 allows the Commission 10 months to act on such a request. The broad concept of due process includes attention to producing an accurate and timely decision, as well as to allowing a full and fair opportunity to examine the reliability of opposing evidence. In this case, the substitution of actual FY 1999 costs for estimates based on historical data has improved test year cost projections. The substitution was accomplished using the rollforward and cost allocation methods that were tested as part of the Service's initial filing. All participants had the opportunity to revise their presentations to incorporate or challenge these data, and many did so. It would be unreasonable to ignore this

supplemental testimony. Some subclasses and rate categories receive smaller increases as a result of this change, while others face larger increases; however, because the recommended rates reflect actual, recent Postal Service operating experience, they are more equitable than recommendations that ignore those facts.