

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

FIRST-CLASS MAIL PACKAGE SERVICE (FCPS)  
SERVICE STANDARD CHANGES, 2021

Docket No. N2021-2

**NOTICE OF DESIGNATED MATERIALS, AND NOTICE OF FILING OF  
DECLARATION ATTESTING TO THE PROPOSED RECORD MATERIAL,  
FOR UNITED STATES POSTAL SERVICE WITNESS KIM**  
(August 10, 2021)

Pursuant to the Presiding Officer's Ruling No. N2021-2/3 (July 26, 2021) and N2021-2/6 (August 6, 2021), the United States Postal Service hereby provides this notice of designated materials, and this notice of the filing of a declaration attesting to the proposed record material for Postal Service witness Kim. Pursuant to the rulings, attached to this notice are: (i) a declaration of witness Kim supporting the authenticity of her testimony and designated responses to interrogatories and Presiding Officer Information Requests, including the library references accompanying her testimony and responses; (ii) the direct testimony of witness Kim, including replacement copies of the pages revised on July 2, 2021; (iii) a list of library references sponsored by witness Kim; and (iv) the designated responses of witness Kim in alphabetical order by party name and by numerical order of request. There are no additional corrections to the attached documents beyond those already filed as errata and incorporated into the attached direct testimony and designated

responses.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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August 10, 2021

**POSTAL REGULATORY COMMISSION  
DOCKET NO. N2021-2  
DECLARATION OF MICHELLE KIM**

I, Michelle M. Kim, hereby declare, under penalty of perjury, that:

The Direct Testimony of Michelle Kim on Behalf of the United States Postal Service, USPS-T-2, was prepared by me or under my direction, and is true and correct to the best of my information, knowledge, and belief;

I am sponsoring Library References USPS-LR-N2021-2-1, USPS-LR-N2021-2-NP1, and USPS-LR-N2021-2-NP11;

The attached responses to interrogatories and Presiding Officer Information Requests, which were filed with my authorization and which have been designated for inclusion in the record in this docket, were prepared by me or under my direction; and

If I were to respond to these interrogatories and Presiding Officer Information Requests orally today, the responses would be the same.

/s/ Michelle M Kim  
Michelle M. Kim

DATE: August 10, 2021

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

FIRST-CLASS PACKAGE SERVICE (FCPS) SERVICE  
STANDARD CHANGES, 2021

Docket No. N2021-2

**DIRECT TESTIMONY OF MICHELLE KIM**  
**ON BEHALF OF THE**  
**UNITED STATES POSTAL SERVICE**  
**(USPS-T-2)**

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1 **AUTOBIOGRAPHICAL SKETCH**

2 My name is Michelle Kim. I am the Director, Cost Systems and Analysis  
3 for the United States Postal Service, reporting to the Vice President, Pricing and  
4 Costing. I have held this position since May 2021. My office is responsible for the  
5 design, development, operation, and enhancement of the ongoing national  
6 statistical sampling systems for distributing costs to products, including the In-  
7 Office Cost System (IOCS), City Carrier Cost System (CCCS), Rural Carrier Cost  
8 System (RCCS), and Transportation Cost System (TRACS).

9 In my prior role as the Manager, Cost Studies and Support my department  
10 was responsible for developing and updating cost models and studies used to  
11 demonstrate compliance with regulatory requirements regarding cost coverage  
12 and workshare arrangements. This includes models filed in the Annual  
13 Compliance Report regarding mail processing, transportation, and delivery. I  
14 have been employed by the Postal Service since 2013.

15 I have spent all of my career in Regulatory Reporting and Cost Analysis  
16 functions at headquarters. I began my career as an analyst in the Statistical  
17 Programs department where I supported postal data collection activities and  
18 developed an understanding of field operations. I have served as the TRACS  
19 team lead, held a temporary assignment as the Program Manager, RPW  
20 Reporting, and have led costing efforts for domestic Negotiated Service  
21 Agreements. I have supported numerous efforts to improve costing  
22 methodologies through petitions to change analytical principals used in periodic  
23 reporting with the Commission on a variety of topics.

1 I graduated with distinction from the University of Virginia with a Bachelor  
2 of Arts degree in Mathematics and was awarded Phi Beta Kappa for scholarly  
3 attainment in the liberal arts and sciences. In 2018 I graduated with a Masters of  
4 Information and Data Science from the University of California, Berkeley.  
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**PURPOSE OF TESTIMONY**

The purpose of my testimony is to describe the methodology that the Postal Service has used to estimate the expected cost savings resulting from the proposed changes in service standards. I will also present the overall estimated change in cost and the additional cost impact of some potential future savings opportunities.

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**ASSOCIATED LIBRARY REFERENCES**

I am sponsoring the following Library References, which are associated

with this testimony:

USPS-LR-N2021-2-1      Calculating Transportation Cost Changes (Public Version)

USPS-LR-N2021-2-NP1      Calculating Transportation Cost Changes (Non-Public Version)

1 **I. ESTIMATED COST SAVINGS FROM SERVICE CHANGE**

2 **A. Methodology for Estimating the Annual Cost Changes Caused**  
3 **by a Change in Service Standards**

4 The purpose of this section is to describe the methodology used to  
5 estimate the potential annual cost savings from the proposed change in First-  
6 Class Package Service (FCPS) service standards. Cost savings are expected in  
7 response to changes in the transportation network, described in witness  
8 Hagenstein’s testimony (USPS-T-1). In particular, both the air and highway  
9 required capacity will be reduced overall. In the highway network, this initiative  
10 will cause an increase in required capacity on Inter-Area contracts, but a  
11 decrease in required capacity within Inter-Cluster and Inter-P&DC contracts.<sup>1</sup>  
12 These changes in network capacity will cause a resulting change in the costs  
13 incurred to operate those networks.

14 Fortunately, the relationship between capacity and cost has been studied  
15 many times in the past several decades, and models describing this relationship  
16 have been approved by the Commission for use in regulatory costing.<sup>2</sup> The

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<sup>1</sup> Inter-Area, Inter-Cluster, and Inter-P&DC are types of accounts within the Inter-SCF cost pool for highway transportation. These accounts are defined as follows:

Inter-Area accounts are used to record the expense for the transportation of mail between a postal facility (except a Network Distribution Center (NDC)) in one postal area and a postal facility (except a NDC) in a different area.

Inter-Cluster accounts are used to record the expense for the transportation of mail between a postal facility in one district and a postal facility in a different district, when both postal facilities are within the same postal area and neither are NDCs (not Inter-NDC).

Inter-P&DC accounts are used to record the expense for the transportation of mail between two postal processing and distribution plants (neither an NDC) within the service area of a postal district within a postal area.

<sup>2</sup> See, e.g., Order No. 2180, Order on Analytical Principles Used in Periodic Reporting (Proposals Three Through Eight), PRC Docket No. RM2014-6 (Sept. 10, 2014), at 15; Direct Testimony of Michael D. Bradley on Behalf of United States Postal Service (USPS-T-18), PRC Docket No.

1 models were litigated in public and transparent proceedings, during which  
2 interested parties were welcome to participate, question, and make suggestions  
3 regarding the appropriate methodology. This analysis will rely on those  
4 established models, which provide a sound economic basis for estimating the  
5 expected changes in cost.

6         Additionally, this cost savings analysis will hold constant the volume of  
7 mail being transported in order to avoid any confounding effects of introducing  
8 volume reductions in addition to operational changes. This aligns with how  
9 similar analysis has been conducted in past proceedings.<sup>3</sup> An assessment of the  
10 potential impact on volume is included in witness Foti's testimony (USPS-T-3).

11         Finally, cost savings will be calculated based on changes in capacity for  
12 both First-Class Mail (FCM) and FCPS combined. The resulting savings will be  
13 compared to the revised FCM-only savings originally calculated in Witness  
14 Whiteman's testimony in Docket No. N2021-1, USPS-T-2, to isolate the  
15 additional savings potential resulting from the proposed FCPS change being  
16 implemented in addition to the proposed FCM change.

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R2000-1 (Jan. 12, 2000), at 1-13 (recounting history of the methodology from before Docket No. R80-1 to Docket No. R97-1).

<sup>3</sup> See Direct Testimony of Michael D. Bradley on Behalf of the United States Postal Service (USPS-T-10), PRC Docket No. N2012-1 (Dec. 5, 2011), at 2.

1           **B.     Cost Changes Arising from the Change in Service Standards**

2                   **1.     Cost Changes Resulting from Changes in Air Capacity**

3           For air transportation, due to the nature of the contracts, the cost is  
4 generally 100 percent volume variable.<sup>4</sup> In other words, if the required capacity  
5 increases by 10 percent, the cost would also increase by 10 percent. The Postal  
6 Service projects a reduction of 61.2 percent of First-Class Mail (FCM) pounds  
7 flown and a corresponding percentage reduction in FCPS pounds flown.<sup>5</sup> These  
8 reductions will be spread across multiple carriers, including commercial air and  
9 network carriers. Mail flown on each carrier incurs a different cost per pound (or  
10 cost per cubic foot) flown. The calculation of the change in capacity per carrier is  
11 calculated in a three-step process.

12           First, the current pounds flown of FCM and FCPS on each carrier are  
13 identified. These data are available from the Transportation Cost System  
14 (TRACS). Second, the reduction in pounds of FCM and FCPS flown on each  
15 carrier is calculated by multiplying the current pounds flown by the percent  
16 reduction. Third, the reduction in total units (pounds or cubic feet) flown is  
17 compared to total units flown on the network (i.e., the total capacity) in order to  
18 calculate the percent reduction in network capacity overall for each carrier.  
19 Additional details regarding this calculation are provided in the preface to Library  
20 Reference USPS-LR-N2021-2-NP1.

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<sup>4</sup> Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2019 (July 1, 2020), "CS14-19.docx", at 14-3.

<sup>5</sup> The projected percentage reductions in pounds flown (including an exact figure for the corresponding reduction in FCPS pounds) are obtained from USPS-LR-N2021-2 -NP2, sponsored by witness Hagenstein.

1           Having calculated the percent reduction in air capacity for each carrier,  
2 calculating the resulting change in cost is straightforward. As stated above, air  
3 transportation costs are, for the most part, fully volume variable.<sup>6</sup> This means that  
4 as capacity requirements change, costs change proportionally. Thus, for each  
5 carrier, the percent capacity reduction calculated above is multiplied by the total  
6 cost in order to calculate the cost savings that will result from this change in  
7 capacity.

8           Lastly, witness Hagenstein projects a range of possible percent capacity  
9 reductions in charters. This percent reduction is multiplied by the charter cost in  
10 order to calculate the expected savings from charters. Charters were used in FY  
11 2020 to mitigate the lack of commercial air capacity availability during the  
12 COVID-19 pandemic. However, as witness Hagenstein describes, given the  
13 continued high levels of network package volumes, even with commercial air at  
14 full capacity, absent the proposed changes in service standards, charters would  
15 continue to be required to handle this package volume.

16           A cost savings of \$304 million is expected as a result of the projected  
17 reduction in air capacity across all carriers. An additional \$15 to \$98 million is  
18 possible as a result of reducing reliance on higher-cost charters. Supporting  
19 workbooks containing the calculations described in this section are filed in Library

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<sup>6</sup> Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2019 (July 1, 2020), "CS14-19.docx", at 14-3. The exception – payments to FedEx and UPS for failure to meet minimum volume commitments – is treated as an institutional cost and accounts for only a 0.4-percentage point diminution in what is otherwise a 100-percent volume-variability ratio. *Id.* at 14-2, 14-3. Moreover, there is sufficient lead time until implementation to adjust the network appropriately and meet new planned minimums.

1 Reference USPS-LR-N2021-2-NP1, Calculating Transportation Cost Changes  
2 (Non-Public Version).<sup>7</sup>

3 **2. Cost Changes Resulting from Changes in Highway**  
4 **Capacity**

5 As FCM and FCPS shifts out of the air network and into the highway  
6 network, the highway network will experience an increase in required capacity to  
7 handle this additional volume. However, the change in service standards will also  
8 enable optimization of the network to transport the volumes more efficiently,  
9 which will offset this increase from handling the additional volume. Capacity on  
10 the highway network is generally measured in cubic foot-miles, and, unlike in the  
11 air network, when highway capacity changes, the associated costs change to a  
12 lesser degree.

13 This relationship between cost and capacity is called the cost-to-capacity  
14 variability, and it has been the subject of many proceedings before the  
15 Commission, most recently in Docket No. RM2014-6. In these proceedings, the  
16 Postal Service presented and the Commission approved econometric models to  
17 measure the cost-to-capacity variability. These models use data from the  
18 Transportation Contract Support System (TCSS) and consider route length,  
19 postal area, and the cost incurred for purchasing highway capacity.<sup>8</sup> The cost-to-  
20 capacity variabilities estimated by these models provide exactly the information

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<sup>7</sup> Corresponding public versions of the supporting workbooks are filed in Library Reference USPS-LR-N2021-2-1 with commercially sensitive data redacted.

<sup>8</sup> USPS-RM2014-6/1, Public Material Relating to Proposal Six (June 20, 2014), "Rpt.Updat.PHT.Cost.Cap.Variab.docx", at 12.

1 needed to assess the impact on costs from the changes in network capacity  
2 initiated by this service standard change.

3 The cost-to-capacity variability for long-haul highway transportation is  
4 estimated in these studies to be roughly 85 to 95 percent, depending on the  
5 exact contract type.<sup>9</sup> In other words, if highway capacity increases by 10 percent,  
6 the cost will only increase by 8.5 to 9.5 percent. This relationship can be  
7 described by the following equation:

$$8 \quad \% \Delta Cost_i = \varepsilon_i * \% \Delta Capacity_i,$$

9 where  $\varepsilon$  is the cost-to-capacity variability. Therefore, the total cost change  
10 resulting from the proposed network change can be calculated as:

$$11 \quad CostChange_i = \varepsilon_i * [\% \Delta CFM] * BaselineCost_i,$$

12 where  $i$  indicates the contract type, e.g., Inter-Area.

13 Capacity requirements will change for several contract types as a result of  
14 the proposed service standards. The methodology is the same for all contract  
15 types, as described above; however, for the purpose of simplicity, the following  
16 discussion will group the contract types based on whether they will experience a  
17 capacity increase or decrease.

18 The Inter-Cluster and Inter-P&DC contract types will experience a  
19 decrease in required capacity. The magnitude of the decrease was estimated by  
20 witness Hagenstein (USPS-T-1) and is included in the table below. The cost-to-  
21 capacity variabilities for each of these contract types was most recently

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<sup>9</sup> USPS-RM2014-6/1, Public Material Relating to Proposal Six (June 20, 2014),  
“Rpt.Updat.PHT.Cost.Cap.Variab.docx”, at 28, 31 (Tables 7 & 10).

1 estimated in Docket No. RM2014-6, and those variabilities are reproduced in  
2 Table 1 below. Multiplying the variability by the capacity change by the baseline  
3 cost provides the projected cost savings.

4 **Table 1: Highway Cost Changes**  
5 **for Contract Types with Expected Capacity Decreases**  
6

<b>Contract Type</b>	<b>Cost-to-Capacity Variability</b>	<b>Capacity Change</b>	<b>Baseline Cost</b>	<b>Projected Cost Savings</b>
Inter-Cluster	89.1%	-10.7%	\$249 million	\$24 million
Inter-P&DC	85.0%	-4.9%	\$174 million	\$7 million

7  
8 The total expected savings from decreases in network capacity across these  
9 contract types is \$31 million.

10 These savings will be offset by increases in network capacity in the Inter-  
11 Area contracts. Witness Hagenstein projects a capacity increase of 2.1 percent in  
12 this contract type. The most recently estimated capacity variability for Inter-Area  
13 transportation is 89.9 percent. The expected cost increase is calculated in the  
14 same manner described above, and since the capacity change is positive, rather  
15 than negative, the result is an increase in cost rather than a cost savings.

16 **Table 2: Highway Cost Changes**  
17 **for Contract Types with Expected Capacity Increases**  
18

<b>Contract Type</b>	<b>Cost-to-Capacity Variability</b>	<b>Capacity Change</b>	<b>Baseline Cost</b>	<b>Projected Cost Increase</b>
Inter-Area	89.9%	2.1%	\$1,091 million	\$21 million

19  
20 In total, an increase in network capacity in the Inter-Area contracts will lead to a  
21 cost increase of \$21 million. Combining this increase with the decrease in the

1 Inter-Cluster and Inter-P&DC accounts leads to a net decrease of \$10 million in  
 2 purchased highway transportation costs.

3 Finally, as described by witness Hagenstein, due to the proposed service  
 4 standard change, there may also be some potential to streamline the NDC  
 5 transportation network. Based on preliminary estimates, witness Hagenstein  
 6 projects a 14 to 28 percent reduction in capacity on the Inter-NDC network and a  
 7 6 to 8 percent reduction in capacity on the Intra-NDC network. If these  
 8 preliminary estimates prove valid once more robust modeling efforts are  
 9 completed, this optimization of the NDC network could result in an additional \$62  
 10 to \$116 million in savings.

11 **Table 3: Range of Potential Highway Cost Savings for NDC Network**  
 12

Contract Type	Cost-to-Capacity Variability	Capacity Change	Baseline Cost	Potential Cost Savings
Lower Range				
Inter-NDC	94.7%	14%	\$367 million	\$49 million
Intra-NDC	94.9%	6%	\$241 million	\$14 million
Upper Range				
Inter-NDC	94.7%	28%	\$367 million	\$97 million
Intra-NDC	94.9%	8%	\$241 million	\$18 million

13  
 14 **3. Net Impact on Purchased Transportation Cost**

15 In summary, the proposed change in service standards will lead to a  
 16 decrease in air capacity requirements and highway capacity requirements. The  
 17 resulting cost savings from the reduction in air capacity is \$304 million, while the  
 18 cost savings resulting from the highway capacity changes is \$10 million. In

1 combination, these changes lead to an overall net expected annual savings of  
2 \$314 million in purchased transportation.

3           However, as mentioned above, the savings calculated in this analysis are  
4 the result of a combined model of both FCM and FCPS service standard  
5 changes being implemented together. In order to isolate the additional savings  
6 anticipated as a result of the proposed FCPS change, this number should be  
7 compared to the cost savings anticipated by the FCM-only service standard  
8 change. The revised FCM-only savings is presented in USPS-LR-N2021-2-1 and  
9 is calculated as \$272 million. Therefore, implementation of the FCPS service  
10 standard change in addition to the FCM service standard change would lead to  
11 an additional savings of \$42 million. However, as described in witness  
12 Hagenstein's testimony, it should be noted that the analysis presented in this  
13 testimony cannot be viewed in isolation from that proposed change. The savings  
14 presented here would not be applicable if FCPS service standards were to  
15 change while FCM service standards remained at current levels.

16           Finally, witness Hagenstein describes two additional potential areas of  
17 opportunity for cost savings: reducing the use of higher-cost charters and  
18 streamlining the NDC network. Although these opportunities have not been fully  
19 modeled yet, preliminary estimates suggest that they may be worth \$15 to \$98  
20 million and \$62 to \$116 million, respectively, in additional savings.

## 21 **II. NET FINANCIAL IMPACT OF INITIATIVE**

22           In conclusion, the additional cost savings expected from this initiative,  
23 beyond the savings calculated for the FCM initiative described in Docket No.  
24 N2021-1, total \$42 million annually. Witness Foti (USPS-T-3) estimates that the

1 initiative will not lead to any loss in volume, so there will be no contribution loss  
2 offsetting these operational savings. Therefore, the overall net impact resulting  
3 from this initiative is estimated to be \$42 million, with the potential for an  
4 additional \$77 to \$214 million from future opportunities in reducing charters and  
5 streamlining the NDC network.

## **LIST OF LIBRARY REFERENCES FOR POSTAL SERVICE WITNESS KIM**

The following are the library references sponsored by Postal Service witness Kim:

### **Public:**

- USPS-LR-N2021-2-1, "Calculating Transportation Cost Changes"

### **Non-Public**

- USPS-LR-N2021-2-NP1, "Calculating Transportation Cost Changes"
- USPS-LR-N2021-2-NP11, "Nonpublic Material Provided by Witness Kim in Response to Presiding Officer's Information Request No. 4"

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 1**

6. Please see Attachment, filed under seal.

**RESPONSE:**

The question filed under seal seeks clarifications or definitions of several terms that appear as column or row labels in various tabs in the nonpublic spreadsheet submitted in USPS-LR-NP2021-2-NP1. Since, however, each of the terms listed appears in the corresponding tabs in both the public (USPS-LR-NP2021-2-1) and nonpublic versions (USPS-LR-NP2021-2-NP1) of the spreadsheet (even if the actual *values* in those columns and rows are in some instances redacted in the public version), it would appear appropriate to provide the requested clarification of the *concepts* behind these terms in a public response. The terms in question are those underlined below, and are followed by the requested clarification or definition.

**Tab “Highway”**

Inter-Cluster accounts are used to record the expense for the transportation of mail between a postal facility in one district and a postal facility in a different district, when both postal facilities are within the same postal area and neither are NDCs (not Inter-NDC). See USPS-T-2 at 1, n1.

Inter-Area accounts are used to record the expense for the transportation of mail between a postal facility (except an NDC) in one postal area and a postal facility (except an NDC) in a different area. See USPS-T-2 at 1, n1.

The Capacity Variability refers to the appropriate cost-to-capacity variability for each contract type, as estimated in Docket No. RM2014-6. See USPS-RM2014-6/1, Public

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 1**

Material Relating to Proposal Six (June 20, 2014), "Rpt.Updat.PHT.Cost.Cap. Variab.docx", at 28, 31 (Tables 7 & 10).

**Tab "Potential-Charter"**

Additional % Change Capacity Needs refers to the additional percent change in capacity requirements for charters, beyond what was already included for the reduction in charter capacity in conjunction with the overall reductions in air capacity.

**Tab "Potential-NDC Network"**

Capacity Change (Low) refers to the lower-end of the range of surface capacity reductions in the Intra- and Inter-NDC networks estimated by witness Hagenstein. See USPS-T-1 at 5.

Capacity Change (High) refers to the higher-end of the range of surface capacity reductions in the Intra- and Inter-NDC networks estimated by witness Hagenstein. See USPS-T-1 at 5.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 4**

21. Please confirm that the base year cost savings from shifting FCPS volumes from air to surface transportation include all charter flights occurring during the base year (FY 2020). If not confirmed, please explain.
- a. If confirmed, please explain the rationale for calculating cost savings using an outlier year as a base year. Additionally, please refer to USPS-T-2, at 4, lines 8-12. The Postal Service states "...witness Hagenstein projects a range of possible percent capacity reductions in charters. This percent reduction is multiplied by the charter cost in order to calculate the expected savings from charters. Charters were used in FY 2020 to mitigate the lack of commercial air capacity availability during the COVID-19 pandemic."
  - b. Please confirm that additional cost savings projected for the proposed changes from charter flights are added on to the base year amount. Please explain the discrepancy between charter flight costs in the base year and the additional savings projected.

**RESPONSE:**

Not confirmed. The baseline *costs* include all costs of charter flights occurring in FY 2020. However, as discussed in greater detail in the nonpublic version of this response filed under seal as part of USPS-LR-N20201-2-NP11, the *cost savings* from shifting FCPS volumes from air to surface only include a portion of the total charter flight costs. The reduction associated with this portion corresponds to the reduction in capacity on FedEx Day Turn, which is the cost pool that includes the charter flight costs.

- a. As described in my testimony USPS-T-2 at 4, lines 10-15:

Charters were used in FY 2020 to mitigate the lack of commercial air capacity availability during the COVID-19 pandemic. However, as witness Hagenstein describes, given the continued high levels of network package volumes, even with commercial air at full capacity, absent the proposed changes in service standards, charters would continue to be required to handle this package volume.

It was determined that although FY 2020 saw a higher use of charters as compared to prior fiscal years, it was still reasonable to use FY 2020 costs

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 4**

as the baseline. This is because charters would continue to be required to handle the higher level of network package volume. The average monthly charter cost for FY 2020 was \$20.5 million. Commercial Air capacity had largely returned to pre-pandemic levels by August 2020. The average monthly charter cost for the period of August 2020 through March 2021 was \$19.3 million. See USPS-LR-N2021-2-NP5. This suggests that although during the peak of the pandemic charter costs were substantially higher than previously experienced, using the FY 2020 costs as a whole is still reasonable to project anticipated savings for future years. The pre-pandemic lower charter costs, when averaged together with the peak-pandemic charter costs, represent a reasonable approximation of what the post-pandemic charter costs would be, in the absence of the proposed changes.

- b. Some savings on charter expenses are already included in the savings that are calculated as a result of witness Hagenstein's extensively modeled air capacity reduction. As discussed in greater detail in the nonpublic version of this response filed under seal as part of USPS-LR-N2021-2-NP11, charter costs are included in the total FedEx Day Turn expenses, off of which a percentage reduction is calculated. See USPS-LR-N2021-2-NP1, FCPS Transportation Savings-Nonpublic.Rev.7.2.2021.xlsx, tab "Air," cell E37. As more volume is expected to shift out of the air network, there will naturally be less demand for charters to supplement this network.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 4**

However, additional savings on charters are also expected, above and beyond this natural decrease of charter expenses in conjunction with other air network expenses. Witness Hagenstein projects a 14 to 48 percent reduction in total charter capacity as a result of this proposed initiative. In order to avoid double counting, the savings that are already included in the air savings as a result of the model are subtracted out from the additional projected savings in charter costs. As a result, instead of calculating the savings resulting from a 14 to 48 percent reduction in charter capacity, a smaller reduction is calculated. The resulting \$15 to \$98 million in charter savings is thus additional to the charter savings that are already included in the total air savings calculation.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM TO PRESIDING  
OFFICER'S INFORMATION REQUEST NO. 4**

**22.** Please see Attachment, filed under seal.

**RESPONSE:**

Please see the response filed under seal as part of USPS-LR-N2021-2-NP11.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 5**

5. Please refer to USPS-T-2 at 4. "A cost savings of \$304 million is expected as a result of the projected reduction in air capacity across all carriers. An additional \$15 to \$98 million is possible as a result of reducing reliance on higher-cost charters." Please explain the methodology and assumptions relied upon for the variance between \$15 to \$98 million. In your response, please include a public discussion of the pros and cons of using this methodology and these assumptions.

**RESPONSE:**

Charter costs are 100 percent volume variable, meaning that if volume or capacity increases by 10 percent, then the costs would also increase by 10 percent. Witness Hagenstein projected a 14 to 48 percent decrease in charter capacity. Therefore, given the 100 percent volume variability, this corresponds to a 14 to 48 percent decrease in charter costs. This is based on the established Commission methodology for attributing air transportation costs. See Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2019 (July 1, 2020), "CS14-19.docx", at 14-3. However, some charter cost savings were already accounted for in the overall air savings calculation based on witness Hagenstein's model. In order to avoid double counting those charter savings, those reductions were subtracted from the additional projected charter reductions. Witness Hagenstein discusses the underlying assumptions for the projected 14 to 48 percent reduction in charter capacity in his response to POIR 2, Question 12, part a.

## RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 5

6. Please refer to USPS-T-2 at 4 n.6. The Postal Service states that “payments to FedEx and UPS for failure to meet minimum volume commitments – is treated as an institutional cost.”
- a. Please elaborate on the terms and conditions that require the Postal Service to make payments to FedEx and UPS for failure to meet minimum volume commitments.
  - b. Please discuss the reasons why these payments are treated as an institutional cost.
  - c. Please provide the total annual payments to FedEx and UPS related to failures to meet volume commitments from FY2017 to FY2020 for each fiscal year.
  - d. Please discuss what impact, if any, the Postal Service expects the implementation of the proposal to have on its ability to meet minimum volume commitments to FedEx and UPS.

### RESPONSE:

- a. These contracts are indefinite delivery, indefinite quantity contracts with minimum volume commitments that apply to each operating period. The minimum commitments were agreed to in order to ensure that the suppliers would provide a consistent amount of lift capacity to meet our continuing needs throughout the term of the contract.  
  
As the response to question 6c below indicates, the payments made to our contract carriers for failure to meet minimum volume commitments are rare, as we typically exceed contract minimums. When the minimum capacity commitments are not achieved, the Postal Service pays the contract carrier the difference in price between the contract minimum and the achieved capacity over that operating period. The specific capacity commitments and advance planning periods differ by contract. Also, for FedEx, the Postal Service is required to provide a minimum average

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 5**

volume of mail, expressed in cubic feet, each operational day. Failure to achieve those minimums would be included in the amounts shown in the response to question 6c. However, in recent years, the Postal Service has not had difficulty tendering the prescribed minimum daily volume, so this portion of the amounts shown in response to question 6c is very small.

- b. The justification for treating these expenses as institutional costs is that they do not vary with volume changes. The same justification was provided when the institutional treatment of these expenses was first introduced in Docket No. R2005-1.<sup>1</sup> This methodological treatment was confirmed by Commission in Docket No. R2006-1 PRC-LR-4, PRC "B" Cost Segment Workpapers, workbook CS14, tab WS14.3. lines 57-59.<sup>2</sup>

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<sup>1</sup> See Docket No R2005-1, Response of the United States Postal Service to Presiding Officer's Information Request No 12, Q14 (August 18, 2005).

<sup>2</sup> Presumably, the Commission treated these costs as institutional in Docket No. R2005-1, PRC-LR-3, Base Year Costs, but those are costs are unavailable on the Commission webpage. However, further support that those expenses were treated as institutional is found in the Commission's display of test year costs by component in which domestic air costs were 99.87 attributable. See Docket No. R2005-1 Opinion and Recommended Decision, Appendix E, page 2, CS 14, Domestic Air.

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c. Payments for Failure to Meet Contract Minimums FY2017- FY2020

<b>Fiscal Year</b>	<b>UPS \$(000)</b>	<b>FEDEX DAY TURN \$(000)</b>	<b>TOTAL \$(000)</b>	<b>% of Transportation Expense</b>
FY 2017	\$ 314	\$ 6,500	\$ 6,814	0.09%
FY 2018	\$ 196	\$ -	\$ 196	0.00%
FY 2019	\$ 3,368	\$ 7,258	\$ 10,625	0.13%
FY 2020	\$ 1,080	\$ -	\$ 1,080	0.01%
<b>Total</b>	<b>\$ 4,958</b>	<b>\$ 13,758</b>	<b>\$ 18,716</b>	

d. The Postal Service does not anticipate that this proposal will result in additional costs for failure to meet minimum commitments. As described in my testimony on page 4, note 6, there is sufficient lead time until implementation to adjust the network appropriately and meet new planned minimums.

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7. Please refer to USPS-T-2 at 8. "If these preliminary estimates prove valid once more robust modeling efforts are completed, this optimization of the NDC network could result in an additional \$62 to \$116 million in savings."
- a. Please confirm that this savings estimate was calculated using assumed increases in capacity utilization. If confirmed, please explain how these estimates were developed. If not confirmed, please provide supporting workpapers.
  - b. Is the Postal Service doing or planning to do more analysis before implementing changes to the NDC network? If so, please describe the nature and scope of that additional analysis, and provide a timeline for the Postal Service plan to provide updated modeling of the NDC network changes.
  - c. Please provide a quantitative and qualitative discussion regarding the use of "more robust modeling efforts" in this context.

**RESPONSE:**

- a. Partially confirmed; the savings estimate is calculated using Witness Hagenstein's estimates of changes in highway capacity in the Inter-NDC and Intra-NDC networks. The Inter-NDC estimate of a 14 to 28 percent capacity reduction was based on assumed increases in capacity utilization, as suggested by the question. These reductions correspond to \$49 to \$97 million. However, the Intra-NDC estimate of a 6 to 8 percent capacity reduction was based on a study of potential trip reductions at two NDC campuses. These reductions correspond to \$14 to \$18 million. Witness Hagenstein discusses the development of these estimates in his response to POIR 1, Question 9.
- b. Redirected to witness Hagenstein.
- c. This phrase is intended to draw a distinction between the robust modeling effort that supports the Inter-Area, Inter-Cluster, and Inter-P&DC capacity

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 5**

change estimates described extensively in Witness Hagenstein's testimony, and the high-level, preliminary estimates that support the Inter- and Intra-NDC capacity changes, which were not based on the same type of modeling effort. However, it is important to recognize that there are opportunities for additional savings in the NDC network that would result from these proposed changes, even if the precise magnitude of those potential savings is not yet known.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM  
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 6  
(REDIRECTED FROM WITNESS HAGENSTEIN)**

1. Please refer to USPS-T-1 at 4, lines 5-7. The Postal Service states that “[a]n estimated 14 to 48 percent reduction in the number of air charters may be possible depending on the final volume of the lanes identified to shift from air to surface transportation.” Please provide the source data and calculations used to estimate the percentage reduction in the number of air charters. If the calculation is not available, please explain the basis for the above statement. Additionally, please discuss the relationship between capacity required, quantity of air charter trips, accrued cost, and attributable cost for the air charter cost driver.

**RESPONSE:**

Witness Hagenstein provided the source data and calculations used to estimate the percentage reduction in the number of air charters in USPS-LR-N2021-2-NP6, in conjunction with his response filed on July 8, 2021, to POIR No. 2, question 12, part a. Charter costs are 100 percent volume variable, meaning that if volume or capacity increases by 10 percent, then the accrued costs would also increase by 10 percent. See Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2019 (July 1, 2020), “CS14-19.docx”, at 14-3. Because attributable costs include volume variable costs, 100 percent of accrued charter costs are attributable.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM  
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 9**

1. Please refer to USPS-T-2 at 8, lines 9-10. The Postal Service states that the “optimization of the [Network Distribution Center (NDC)] network could result in an additional \$62 to \$116 million in savings.” Please also refer to the Postal Service’s 10-year strategic plan,<sup>1</sup> which states that “[a]ll [Regional Distribution Center] will be equipped with additional package processing capability to increase capacity, reliability and reach.”
  - a. In response to Presiding Officer’s Information Request No. 1, question 4.c., the Postal Service stated that it acquired “additional space in 46 locations to accommodate package growth. The Postal Service also purchased 138 additional package sorting machines this year and added over 14,000 permanent positions to its workforce.”<sup>2</sup> Please quantify the costs, separately by category, for the infrastructure items included in this response.
  - b. Please identify any additional costs incurred in optimizing the NDC network.
  - c. Please confirm that costs to optimize the NDC network are included in the estimated cost savings of \$62 million to \$116 million. If confirmed, please separately quantify by category the costs included in the cost savings. If not confirmed, please provide the rationale for not including costs incurred to optimize the NDC network in the cost savings.

**RESPONSE:**

- a. The Postal Service has approved \$209 million in infrastructure funding for acquiring additional space in up to 46 locations and \$240 million in funding for additional package sorting machines. These costs represent the total approved investment, which may be spread across multiple years.

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<sup>1</sup> See United States Postal Service, *Delivering for America: Our Vision and Ten-Year Plan to Achieve Financial Sustainability and Service Excellence*, March 23, 2021, at 29, available at [https://about.usps.com/what/strategic-plans/delivering-for-america/assets/USPS\\_Delivering-For-America.pdf](https://about.usps.com/what/strategic-plans/delivering-for-america/assets/USPS_Delivering-For-America.pdf).

<sup>2</sup> Responses of the United States Postal Service to Questions 1-8.a, 9-11 of Presiding Officer’s Information Request No. 1, July 6, 2021.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM  
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 9**

- b. Because the initiative to optimize the NDC network is currently in the early planning stages, additional costs expected to be incurred as a result of this initiative have not yet been quantified.
- c. Not confirmed. The focus of the savings in the instant proceeding is on the potential transportation network savings that may result from the proposed service standard changes. The \$62 to \$116 million savings in the NDC network reflect the potential annual savings in the Intra- and Inter-NDC transportation network once the optimization is complete.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIM  
TO INTERROGATORIES OF THE PUBLIC REPRESENTATIVE**

**PR/USPS-T2-1.** Please refer to USPS-T-2, at 8, lines 5-10. Witness Kim states that “[b]ased on preliminary estimates, [W]itness Hagenstein projects a 14 to 28 percent reduction in capacity on the Inter-[Network Distribution Center (NDC)] network and a 6 to 8 percent reduction in capacity on the Intra-NDC network. If these preliminary estimates prove valid once more robust modeling efforts are completed, this optimization of the NDC network could result in an additional \$62 to \$116 million in savings.”

- a. Please provide a disaggregated yearly cost savings of \$62 to \$116 million based on time line provided by Witness Hagenstein on the transition of the NDCs to Regional Distribution Centers.<sup>1</sup>

**RESPONSE:**

- a. Please see the response of witness Hagenstein to PR/USPS-T1-9. The \$62 to \$116 million in savings within this network are annual savings that would be expected after such time as the NDCs are transitioned to RDCs and the surface networks are merged.

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<sup>1</sup> See Public Representative’s Second Set of Interrogatories and Request for Production to United States Postal Service Witness Stephen B. Hagenstein (PR/USPS-T-1), July 16, 2021, question 1.