

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

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POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS KASHANI TO INTERROGATORIES OF
THE ASSOCIATION OF AMERICAN PUBLISHERS
(AAP/USPS-T14-1-5)

The United States Postal Service hereby provides the responses of witness Kashani to the following interrogatories of the Association of American Publishers: AAP/USPS-T14-1-5, filed on March 10, 2000.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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March 24, 2000

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KASHANI
TO INTERROGATORIES OF
ASSOCIATION OF AMERICAN PUBLISHERS**

AAP/USPS-T14-1 On page 3 (lines 3-10) of your testimony, you discuss the process used to project Base Year 1998 costs to FY 1999 and to project costs in later years up through the test year at both current (TYBR) and proposed (TYAR) rates. With respect to this process:

(a) Please state whether this process is sufficiently automated so that the cost effect on a subclass of a change in the assumed volume variability of a cost pool in C/S 03 in Base Year 1998 would be captured automatically in TYBR and TYAR costs for that subclass without any manual adjustments.

(b) If your answer is no, please provide a specific example and a step-by-step explanation as to how such a change would be inputted or reflected in the Postal Service's electronic files pertaining to TYBR and TYAR costs for a subclass.

(c) If your answer is yes, please describe each manual adjustment that would be required to derive TYBR and TYAR costs at the subclass level from BY 1998 cost pool data.

RESPONSE

a, b, & c) Your questions are confusing, therefore, I am providing my response in the context of two possible scenarios.

1. If you are referring to changing the assumed volume variability of a cost pool in a C/S 03 cost component, a new Base Year 1998 would be required. Then to measure its impact on the Test Year, the rollforward model could be run automatically without manual adjustments.

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AAP/USPS-T14-1 (CONTINUED)

2. If you are referring to rolling forward all individual cost pools in C/S 03, complicated manual adjustments would be required. The proper method of capturing the effect of cost pool changes on the Postal Service's electronic files pertaining to TYAR and TYBR costs is to explicitly incorporate them into the CRA/rollforward model. However, there are tremendous hurdles that would need to be overcome. There are 54 cost pools which make up component 35, Mail Processing, of the CRA/rollforward model. Under present procedures, component 35 is adjusted by a vector of rollforward change factors for Cost Level, Mail Volume, Non-workload, Additional Workdays, Cost Reductions, and Other Programs for FY 1999, FY 2000, TY 2001 Before Rates, and TY 2001 After Rates. There are also additional procedures applied to a particular year, such as the workyear mix adjustment. Another area that would be affected is the lagged or PESSA costs in the "B Reports."

The example you suggested can be reviewed as follows. Component 35 is replaced by 54 cost pool components and each is treated individually in the CRA/rollforward, that is Cost Levels through Other Programs are applied to each cost pool component. There are additional adjustments such as the workyear mix adjustment, which is applied to the 54 cost pools. The lagged or PESSA costs would also need to be calculated in the "B Report." One way of doing this would be to apply every component 35 piggy back to the 54 cost

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AAP/USPS-T14-1 (CONTINUED)

pool components. For instance, supervisors of mail processing costs could be charged to 54 cost pools. The existing Rollforward matrix is comprised of 200 columns and 1600 rows, which would have to be expanded to incorporate additional components relating to implementation of 54 cost pools. An expansion of the rollforward requires rewriting the underlying COBOL program under which the program changes, testing, and mainframe resource allocation would be a costly and complicated undertaking.

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AAP/USPS-T14-2 Has the Postal Service compared or evaluated in any way the cost levels predicted in R97-1 with actual cost levels that ensued taking into account such factors as variances in volume and cost level? If your answer is yes, please provide any such "back-cast" or related analyses of the accuracy of the Postal Service's roll-forward procedures as applied in R97-1.

RESPONSE

a) No.

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AAP/USPS-T14-3 On page 4 (line 4) of your testimony, you state that test year estimates of volume variable costs are developed by adjusting base year volume variable costs for "changes in cost level." In footnote 1 of your testimony, you also explain that cost level changes refer to the price levels of inputs to the Postal Service. With respect to these statements:

- (a) Please provide a list of all expected changes in cost levels that you relied upon in developing test year volume variable costs.
- (b) Please explain how the Postal Service verifies or validates specific changes in cost levels for volume variable costs that are expected to occur by the test year. Please provide any reports or data references from sources other than the Postal Service used to verify or validate expected "changes in cost level."
- (c) Please describe the manner in which the Postal Service accounts for changes in postal productivity between TYBR costs and TYAR costs and provide any definition of productivity relied upon to develop the roll forward models.

RESPONSE

- a) Please see my Exhibit 14A, pages 1 through 8 for a list of the rollforward change factors including cost level changes.
- b) The Postal Service does not verify or validate that the cost level changes estimated in the Test Year actually occurred.

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AAP/USPS-T14-3 (CONTINUED)

- c) The effect of Postal Service productivity changes is captured through cost reductions, such as labor cost savings due to automation. There is no precise definition of productivity used to develop the rollforward model.

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AAP/USPS-T14-4 On pages 10-13 of your testimony, you describe the five types of volume variable costs that receive different treatment relative to the determination of the effect of mail-volume changes. With respect to these five types of volume variable costs:

- (a) Please indicate, by individual cost segment and cost components, the respective volume variable costs that fall into each of the five types of volume variable costs.

- (b) Please provide mathematical examples of "costs that vary directly with volume" and of a "cost distribution that varies directly by volume." Please explain the extent to which "costs that vary directly with volume" differs from a "cost distribution that varies directly by volume" and whether the two types of costs are independent of each other or related.

RESPONSE

- a) The following chart displays individual cost components and their respective types of volume variable cost:

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AAP/USPS-T14-4 (CONTINUED)

Cost Segments	Cost Components	Cost Categories				
		1	2	3	4	5
1.	1 Postmasters EAS 23 & Below	x				
2.	Supervisors and Technicians					
	4 Direct labor & Overhead			x		
	7 Window Service			x		
	9 Time Attendance Supervision				x	
	13 City Delivery Carrier - Office			x		
	14 City Delivery Carrier - Street Elemental			x		
	16 City Delivery Carrier - Street Access			x		
	17 City Delivery Carrier - Street Other				x	
	18 City Delivery Carrier - Street Route			x		
	25 Special Delivery Messengers - Office			x		
	26 Special Delivery Messengers - Street			x		
	30 Higher Level Superv.				x	
	31 Gen Sup - Mail Proc.			x		
	601 Sup Training - Other			x		
	674 Supv. Rural Delivery				x	
	675 Supv. Veh. Service			x		
	676 Supv. QC/Rev. Protec.			x		
	677 Supv. CMU			x		
	678 Joint Supv Clks/Cars.				x	
3.	Clerks and Mailhandlers CAG A - J Offices:					
	35 Mail Process. -Direct	x				
	40 Window Service	x				
	Administrative Clerks:					
	66 Claims & Inquiry	x				
	421 Data Coll. & Proc	x				
	422 Gen'l Office & Cler.	x				
	423 Quality Control	x				
	467 Training Schemes	x				
	468 Training Mail Proc Non Parcel	x				
	469 Training Mail Proc Parcel	x				
	470 Training Other	x				
	228 Time & Attendance				x	
	Special Delivery Messengers:					
	58 Salaries - Office	x				
	59 Salaries - Street	x				
	62 Equip. Maintenance	x				
	63 Fees	x				
4.	42 Clerks, CAG K Offices:	x				
6&7.	City Delivery Carrier- Office					
	43 Office Direct Labor	x		x		
	44 In-Office Support			x		

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AAP/USPS-T14-4 (CONTINUED)

Cost Segments	Cost Components	Cost Categories				
		1	2	3	4	5
	45 CAG K			x		
	City Delivery Carriers - Street					
	46 Street Elemental Load	x		x		
	48 Street Access		x	x		
	49 Other Office			x		
	50 Other Elemental Load			x		
	52 Other Access			x		
	53 Other Route			x		
	54 Route	x		x		
8.	57 Vehicle Service Drivers	x				
9.	Not Used					
10.	Rural Carriers					
	69 Evaluated Routes	x				
	70 Other Routes	x				
11.	Custodial & Maintenance:					
	75 Mail Processing Equipment	x				
12.	Motor Vehicle Service					
	Personnel:					
	82 City Delivery Office			x		
	83 City Delivery Street Elemental Load			x		
	85 City Delivery Street Access			x		
	86 City Delivery Street Route			x		
	88 Clcks Special Delivery Messengers				x	
	Supplies & Materials:					
	91 City Delivery Office			x		
	92 City Delivery Street Elemental Load			x		
	94 City Delivery Street Access			x		
	95 City Delivery Street Route			x		
	97 Special Delivery				x	
	Vehicle Hire:					
	100 City Delivery Office			x		
	101 City Delivery Street Elemental Load			x		
	103 City Delivery Street Access			x		
	104 City Delivery Street Route			x		
	106 Special Delivery				x	
13.	Miscellaneous Operating Expenses:					
	Salaries					
	Carfare					
	127 City Delivery Office			x		
	128 City Delivery Street Elemental Load			x		

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AAP/USPS-T14-4 (CONTINUED)

Cost Segments	Cost Components	Cost Categories				
		1	2	3	4	5
	130 City Delivery Street Access			x		
	131 City Delivery Street Route			x		
	133 Special Delivery				x	
	Driveout - City Delivery					
	136 City Delivery Office			x		
	137 City Delivery Street Elemental Load			x		
	139 City Delivery Street Access			x		
	140 City Delivery Street Route			x		
14.	Purchased Transportation:					
	142 Domestic Air Service	x				
	681 Domestic Alaska Air	x				
	144 Railroad Service	x				
	145 Domestic Water	x				
	143 Highway Contract	x				
	146 International	x				
15.	Building Occupancy:					
16.	Supplies & Services					
	180 Stampes & Acct Paper	x				
	181 Money Orders	x				
	248 Stamped Envelopes	x				
	184 Operating Equipment			x		
17.	190 Research & Development					
18.	Admin and Regional Operations					
	199 Repriced Annual Leave					x
	200 Holiday Leave					x
	201 CS Ret Fund Deficit Curret					x
	204 Workers Comp Current					x
19.	Gen. Management Systems					
20.	Other Accrued Expenses:					
	City Delivery Vehicle Depreciation					
	239 Domestic Indemnities	x				
	240 International Indemnities	x				

- Category 1: costs that vary directly with volume
- Category 2: cost distributions that vary directly with volume
- Category 3: costs that vary indirectly with volume
- Category 4: costs that vary with both direct and indirect volume
- Category 5: cost distributions that vary indirectly with volume

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AAP/USPS-T14-4 (CONTINUED)

b) As I have explained in my testimony, costs that vary directly with volume are developed by applying a ratio of the volume change to price-level adjusted costs. For example, FY 1999 Volume Adjusted Costs = Base Year 1998 Costs * (1+ FY 1999 Cost Level Change)*(1+FY 1999 Mail Volume Change). The effect of the volume adjustment is such that the unit variable costs remain unchanged relative to the volume increase. In contrast, cost distributions that vary directly with volume reflect a redistribution of the costs among classes, and subclasses, in that, the price-level adjusted costs (FY 1999 Price Level Adjusted Costs = BY 1998 Costs * (1+ FY 1999 Cost Level Change) are redistributed in proportion to the mail volume change. That means the total volume variable cost does not change. A hypothetical example of cost distribution for mail processing component is listed below:

LINE #	MAIL CATEGORY	BY 98 COSTS (A)	FY 99 COST FACTOR FOR MAIL PROCESSING (B)	FY 99 COST LEVEL CHANGE (C) = (A)X(B)	TOTAL FY 99 COST LEVEL ADJUSTED (D) = (A)+(C)	FY 99 MAIL VOLUME CHANGE FACTOR (E)	FY 99 MAIL VOLUME LEVEL CHANGE (F) = (D)X(E)	TOTAL FY 99 MAIL VOLUME ADJUSTED (G) = (D)+(F)	REDISTRIBUTION FACTOR (H) = (C5)/(G(5))	TOTAL FY 99 VOLUME ADJUSTED (I) = ((H)X(G)
1	CLASS A	100	0.05	5.00	105.00	0.10	10.50	115.50	0.95	110.15
2	CLASS B	50	0.05	2.50	52.50	0.02	1.05	53.55	0.95	51.07
3	CLASS C	200	0.05	10.00	210.00	0.03	6.30	216.30	0.95	206.28
4										
5	TOTAL VOLUME VARIABLE COST	350		17.50	367.50		17.85	385.35		387.50
6										
7	TOTAL COST	50	0.05	2.50	52.50			52.50		52.50
8										
9		400			420.00			437.85		420.00

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AAP/USPS-T14-5 On page 34 of Appendix A to your testimony, you provide TY 2001 AR Distribution Keys. Footnote 1 states that "[e]ach distribution on pages 32-33 cols (3)-(26) is multiplied by the mail volume effect for each class of mail from Exhibit USPS-14A." Please provide a mathematical example using numbers from these exhibits that explain or demonstrate how this calculation is made.

RESPONSE

A mathematical example of volume adjusted distribution keys has already been provided in the electronic version of my Appendix A, which illustrates the calculation used to develop TY 2001 AR distribution keys.

DECLARATION

I, Cameron Kashani, declare under penalty of perjury that the foregoing answers are true and correct, to the best of my knowledge, information, and belief.

Cameron Kashani

Dated: 3/24/2000

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.



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