

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

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

**RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA
(NAA/USPS—1(b-c), 2(a), 3-10)**

The United States Postal Service hereby provides responses to the following interrogatories of the Newspaper Association of America:

NAA/USPS—1-10, filed on March 23, 2000. An objection to interrogatory 1(a)&(d) was filed on April 3, 2000. The Postal Service will move for late acceptance with respect to interrogatory 2(b)-(d).

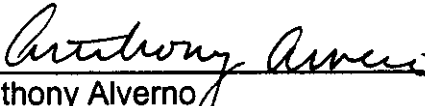
Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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April 6, 2000

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NAA/USPS-1. Please refer to the United States Postal Service 1998 Marketing Plans, filed in Docket No. R97-1 as library reference NAA LR-NAA/R97-1 LR 2.

- a. Does Postal Service management currently use this document?
- b. At AD Page 11 of this document, the following passage appears: "Newspapers are the major, direct competitors for advertising mail dollars." Does the Postal Service believe this to be true today?
- c. At AD Page 11 of this document, the following passage appears: "Pre-printed inserts have been and will continue to be the single newspaper application which is most vulnerable to diversion to Ad Mail." Does the Postal Service believe this to be true today?
- d. Has the Postal Service produced a more recent marketing plan, comparable to this one, since October 1997?

RESPONSE:

a) Objection filed.

b-c) While newspapers can serve as alternatives from the perspective of advertisers, the Postal Service views newspapers as partners in many instances. For example, newspapers use postal delivery for total market coverage products. The newspaper industry is also comprised of users of many other postal services, including First-Class Mail and Periodicals.

d) Objection filed.

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NAA/USPS-2. On June 10, 1998, the Postal Service released a press release (News Release Number 57) in which Postmaster General William J. Henderson announced that the Postal Service would "discontinue its operational test of an advertising mail concept called Auto Day."

- a. Please confirm that the Postal Service incurred costs in connection with the Auto Day program during FY98. If you cannot confirm, please explain why not.
- b. In what account are those costs located?
- c. Were those costs treated as attributable in the Base Year? If so, please explain how those costs were attributed.
- d. Has the Postal Service made an adjustment to remove those costs in the Test Year cost projection? If so, please describe the adjustment.

RESPONSE:

a) All costs were incurred in FY 98.

b-d) Response to be provided.

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NAA/USPS-3. Please refer to the Response of the United States Postal Service to UPS/USPS-T23-2 (redirected from witness Kay). At page 2 of the response, the following passage appears:

In particular, when addressing cost associated with those types of multiproduct advertising, consideration was given to the extent, if any, to which the existence of a specific product or product group "caused" (i.e., was the reason why the Postal Service engaged in) that type of advertising.

Has the Postal Service attributed any Base Year 1998 advertising costs that were incurred in a multiproduct advertising effort? If so, please identify:

- a. The products involved
- b. On what basis (e.g., percentage, etc.) the costs were attributed

RESPONSE:

a.-b. Costs associated with multiproduct advertising were included in cost pools that were allocated to specific products or product groups for use in the estimation of BY 1998 incremental advertising costs, as discussed in the response to UPS/USPS-T23-2.

It may be useful to clarify, however, the procedures that were not used, as well as those that were. The Postal Service did not engage in a "bottom-up" approach in which:

- 1) All costs were broken out to specific advertisements;
- 2) All costs associated with specific single product advertisements were allocated to those single products;
- 3) All costs associated with specific multiproduct advertisements were further broken out to individual products within the set of those featured in the advertisement on the basis of a post hoc analysis of the advertisement itself (e.g., estimation of proportionate shares of some quantitative factor); and
- 4) For each product or product group, the costs identified in Steps 2 and 3 are summed to obtain the total advertising costs for that product or product group.

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To the extent that subpart b. of the question may be inquiring about Step 3 of such a hypothetical procedure, it did not occur. (The only instance in which anything approaching a "bottom-up" procedure was used was in the Package services, in which the advertising agency broke out media and production costs on the basis of the product for which the campaigns were conducted. The agency, however, broke out all of the costs to the three specific products, and did not identify any multiproduct advertising costs.) The difficulties that attempting such a procedure would entail are discussed at some length in the Postal Service's February 29th response to UPS/USPS-T34-9, redirected from witness Robinson, and the advertisement attached to that question underscores the types of problems involved. In particular, it would be difficult under such an approach to avoid arbitrary allocations lacking any coherent causal basis. Moreover, such an approach would preclude the possibility that some of the costs cannot rationally be linked with any specific product or product group, and properly should be considered institutional.

The procedure actually employed was to request responsible product managers and channel managers to estimate judgmentally the products or product groups on which they chose to spend their advertising dollars. That process is easiest, of course, when large amounts of the budget are spent on advertisements featuring only one product. In some instances that was not the case, however, and the reality might be that much of the budget was spent on multiproduct advertisements. It was in that context that considerations of the type quoted in the instant question were appropriate, trying to get beyond the

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range of products that might merely be featured to one degree or another in specific advertisements, and to identify the products or product groups that were driving the allocation of the overall budget for which that manager was responsible.

The results of that exercise are reported on pages 5 and 5A of USPS-LR-150, as revised on March 13. On page 5 can be seen breakouts of cost pool such as Corporate Brand, Sponsors, Holiday, Specialty Markets, Retail Channel, and Areas to product groups. Although it is not possible under this methodology to identify which of those dollars were associated specifically with multiproduct advertisements, it seems reasonable to conclude that some portion of the amounts shown would reflect such costs. Further breakouts of those costs to specific products are shown on page 5A.

The ultimate result is that the BY 1998 product specific and product group specific costs identified by witness Kay in her response to UPS/USPS-T23-1 should include some costs associated with advertisements which featured more than one product (i.e., multiproduct advertising).

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NAA/USPS-4. Please provide an electronic version of Library Reference USPS LR-I-205.

RESPONSE:

There is no electronic copy to file as USPS LR-I-205 is the output of a query from a mainframe.

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NAA/USPS-5. Please refer to the Data Quality Study Summary Report (dated April 16, 1999) prepared by Link, a division of A.T. Kearney Inc. At page 34, the Summary Report states: "To the extent that weight is a cost driver, the current costing systems do not allow for the estimation of the effect of weight independent of other cost causing characteristics." Does the Postal Service agree with this conclusion?

RESPONSE:

The Postal Service agrees that the existing cost data do not permit the effect of weight on cost to be estimated independent of *all* other factors. See also witness Daniel's testimony, USPS-T-28, at page 3 (line 21) to page 4 (line 7). However, the Postal Service observes that the data do permit witness Daniel to control for important cost causing characteristics including shape and subclass, and *disagrees to the extent the A.T. Kearney Study's conclusion suggests that it is not possible to control for any such characteristics.* Data have been provided in response to ANM/USPS-T28-8(c) and MMA/USPS-T28-11 that let one attempt to normalize for non-weight factors such as presorting, prebarcoding and dropshipping using cost studies presented by witnesses Miller (USPS-T-24), Yacobucci (USPS-T-25), Crum (USPS-T-27) and Daniel (USPS-T-28) in order to better isolate weight-related cost effects.

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NAA/USPS-6. Please refer to the Data Quality Study Summary Report (dated April 16, 1999) prepared by Link, a division of A.T. Kearney Inc. At page 50, the Summary Report recommends that the Postal Service: "Re-examine these assumed institutional costs periodically to assess whether these are truly fixed institutional costs or whether any of these costs can be allocated to specific activities that can be attributed and distributed to specific sub-classes of mail." The Summary Report goes on to say: "This periodic re-examination should happen when any one of the following conditions occurs:

- . The nature of the business changes (e.g., due to electronic substitution or other outside influences).
 - . Costing theory and practice change (e.g. the field of study develops new concepts and procedures)
 - . The product or service mix changes (e.g. the significant increase in advertising mail as a proportion of total mail volume).
 - . Technology improvements create new processes or operational activities and/or provide better sources of data to analyze institutional costs."
- a. Does the Postal Service agree with this recommendation of the Summary Report?
- b. Does the Postal Service believe that any of the four listed conditions has occurred or will occur by the end of the Test Year in this proceeding?
- c. If so, how has the Postal Service re-examined institutional costs in this proceeding in a manner consistent with this recommendation?

RESPONSE:

a. It would be difficult to categorically *disagree* with the recommendation as set forth above, as it in essence merely sets forth conventional wisdom that, as the world changes, it is a good idea to step back and reevaluate existing procedures (of almost any variety) to determine whether they can be improved in light of the changes that have occurred. It bears noting, however, that the Postal Service does relatively little analysis of institutional costs *qua* institutional costs. Rather, the Postal Service generally does its analysis by cost segment or component, and institutional costs, in

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general, are simply the residual costs left when all of the costs of the segment or component that can be attributed and distributed have been so treated. (Perhaps this is why the cited portion of the Data Quality Study Summary Report, pgs. 50-51, assigned this recommendation its lowest priority.) In this context, the Postal Service is constantly seeking to improve its costing analyses, and the types of triggering events identified in the above quotation are most likely to foster increased attention to the costing procedures applied to the cost segments and components likely to be affected by such events. To the extent that any resulting improved procedures change the totality of costs attributed and distributed to subclasses, this, in turn, necessarily changes the pool of residual costs considered to be institutional.

It should also be noted, however, that even though institutional costs in many cost segments are identified as the residual after attributable costs have been estimated, they are not necessarily ignored in the Postal Service's analyses. The Postal Service seeks to base its empirical cost analyses on a solid operational foundation, to the extent possible. In instances in which empirical analyses suggest that costs do not vary proportionately with volume (i.e., that there will be residual institutional costs), the Postal Service seeks to understand why such a conclusion is consistent with operational practices. In certain instances, such efforts do cause the Postal Service to focus its analysis more directly on institutional costs than the above general description of cost attribution by segment might imply.

Incremental cost analysis is another context in which the Postal Service does examine costs which otherwise might, in some sense, be considered institutional --

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costs that do not vary with mail volume on the margin. In that context, the Postal Service first considers, beyond those costs that vary on the margin, the costs that would vary in response to elimination of the entire volume of a subclass. Additionally, the Postal Service seeks to identify all product specific costs. As discussed more below, the process of developing and presenting incremental cost analyses in Docket Nos. R97-1 and R2000-1 has improved the Postal Service's ability to re-examine pools of what previously had been considered institutional costs and allocate them to specific products on a causal basis. Moreover, to the extent that the incremental cost analysis is extended beyond individual products to groups of products, this likewise has the potential to reduce the pool of "institutional" costs that remain unassociated with any subset of products.

Finally, in terms of the Postal Service's general reaction to the quoted recommendation of the Summary Report, it may be useful reiterate part of the Postal Service's response to GCA/USPS-T41-37 (redirected from witness Bernstein):

The Postal Service subscribes to the principle that the attribution exercise should be conducted with the objective of providing the most accurate possible estimates of subclass costs. By definition, accurate subclass costing will attribute to subclasses as many of the Postal Service's total costs as possible, in the sense that it is impossible to attribute accurately to subclasses any more of the Postal Service's total costs. The Postal Service, however, does not subscribe to the principle that seeking either higher or lower levels of attribution, *a priori*, is an appropriate objective of the attribution exercise, as that would conflict with the objective of providing the most accurate possible estimates of subclass costs.

At one level, since the quoted Summary Report recommendation only speaks to practices which could only **reduce** institutional costs, it may seem as if the

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recommendation is inappropriately one-sided. In fact, however, to the extent that the recommendation is limited to a re-examination of costs previously believed to be institutional, any change would, by definition, be limited to a reduction of such costs. Presumably the authors of the Report did not intend by this recommendation to exclude the possibility that corresponding re-examination of costs previously believed to be attributable might similarly reveal some of those costs instead to be institutional. Both types of re-examination have the potential to improve the accuracy of subclass costs. Therefore, the recommendation is consistent with the Postal Service's costing objective of providing the most accurate possible estimates of subclass costs.

b. Each of the four conditions presumes a change. To identify the occurrence of a change, it is necessary to establish a baseline from which the presence or absence of change can be evaluated. Neither the Summary Report nor your question suggests any such baseline. One approach would be to assume the baseline conditions to be those in existence as of the issuance of the Summary Report. Since that occurred less than one year ago, it is unlikely that any material changes have occurred. Over the long run, it would seem most practical to consider the baseline to be conditions as they existed at the time the costs in question were last analyzed. With such a baseline, however, the response to whether any of the four conditions has changed would vary depending upon the particular costs under examination. For example, at a fairly broad level of analysis, one could examine mail processing costs and consider the four factors with respect to a baseline of conditions as they existed at the time the assumption of 100 percent variability was adopted for most mail processing operations. Dr. Bozzo, in

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fact, discusses these at some length at pages 4-13 and 128-129 of USPS-T-15. From his discussion of such a baseline, one would conclude that, at the very least, changes have occurred in factor 2 (costing theory and practice), factor 3 (product mix), and factor 4 (technology) since that assumption was adopted. Of course, those are exactly the types of changes that caused the Postal Service to propose fundamental changes in its mail processing costing procedures in Docket No. R97-1. Another instance of potentially relevant costing theory and practice changes would be the effort in this case and Docket No. R97-1 to present actual estimates of incremental costs for each subclass. As discussed above and below, this change did cause additional scrutiny of costs that previously had been considered institutional.

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c. Without necessarily attempting to identify any particular triggering event of the type suggested by the Summary Report, the Postal Service, consistent with this recommendation, has in this proceeding allocated to products certain costs that previously would have been considered institutional. Some examples include the allocation to International Mail of Headquarters phone utility related expenses, Headquarters automated data processing (ADP) supplies and services, Headquarters and Area personnel expenses, Headquarters supplies and contractual services, Headquarters training expenses, and Headquarters miscellaneous support costs that could be determined to be dedicated to International Mail. In Fiscal Year 1998, these items totaled over \$36 million. Similarly, allocated to Priority Mail were Headquarters phone utility related expenses, Headquarters and Area personnel expenses, Headquarters supplies and contractual services, Headquarters miscellaneous support costs, Headquarters training expenses, and Headquarters miscellaneous support costs that could be determined to be dedicated to Priority Mail. Also allocated to Priority Mail were the contractual costs and postage costs for the Priority End-To-End (PETE) measurement system. These items totaled over \$17 million in FY 1998. The contractual costs and postage costs for the External First-Class Measurement System (EXFC) were identified and assigned to First-Class Mail. In FY98, this amounted to over \$13 million.

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NAA/USPS-7. Please refer to the Data Quality Study Summary Report (dated April 16, 1999) prepared by Link, a division of A.T. Kearney Inc. At page 56, the Summary Report presents a calculation of the coefficient of variation of overall unit volume variable costs for three subclasses as follows:

- Periodicals - within county at 10.09%
 - Standard A - enhanced carrier route at 8.00%
 - Standard B - library at 13.48%
- a. For what period of time do these calculations apply?
 - b. Does the Postal Service believe that these coefficients of variation of overall unit volume variable costs are correctly calculated?
 - c. The Summary Report notes that the coefficient of variation for Standard Enhanced Carrier Route mail received 83 percent of its sampling error from the delivery special studies. Has the Engineered Standards/Redesign Project described in the testimony of witness Raymond replaced one of the delivery special studies (the STS study) to which the Summary Report refers?
 - d. If the answer to (c) is affirmative, please describe the effect of the Engineered Standards/Redesign Project on the coefficient of variation for ECR mail in this proceeding and provide that coefficient.

RESPONSE:

- a) These calculations are for FY 1996.
- b) The results presented in the Data Quality Study are obtained from a complex simulation model. Hence, a different set of replications may result in slightly different estimates of the CVs. The Postal Service believes that the methodology used to calculate these CVs is sound, and that these estimated CVs provide a reasonable indication of the reliability of unit volume variable costs for that time period. These calculations include 29 major cost pools, accounting for 55.8% of the total volume variable costs.
- c) Yes.
- d) The effect of the new STS study on the CVs for ECR mail has not been studied.

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NAA/USPS-8. Please refer to the Data Quality Study Summary Report (dated April 16, 1999) prepared by Link, a division of A.T. Kearney Inc. Recommendation 36, at page 83, states: "The data currently available from [the Delivery Redesign] initiative should be reviewed to assess its usefulness to the rate making process. The use of this data will link the letter carrier costs to the direct cause of those costs (e.g. hiring and retaining a letter carrier." Please confirm that the Postal Service in fact "assessed the usefulness" of the Delivery Redesign initiative to the rate making process and concluded, as shown by the testimony of witness Raymond, that the initiative is in fact useful for ratemaking.

RESPONSE:

The Postal Service has assessed the usefulness of that part of the Delivery Redesign data gathering effort germane to the estimation of street time proportions. It is the view of the Postal Service that the data provided by the Delivery Redesign initiative are superior to the data generated by the 1985 STS study replaced in the current filing. Therefore, these data are definitely useful for ratemaking.

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NAA/USPS-9. Please refer to the Data Quality Study Summary Report (dated April 16, 1999) prepared by Link, a division of A.T. Kearney Inc. At page 93, the Summary Report states, in connection with estimating costs relating to weight:

"c) The thinness of the data is a concern. Weight information can only be obtained from mail that is identified individually, which is now less than half of all IOCS tallies. As information is needed on many weight categories each category may have extremely small samples resulting in large sample variations. The difficulties with small sample sizes are most noted at the low and high end of the weight spectrum for a particular sub-class."

- a. Does the Postal Service agree with this conclusion of the Summary Report?
- b. What proportion of IOCS tallies from the Base Year was obtained from mail that is identified individually?

RESPONSE:

- a. The Postal Service agrees that some of the cost estimates by weight increment have relatively large coefficients of variation. However, the Postal Service notes that those estimates are associated with very small volumes and costs. Additionally, the Postal Service does not make direct use of the point estimates of cost by subclass and weight increment, as witness Daniel indicates in her response to NAA/USPS-T28-22(c). The Postal Service does not agree that "thinness" of the data is a concern for all combinations of subclass and weight increment.
- b. "Direct" IOCS tallies, where a specific subclass or special service is identified, are 83.4% of dollar-weighted tallies of employees handling mail and 36.1% of all dollar-weighted tallies of in-office activities (including handling and not-handling tallies, but excluding \$7.883 billion in dollar-weighted tallies of city carrier street activity, where the carrier's specific activity at the time of the reading is not observed).

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NAA/USPS-10. Please refer to the Data Quality Study Summary Report (dated April 16, 1999) prepared by Link, a division of A.T. Kearney Inc. At page 93, the Summary Report states, in connection with estimating costs relating to weight:

“g) To counter this missing information [data on volume of mail by weight increment for much of First Class, Periodical, Standard A and Standard B mail] the Postal Service has attempted to impute the volume by weight category. The Postal Service’s studies show that the estimates of costs per weight category can vary significantly depending upon the methodology used to impute volume by weight category. Based upon this weakness, the existing costing and volume reporting systems do not provide reliable and complete estimates of mail volumes by weight. Thus, sufficiently complete and accurate data on which to base some rate designs at the rate element level are not available.”

The Summary Report goes on to recommend (at page 94) that the Postal Service “Develop engineering studies that track weight in conjunction with other mail cost-causing characteristics through the entire production process.”

- a. Has the Postal Service developed the recommended engineering studies?
- b. Why or why not?

RESPONSE:

- a-b) No. Please see response to interrogatory ABA&NAPM/USPS-T28-9(b). Furthermore, engineering studies may not reflect real-world operational conditions. For example, see response to VP-CW/USPS-T28-7(d).

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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April 6, 2000