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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

Before the

UNITED STATES POSTAL RATE COMMISSION

In the Matter of:

POSTAL RATE AND FEE CHANGE

Docket No.

R2000-1

VOLUME 6

DATE: Monday, April 17, 2000

PLACE: Washington, D.C.

PAGES: 2156 - 2674

ANN RILEY & ASSOCIATES, LTD.

1025 Connecticut Avenue, N.W., Suite 1014

Washington, D.C. 20036

(202) 542-0034

BEFORE THE
POSTAL RATE COMMISSION

- - - - -X
In the Matter of: :
POSTAL RATE AND FEE CHANGE : Docket No. R2000-1
- - - - -X

Third Floor Hearing Room
Postal Rate Commission
1333 H Street, N.W.
Washington, D.C. 20268

Volume VI
Monday, April 17, 2000

The above-entitled matter came on for hearing,
pursuant to notice, at 9:35 a.m.

BEFORE:

HON. EDWARD J. GEILMAN, CHAIRMAN
HON. GEORGE A. OMAS, VICE CHAIRMAN
HON. W.H. "TREY" LeBLANC, COMMISSIONER
HON. DANA B. "DANNY" COVINGTON, COMMISSIONER
HON. RUTH GOLDWAY, COMMISSIONER

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P R O C E E D I N G S

[9:35 a.m.]

1
2
3 COMMISSIONER GLEIMAN: I guess I'll start off by
4 saying "Morning" as opposed to "Good morning" -- Mornin' --
5 today we continue our hearings to receive testimony of
6 Postal Service witnesses in support of Docket R1001, and I
7 want to commend the hardy souls who made it in for today's
8 hearing despite all the news about altered traffic flows and
9 closed streets and what have you. I don't know how all of
10 you found it, but maybe it's because so many other folks
11 stayed home that it seemed to be relatively easy to get in
12 today. I hope that everyone who wants to cross examine the
13 witnesses scheduled to appear was able to make it to the
14 hearing, but just let me state that if someone was unable to
15 get here for our hearing today and files an appropriate
16 motion by April 20th I'll recall the witness to reserve
17 everyone's fair opportunity for cross examination.
18 Hopefully that won't be necessary. From the looks of it, it
19 may not be, but we don't want to deny anybody an opportunity
20 to cross examine a witness.

21 Does any party have a procedural matter that they
22 would like to raise before we begin this morning?

23 [No response.]

24 COMMISSIONER GLEIMAN: If not, four witnesses are
25 scheduled to appear today -- Witnesses Bernstein, Bradley

1 presenting his testimony identified as T18, Witness Pickett,
2 and Witness Meehan.

3 Mr. Koetting, we can move to your first witness.

4 MR. KOETTING: Thank you, Mr. Chairman. The
5 Postal Service calls as its first witness Peter Bernstein.

6 COMMISSIONER GLEIMAN: Mr. Bernstein, would you
7 please stand so I can swear you in?

8 MR. KOETTING: Before I begin, I will note what I
9 announced earlier in the hearing room, which is we did file
10 two things on Friday relating to Mr. Bernstein's testimony,
11 the last outstanding UPS interrogatory responses, as well as
12 a revision to an earlier UPS response and one page of the
13 testimony and copies of those pleadings are available on the
14 table behind me.

15 Whereupon,

16 PETER BERNSTEIN,
17 a witness, was called for examination by counsel for the
18 U.S. Postal Service and, having been first duly sworn, was
19 examined and testified as follows:

20 DIRECT EXAMINATION

21 BY MR. KOETTING:

22 Q Mr. Bernstein, I have handed you a document
23 entitled "Direct Testimony of Peter Bernstein on behalf of
24 the United States Postal Service," which has been designated
25 as USPS-T-41. Are you familiar with this document?

1 A Yes.

2 Q Was it prepared by you or under your supervision?

3 A Yes.

4 Q Does the copy that I have handed you contain the
5 revised page 43, which was filed last Friday, April 14th?

6 A Yes, it does.

7 Q If you were to testify orally today with that
8 revision, would this be your testimony?

9 A Yes, it would.

10 COMMISSIONER LeBLANC: Is your mike on, sir?

11 THE WITNESS: That might help. It does not help?

12 CHAIRMAN GLEIMAN: Why don't you flip that one on?

13 It worked when you were standing up. You can
14 stand up and testify today -- use the lapel mike or sit down
15 and --

16 THE WITNESS: -- use this mike.

17 CHAIRMAN GLEIMAN: -- and use the regular mike.
18 It is your choice.

19 THE WITNESS: I think I would rather sit.

20 MR. KOETTING: Mr. Chairman, the Postal Service
21 would move that the direct testimony of Peter Bernstein on
22 behalf of the United States Postal Service, USPS-T-41, be
23 entered into evidence in this proceeding.

24 CHAIRMAN GLEIMAN: Is there any objection?

25 Hearing none, if counsel would provide two copies of Witness

1 Bernstein's testimony to the report, the testimony will be
2 received into evidence and as is our practice, it will not
3 be transcribed into the record.

4 [Direct Testimony and Exhibits of
5 Peter Bernstein, USPS-T-41, were
6 received into evidence.]

7 CHAIRMAN GLEIMAN: Mr. Koetting, is Witness
8 Bernstein sponsoring any Category 2 Library References in
9 this case?

10 MR. KOETTING: He is, Mr. Chairman. Presiding
11 Officer's Ruling Number R2001/13 indicated that Library
12 Reference I-156, Computer Program Relating to the Testimony
13 of Witness Bernstein, USPS-T-41" should be sponsored by this
14 witness.

15 Mr. Bernstein, are you familiar with that Library
16 Reference?

17 THE WITNESS: Yes, I am.

18 MR. KOETTING: Are you prepared to sponsor it into
19 evidence?

20 THE WITNESS: Yes.

21 MR. KOETTING: Mr. Chairman, in accordance with
22 that ruling, we, the Postal Service, would move that into
23 evidence.

24 CHAIRMAN GLEIMAN: Without objection, the Library
25 Reference in question is moved into evidence and it will not

1 be transcribed into the record.

2 [Library Reference I-156 was
3 received into evidence.]

4 CHAIRMAN GLEIMAN: Mr. Bernstein, have you had an
5 opportunity to examine the packet of designated written
6 cross examination that was made available to you earlier
7 today?

8 THE WITNESS: Yes, I have.

9 CHAIRMAN GLEIMAN: If these questions were asked
10 of you today, would your answers be the same as those you
11 previously provided in writing?

12 THE WITNESS: Yes, including the revision to
13 UPS-6.

14 CHAIRMAN GLEIMAN: That would be the only
15 correction?

16 THE WITNESS: Yes.

17 CHAIRMAN GLEIMAN: Counsel, if you would please
18 provide two copies of the corrected designated written cross
19 examination of the witness to the report, that material will
20 be received into evidence and transcribed into the record.

21 MR. KOETTING: And Mr. Chairman, I would note that
22 does include the revised copy --

23 [Designation of Written
24 Cross-Examination of Peter
25 Bernstein was received into

1 evidence and transcribed into the
2 record.]

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 2000

Docket No. R2000-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS PETER BERNSTEIN
(USPS-T-41)

Party

Interrogatories

Greeting Card Association

GCA/USPS-T41-1-2, 4-7, 9, 11-25, 29-33, 35, 38-39, 45-46, 48-49, 53, 56, 60-61, 65-67, 69, 71-74, 76, 78-81, 84-86, 88
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Mail Order Association of America

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UPS/USPS-T41-2-6

Newspaper Association of America

GCA/USPS-T41-1-36, 46, 56, 58
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Office of the Consumer Advocate

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MOAA/USPS-T41-3
NAA/USPS-T41-13
OCA/USPS-T41-1-4

Parcel Shippers Association

UPS/USPS-T41-4-5

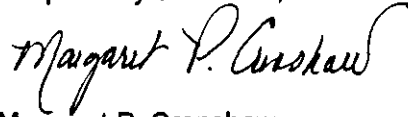
United Parcel Service

GCA/USPS-T41-13-14, 20, 23
MOAA/USPS-T41-3

United Parcel Service

NAA/USPS-T41-20
UPS/USPS-T41-1-4, 6

Respectfully submitted,

A handwritten signature in black ink, reading "Margaret P. Crenshaw". The signature is written in a cursive style with a large, looping initial "M".

Margaret P. Crenshaw
Secretary

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS PETER BERNSTEIN (T-41)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory:

GCA/USPS-T41-1
GCA/USPS-T41-2
GCA/USPS-T41-3
GCA/USPS-T41-4
GCA/USPS-T41-5
GCA/USPS-T41-6
GCA/USPS-T41-7
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GCA/USPS-T41-10
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GCA/USPS-T41-30
GCA/USPS-T41-31
GCA/USPS-T41-32
GCA/USPS-T41-33

Designating Parties:

GCA, NAA
GCA, MOAA, NAA
NAA
GCA, MOAA, NAA
GCA, MOAA, NAA
GCA, MOAA, NAA
GCA, MOAA, NAA
MOAA, NAA
GCA, MOAA, NAA
MOAA, NAA
GCA, MOAA, NAA
GCA, MOAA, NAA
GCA, MOAA, NAA, UPS
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GCA, NAA
GCA, MOAA, NAA

GCA/USPS-T41-34	MOAA, NAA
GCA/USPS-T41-35	GCA, MOAA, NAA
GCA/USPS-T41-36	MOAA, NAA
GCA/USPS-T41-38	GCA, MOAA
GCA/USPS-T41-39	GCA, MOAA
GCA/USPS-T41-41	MOAA
GCA/USPS-T41-42	MOAA
GCA/USPS-T41-43	MOAA
GCA/USPS-T41-44	MOAA
GCA/USPS-T41-45	GCA, MOAA
GCA/USPS-T41-46	GCA, MOAA, NAA
GCA/USPS-T41-47	MOAA
GCA/USPS-T41-48	GCA, MOAA
GCA/USPS-T41-49	GCA, MOAA
GCA/USPS-T41-50	MOAA
GCA/USPS-T41-51	MOAA
GCA/USPS-T41-52	MOAA
GCA/USPS-T41-53	GCA, MOAA
GCA/USPS-T41-54	MOAA
GCA/USPS-T41-55	MOAA
GCA/USPS-T41-56	GCA, MOAA, NAA
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GCA/USPS-T41-58	MOAA, NAA
GCA/USPS-T41-59	MOAA
GCA/USPS-T41-60	GCA, MOAA, OCA
GCA/USPS-T41-61	GCA, MOAA, OCA
GCA/USPS-T41-62	MOAA, OCA
GCA/USPS-T41-63	MOAA
GCA/USPS-T41-65	GCA
GCA/USPS-T41-66	GCA
GCA/USPS-T41-67	GCA, MOAA
GCA/USPS-T41-68	MOAA
GCA/USPS-T41-69	GCA, MOAA
GCA/USPS-T41-70	MOAA
GCA/USPS-T41-71	GCA, MOAA
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GCA/USPS-T41-73	GCA, MOAA
GCA/USPS-T41-74	GCA, MOAA
GCA/USPS-T41-75	MOAA

GCA/USPS-T41-76	GCA, MOAA
GCA/USPS-T41-78	GCA
GCA/USPS-T41-79	GCA
GCA/USPS-T41-80	GCA
GCA/USPS-T41-81	GCA
GCA/USPS-T41-84	GCA
GCA/USPS-T41-85	GCA
GCA/USPS-T41-86	GCA
GCA/USPS-T41-88	GCA
MOAA/USPS-T41-1	MOAA
MOAA/USPS-T41-2	MOAA
MOAA/USPS-T41-3	MOAA, OCA, UPS
MOAA/USPS-T41-4	MOAA
NAA/USPS-T41-1	NAA
NAA/USPS-T41-2	NAA
NAA/USPS-T41-3	NAA
NAA/USPS-T41-4	NAA
NAA/USPS-T41-5	NAA
NAA/USPS-T41-6	GCA, MOAA, NAA
NAA/USPS-T41-7	GCA, MOAA, NAA
NAA/USPS-T41-8	NAA
NAA/USPS-T41-9	MOAA, NAA
NAA/USPS-T41-10	GCA, MOAA, NAA
NAA/USPS-T41-11	GCA, NAA
NAA/USPS-T41-12	GCA, MOAA, NAA
NAA/USPS-T41-13	GCA, MOAA, OCA
NAA/USPS-T41-14	MOAA, NAA
NAA/USPS-T41-15	NAA
NAA/USPS-T41-16	GCA, MOAA, NAA
NAA/USPS-T41-17	GCA, MOAA, NAA
NAA/USPS-T41-18	MOAA, NAA
NAA/USPS-T41-19	MOAA, NAA
NAA/USPS-T41-20	MOAA, NAA, UPS
NAA/USPS-T41-21	MOAA, NAA
OCA/USPS-T41-1	OCA
OCA/USPS-T41-2	GCA, OCA
OCA/USPS-T41-3	OCA
OCA/USPS-T41-4	OCA
UPS/USPS-T41-1	NAA, UPS

UPS/USPS-T41-2
UPS/USPS-T41-3
UPS/USPS-T41-4
UPS/USPS-T41-5
UPS/USPS-T41-6
UPS/USPS-T41-6b

GCA, MOAA, NAA, UPS
GCA, MOAA, UPS
GCA, MOAA, PSA, UPS
GCA, MOAA, PSA
MOAA, UPS
GCA

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GCA/USPS -T41-1. Please state when you were retained by the Postal Service to prepare the testimony submitted in this proceeding.

RESPONSE:

My work at RCF on behalf of the Postal Service has been continuous since 1992. I do not recall the exact date on which I was asked to prepare my testimony for the current case. I believe that it was some time in the Spring of 1999.

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GCA/USPS-T41-2. Please state the assignment you were given at that time.

RESPONSE:

In general, I was asked to prepare testimony similar to my testimony in R97-1. More specifically, I was asked to calculate Test Year Ramsey prices for the mail subclasses and special services that have estimated elasticities of demand, compare the Ramsey prices to other sets of Test Year rates including, but not limited to, rates based on the Postal Rate Commission's recommended mark-ups in R97-1, and as part of that comparison, analyze the impact on mailers as measured by the change in consumer surplus.

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GCA/USPS-T41-3. With whom did you consult or confer during, or for, the preparation of your testimony? What was the purpose of each such consultation or conference.

RESPONSE:

I cannot possibly recall the purpose of each consultation I had during the course of preparing my testimony. Within RCF, I consulted with George Tolley and Tom Thress regarding the mail product demand equations and the volume forecasts, and with other colleagues regarding the development of the computer program used to calculate the prices presented in my testimony. Within the Postal Service, I spoke with individual in the pricing area about the general scope of my testimony, my preliminary Ramsey price calculations, and the "effective Test Year" price elasticities. I spoke with individuals in the costing area regarding Test Year cost data. I also consulted with the Postal Service attorney assigned to my testimony about a host of issues related to its preparation.

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GCA/USPS-T41-4. In preparing your testimony, did you consider alternatives to the pricing scheme you testify to? If your answer is in the affirmative, please describe each such scheme and your reasons for rejecting it.

RESPONSE:

I do not recall testifying to a pricing "scheme." My testimony presents prices based on the Ramsey pricing formula. As I stated in my testimony, the prices presented in my testimony are not pure Ramsey prices, i.e., those that would be obtained from a strict application of the Ramsey pricing formula. I chose to reject a presentation of pure Ramsey prices because they would violate certain regulations and common practices of postal rate-making and therefore would not provide rate makers with information that I believe would be of use.

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GCA/USPS-T41-5. Please provide your definition of the term "welfare economics" and state whether your testimony here addresses issues of welfare economics.

RESPONSE:

A definition of "welfare economics" that is consistent with the issues addressed in my testimony is presented in "A Dictionary of Economics," by Harold Sloan and Arnold J Zurcher. They define welfare economics as "the extent to which an economic system attains predetermined goals assumed to maximize human welfare, and the evaluation of public policies designed to effect economic changes to those ends."

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GCA/USPS-T41-6. In your testimony, do you claim to give any consideration to the value of mail to recipients? If your answer is other than an unqualified "no," please

- a. Identify and describe that consideration:
- b. Provide any and all quantifications of that consideration that your testimony relies upon.
- c. State whether and how such consideration extends beyond such value to recipients as is reflected in consumption of mail services by senders.

RESPONSE:

a. Mail services are a joint activity between the sender and the recipient, and the decision to use the mail reflects consideration of the values of both parties. For example, when a bank sends a statement to a household, it seems unlikely that the bank receives any direct benefit from the activity. Instead, the statement is mailed because the bank realizes that the recipient values statements through the mail as opposed to some other alternative, such as having to come to the bank to pick up the statement. The value to the recipient is indirectly, or implicitly, embedded in the bank's demand curve for mail. That is, if recipients no longer valued bank statements through the mail, banks would stop sending them. In other words, for a joint product such as the mail, it is essentially meaningless to divorce the value to the sender from the value to the recipient.

Consider another example: Periodicals Mail. Magazines are mailed because that is the most effective way for subscribers (the recipients) to receive the magazine. If Periodicals postage rates increase, this might lead to an increase in the price of magazines subscriptions. Some subscribers, but not many given the inelasticity of the demand for Periodicals, may choose to cancel their subscription in response to the

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price increase which will in turn reduce the sender's use of Periodical mail. Clearly, the sender's demand for mail reflects the value to the recipient.

Even in the small portion of mail services which do not reflect a business-like activity, the value to the recipient is included in the sender's demand curve for mail. Consider the decision to send a birthday card. A mailer makes a decision whether it is worth the time and \$1.75 for a card and \$0.33 for the postage to send a birthday card. To some extent, this may reflect the mailer's own value inherent in the joy of giving. But quite clearly, it also reflects the mailer's view of the value of the birthday card to the recipient. That is, even if the mailer received no value, a birthday card would still be sent because of the perceived value to the recipient.

If postage rates increase to \$0.34, the mailer must now decide if it is worth the time and \$2.09 (\$1.75 for the card plus \$0.34 for postage) to mail the card as opposed to \$2.08 (\$1.75 for the card plus \$0.33 for postage). Most likely, the one cent increase in postage will have little impact on the decision as it represents a small portion of the total cost of sending a birthday card, consistent with the relatively inelastic demand of First-Class letter mail. But if the mailer chooses not to send the card, he or she is implicitly measuring the value of the card to the recipient.

b. As explained in my response to (a), the value to the recipient and the value to the sender are jointly reflected in the demand curve, which is quantified by the price elasticity of demand.

c. Again, as stated in my response to (a), the demand curve for mail reflects the value to senders and recipients.

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GCA/USPS-T41-7. Please confirm that your testimony does not provide or reflect a quantified consideration of i) dead-weight losses to senders of First-Class mail and/or First-Class single-piece mail specifically or ii) losses, whether or not of an economic nature associated with increases in mailing costs. If you do not so confirm, please explain where and how such losses were considered.

RESPONSE:

Not confirmed. Dead-weight gains or losses refer to the overall impact to buyers and sellers, which in regard to postal rates can be measured by the sum of consumer surplus and Postal Service net revenues. When prices are raised further from marginal cost, a dead-weight loss occurs because the increase in Postal Service net revenues is less than the decrease in consumer surplus. Conversely, when prices are moved closer to marginal cost, a dead-weight gain occurs because the increase in consumer surplus exceeds the decrease in Postal Service net revenues. The Ramsey-based rates that I present yield dead-weight *gains*, in that they raise the same level of net revenue for the Postal Service as other rate schedules while yielding a higher level of total consumer surplus. Similarly, my testimony shows the gains to mailers associated with an overall *decline* in mailing costs.

However, on a product-by-product basis, users of some mail products experience a gain due to a lower price and others experience a loss due to a higher price. First-Class letters is one subclass that has a higher Ramsey price than R97-1 Index price. Considering this subclass only, the dead-weight loss is approximately equal to the change in consumer surplus (-\$2,611.1million) plus the change in Postal Service net revenues earned from First-Class letters (+\$2,293 million). Therefore, the dead-weight loss within the First-Class letter subclass is \$318.1 million.

I did not calculate Ramsey prices for single-piece First-Class letters and have no measure of the dead-weight gains or losses for this mail product.

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With regard to the recipients of First-Class letters, a measure of the loss that results from a Ramsey price higher than the R97-1 Index price is the decline in volume due to that price increase. As stated in my response to GCA/USPS-T41-6, much of this loss is already reflected in the loss of consumer surplus experienced by users of First-Class letters.

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GCA/USPS-T41-8. Please confirm:

- a. That you have neither performed nor relied on any investigation or factual inquiry into the dead-weight losses referred to in GCA/USPS-T41-7, or their nature and incidence in their preparation of your testimony. If you do not so confirm, please explain where and how such losses were considered; and,
- b. That your testimony does not address whether and how dead-weight losses may vary in the amount and rapidity which they are incurred, or with respect to the classes of mailers on which they are inflicted. If you do not so confirm, please identify where and explain how these matters are addressed.

RESPONSE:

a. Not confirmed. Although I do not use the term "dead-weight," my entire testimony focuses on what are essentially the dead-weight gains and losses resulting from different postal rate schedules. As explained in my response to GCA/USPS-T41-7, the "dead-weight" gains and losses resulting from changes in postal rates are equal to the change in consumer surplus plus the change in Postal Service net revenues. Since all Test Year postal rate schedules must generate the same net revenues, the net revenue requirement is treated as a constraint common to the rate schedules I examined. Thus, the overall dead-weight gains are equal to the overall change in consumer surplus, or \$1,272 million. For individual mail products, the dead-weight gains or losses are equal to the sum of consumer surplus and postal net revenues. Although I do not present this specific calculation, my Table 11 (which shows net revenues under the different rate schedules) and my Table 13 (which shows the change in consumer surplus) will provide the necessary information.

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b. With respect to the rapidity of the gains, I am not sure what exactly is meant by that, but I take account of the lagged response of mail demand to changes in mail prices through my calculation of effective Test Year elasticities.

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GCA/USPS-T41-9. Do you contend that the magnitude of the dead-weight loss on mailers of First-Class mail and/or single-piece First-Class Mail is substantially less than the magnitude of the effect of mail cross-elasticity on single-piece First-Class mail. If your answer is not an unqualified "no," please provide the basis of any such contention.

RESPONSE:

First, my testimony does not quantify the impact on single-piece mailers separate from the impact on the entire subclass. But more to the point, I find this to be a particularly confusing question. Dead-weight losses are measured in dollars whereas cross-elasticity effects are measured in terms of percentage change in volume with respect to a percentage change in price. I don't understand what kind of comparison you are asking me to make. However, to be responsive, let me simply say that I do not contend whatever it is you are stating in your question.

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GCA/USPS-T-41-10. Please confirm that you seek to optimize the sum of Postal Service net revenues and total consumer (mailer) surplus.

RESPONSE:

Not confirmed. The optimal (e.g., maximum) sum of Postal Service net revenues and total consumer surplus would occur when postal product prices are set equal to their marginal costs. This would yield a large negative net revenue for the Postal Service, but it would be substantially less than the large positive increase in mail consumer surplus. However, this rate schedule is not permitted.

What I do in my testimony is compare the impact on consumer surplus of different rate schedules that yield the same level of Postal Service net revenues. The Ramsey-based prices I present yield a gain in consumer surplus relative to rates based on the PRC R97-1 mark-ups. It is not, however, the optimal or maximum gain possible.

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GCA/USPS-T41-11.

- a. Do you agree with the statement that the relevant measure of value in welfare economics is the marginal utility to individuals of an additional unit of consumption? If you do not agree, please explain your understanding of what the relevant measure of value is.
- b. Do you recognize differences between the meaning of "utility" for an individual person and the meaning of "utility" for a collective enterprise such as the Postal Service of corporate enterprises? If you do, please explain your understanding of those differences.

RESPONSE:

- a. I believe that the relevant measures in welfare economics are marginal benefit and marginal cost. Marginal utility is a term often used in economics, but I refer the simple straightforward term "marginal benefit."
- b. Within economics, "utility" is often used to refer to the marginal benefit of consumption. A person will consume a unit of a good if its marginal utility exceeds its price. For a corporation, the purchase of inputs to production is typically analyzed in terms of marginal revenue product or some similar term. A corporation will purchase a unit of an input if the marginal revenue product (the revenue the input generates for the firm) exceeds its price. To me, the distinction between "marginal utility" and "marginal revenue product" is largely semantic. In either case, a good is purchased as long as its marginal benefit exceeds its price. That is why I prefer to use the common term, *marginal benefit*, as the relevant measure of value.

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GCA/USPS-T41-12. Do you agree that the types of mailers covered by the Ramsey-type prices you present in your testimony include corporations, nonprofits, and governmental units as well as individuals. If your answer is in the affirmative, please provide your understanding as to whether and how marginal utility of mail to these different types of mailers may vary inter se.

RESPONSE:

Corporation, nonprofits, governmental units and individuals are affected by postal rates, whether these rates are Ramsey-based or not. The marginal utility, or marginal benefit, of mail to these mailers is measured by the demand curve for mail. For example, if the price of a single-piece letter is increased from 33 cents to 34 cents, there will be a decline in letter volume. Most likely, less mail will be sent by corporations, nonprofits, government units and individuals. For all of these parties, there is a reduction in letter volume to the extent that the marginal benefit of some letter mail is more than 33 cents but less than 34 cents. Therefore, no distinction has to be made between these different types of mailers.

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GCA/USPS-T-41-13.

- a. Please confirm that your testimony assumes that the price and volume changes of all classes of mail can be summed meaningfully, without distinction as to the type of mailer being affected.
- b. If you so confirm, please also confirm that in so equating the sum of price and mailing volume changes, you do not address whether a change in mailing volume on the part of e.g., a catalog mailer, has the same value or disvalue to that mailer as a change in mailing volume of (single-piece) letters has to a household. If you do not confirm this additional proposition, please explain why.

RESPONSE:

- a. My testimony used price and volume changes of individual mail products to calculate the change in consumer surplus for users of that product. I believe that changes in consumer surplus can be summed meaningfully.
- b. Your proposition is a bit of an oversimplification. However, I can confirm what appears to be your general point, that I treat \$1 to a catalog mailer to be of equal value as \$1 to a household mailer.

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GCA/USPS-T41-14. Please confirm that at USPS-T-41, p. 31-33, you compare directly – and treat as equal in value – gains in net revenue to the USPS and increased costs to mailers.

RESPONSE:

Confirmed.

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GCA/USPS-T41-15. Please confirm that when costs that are not incurred efficiently are allocated on the basis of Ramsey pricing, the allocation of those costs will be directed to captive (*inelastic demand*) customers. If you do not so confirm, please provide and explain your understanding as to why Ramsey prices would not place most of the burden of productive inefficiency on inelastic classes.

RESPONSE:

I cannot say how Ramsey pricing, or any other pricing strategy, would allocate the costs of an inefficiency without specific knowledge of how the alleged inefficiency affects Postal Service costs, including the costs of individual mail products.

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GCA/USPS-T-41-16. In preparing your testimony, have you inquired into the effects (i) on future productive efficiency of the Postal Service and (ii) on the efficiency of the economy as a whole if Ramsey prices are used, thereby serving to place the burden of productive inefficiency on the most inelastic trade? If you have so inquired, describe and provide that inquiry and results.

RESPONSE:

I have made no formal inquiry regarding the issues raised in your question. I like to think that to the extent that my testimony brings attention to the issue of pricing efficiency, it will also inspire the Postal Service to seek out any other kinds of efficiency gains that may be possible. With respect to the economy as a whole, Ramsey pricing should make the economy more efficient as it increases the overall consumer surplus of users of the mail and lowers the overall cost of postal services. As a final note, I do not contend that Ramsey prices serve to place the burden of productive inefficiency on the most inelastic trade.

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GCA/USPS-T41-17. Do you agree that many ECSI values are *not* reasonably quantifiable?

RESPONSE:

I believe that many ECSI values are not *objectively* quantifiable. However, to the extent that consideration of ECSI values leads to a change in postal rates, the impact of that change on postal volumes, revenues, costs, net revenues, and consumer surplus is quantifiable.

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GCA/USPS-T41-18. Please refer to USPS-T41, at 86. Please confirm that it is your view that ECSI values can be reflected in Ramsey-type prices only if and to the extent that they can be quantified.

RESPONSE:

The above statement is tautologically true. Any reflection of ECSI values in Ramsey-type prices, or for that matter any other types of prices, is by its very nature some kind of quantification of those values.

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GCA/USPS-T-41-19. Please confirm the following:

- a. In your testimony, you do not modify your Ramsey prices to reflect ECSI values for First-Class mail:
- b. In your testimony, you treat change in consumer surplus – i.e., all that benefit which does not accrue to the producer (USPS) – as identical with the change in mailer surplus.
- c. In your testimony, your quantitative analysis includes no term for value of mail to recipients; and
- d. You consider only effects from Ramsey pricing that would occur in the market for postal services.

RESPONSE:

- a. Confirmed.
- b. Confirmed.
- c. Please see my response to GCA/USPS-T41-6.
- d. Confirmed, understanding that for many mailers, their uses of postal services are part of a larger productive enterprise and so the effects quantified in my testimony may ultimately be borne elsewhere in the economy. For example, higher rates for Periodicals Mail might lead to higher prices for magazines subscriptions, but the impacts of these higher prices are captured by the analysis presented in my testimony.

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GCA/USPS-41-20. With regard to the increase in rates for single-piece First-Class mail that would result from implementation of Ramsey pricing:

- a. Please confirm that implementation of Ramsey-type prices presented in your testimony would increase postal rates for First-Class single-piece mail by over 12%:
- b. Please identify and provide each and every study your testimony relies on regarding the effect of an increase in postal rates of that size (i.e., 12%) on mail volumes, marginal costs, and revenues, and:
- c. Please confirm that for estimates of mail volumes your testimony relies solely on the testimony of witness Tolley. If you do not confirm, please identify and provide the volume estimates relied upon for your testimony.

RESPONSE:

- a. Not confirmed. The prices presented in my testimony are fixed-weight index prices, or average revenue per piece, for mail subclasses. The Ramsey First-Class letters price of \$0.3704 reflects the impact of workshare discounts and extra ounce charges. It is directly comparable to the before-rates fixed weight index price of \$0.3437, presented in my Summary Table 1. Comparing these two prices, the Ramsey price of the First-Class letter subclass is about 7.8 percent greater than the before-rates price.
- b. The impact of an increase in postal rates on mail volumes are based on the demand elasticity estimates presented by witness Thress (USPS-T-7), adjusted by my calculation of the effective Test Year elasticity as explained at pgs. 59-61. I assume that marginal costs are not affected by the changes in rates, which is a simplifying assumption made for all the rate schedules I considered in my testimony. The impact of price changes on revenues is given in my testimony where appropriate, as for

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example my Table 11 which compares, among other things, revenues at the Ramsey-based rates and at rates based on the R97-1 mark-up index.

c. The starting points for the volume forecasts presented in my testimony are the before-rates Test Year volumes presented in the testimonies of Dr. Tolley (USPS-T-6) and Dr. Musgrave (USPS-T-8). The after-rates volumes presented in my testimony were obtained by adjusting the before-rates volumes for the impact of changes in postal rates, using the effective Test Year volume elasticities discussed in my testimony at pgs. 59 - 61.

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GCA/USPS-T41-21. Please identify and provide any and all studies of the accuracy of Postal Service costs and volumes that you relied on in the preparation of your testimony.

RESPONSE:

I did not rely on any studies of the accuracy of Postal Service costs and volumes in the preparation of my testimony. I would note that the volume and cost information used in my testimony is the same as used by all other witnesses.

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GCA/USPS-T41-22. Do you agree that marginal costs incurred to provide a postal service are likely to change over time?

RESPONSE:

Yes.

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GCA/USPS-T-41-23. Please confirm that you are using a "Point Elasticity" throughout the analysis you testify to. If you do not confirm, please identify and explain any use of an elasticity other than a point elasticity.

RESPONSE:

Confirmed.

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GCA/USPS-T-41-24. Please provide all analyses you have performed or relied on regarding your testimony employing an "Arc Elasticity."

RESPONSE:

At some time in the past, before the presentation of my testimony in this case or R97-1, I performed some Ramsey price analysis using what I called "linearized" demand curves. These demand curves essentially took the point elasticity estimates and converted them into arc elasticities as would occur with a linear demand curve. A feature of these demand curves is that the price elasticity changes as the price changes. I found that this move from point elasticity to arc elasticity had only a small effect on the Ramsey prices.

I have not performed any similar calculations for the present case, though based on my earlier work, I suspect that doing so would not meaningfully affect the results.

I also think that the Ramsey prices presented by Roger Sherman (Docket No. R97-1, OCA-T-300) used linear (arc) elasticities in his calculation of Ramsey mail volumes, though I believe he used the point elasticities to calculate Ramsey prices. Professor Sherman found that the difference was not meaningful.

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GCA/USPS-T-41-25. Please provide your understanding or assumptions, if any, as to the expected life of the rates sought in this proceeding.

RESPONSE:

Typically, rates are changed every two to four years and I would expect that to be true for this case. My testimony makes no assumptions regarding the expected life of rates in this case. As was true for other witness, rates presented in my testimony were calculated for the Test Year beginning October 1, 2000 and ending September 30, 2001. I think it is well understood that the new rates will not actually take effect on October 1, 2000. As such, the expected life of the rates presented in my testimony did not seem particularly relevant to me.

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GCA/USPS-T41-26. Please confirm that (i) in deriving your Ramsey prices you assume that the elasticities used for that purpose do not change with price and volume, and (ii) you recognize (USPS-T-41, at 50-52, 59-60) that with respect to worksharing elasticities (i.e., the relation between the size of the discount and a change in the volume of mail workshared) do change. If you do not so confirm, please explain why.

RESPONSE:

I make no assumptions about the price elasticities used in my testimony.

Instead, I use the elasticity estimates of witnesses Thress and Musgrave obtained from their econometric work. Both these witnesses estimate logarithmic demand curves which have the feature that the elasticities do not change when price or volume change. In the case of the elasticity estimates of Mr. Thress, the details of which I am quite familiar, the logarithmic constant elasticity demand specification has an excellent record of explaining the response of mail volumes to changes in postal rates.

With respect to the worksharing categories of First-Class letters, the demand equations estimated for Mr. Thress include terms for the logarithm of the own-price and the logarithm of the discount. The constant discount elasticity can be mathematically converted into a cross-price elasticity, but the resulting cross-price elasticity will have the feature that its magnitude depends on the prices of the single-piece and workshared categories. Again, this is not my assumption, but a mathematical result given the features of the demand equations estimated for single-piece and workshared letters.

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GCA/USPS-T-41-27. Please explain why elasticities that change with price and volume could not also exist for base rates. Please provide all studies of elasticities relied upon for your response.

RESPONSE:

Elasticities that change with price and volume could exist for base rates. It is simply a matter of which demand specification (constant elasticity or varying elasticity) most accurately explains the historical relation between mail volumes and base rates. The work of Mr. Thress, and Dr. Tolley before him, as well as that of Dr. Musgrave, has found that a constant elasticity specification has been exceedingly successful at explaining this historical relation and that is why it is used in the mail volume demand equations.

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GCA/USPS-T-41-28. Please provide the citation for the Robert Mitchell work referred to at line 25 on p. 75 of USPS-T-41.

RESPONSE:

Robert Mitchell's paper is "Postal Worksharing: Welfare, Technical Efficiency, and Pareto Optimality," which he presented at the Sixth Conference on Postal and Delivery Economics, the Center for Research in Regulated Industries at Rutgers University, Montreux, Switzerland, June 17-20, 1998.

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GCA/USPS-T-41-29. Please state whether you consider equity (in any sense) to be a consideration at any stage in the construction of Ramsey-type prices. If your answer is in the affirmative, explain how such consideration should be given.

RESPONSE:

My testimony addresses equity in that it treats all users of the mail equally. I view a dollar gained (or lost) by a user of one mail product to be equal to a dollar gained (or lost) by a user of another mail product. This consideration allows me to use the sum of the changes in consumer surpluses across different mail products as a measure of the overall impact of prices changes on users of the mail.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF THE GREETING CARD ASSOCIATION**

GCA/USPS-T-41-30. Reference USPS-T-41, p. 99. Please -

- a. Provide the definition of "economic equity" used in your testimony.
- b. State any other definitions of the term "economic equity" of which you are aware.
- c. Explain why the importance of additional money to rich (or poor) persons could not vary in the same way as consumption of additional goods (declining marginal utility, which you acknowledge at USPS-T41, p. 17);
- d. State whether you believe that is it consistent with equity (or with "economic equity") for a multi-product firm to construct prices based on relative demand when it enjoys a statutory monopoly on some but not all of its product lines.
- e. Identify any "fairness and/or equity" issues - other than income redistribution - you addressed in preparing your testimony and explain how and why you chose to address any such issues or chose not to address them.

RESPONSE:

- a. My testimony does not directly address the issue of "economic equity" except to the extent that I consider a dollar to one mailer to be equal to a dollar of another mailer.
- b. There are many definitions of "economic equity," of which I am aware. For example, with regard to the issue of taxes, some people argue that economic equity requires that everyone pay the same level of taxes (say, \$5,000) regardless of their income. Others argue that equity requires that everyone pays the same percentage of their income in taxes. Still others argue that equity requires that those who have higher incomes pay a greater percentage of their income in taxes than those with lower income.

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Beyond tax issues, equity definitions might have to do with equality of outcome versus equality of opportunity. And of course, there is the view that many people seem to have, that equity means a little bit more for me and a little bit less for everyone else.

c. Money may experience declining marginal utility in that money is used to purchase goods and the consumption of goods experiences declining marginal utility. However, it does not follow that money is therefore less valuable to a rich person than to a poor person. For example, declining marginal utility implies that John's seventh apple is worth less to him than his sixth apple. Similarly, Jane's third apple is worth less to her than her second apple. However, this logic does not allow any comparison between the value of John's seventh apple and the value of Jane's third apple. Maybe John really likes apples and even though he is apple-richer than Jane, he still values his seventh apple more than she values her third apple. How would we know this? We would know this if at the current price of apples, John bought seven and Jane only bought two. That would imply that John's seventh apple is worth more to him (because he bought it) than Jane's third apple is worth to her (because she did not buy it).

d. Yes.

e. The incremental cost test is applied in my testimony to ensure that there is no cross-subsidization of postal products, which would be unfair to actual or potential competitors.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF THE GREETING CARD ASSOCIATION**

GCA/USPS-T-41-31. Please -

- a. Confirm that in your testimony that a lower level of competition justifies higher Ramsey prices (USPS-T-41, at 44).
- b. Explain fully your understanding, if any, as to whether the assignment of higher Ramsey prices in circumstances of limited competition would tend to invite collusion among potential or actual competitors.

RESPONSE:

a. The discussion you refer to at page 44 regards Ramsey pricing with competing private firms. As explained in that section of my testimony, competing firms only need to be considered if they are pricing above marginal cost. Given this condition, one term in the expanded Ramsey pricing equation presented in that discussion is the cross-price elasticity between the Postal Service and the competing private firm. A high cross-price elasticity is often viewed as a measure of the degree of competitiveness between two firms. Equation (8b) shows that if the rival firm does not adjust its price in response to a change in the Postal Service, then a greater cross-price elasticity (greater competition) justifies a *higher* Ramsey price, in contrast to the proposition presented in your question.

However, as my testimony explains, if the rival firm changes its price in response to a change in the price of the postal product, then a lower Ramsey price might result. This result is more of a function of the strategy of the rival firm than it is to the level of competition between the two firms.

b. Collusion is more likely to occur when there is limited competition, since it is easier for a few firms to agree to fix prices than it is for many firms to do so. However, I do not believe that Ramsey pricing makes collusion more likely, and in fact believe that it

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
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makes it less likely. Collusion generally is motivated by low prices, as for example when OPEC responds to a low price of oil by agreeing to cut production to drive up prices. High prices tend to cause collusive arrangements to break down because of the larger profit opportunities that can be realized if a firm cheats on the pre-arranged agreement.

More to the point, it would seem extremely difficult for the Postal Service to engage in collusive activities, whether based on Ramsey pricing or any other principle. *Price-fixing is illegal in the United States and, if that were not enough of a hindrance, it would seem that the Postal Rate Commission would oppose any price-fixing efforts by the Postal Service and its competitors.* Furthermore, because Postal Service rates remain in place for a relatively long period of time, it seems far more likely that competing firms would attempt to undercut Postal Service prices to take market share, the exact opposite of what would occur under a collusive arrangement, and made possible because the Postal Service cannot immediately respond to a cut in a competitor's price with a price reduction of their own.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF THE GREETING CARD ASSOCIATION**

GCA/USPS-T-41-32. Have you, in preparing your testimony, reviewed any other regulatory commission's practices regarding pricing to captive customers? If you did, please identify the regulatory commission, the practices reviewed and any examples of the adoption or rejection of Ramsey prices for such customers.

RESPONSE:

For my testimony, I did not review the pricing practices of other regulatory commissions.

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GCA/USPS-T41-33.

- a. Please confirm that in your testimony you use the term "consumer surplus" and do not use the term "consumer's surplus."
- b. *In your testimony, are you making interpersonal comparisons of cardinal utility?*

RESPONSE:

- a. I can confirm that the term "consumer's surplus" does not appear in my testimony.
- b. Nowhere in my testimony do I specifically compare the cardinal utility of two or more people. My testimony examines the impact on mailer consumer surplus of changes in postal rates. Consumer surplus changes act to measure changes in utility in terms of dollars, specifically in terms of dollars spent on postal services versus dollars that could be spent on other products. The value, or utility, of dollars spent on postal services is measured by the mail product demand curves which are integral to the calculations of consumer surplus changes presented in my testimony.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-34

- a. Please confirm that the "Ramsey pricing" principle derives from Frank Ramsey's pioneering article, "A Contribution to the Theory of Taxation," Economic Journal, 37: 47-61.
- b. Please confirm that Ramsey's principle concerned how a national tax authority, a monopolistic entity, could maximize tax revenues across various taxpayers when imposing small changes in tax by, in essence, using what has come to be called the inverse elasticity rule. If you do not so confirm, please provide your understanding of the principle set forth in the Ramsey article.
- c. As applied to the Postal Service, please confirm that Ramsey pricing is a revenue maximization scheme.

RESPONSE:

- a. Confirmed.
- b. Not confirmed. The Ramsey article is not focused on tax revenue maximization. As Ramsey states, "The problem I proposed to tackle is this: a given revenue is to be raised by proportionate taxes on some or all uses of income, the taxes on different uses being possibly at different rates; how should these rates be adjusted in order that the decrement of utility may be a minimum?"
- c. Not confirmed.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA**

GCA/USPS-T41-35

- a. Please confirm that wide, unpredictable swings in postal pricing are generally undesirable in the eyes of the Postal Service.
- b. Please confirm the following percentage changes in USPS own-price elasticity estimates for various mail categories between R97-1 and R2000-1:

Percentage Change in Own-Price Elasticities

Category	R97-1	R2000-1	% Change
First Class S.P.	-0.189	-0.262	38.6%
Standard A Regular	-0.382	-0.570	49.2%
Standard A ECR	-0.598	-0.808	35.1%

- c. Please confirm that wide swings in elasticity estimates would lead to wide swings in postal prices if Ramsey pricing were adopted.

RESPONSE:

- a. I do not claim to speak for the Postal Service, but it is my impression that wide swings in postal prices (whether predictable or not) are generally viewed as being undesirable.
- b. I can confirm that mathematical calculations presented in your question. However, for the record, changes in the First-Class single-piece own-price elasticity are misleading because the demand specification for that category includes an important role for the discount elasticity. Furthermore, my Ramsey price calculations use the subclass own-price elasticity. In R97-1, the First-Class letter subclass own-price elasticity was -0.232. In R2000-1, the subclass elasticity is -0.229, a difference of about one percent.

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TO INTERROGATORIES OF GCA

- c. "Wide swings" is a vague term. If you are referring to the changes in elasticities that occurred between R97-1 and R2000-1, the record shows that these do not lead to wide swings in postal prices. My Table 14D shows a comparison of the R97-1 and R2000-1 Ramsey prices and my discussion at page 105, lines 7 to 18, emphasizes that the percentage change in the Ramsey prices closely *corresponds to the percentage change in marginal costs* and that the correlation between these two variables is about 0.9, indicating that changes in costs – not changes in demand elasticities – are the predominant factor driving changes in the Ramsey prices.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-36

- a. Please confirm that economic welfare is measured by continuous utility functions such as that found at page 50 in Microeconomic Theory, (1995), a textbook authored by Andreu Mas-Colell, Michael Whinston and Jerry Green.
- b. Please confirm that your Summary Table 3 on page 13, "Changes in Consumer Surplus," does not show that economic welfare will increase (or even stay the same) as a result of moving from R97-1 Index prices to Ramsey prices.
- c. Please confirm that your estimated increase in consumer surplus in Table 3 from reliance on Ramsey pricing is:
 - i. less than 2.2 percent of postal revenues in FY1997.
 - ii. less than the Postal Service's 2.5 percent contingency proposed in R2000-1.
- d. Please confirm that even if your estimated positive change in consumer surplus from reliance on Ramsey pricing is correct, economic welfare as defined in a. above could be substantially lower under the Ramsey prices than under R97-1 Index prices.

RESPONSE:

- a. Confirmed.
- b. Not confirmed.
- c. Confirmed.
- d. Not confirmed.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
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GCA/USPS-T41-38

- a. Please confirm that the Ramsey pricing exercise you perform in your testimony is statical pricing, as that term is commonly understood in microeconomic theory.
- b. In arriving at your conclusion about the superiority of Ramsey pricing for postal services, did you consider any of the dynamic factors that render Ramsey pricing inappropriate, such as the GAO report on electronic diversion.
- c. Have you examined what the impact of your Ramsey prices are for the investment planning decisions of the Postal Service, or other dynamic considerations? If so, please explain fully what your examination consisted of. If not, please explain why not.

RESPONSE:

- a. Confirmed.
- b. I did not consider the GAO report on electronic diversion in my testimony but do not believe that such a report renders Ramsey pricing inappropriate. In fact, it would appear that in a changing market environment posited by the GAO, the information provided in a Ramsey pricing analysis becomes even more important. This is consistent with the point of the GAO in its 1992 report, "U.S. Postal Service: Pricing Postal Services in a Competitive Environment," which supported the use of demand information in postal pricing.
- c. I did not consider the impact of Ramsey pricing on the investment planning decisions of the Postal Service because it was beyond the scope of my testimony.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
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GCA/USPS-T41-39.

- a. Please confirm that in a market environment of rapid technological change generally, Ramsey pricing can have serious adverse consequences for investment planning, for example premature or excessive investment, or misallocated investment.
- b. Please confirm that the Postal Service faces rapid technological change in at least two of its major market segments: (1) on the positive side, the emergence of e-mail commerce which creates an opportunity for increased package business; (2) on the negative side, the emergence of electronic diversion of letter mail including bills, bill payments, advertising, and the like, which creates conditions for disinvestment in personnel and equipment.

RESPONSE:

a and b. Rapid technological change can have adverse consequences for investment planning, but I don't see how this is at all related to Ramsey pricing. Ramsey pricing is merely a way of formally capturing the information about mailer response to price changes, information that exists whether or not Ramsey prices are used. In making investment planning decisions, the Postal Service can ignore demand information or use demand information. It would seem that if anything, using demand information would help the Postal Service make correct investment decisions. For example, with respect to E-commerce, one should realize that the Postal Service's ability to capture the increased package business is particularly sensitive to the rates charged for Priority Mail and parcel post, as reflected in these products relatively high own-price elasticities of demand. With respect to electronic diversion of letter mail, which has been going on for some time now, it does not appear that diversion is being driven by changes in postal rates as evidenced by the relatively low price elasticity of demand for First-Class letters. In both cases, I think investment decisions should take account of these

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relations between prices and future volumes, and demand elasticities provide a formal way of analyzing this relationship.

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GCA/USPS-T41-41. A point made about Ramsey pricing by Dennis Carlton in Modern Industrial Organization (1990), page 798 is as follows: "The solution is similar to optimal monopoly price discrimination."

- a. Do you agree or disagree with this statement with respect to your calculation of Ramsey prices?
- b. If you agree, please explain why the regulatory process in postal rate making should support any form of monopoly pricing, as opposed to replicating the price structure of a competitive market.
- c. If you disagree, please explain why your Ramsey prices are not a form of monopolistic price discrimination.

RESPONSE:

a through c. Ramsey pricing is similar to optimal monopoly price discrimination in that both use demand elasticity information to set prices. The key difference is that optimal monopoly price discrimination uses demand information to extract as much consumer surplus as possible, while Ramsey pricing uses demand information to extract as little consumer surplus as possible. Postal rate-making cannot replicate the price structure of competitive market because under competition, price will be equal to marginal cost. Postal rates must be set above marginal cost, and in that sense, any break-even postal rate schedule (Ramsey or otherwise) is similar to monopoly pricing.

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GCA/USPS-T41-42.

- a. Please confirm that Ramsey pricing would never be advocated for a multi-product competitive firm in competitive product markets.
- b. Please confirm that it is a goal of postal pricing sine qua non to reproduce in a regulatory setting a set of prices for postal services that would exist as if each price were set in a fully competitive market.

RESPONSE:

a. Not confirmed. To the extent that a multi-product competitive firm can set price above marginal cost, the mark-ups of product prices over product marginal costs almost certainly reflect differences in demand elasticities. Consider a grocery store - a multi-product firm with a certain amount of overhead, similar to institutional costs, that cannot be attributed to individual products. It seems highly unlikely that the grocery store will set the exact same mark-up for every product. Instead, less price elastic products will be assigned a higher than average mark-up and more price elastic products will be assigned a lower than average mark-up, consistent with the Ramsey pricing principles set forth in my testimony.

b. In a fully competitive market, price is equal to marginal cost. The Postal Service cannot set price equal to marginal cost and also satisfy its break-even requirement. Therefore, whether fully competitive pricing is a goal, it is by the very nature of the problem an impossible goal to achieve. Therefore, some other pricing strategy must be employed. Ramsey pricing carries with it important features of competitive pricing. First both competitive pricing and Ramsey pricing are based on marginal costs. Second, competitive pricing maximizes total consumer surplus while Ramsey pricing maximizes total consumer surplus subject to the break-even constraint. Third, as

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explained in my answer to (a), Ramsey pricing is similar to competitive pricing for a multi-product firm that can set price above marginal cost.

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GCA/USPS-T41-43. The mail processing business now has a number of competitors indicating the absence of any remaining economies of scale for the Postal Service in this area. Assume mail processing was a separately priced postal service for each category of mail. Please confirm that Ramsey pricing would not make sense.

RESPONSE: Not confirmed. First, the presence of competitors does not indicate that there are no remaining economies of scale for the Postal Service. Second, economics of scale are not a necessary element of Ramsey pricing. Third, Ramsey pricing of separate postal activities, such as mail processing, would make sense because it would lead to an increase in total consumer surplus while still satisfying the Postal Service's break-even requirement. Please see my R97-1 testimony for a discussion of the benefits of applying Ramsey pricing principles to the separate pricing of postal worksharing activities.

As a side note, if mail processing were a perfectly competitive industry and Postal Service costs were identical to competitor costs, then the Ramsey price of mail processing would be identical to the competitive price, i.e., marginal cost.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-44.

- a. Due to the amount of purchased transportation used by the Postal Service, is it not reasonable to conclude that there are no local economies for the USPS in this postal service as such.
- b. Assume mail transportation was a separately priced postal service for each category of mail. Please confirm in the circumstances indicated in a. above (whether or not you agree with a.), Ramsey pricing would not make sense.

RESPONSE:

- a. I am not an expert on postal costing, but the information provided in your question does not lead me to conclude that there are no local economies for the USPS in the transportation area.
- b. Not confirmed. For example, if the elasticity of demand for long distance mail transportation were different than for short distance mail transportation, mail transportation rates could vary according to the Ramsey pricing principles.

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TO INTERROGATORIES OF GCA

GCA/USPS-T41-45

- a. In contrast to Ramsey pricing, have you or the Postal Service considered any form of non-linear pricing? If so, please provide all such studies or citations to same if publicly available.
- b. Please confirm that non-linear pricing can dominate Ramsey pricing efficiency in general, and by way of example, if bulk purchases of postage stamps for Christmas cards were priced in a non-linear way.

RESPONSE:

a. In preparing my Ramsey pricing testimony, I did not consider any form of non-linear pricing. I do not know if the Postal Service considered this issue, though it seems to me that the current rate schedule includes some forms of non-linear pricing as reflected in the presence of piece/pound rates and bulk discounts.

b. If by "dominate," you mean that non-linear pricing can yield an even higher level of total consumer surplus than Ramsey pricing, while still satisfying the postal break-even requirement, then I would confirm your statement. Non-linear pricing can dominate Ramsey pricing if it takes even greater advantage of differences in marginal costs and demand elasticities.

I have not analyzed the efficiency implications of your specific example, bulk purchases of postage for Christmas cards.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA**

GCA/USPS-T41-46. Do the Postal Service's rate proposals in R2000-1 represent a movement even further toward pure Ramsey prices:

- a. relative to your R97-1 Index prices
- b. relative to the rates adopted in R97-1 and implemented in 1999?

RESPONSE:

a and b. First, I did not present pure Ramsey prices in my testimony. Second, I am not sure what you mean by "even further toward," since it suggests a specific alternative from which postal prices have moved away.

The table accompanying this response compares the Ramsey and R97-1 Index rates presented in my testimony with the Postal Service's proposed after-rates prices. For each subclass, there is an indication as to whether the Postal Service proposed rates are closer to the Ramsey rates or the R97-1 Index rates. As the table shows, of the 22 products considered in my testimony, the Postal Service's proposed rates are closer to the R97-1 Index prices for 13 products, closer to the Ramsey prices for six products, and closer to the before-rates prices for three products.

TABLE ACCOMPANYING WITNESS BERNSTEIN'S RESPONSE TO GCA/USPS-T41-46
Comparison of USPS Proposed After-Rates Prices with Ramsey, R97-1 Index, and Before-Rates Prices

Mail Product	BR Price	USPS AR	Ramsey	R97-1 Index	USPS vs. Ramsey % Difference	USPS vs. R97-1 Index % Difference	USPS vs. Before-Rates % Difference
First-Class LFIPPs	0.3437	0.3560	0.3704	0.3442	-3.9%	3.4%	3.6%
First-Class Cards	0.1841	0.1939	0.1794	0.2111	8.1%	-8.2%	5.4%
Priority Mail	3.8550	4.4358	3.0037	4.4382	47.7%	-0.1%	15.1%
Express Mail	14.0402	14.5760	10.0346	11.2503	45.3%	29.6%	3.8%
Periodicals In-County	0.0854	0.0928	0.1414	0.0979	-34.4%	-5.3%	8.6%
Periodicals Nonprofit	0.1614	0.1804	0.2650	0.1881	-31.9%	-4.1%	11.8%
Periodicals Classroom	0.2293	0.2610	0.3798	0.2692	-31.3%	-3.0%	13.8%
Periodicals Regular	0.2409	0.2735	0.5482	0.2927	-50.1%	-6.5%	13.5%
Standard A Regular	0.2018	0.2209	0.2251	0.2407	-1.9%	-8.2%	9.5%
Standard A ECR	0.1494	0.1568	0.0864	0.1594	81.5%	-1.6%	5.0%
Standard A Nonprofit	0.1231	0.1302	0.1355	0.1450	-3.9%	-10.2%	5.8%
Standard A Nonprofit ECR	0.0763	0.0881	0.0785	0.1163	12.2%	-24.2%	15.5%
Standard B Parcel Post	3.1054	3.2290	3.2448	3.1547	-0.5%	2.4%	4.0%
Standard B Bound Printed	0.9101	1.0713	1.2449	1.2271	-13.9%	-12.7%	17.7%
Standard B Special Rate	1.5685	1.6443	2.2677	1.5895	-27.5%	3.4%	4.8%
Standard B Library	1.7161	1.7918	2.1246	1.7593	-15.7%	1.8%	4.4%
Registered	7.6346	9.4645	13.5165	9.1146	-30.0%	3.8%	24.0%
Insured	1.8760	2.2903	4.1719	2.4969	-45.1%	-8.3%	22.1%
Certified	1.4398	2.1463	2.6317	2.0606	-18.4%	4.2%	49.1%
COD	5.1458	5.6458	9.3407	4.7301	-39.6%	19.4%	9.7%
Return Receipts	1.2566	1.5118	1.7021	1.8502	11.2%	-18.3%	20.3%
Money Orders	0.8088	0.9096	0.8995	1.0436	1.1%	-12.8%	12.5%

Bold indicates which price (Ramsey, R97-1 Index, or Before-Rates) is closest to the Postal Service's proposed After-Rates price

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GCA/USPS-T41-47. Please confirm that a welfare goal which simply aggregates an unweighted sum of producer and consumer surplus is:

- a. essentially an arbitrary goal.
- b. not a goal required or encouraged by the Postal Reorganization Act.

RESPONSE:

- a. Not confirmed. First, I do not consider producer surplus in my testimony. I examine aggregate consumer surplus subject to a break-even constraint. To that end, I would say that anything but an unweighted sum (e.g., some kind of weighted sum) of the changes in consumer surpluses across different mail categories is an arbitrary goal.
- b. It seems to me that economic efficiency is a goal encouraged by the Postal Reorganization Act.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-48

- a. Please confirm that second best solutions, including Ramsey pricing, are quite sensitive to the assumptions being made.
- b. Please confirm that the following assumptions are among those necessary for the Ramsey inverse elasticity rule of demand pricing to hold true:
 - 1. economies of scale or scope such that marginal cost pricing would not cover all costs.
 - 2. all cross price elasticities of demand are zero or
 - 2.a. demand interdependencies that require direct and cross price elasticities to act in a multiplicative fashion
 - 3. the rest of the economic is perfectly competitive
 - 4. no production or consumption externalities
 - 5. Equal welfare weights between producer surplus (profit) and consumer surplus (utility).
 - 6. no nonmarket clearing, no taxation or government regulation and no public sector.
 - 7. no income effects.
 - 8. monopoly under no threat of entry
 - 9. constant factor prices
 - 10. constant marginal costs
 - 11. no intermediate good production by the firm'
 - 12. no two part tariffs, or other forms of taxation to raise revenue
 - 13. costs can be measured without institutional constraint
 - 14. Information is accurate and reasonably priced

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

15. Income distribution is optimal

16. Dynamic efficiency is optimal

- c. *If you believe any of the above assumptions can be assumed to be true for Ramsey pricing in the institutional context of the Postal Service, please list by number and defend your answer fully.*

RESPONSE:

a. Second-best models, like Ramsey pricing, are versions of the first-best model of perfect competition. All of these models make use of a number of assumptions which greatly simplify their exposition. The strength of the work is not whether the circumstances of the real world exactly replicate those of the textbook, but rather the value of the predictions and information of the model.

Few if any of the assumptions of perfect competition hold exactly in the real world: industries are rarely characterized by a large number of small firms, producing a homogenous product using identical technologies, free of any constraints, taxes, transactions or information costs. Yet, the perfect competition model serves as the fundamental tool for the analysis of market behavior because the important conclusions of the model are largely unaffected by differences between theoretical assumption and real world conditions.

With respect to your question then, I think it is necessary to explain that my testimony is designed to show the importance of demand factors in pricing. It shows this importance by examining the impact of prices on postal net revenues and mailer consumer surplus. Therefore, with respect to (a), I do not believe that the value of the Ramsey pricing model as it used in my testimony is particularly sensitive to any of the assumptions presented in part b of your question. This is true either because the

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assumption is not necessary for a Ramsey price model or because relaxation of the assumption to match real world conditions does not have a meaningful impact on the calculation of consumer surplus.

1. economies of scale or scope are not necessary for a Ramsey model. In any event, it is well understood that marginal cost pricing will not cover all the costs of the Postal Service.
2. A Ramsey pricing model can be developed under any demand conditions. However, for the record, the conditions stated in (2.a) hold for the mail products I consider, based on the work of Thomas Thress (USPS-T-7).
3. The degree of competition in markets unrelated to the market for postal services will have a trivial impact on the consumer surplus calculations presented in my testimony. My testimony addresses competition between the Postal Service and private competitors.
4. A Ramsey pricing model can be modified to take account of externalities. In any event, whatever externalities might exist would seem to be of minor importance.
5. I do not address producer surplus in my testimony. Equal weight among different consumers can be assumed to be true.

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6. While these conditions do not hold, I do not think they meaningfully affect the gains to mailers presented in my testimony.
 7. Income effects are quite small and will not meaningfully affect the gains to mailers presented in my testimony.
 8. This is not a necessary condition of a Ramsey pricing model.
 9. This is not a necessary condition of a Ramsey pricing model.
 10. This is not a necessary condition of a Ramsey pricing model.
 11. This is not a necessary condition of a Ramsey pricing model.
 12. Two part tariffs considerations can be included in a Ramsey pricing model. The issue of taxation was addressed in (6) above.
 13. I am not sure what this means.
 14. I believe these conditions exist.
 15. I am not sure what you mean by an optimal distribution of income.
-

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16. Dynamic considerations are not a necessary condition of a Ramsey pricing model.
- c. Please see my responses to (a) and (b).
-

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GCA/USPS-T41-49. Please refer to Stiglitz, Economics of the Public Sector, second edition (1988) page 495. He states that "if elasticity of supply is infinite (a horizontal supply schedule), the tax should simply be inversely proportional to the compensated elasticity of demand."

- a. Please confirm that you are assuming in your equations that the elasticity of supply is infinite (supply is perfectly elastic) and thus the reciprocal of supply elasticity equals zero.
- b. Explain what would happen to the Ramsey pricing if the supply curve is not perfectly elastic. How does it affect the deadweight loss or the consumer surplus?

RESPONSE:

- a. I assume that marginal cost of postal products is constant in the range of volumes considered in my testimony, which is the same as a perfectly elastic supply curve. It appears that there are small changes in postal marginal cost that occur with volume changes, but I ignored these small differences because they do not have a meaningful effect on the Ramsey results. I can also confirm that the reciprocal of infinity is zero.
- b. Assume marginal cost declines as volume increases. A Ramsey product with a lower price than R97-1 Index price, will have a higher volume and therefore a lower marginal cost, since marginal cost declines as volume increases. The decline in marginal cost will lead to an even lower Ramsey price as the Ramsey mark-up will be applied to a lower marginal cost.

If marginal costs increase as volume increases, then a Ramsey product with a lower price will have higher marginal costs. This will cause the Ramsey price to be somewhat higher than if marginal costs are constant because the mark-up is applied to a higher marginal cost.

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The magnitude of the impact of non-constant marginal costs (non-infinite supply elasticity) depends on the degree to which marginal costs change when volume changes. It appears, based on a review of the before-rates and after-rates marginal costs, that postal marginal costs do not change much with volume, consistent with the simplifying assumption presented in my testimony.

The impact of non-constant marginal costs on consumer surplus depends on the impact of the non-constancy on the Ramsey prices. With respect to the Postal Service, it appears that marginal costs do not vary much with volume and so the impact on the Ramsey prices and consumer surplus will be quite small. Please also see my responses to your interrogatories GCA/USPS-T41-57 and 62.

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GCA/USPS-T41-50.

- a. Please confirm that you are assuming in your testimony that every mailer has the same utility function. If you do not confirm, please explain the assumptions you rely on regarding variations in mailers' utility functions.**
- b. What happens to the Ramsey pricing if mailers have heterogenous utility functions?**

RESPONSE:

- a. I do not assume that each mailer has the same utility assumptions. I only assume that mailer's utility functions are continuous and strictly quasi-concave.**
- b. The Ramsey pricing formula used in my testimony is valid whether or not each mailer has the same utility function.**

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GCA/USPS-T41-51.

- a. Please confirm that in your calculations you used linear demand curves rather than non-linear ones.
- b. What happens to the Ramsey prices and total consumer surplus if you use non-linear demand curves? Is it possible to improve on your Ramsey results?
- c. Would your Ramsey results in terms of deadweight loss be improved by using non-linear demand curves? Please explain fully either a "yes" or "no" answer.

RESPONSE:

- a. I use non-linear (logarithmic) demand curves estimated by Mr. Thress (USPS-T-7) in the calculations of the Ramsey prices and Ramsey volumes. My calculation of consumer surplus uses a linear approximation of the integral of the demand curve, as I explained in my testimony at pages 94 and 95.
- b. As I explained in (a), the Ramsey prices and volumes use the econometrically estimated demand curves. A more accurate measure of the change in consumer surplus would use the mathematic integral of the demand curve instead of the linear approximation. However, I felt that this was unnecessarily complex for the purposes of my testimony. In the R97-1 case, Roger Sherman presented a better linear estimate of the integral of the demand curve (OCA-T-300). Professor Sherman found that the difference between his somewhat more accurate approach and my approach was small, and for that reason I used the simple linear approximation described in my testimony.

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c. Integrating the demand curve would provide a more accurate measure of the change in consumer surplus resulting from a move to Ramsey prices. Integrating the demand curve will most likely cause the gains to mailers from Ramsey pricing to be somewhat smaller than presented my testimony. However, the work of Professor Sherman, cited in (b), suggests that the difference is small.

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GCA/USPS-T41-52. Refer to Stiglitz (1988), page 495. He states that "In his analysis, Ramsey assumed that individuals are identical."

- a. Are you assuming that all mailers' demand curves are identical for a class of mail?**
- b. What would happen to the Ramsey prices and the total consumer surplus if this assumption is dropped?**

RESPONSE:

a and b. I do not assume that all mailers' demand curves are identical. My analysis is based on the total demand for a mail product. By definition, the total demand for a mail product is the sum of the individual mailer demands. The response of mail volume to a change in price (the price-elasticity) represents an aggregation of the various individual mailer responses. For example, if the price elasticity of demand for product A is -0.5, it means that a 10 percent increase in price causes a 5 percent decline in total volume. This elasticity estimate does not imply that every single mailer responds by decreasing volume by 5 percent, nor is such an assumption necessary, as my calculations are based on the change in total volume in response to a change in price.

The Ramsey pricing formula and the calculation of changes in consumer surplus are valid even if all mailers' demand curves are not identical.

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GCA/USPS-T41-53 Refer to Stiglitz (1988), page 113. He states that "A compensated demand curve gives the demand for a commodity under the assumption that as its price rises, the individual is given sufficient additional income that his level of utility remains unchanged. If when the individual is given more income (compensated for the price increase), his demand for the commodity is unchanged, then the compensated and ordinary demand curves will exactly coincide." On page 261, Stiglitz further states that if an individual's demand does depend on income, compensated and ordinary demand curves "differ as a result of the "income effect" associated with taking away or giving income as compensation." Finally, at page 449, footnote 7, Stiglitz states that "In measuring the deadweight loss in an economy . . . we use the elasticity of the compensated market demand curve. The number can be estimated through statistical techniques."

- a. In your maximization of consumer surplus or minimization of deadweight loss associated with a change in prices to Ramsey prices, did you use compensated demand curves?
- b. (i) If your answer to part (a) is yes, then did you apply the Hausman methodology ("Exact Consumer Surplus and Deadweight Loss," American Economic Review, Vol. 11, 1981, page 662-76) or another methodology to estimate elasticity of compensated demand? (ii) Please identify the methodology, if any, you used.
- c. (1) If your answer to part (a) and/or (b) (i) is "no", how reliable are the Ramsey prices you obtained in your testimony? (ii) What condition(s) may have to prevail in the postal market so that you could make the assumption that either the compensated demand curve and ordinary demand curves coincide or the effect on Ramsey prices is inconsequential if you use one demand curve rather than the other?

RESPONSE:

a and b. I used the uncompensated demand curves estimated by Mr. Thress (USPS-T-7) and Dr. Musgrave (USPS-T-8).

c. The difference between the compensated and uncompensated demand curves for postal products is trivial. The income compensation discussed in your question

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involves taking account of the impact of postal prices on the overall cost of living (consumer's real income). The Postal Service accounts for less than one percent of GDP, and changes in postal prices have a tiny impact on the overall cost of living, meaning that there is virtually no difference between the compensated and uncompensated demand curves for postal products.

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GCA/USPS-T41-54 Please confirm that optimal Ramsey pricing, like commodity taxation, entails that marginal excess burden per marginal dollar raised be the same for all products?

RESPONSE:

Confirmed. However, the Ramsey pricing of postal products is not a tax policy. It is a multi-product pricing policy as described by Baumol and Bradford in their 1970 article, "Optimal Departures from Marginal Cost Pricing," *American Economic Review*, Volume 60, June 1970.

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GCA/USPS-T41-55 Please refer to Stiglitz (1988) pp. 454-55. He derives the deadweight loss as a function of the square of the change in prices, a non-linearity. On page 495, he states that the prices (taxes) should be set . . . "so that excess burden increases as the revenue raised increases, but also so that each increment in revenue increases the excess burden more. This follows the fact that the deadweight loss increases with the square of the tax rate."

- a. In your formulation of Ramsey pricing, have you have taken account of the non-linearity in deadweight loss or consumer surplus gain and price change.
- b. If your answer is no, please then explain your answer fully, stating your reasons for considering your model superior.

RESPONSE:

a and b. The Ramsey pricing formula presented in my testimony takes account of the non-linearity discussed in your question.

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GCA/USPS-T41-56 Please refer to the accompanying table, which reproduces Table 13 in your testimony in R2000-1 and Table 13 in your testimony in R97-1 (R97-1, USPS -T-31). Comparing the gains and losses in consumer surplus for each corresponding mail type we observe several shifts. For example, for Standard A Regular we observe a shift from a loss of consumer surplus of \$2,278.9 million in R97-1 to a gain of \$616.6 million in R2000-1.

Please confirm from the table in your R2000-1 testimony that there are five such shifts where your conclusions about a gain from or a loss in consumer surplus in a mail category from Ramsey pricing are diametrically opposed to the conclusions you reached in R97-1.

- a. Please explain the reasons for such a shift.
- b. Would you consider it necessary for a regulatory commission, before it adopted Ramsey pricing, to have confidence that, under Ramsey pricing:
 - (i) it knew — on at least a qualitative basis — where, as among customer classes, the resulting welfare gains and losses would not be subject to shifts between one rate case and the next, such as those cited above? If your answer is not an unqualified "yes," please explain fully.

RESPONSE:

- a. Of the five cases in which the sign of the change in consumer surplus is different in R2000-1 than it was in R97-1, one is due to a change in the estimated elasticity, one is due to the rule that ties nonprofit mark-ups to regular mark-ups, one represents a changes from a small negative to a small positive, and two represent changes due to differences in the non-Ramsey mark-ups, not the Ramsey mark-ups.

Specifically, in the case of Standard A Regular mail, the R2000-1 estimated elasticity is higher than the R97-1 estimated elasticity. This causes the R2000-1 Ramsey mark-up of Standard A Regular mail (35.2%) to be lower than in R97-1 mark-up (78.6 percent), explaining the change in the sign of the change in consumer surplus for this subclass.

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Standard A Nonprofit mail price is affected by the Standard A Regular mail price due to the requirement that nonprofit mark-ups equal one-half the mark-up of the corresponding commercial subclass.

In the case of Standard B Bound Printed Matter, it seems to me that in both R2000-1 and R97-1, the change in consumer surplus is relatively small, indicating that the current mark-up of bound printed matter is very close to its Ramsey mark-up. In R97-1, the Ramsey mark-up was 38.2 percent; in R2000-1 it is 36.7 percent, which might explain why the consumer surplus change went from slightly negative to slightly positive.

The change in the sign of the consumer surplus of Certified Mail is due to a change in the non-Ramsey pricing of this mail product. The Ramsey R2000-1 mark-up of certified mail (57.3 percent) is very close to the Ramsey R97-1 mark-up (53.5 percent). On the other hand, the R97-1 Index mark-up in R2000-1 is 23.1 percent as compared to 93.9 percent in R97-1. The same logic applies for Money Orders, where the change in the sign of the consumer surplus is due to differences in the non-Ramsey price to which the Ramsey price is compared. The R97-1 and R2000-1 Ramsey mark-ups for money orders are 34.3 percent and 32.4 percent, respectively.

b. I think the Postal Rate Commission and the Postal Service should be aware of how Ramsey pricing would affect the changes in consumer surplus before adopting any set of prices. The main purpose of my testimony is to provide exactly that kind of information.

However, I see no merit to the view that gains and losses cannot shift from one rate case to another. To argue that such shifts cannot occur is to argue that there can

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never be a change in relative rate relationships between the many postal products.

Since demand and cost conditions are subject to change over time, it seems only logical that rate relations also be subject to change.

ATTACHMENT TO QUESTION, GCA/USPS-T41-56

**Comparison of the Changes in the Consumer Surplus from Ramsey Pricing
Between R2000-1 and R97-1**

Mail Product	testimony R2000-1 Change in Consumer Surplus (millions)	R97-1 testimony Change in Consumer Surplus (millions)	Change in the Sign of the Consumer Surplus
First-Class LFIPPs	(\$2,611.1)	(\$608.9)	
First-Class Cards	\$170.3	\$124.1	
Priority Mail	\$2,025.3	\$2,433.7	
Express Mail	\$132.1	\$173.1	
Periodicals In-County	(\$36.3)	(\$33.4)	
Periodicals Nonprofit	(\$149.4)	(\$146.4)	
Periodicals Classroom	(\$5.5)	(\$3.9)	
Periodicals Regular	(\$1,758.6)	(\$1,396.2)	
Standard Single Piece	N/A	(\$21.8)	
Standard A Regular	\$616.6	(\$2,278.9)	*****
Standard A ECR	\$3,076.5	\$3,030.8	
Standard A Nonprofit	\$107.4	(\$248.6)	*****
Standard A Nonprofit ECR	\$106.0	\$99.5	
Standard B Parcel Post	(\$32.7)	(\$99.3)	
Standard B Bound Printed Matter	(\$8.6)	\$21.7	*****
Standard B Special Rate	(\$133.9)	(\$86.0)	
Standard B Library	(\$9.8)	(\$7.7)	
Registered	(\$46.5)	(\$1.5)	
Insured	(\$69.4)	(\$25.2)	
Certified	(\$147.1)	\$143.0	*****
COD	(\$15.7)	(\$17.9)	
Return Receipts	\$32.0	N/A	
Money Orders	\$31.3	(\$29.2)	*****
Total Change in Consumer Surplus	\$1,271.9	\$1,023.0	

Source: Peter Bernstein R2000-1 T41 and R97-1 T31

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GCA/USPS-T41-57 Please explain in calculating Ramsey pricing, why you did not use the test year after-rate cost structure in order to be consistent with the proposed rates? Are you assuming that the TY cost structure remains the same before and after your Ramsey rates?

RESPONSE:

As I explained in GCA/USPS-T41-49, I assumed that after-rates marginal costs (volume variable costs per piece) were identical to the before-rates marginal costs. This was merely a simplifying assumption based on the fact that there is only a tiny difference between the before-rates and after-rates marginal costs.

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GCA/USPS-T41-58 Please refer to page 15, line 7 of your testimony. You state that "Volume variable cost per piece is essentially equal to marginal cost . . ." What do you mean by "essentially"?

RESPONSE:

By essentially, I mean that any difference between volume variable cost per piece and marginal cost is unlikely to have a meaningful impact on the results of my work.

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GCA/USPS-T41-59 Please refer to page 15, line 15. You state "A price above marginal cost imposes a burden on consumers."

- a. Is this statement in general true whether we are in short-run or a long-run state?**
- b. Are you assuming your Ramsey pricing is based on the long-run state?**
- c. Are you assuming that all cost structures and elasticities are for a long-run state?**

RESPONSE:

- a. Yes.**

b and c. My Ramsey work uses the long-run estimated price elasticities and the cost and volume conditions expected to prevail in the Test Year. I make no particular assumption about the short-run or long-run nature of costs. I use the long-run estimated price elasticities because they measure the full response of mailers to changes in postal rates, which is the relevant measure for the calculation of Ramsey prices.

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GCA/USPS-T41-60 Please refer to page 25, line 15 of your testimony. You state that "For example, a positive cross-price elasticity exists between First-Class cards and First-Class letters because an increase in the price of letters [. . .] would cause some mailers to substitute cards for letters."

- a. Please confirm that 2003-2008 volume estimates in LR-I-179 show a divergence of First Class letter mail to electronic substitutes.
- b. Would such as opportunity for mailers to substitute electronic mail or instant messaging for First-Class letters also result in the existence of a cross-price elasticity? If your answer is not an unqualified "yes," please explain fully.
- c. On the assumption that you have answered "yes" to part b. would a decline in the price of electronic mail or instant messaging, other things being equal, lead to a decline in the volume of First-Class letters?
- d. On the assumption that you have answered "yes" to part c., would the long-run elasticities for First-Class mail reported in your LR-H-165 be too low? Please explain fully any negative answer.
- e. In principle, shouldn't high risk factors and high probability factors such as those found in LR-I-179 be incorporated into long-run elasticity estimates even-if the risk is a few years into the future?

RESPONSE:

- a. Confirmed.
- b. Not necessarily. Products can be substitutes without being price-substitutes. It may be the case that any substitution between First-Class letters and electronic alternatives is based on service characteristics and not price.
- c. If First-Class letters and electronic alternatives are price substitutes, then it would follow that a decline in the price of electronic mail or instant messaging would lead to a

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decline in the volume of First-Class letters, although the magnitude of the decline would depend on the level of the cross-price elasticity. However, my understanding of the volume forecasts presented in LR-I-179 is that there is no cross-elasticity between First-Class letters and electronic alternatives and, for that matter, no explicit adjustment to the First-Class letter own-price elasticity to take account of the diversion of letter mail to electronic alternatives.

d. No. First of all, the elasticities I use in my testimony are presented in LR-I-156. The elasticities presented in LR-I-156 are the same elasticities used in the volume forecasts presented by Drs. Tolley and Musgrave for the GFY 2001 Test Year. LR-I-179 considers volume impacts in 2003 and beyond, which is outside the scope of the current case.

e. Long-run elasticities are defined as the volume response that occurs after taking full account of the lagged response of mailers to changes in real postal rates. The lagged response can take up to one year, so that the full long-run impact of postal rate changes is realized one year after the rate change. Consideration of years in the future, namely 2003 to 2008, should not be incorporated into the elasticity estimates used to make forecasts for 2001 and 2002.

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GCA/USPS-T41-61 Please refer to page 23, line 18. You state "By the methodology of postal service costing, product volume variable cost is equal to product marginal cost multiplied by product volume. Therefore, marginal cost is equal to volume variable cost per piece, obtained by dividing product volume variable cost by product volume."

- a. Is this an economic approach or an accounting approach to costing?
- b. In your opinion, does it make a difference for Ramsey prices to be based on an accounting approach as opposed to an economic approach?
- c. Are you assuming either (i) that marginal cost is constant over all ranges of output or (ii) that the Postal Service is at the minimum point of its long-run average variable cost?

RESPONSE:

- a. It is my understanding that it is both an economic and accounting approach to costing.
- b. Ramsey prices, and for that matter any set of prices, should be based on the most accurate estimate of marginal costs, whether that approach is accounting, economic, or both.
- c. I am assuming that marginal cost is constant over the ranges of output considered in my testimony. I am not assuming that the Postal Service is at the minimum point of its long-run average cost.

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GCA/USPS-T41-62 Please refer to page 53, lines 12-13, of your testimony. On what basis do you assume that in the range of volumes being considered, volume variable cost per piece and thus, marginal cost is constant?

RESPONSE:

This assumption is based on my examination of the before-rates and after-rates volume variable costs per piece of the postal products considered in my testimony. My review shows virtually no difference in costs despite differences in volume, indicating that constant marginal costs is a reasonable simplifying assumption.

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GCA/USPS-T41-63 Please refer to page 53 lines 13-16, of your testimony. You state "In fact, Postal Service analysis shows that the marginal costs at the after-rates volumes are slightly different. However, for simplicity and consistency this testimony uses before-rates marginal costs throughout the analysis." Please provide Ramsey prices for the after-rates.

RESPONSE:

I do not have the data to answer this question. To perform this exercise, the Postal Service would have to estimate costs at the Ramsey volumes. At that point, Ramsey prices would have to be recalculated based on the new cost estimates, which would in turn create new volume estimates, requiring the Postal Service to perform another cost iteration. Given that there appears so little difference in the marginal costs between the after-rates and before-rates volumes, I decided not to burden the Postal Service with these additional requests.

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GCA/USPS-T41-65. Please refer to your response to GCA/USPS-T41-4.

- a. Is the set of "pure Ramsey prices" referred to in this response the only alternative set of prices you considered? If not, please describe fully any others.
- b. Did you prepare a set of "pure Ramsey prices" before deciding not to present such prices? If so, please provide it.

RESPONSE:

- a. My testimony includes a set of Ramsey prices with the prices of the Periodicals subclasses constrained to reflect possible interpretations of the ECSI value of this mail. I considered replicating the approach used in the R97-1 testimony of Roger Sherman (OCA-T-300), in which he presented several different versions of Ramsey prices. Ultimately, I did not pursue this approach.
- b. No.

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CA/USPS-T41-66. Please refer to your response to GCA/USPS-T41-6(b) and (c).

- a. Under the approach you describe in your answer to part (a) of this interrogatory, is it possible to quantify *separately* the value to the recipient which you state is jointly reflected, along with the value to the mailer, in the demand curve?
- b. If your answer to part a. is negative, do you assert that the value recipients attach to the receipt of mail is identical with the value to the mailer?

RESPONSE:

- a. I am not aware of any approach that would allow one to separately quantify the value to the recipient and the value to the mailer reflected in a postal demand curve.
- b. No.

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CA/USPS-T41-67. In GCA/USPS-T41-7, you were asked to confirm that your testimony does not provide or reflect quantified consideration of "losses, whether or not of an economic nature associated with increases in mailing costs" (emphasis added). Your response discusses dead-weight losses but does not appear to state whether losses of a non-economic nature were considered. Were they?

RESPONSE:

I am not sure what is meant by losses of a non-economic nature in this case. My testimony examines the impact of changes in postal prices on postal volumes. Any reduction in the volume of some mail product is, in my mind, by definition an economic loss -- it is a loss of volume that occurs in response to a specific economic change, e.g., an increase in price. The loss to mailers from a rise in price is equal to the loss of consumer surplus, which reflects the sum of i) the increase in expenditures for that mail which is still sent at the higher price and ii) the lost net value of mail that is no longer sent because of the price rise.

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GCA/USPS-T41-68. Please refer to your response to GCA/USPS-T41-8(a). Please confirm that your reference to Table 11, as regards to First-Class Mail, is to a sum of \$18,304.2 million and that your reference to Table 13, as regards First-Class Mail is to a sum of \$2,611.1 million. If you do not so confirm, please supply the correct values for First-Class Mail.

RESPONSE:

I assume that you are referring to the First-Class letter subclass and not the entirety of First-Class Mail. With respect of GCA/USPS-T41-8(a), the dead-weight loss associated with the increase in the price of First-Class letters is the sum of the increase in Postal Service net revenues and the decrease in mailer consumer surplus, both measured at the Ramsey prices relative to the R97-1 Index prices. For the First-Class letter subclass, the calculations based on results presented in Tables 11 and 13 are shown below, with all numbers in millions.

Ramsey First-Class Letter Net Revenue	=	\$18,304.2
R97-1 Index First-Class Letter Net Revenues	=	\$16,011.2
Increase in Net Revenues	=	\$2,293.0
Change in Consumer Surplus	=	-\$2,611.0
Dead-Weight Loss	=	-\$ 318.0

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GCA/USPS-T41-69. Please refer to your response to GCA/USPS-T41-9. Please provide your understanding, if any, of the effect on Postal Service revenues of any cross-elasticities that affect the volume of (i) First-Class Mail, and (ii) single-piece First-Class Mail.

RESPONSE:

Again, I assume that you are referring to the First-Class letter subclass and not to First-Class Mail. With respect to First-Class letters, the most important cross-elasticity is with Standard A Regular mail, as well as a cross-price elasticity with First-Class cards. As I explained in my testimony, when a cross-elasticity exists between two postal products, an increase in the price of one product, say First-Class letters, leads to an increase in the volume of any other substitute product(s), in this case, First-Class cards and Standard A Regular mail as some mailers shift from First-Class letters to First-Class cards or Standard A. Therefore, some of the net revenue that "leaks" away from First-Class letters is recovered through increased volume of cards and Standard A. The same impact occurs when the price of First-Class cards or Standard A mail is raised, as some mailers would shift to First-Class letters. Therefore, with cross-price elasticities, price increases lead to greater increases in overall postal revenues (and net revenues).

The same logic applies to the demand for single-piece letters, which have a strong cross-price elasticity relation with workshared letters. An increase in the price of single-piece letters causes a decline in single-piece letter volume. To the extent that some of that decline represents a shift to workshare letters (because the single-piece price increase leads to an increase in the workshare discount) then Postal Service revenues and net revenues are greater than if there was no shift of volume between the two categories. Please also see my testimony at pages 34 to 36.

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GCA/USPS-T41-70. Please refer to your response to GCA/USPS-T41-10. Given that the range of possible sets of prices is limited by the constraint imposed by the requirement that the Postal Service breakeven, do you assert that your Ramsey-based prices would provide the optimal sum of Postal Service net revenues and total consumer (mailer) surplus which is possible under the breakeven constraint?

RESPONSE:

No. I assert that the Ramsey-based prices yield \$1,272 million increase in total consumer surplus as compared to the R97-1 Index prices. I also assert that postal prices that reflect Ramsey pricing principles will yield higher consumer surplus than postal prices that do not.

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GCA/USPS-T41-71. Please refer to your response to GCA/USPS-T41-11. Would you agree that marginal benefit to an individual (i) is sometimes path-determined, and (ii) may not be governed by, or expressible in, economic terms? Please explain your answers.

RESPONSE:

I do not know what you mean by "path-determined" marginal benefit unless it is that the n th unit of a good has greater marginal benefit than the $n+1$ th unit of the good. With respect to whether marginal benefit may not be expressible in economic terms, I suppose this is largely a question of semantics. Economists tend to think in economic terms and view people's decisions as reflecting a kind of cost-benefit analysis even if those costs and benefits are not always measured in dollars. A person can choose between buying a puppy or buying a kitten without much regard for the cost of either pet. Still, economists would argue that in choosing one over the other, the person is weighing marginal costs and marginal benefits and therefore, their decision is governed by and expressible in economic terms.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
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GCA/USPS-T41-72. Please refer to your response to GCA/USPS-T41-15. Please assume that certain costs of the Postal Service both (i) are not attributable to classes and services and (ii) are inefficiently incurred. As to these costs, please confirm that, if they were allocated to classes and services on the basis of Ramsey pricing, they will be allocated preferentially to captive (inelastic demand) customers. If you do not so confirm, please provide and explain your understanding as to why Ramsey prices would not place on inelastic classes most of the burden of the productive inefficiency represented by these costs.

RESPONSE:

Under Ramsey pricing, costs that are not attributable (not volume variable) will be allocated to a relatively greater degree to mail products that have a relatively less elastic demand curve. This holds however these costs are incurred.

For the record, however, I see no reason why non-volume variable costs should be particularly prone to "inefficiency" and they certainly should not be viewed as a measure of the inefficiency of the Postal Service. In fact, a higher level of non-volume variable costs would generally be seen as evidence of greater efficiency of the system since greater non-volume variable costs imply lower volume variable costs and, hence, lower marginal costs. From an efficiency standpoint, one should prefer an operation that has lower marginal costs to one that has higher marginal costs.

For my general view of this issue of postal efficiency, please see my response to NAA/USPS-T-13.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA**

GCA/USPS-T41-73. In your response to GCA/USPS-T41-19(d) you state that the "impacts of these higher prices [viz., for subscriptions to periodicals] are captured by the analysis presented in my testimony. Are the "impacts" referred to in the quotation only reduced volumes of mail sent in the affected subclasses? If your answer is not an unqualified "yes," please describe any other impacts and state where they are discussed in your testimony.

RESPONSE:

No. The impacts of higher prices of Periodicals mail are the increase in expenditures that must be made on those Periodicals that are still mailed at the higher price as well as the decrease in net value resulting from the small decline in Periodicals volume that occurs due to the rise in price. The demand curve for Periodicals reflects both these impacts as explained in Chapter 1 of my testimony.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-74. Please refer to your response to GCA/USPS-T41-20(a). Do you have an opinion regarding the level of the first-ounce rate for First-Class single-piece letters (i.e., the rate corresponding to the present 33-cent letter stamp) which is implied by your Ramsey-derived fixed-weighted index price for First-Class letters? If you do, please state it and indicate how it was derived.

RESPONSE:

My testimony addresses rates at the subclass level and does not address issues of rate design for particular rate categories. My Table 14A at page 101 shows that the Ramsey price of First-Class letter subclass is 7.8 percent greater than the before-rates price. My testimony does not examine how this subclass rate increase would be applied to individual letter mail categories. Mathematically, applying a 7.8 percent price increase to the present one-ounce rate of 33 cents would yield a price of 35.57 cents. However, I have not analyzed the efficiency implications of assigning the First-Class letter subclass percentage price increase identically to single-piece and workshare letters.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA**

GCA/USPS-T41-75. Please described and provide any materials you rely on for your conclusion that "the logarithmic constant elasticity demand specification has an excellent record of explaining the response of mail volume to changes in postal rates."

RESPONSE:

The Postal Service and the Postal Rate Commission have been using the logarithmic demand specification to make volume forecasts for the past 20 years. With respect to the current case, the Forecast Error Analysis found in the Technical Appendix of the testimony of Dr. George Tolley (USPS-T-6) shows the performance of the forecast model over the past five years. In particular, the Forecast Error Analysis shows that for most mail products, the five-year mechanical net trend is close to 1.000, meaning that over the most recent five-year period, actual volume was very close to the volume predicted by the econometric model.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA**

GCA/USPS-T41-76. Please refer to your response to GCA/USPS-T41-30(c). Does the term "worth," in the example you give there, refer to (i) the willingness of a person to pay for an apple, (ii) the ability of a person to pay for an apple, (iii), the combination of such willingness and ability, or (iv) some other referend. If your answer is affirmative to subpart (iv), please explain fully.

RESPONSE:

In GCA/USPS-T41-30(c), "worth" refers to what someone is willing and able to pay.

RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-78 Please refer to your response to GCA/USPS-T41-36. In this question, a sentence was inadvertently omitted from the end of part a. That sentence reads "If you so confirm, please assume in answering parts b. and d. below that individual consumers in general have *different (cardinal) utility functions*." The context of questions b. and d. may be clarified if you understand that we are asking whether you can assure us that in a situation where interpersonal comparisons of utility cannot in general be made, your net increase in consumer surplus represents a Pareto improvement, that no individual mailer is made worse off by the change to Ramsey prices, and at least one individual mailer is made better off.

RESPONSE:

I do not assert that no individual would be made worse off by the change to Ramsey prices.

RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-79

Please refer to your response to GCA/USPS-T41-38. B.

- a. With reference to your last sentence, are you saying that the Postal Service does not now use any demand information in recommending postal rates?
- b. Are you saying that the Postal Rate Commission does not now use any demand information in setting postal rates in its O&RDs?
- c. Would you agree that (i) the "changing market environment posited by the GAO" electronic diversion report implies substantial increases in substitutability for First Class letter mail, and (ii) in such circumstances, aggressive price competition in First Class letter mail is one possibly appropriate response by the Postal Service?

RESPONSE:

- a. No.
- b. No.
- c. If some time in the future, First-Class mail became materially more price sensitive due to increases in substitutability with electronic alternatives, aggressive price competition (e.g., lower rates) would be an appropriate response, understanding that this is exactly the response that would occur under Ramsey pricing.

RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-80

Please refer to your response to GCA/USPS-T41-39.

- a. You refer to "relatively high own-price elasticities of demand" for priority mail and parcel post. Please confirm that your own price elasticity for priority mail puts it within the range of a price inelastic product, that is the absolute value is less than one. Please confirm that when the cross-price elasticity is factored in, that own price elasticity is offset somewhat.
- b. Would you agree that the "demand information" the Postal Service needs to make correct investment and pricing decisions includes shifts in the demand curves for its products?
- c. Would you agree that the Postal Service could use demand information (i.e., shifts in demand curves) to "make correct investment decisions" without resorting to the use of Ramsey prices?
- d. Would you agree that the Postal Service could price more aggressively in First Class letter mail than it is doing (as a result of electronic diversion shifting the demand curve inward), and also could fund capital investments needed to compete for the growing e-commerce business (an upward shift in the demand curve) by raising the price of priority mail more than it is doing in this case?
- e. Would you agree that the "relatively low price elasticity of demand for First-Class letters" along a demand curve does not answer the question about what price policy should be for First Class letters when the demand curve is shifting inward due to electronic diversion?

RESPONSE:

- a. Confirmed, understanding that the price elasticity for Priority Mail is not mine. It is estimated by Dr. Musgrave and used by me in my analysis.
- b. Confirmed.
- c. I do not know how the Postal Service uses demand information or Ramsey price information in making its investment decisions. My point is that Ramsey prices

RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

provide information and more information is better than less when making decisions.

- d. It is mathematically true that the Postal Service could lower First-Class letter rates and raise Priority Mail rates. The wisdom of such an approach depends on, among other things, the impact of lower prices for First-Class letters on the volume of First-Class letters and the impact of higher prices for Priority Mail on the volume of Priority Mail. The inelastic demand curve for letters implies that lower prices will not have much of an impact on letter volume. The relatively high own-price elasticity of Priority Mail, on the other hand, implies that higher prices for this product will substantially reduce volume. Shifts in the demand curve, if any such shifts have occurred, do not change this result.
- e. First, the demand curve for First-Class letters is not shifting inward. Volume continues to grow. Second, and more important, your question confuses a shift in the demand curve with a change in the price sensitivity (elasticity) of the demand curve. If the demand is quite inelastic (as is the case with First-Class letters), price cuts will not have much impact on volume. This holds true whether the demand curve has shifted inward, outward, or not at all.

RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-81 Please refer to your response to GCA/USPS-T41-41 and also to Summary Table 3 on page 14.

- a. Please confirm that your Ramsey prices in Summary Table 3 extract 2.6111 billion dollars in consumer surplus from those mailers that use the First Class letters mail product, which amount would not be extracted under the "R97-1 Index Price."
- b. Please confirm that your Ramsey prices extract 1.7586 billion dollars in consumer surplus from those mailers that use the Periodicals regular mail product, which amount would not be extracted under the "R97-1 Index Price."

RESPONSE:

a and b. Confirmed.

RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-84. Please refer to your response to GCA/USPS-T41-46. While we are aware that your Ramsey prices are not pure Ramsey prices, the question concerns how much farther the Postal Service has moved in this case toward the pure Ramsey prices, relative to a situation where demand conditions were not at all factored into the rate setting process, and prices were purely cost based with equal percentage mark-ups. Please answer the question.

RESPONSE:

The question, as I understand it, is whether the Postal Service proposed rates in this case are closer to or further from equal percentage mark-up rates, as compared with rates proposed in the last case. However, I do not know what rates would result from applying equal percentage mark-ups in this case, or what rates would have resulted from such an approach in the previous case, so I cannot make this comparison.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA**

GCA/USPS-T41-85 Please refer to your response to GCA/USPS-T41-50. a. Would you agree that the continuity you assume in your utility functions is a cardinal, and not an ordinal, property of those functions? If your answer is "no", please explain why not. If your answer is "yes", can you state that the \$1,272.0 increase in total consumer surplus in your Summary Table 3 is a clear cut Pareto improvement in welfare?

RESPONSE:

Continuity is both a cardinal and an ordinal property of utility functions because any function that is cardinal is also ordinal. The 1,272.0 million increase in consumer surplus is a clear cut improvement in welfare. With respect to issues of Pareto optimality, please see my response to GCA/USPS-T-78.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA**

GCA/USPS-T41-86 Please refer to your response to GCA/USPS-T41-52. You state that the total demand for a mail product that you measure is "the sum of the individual mailer demands".

- a. Would you agree that what underlies individual mailer demands are individual utility functions as you seem to imply in your response to GCA/USPS-T41-50?
- b. If your response to a. is in the affirmative and if these individual utility functions are cardinal utility functions, can you state that the \$1,272.0 increase in total consumer surplus in your Summary Table 3 is a clear cut Pareto improvement in social welfare?

RESPONSE:

- a. Yes.
- b. The overall gain in consumer surplus is clear cut to me. With respect to issues of Pareto optimality, please see my response to GCA/USPS-T-78.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA**

GCA/USPS-T41-88 Please refer to your response to GCA/USPS-T41-61. b. Is there a marginal cost approach to cost accounting, for example as found in a standard textbook: Cost Accounting, a Managerial Emphasis, by Charles T. Horngren and George Foster?

RESPONSE:

The use of accounting costs to derive marginal costs was a topic of the testimony of Dr. John Panzar in the R97-1 case (USPS-T-11). Please also see "On Setting Prices and Testing Cross-Subsidy with Accounting Data," by Michael Bradley, Jeff Colvin, and John Panzar, *Journal of Regulatory Economics*, 16:83-100 (1999).

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF MOAA

MOAA/USPS-T41-1. In your view, would the economic viability of the Postal Service be enhanced by the adoption of Ramsey prices, i.e., is it your view that minimizing volume loss resulting from increased prices would serve, all other factors being equal, to enhance the ability of the Postal Service to carry out its overall mission while at the same time enhancing consumer surplus?

RESPONSE:

I believe that greater consideration of demand factors in pricing would enhance the economic viability of the Postal Service. I do not think that this requires that the Postal Service adopt Ramsey prices, or even the Ramsey-based prices presented in my testimony, but I do believe that greater understanding of the volume impacts of price changes would help the Postal Service carry out its overall mission.

Incidentally, Ramsey pricing does not minimize the volume loss from price increases. It minimizes the loss of consumer surplus.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF MOAA

MOAA/USPS-T-41-2. Is it a correct interpretation of your testimony at page 102 that the economic cost of across-the-board rate increases will be larger if before-rates prices do not take account of differences in demand elasticities?

RESPONSE:

Equal across-the-board rate increases preserve the rate relations of the before-rates schedule. To the extent that the before-rates prices do not take account of demand differences, then the after-rates prices will also fail to take account of demand differences and yield a similar economic cost.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF MOAA

MOAA/USPS-T41-3. Do you agree that if there have been significant changes in relative costs, an across-the-board approach to rate increases will inevitably produce uneconomic rates even if each rate produces revenues at least equal to volume variable costs?

RESPONSE:

In general, yes. An equal across-the-board rate increase approach does not take account of changes in relative costs which will generally lead to rates that are not economically efficient.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF MOAA

MOAA/USPS-T41-4. Is it not inevitable that a failure of a multi-product enterprise to establish rates at or near Ramsey levels will inevitably cause a weakening in the economic viability of such an enterprise?

RESPONSE:

I hesitate to say that it is inevitable, but as I said in my response to MOAA/USPS-T41-1, I believe failure to take account of demand differences in pricing will weaken the economic viability of any firm, including the Postal Service.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T41-1: Please refer to your testimony. For each of the following tables, please cite the particular library reference spreadsheet or document which contains the backup for each of the numbers in the tables. If such backup is not currently available, please provide it.

- a. Summary Table 1, page 10.
- b. Summary Table 2, page 11.
- c. Summary Table 3, page 13.
- d. Table 9, page 67.
- e. Table 10, page 69.
- f. Table 12, page 73.

RESPONSE:

- a. The before-rates prices presented in Summary Table 1 are found in column D of the spreadsheet file R00DATA.WK4, sheet "BR Data," the details of which are addressed in my response to your interrogatory NAA/USPS-T41-3. The after-rates R97-1 Index and Ramsey prices are found in the same spreadsheet, columns AA and Y, respectively.
- b. The own-price elasticities presented in Summary Table 2 are found in columns C through F of the spreadsheet file R00DATA.WK4, sheet "Elasticities." The R97-1 Index and Ramsey mark-ups are found in the spreadsheet file RAMOUT1.WK1, in columns D and J respectively.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

- c. The R97-1 Index price, the Ramsey price, and the change in consumer surplus presented in Summary Table 3 are found in the spreadsheet file R00DATA.WK4, sheet "BR Data" in columns AA, Y, and AD respectively.
 - d. The R97-1 Recommended Mark-ups presented in Table 9 are from Appendix G, Schedule 1 of the Postal Rate Commission's R97-1 Opinion and Recommended Decision. Note that the R97-1 Opinion did not present a mark-up for return receipts. Therefore, I used the average recommended mark-up for the special services (43.5 percent) as the R97-1 mark-up of return receipts. The R97-1 Mark-Up Index is calculated by dividing the recommended mark-up by the system-wide mark-up of 55.3, as shown in Table 9.
 - e. The R2000-1 price presented in Table 10 is found in column AA of the spreadsheet file R00DATA.WK4, sheet "BR Data." The R2000-1 mark-up is calculated as the mark-up of price over estimated attributable cost per piece, using the PRC costing methodology, and found in LR-I-240, filed in conjunction with this response. The R97-1 Mark-ups are from Appendix G, Schedule 1 referenced in (d.) above.
 - f. The R97-1 Index Mark-Up and the Ramsey Mark-up presented in Table 12 are found in the spreadsheet file RAMOUT1.WK1 in columns D and J, respectively. The Mark-up Indexes presented in Table 12 are calculated by dividing each mail product mark-up by the overall mark-up shown in Table 12.
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**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T41-2: Please refer to Library Reference USPS-LR-I-156, "Computer Program Relating to the Testimony of Witness Bernstein, USPS-T-41."

- a. Please confirm that the file called atb.wk1 is the output of the program atb.m.
- b. Please confirm that the file called ramout1.wk1 is the output of the program Rprice1.m.
- c. Please confirm that the file called call1.wk1 is an input for the program prep1.m.
- d. Please provide the output file to the program prep1.m.

RESPONSE:

a. through c. Confirmed

- d. The requested output file, rcddata1.mat, is included in LR-I-240, filed in conjunction with this response. Note that this is file can only be read using the MATLAB computer program.
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**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T41-3: Please refer to Library Reference USPS-LR-I-156, "Computer Program Relating to the Testimony of Witness Bernstein, USPS-T-41." Please refer to the file called "R00DATA.WK4." Please cite the particular library reference spreadsheet or document which contains the backup for each of the numbers on worksheet "BR Data" including the following:

- a. Column B, Before-rates volumes.
- b. Column D, Before-rates FWI postage.
- c. Column E, user cost.
- d. Column G, Before-rates IC.
- e. Column H, Before-rates WC.
- f. Column N, After-rates volume.
- g. Column O, After-rates price.
- h. Column Q, After-rates WC.
- i. Column S, PRC Attributable (BR).
- j. Column V, R97-1 PRC Markup.
- k. Column Y, Ramsey Price.
- l. Column Z, Ramsey Volume.
- m. Column AA, PRC Price
- n. Column AB, PRC Volume

RESPONSE:

- a. USPS-T-6, Attachment A.
 - b. Data are in the spreadsheet file, PRICES.WK4, included in LR-I-240, filed in conjunction with this response.
 - c. Data are in the spreadsheet file, USERCOST.WK4, included in LR-I-240, filed in conjunction with this response.
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**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

- d. USPS-T-23, Attachment A.
- e. USPS-T-23, Attachment A.
- f. USPS-T-6, Attachment A.
- g. PRICES.WK4, included in LR-I-240, filed in conjunction with this response.
- h. USPS-T-23, Attachment A.
- i. LR-J-131.
- j. Postal Rate Commission's R97-1 Opinion and Recommended Decision, Appendix G, Schedule 1. [Note, however, that the R97-1 Mark-ups of the preferred subclasses were adjusted to equal one-half the R97-1 mark-up of the corresponding commercial class.]
- k. RAMOUT1.WK1.
- l. RAMOUT1.WK1.
- m. RAMOUT1.WK1.
- n. RAMOUT1.WK1.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T41-4. For each of the following tables in your testimony, please cite the particular library reference spreadsheet or document which contains the source of the data for each of the numbers in the tables. If such source is not currently available, please provide it.

- a. Table 7, page 55.**
- b. Table 8, page 63.**
- c. Table 11, page 71.**

RESPONSE:

- a. The data in Table 7 are found in the spreadsheet file R00DATA.WK4. Please also see my response to NAA/USPS-T41-3 for more detail about R00DATA.WK4.**
- b. The data in Table 8 are found in the spreadsheet file R00DATA.WK4. Please also see my response to NAA/USPS-T41-3 for more detail about R00DATA.WK4.**
- c. The data in Table 11 are found in the spreadsheet file RAMOUT.WK1.**

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T41-5. Please refer to your testimony at page 10, Summary Table 1, column 1, labeled "Before-Rates Price." The figure you give for Standard ECR is 0.1494. Witness Moeller's WP1, page 8, column (6) provides a figure of 0.1498 for "rev/pc" for ECR Mail in a Table titled "Test Year Before Rates Summary." Please reconcile the discrepancy.

RESPONSE:

The small difference in the Standard ECR subclass price is due to a slightly different weighting of the incidence of the parcel surcharge.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T41-6. Please refer to your testimony at page 9, lines 10-11, where you states that the "overall markup" under Ramsey pricing is 63.7 percent, as compared with your estimate of 67.6 percent for "R97-1 Index pricing." You conclude that these percentages provide "... evidence that the Ramsey prices raise the required net revenue in a more efficient way." Table 8, page 63, provides "After Rates GFY 2001 Net Revenues at Proposed USPS Rates," but does not provide the markup indices at these rates.

- a. Please provide the data for a fourth column of Summary Table 2, page 11, which calculates the "% markup" for the "After-Rates Price" at proposed USPS Rates, (as estimated by you in column 2 of Table 8 at page 63 of USPS-T-41). Please make sure that you provide the "overall" markup for Proposed USPS Rates that you estimate.
- b. Witness Mayes, Exhibit USPS-32B, page 1 of 2, column (3), provides "Revenue as Percent of Cost" of 168.0% or a markup of 68.0% for total mail and services. Do your calculations concur with this figure? If not, please reconcile the discrepancy.
- c. Do you find any similarity to your answer to (a) and Witness Mayes's estimate of 68.0% What conclusions do you draw as to the "efficiency" of the R97-1 Index prices, relative to proposed USPS rates, as you employ that term?
- d. At USPS-T-41, page 93, lines 12-13, you state that "[i]n fact, any two rate schedules—however those rates are obtained—can be compared in terms of changes in consumer surplus." Please provide the data in the format of a fourth column of Table 3, USPS-T-41, page 13, which would calculate the change in consumer surplus, using your methodology, between (1) the "R97-1 Index prices" given in Summary Table 3, page 13, and (2) the "After [USPS] Rates Price" in Table 8, page 63.

RESPONSE:

- a. Please see the table accompanying this response.
- b. My calculated overall mark-up is 66.9 percent. The small difference between my figure and Witness Mayes figure of 68.0 percent is due to two factors. First, my

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

calculations use before-rates volume variable cost per piece (marginal cost), which are very close to but not identical to the after-rates costs per piece used by Witness Mayes. Second, Witness Mayes' calculations include some postal products that are not considered in my testimony.

- c. In terms of overall mark-ups above volume variable costs, my calculations show that the Postal Service proposed rates yield an overall mark-up of 66.9 percent while my R97-1 Index rates have an overall mark-up of 67.6 percent. Based on this measure, it appears that the Postal Service proposed rates are somewhat more efficient than my R97-1 Index rates.
 - d. Please see the Table accompanying this response. The results show that total consumer surplus is \$14.2 million greater at USPS proposed rates than at the R97-1 Index rates.
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TABLE ACCOMPANYING RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN TO NAA/USPS-T41-6(a)

Mail Product	USPS Proposed		After-Rates Volume	Revenue	Volume Variable Cost	Percent Mark-Up
	After-Rates Price	Before-Rates Marginal Cost				
First-Class LFIPPs	\$0.3560	\$0.1852	99,857.394	\$35,546.436	\$18,491.093	92.2%
First-Class Cards	\$0.1939	\$0.1309	5,440.951	\$1,055.164	\$712.269	48.1%
Priority Mail	\$4.4358	\$2.4516	1,226.160	\$5,438.988	\$3,006.108	80.9%
Express Mail	\$14.5760	\$6.6530	72.301	\$1,053.858	\$481.022	119.1%
Periodicals In-County	\$0.0928	\$0.0943	862.061	\$79.960	\$81.272	-1.6%
Periodicals Nonprofit	\$0.1804	\$0.1787	2,052.208	\$370.263	\$362.576	2.1%
Periodicals Classroom	\$0.2610	\$0.2532	55.089	\$14.380	\$13.948	3.1%
Periodicals Regular	\$0.2735	\$0.2741	7,351.808	\$2,010.808	\$2,015.233	-0.2%
Standard A Regular	\$0.2209	\$0.1665	40,998.656	\$9,057.587	\$6,827.793	32.7%
Standard A ECR	\$0.1568	\$0.0752	32,828.211	\$5,148.875	\$2,467.467	108.7%
Standard A Nonprofit	\$0.1302	\$0.1152	11,425.579	\$1,487.885	\$1,316.284	13.0%
Standard A Nonprofit ECR	\$0.0881	\$0.0731	2,851.875	\$251.373	\$208.347	20.7%
Standard B Parcel Post	\$3.2290	\$2.8490	374.096	\$1,207.957	\$1,065.806	13.3%
Standard B Bound Printed	\$1.0713	\$0.9104	524.743	\$562.131	\$477.735	17.7%
Standard B Special Rate	\$1.6443	\$1.4608	205.789	\$338.384	\$300.613	12.6%
Standard B Library	\$1.7918	\$1.6648	28.432	\$50.943	\$47.334	7.6%
Registered	\$9.4645	\$7.7205	10.966	\$103.788	\$84.663	22.6%
Insured	\$2.2903	\$1.7137	44.680	\$102.331	\$76.568	33.6%
Certified	\$2.1463	\$1.6736	274.934	\$590.080	\$460.121	28.2%
COD	\$5.6458	\$4.2240	3.544	\$20.009	\$14.970	33.7%
Return Receipts	\$1.5118	\$1.3047	220.088	\$332.732	\$287.145	15.9%
Money Orders	\$0.9096	\$0.6792	226.435	\$205.964	\$153.792	33.9%
Total				\$65,029.894	\$38,952.159	66.9%

TABLE ACCOMPANYING RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN TO NAA/USPS-T41-6(d)

Mail Product	R97-1 Index Price	R97-1 Index Volume	USPS Proposed Price	USPS Volume	Change in Consumer Surplus
First-Class LFIPPs	\$0.3442	100,665.820	\$0.3560	99,857.394	(\$1,177.5)
First-Class Cards	\$0.2111	4,974.066	\$0.1939	5,440.951	\$89.7
Priority Mail	\$4.4382	1,186.918	\$4.4358	1,228.160	\$2.9
Express Mail	\$11.2503	106.789	\$14.5760	72.301	(\$297.8)
Periodicals In-County	\$0.0979	855.493	\$0.0928	862.061	\$4.4
Periodicals Nonprofit	\$0.1881	2,021.446	\$0.1804	2,052.208	\$15.7
Periodicals Classroom	\$0.2692	52.857	\$0.2610	55.089	\$0.4
Periodicals Regular	\$0.2827	7,200.226	\$0.2735	7,351.808	\$138.4
Standard A Regular	\$0.2407	38,737.214	\$0.2209	40,998.656	\$788.1
Standard A ECR	\$0.1594	31,907.618	\$0.1568	32,828.211	\$84.0
Standard A Nonprofit	\$0.1450	11,216.215	\$0.1302	11,425.579	\$167.2
Standard A Nonprofit ECR	\$0.1163	2,715.772	\$0.0881	2,851.875	\$78.4
Standard B Parcel Post	\$3.1547	379.007	\$3.2290	374.096	(\$28.0)
Standard B Bound Printed	\$1.2271	482.080	\$1.0713	524.743	\$78.4
Standard B Special Rate	\$1.5895	207.869	\$1.6443	205.789	(\$11.3)
Standard B Library	\$1.7593	28.541	\$1.7918	28.432	(\$0.9)
Registered	\$9.1146	11.071	\$9.4645	10.966	(\$3.9)
Insured	\$2.4969	43.338	\$2.2903	44.680	\$9.1
Certified	\$2.0606	266.612	\$2.1463	274.934	(\$23.2)
COD	\$4.7301	3.634	\$5.6458	3.544	(\$3.3)
Return Receipts	\$1.8502	212.127	\$1.5118	220.088	\$73.1
Money Orders	\$1.0436	210.609	\$0.9096	226.435	\$29.3
Total					\$14.2

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T41-7. Please refer to your testimony at page 41, lines 23-26, where you state that consideration of USPS competition with non-postal firms in your Ramsey Pricing model involves consideration of the "producer and consumer surplus associated with competing products." At page 45, line 24 to page 46, line 12 you conclude that such effects on competing products may be safely ignored.. At page 101, you calculate that adoption of your Ramsey prices would require a 42.2% rate cut for Standard A ECR Mail relative to current prices. At page 71, Table 11, you calculate that this rate cut would produce a volume increase of ECR Mail from 31,907.6 million pieces to 52,337.1 pieces, or approximately 64 percent. At page 87, line 24 to page 88, line 14, you review your Ramsey pricing proposals and conclude that "any reduction in the economic value of these media in response to a decline in Standard A ECR leads to an equal reduction in economic cost, yielding no net change in overall economic efficiency."

- a. Please confirm that your testimony at page 41, line 13 to page 46, line 12 and page 87, line 24 to page 88, line 14, represents the entirety of your consideration of the effect of your Ramsey rate proposals for ECR on "enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters."
- b. If you are unable to confirm (a), please explain what other consideration you gave.
- c. Is it your testimony that private enterprise competitors of ECR mail would be unaffected by and therefore indifferent to a 42.2% cut in rates for Standard A ECR Mail and an accompanying 64 percent increase in ECR volume? Explain your answer fully.

RESPONSE:

a and b. Confirmed.

c. No, I do not claim that private competitors of ECR mail would be unaffected by the reduction in Standard A ECR mail rates. They may experience a decline in the level of their business as some advertisers shift to Standard A. I have no estimate of the shift of business and, in fact, a good portion of the increase in ECR mail volume results from

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
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a decline in postage costs which allow current advertising mailers to send more mail, without having to shift resources from other advertising media.

However, from the standpoint of overall economic efficiency, as long as the private firms competing with the Postal Service are pricing at marginal cost (a reasonable assumption given the competitive nature of their enterprise), then "any reduction in the economic value of these media in response to a decline in Standard A ECR leads to an equal reduction in economic cost, yielding no net change in overall economic efficiency."

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
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NAA/USPS-T-41-8. Please refer to your testimony at page 63, Table 8.

- a. Please provide the necessary source data to reproduce the data in this table.**
- b. Witness Moeller USPS-T-35, WP1, page 24, provides at line 32 a "TYAR revenue per piece of \$0.1572. Please reconcile this figure with the comparable entry of \$0.1568 in column 2 of your Table 8.**

RESPONSE:

- a. Please see my response to NAA/USPS-T41-4(b).**
 - b. As is the case with the before-rates price of Standard A ECR mail (please see my response to NAA/USPS-T41-5), the tiny difference between my after-rates price of Standard A ECR mail and Witness Moeller's after-rates price is due to a slightly different weighting of the incidence of the parcel surcharge.**
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**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T41-9. Please refer to your testimony at page 66, lines 8-9.

- a. Please also provide the GFY 2001 attributable costs using the PRC costing methodology presented at page 66 of your direct testimony and employed by you to calculate the "R2000-1 price" as reported by you in Table 10, page 69, together with all source data necessary to reproduce the result.**
- b. Please also provide for the "R2000-1 Price" as reported by you in Table 10, the "overall % mark-up" (see your Table 2 for examples), together with the necessary source data to reproduce this result.**

RESPONSE:

a. The PRC attributable costs can be found in the spreadsheet file R00DATA.WK4. The source of this data is LR-I-131.

b. I cannot calculate the exact overall % mark-up that results at the R2000-1 Prices presented in Table 10 because I do not have an estimate of the attributable costs that would exist at the volumes corresponding to those prices. However, making the simplifying assumption that attributable costs per piece is constant as volume changes (which is less true than for marginal cost), I can provide an estimated overall % mark-up, as shown in the table accompanying this response.

The data used in constructing the table are found in R00DATA.WK4.

TABLE ACCOMPANYING RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN TO NAA/USPS-T41-9

Mail Product	Price	Attributable Cost/Piece	Volume	Revenue	Attributable Cost	Percent Mark-Up
First-Class LFIPPs	0.3442	0.2030	100,665,820	\$34,651.986	\$20,433.148	69.6%
First-Class Cards	0.2111	0.1422	4,974,066	\$1,050.265	\$707.068	48.5%
Priority Mail	4.4382	2.7140	1,186,918	\$5,267.764	\$3,221.246	63.5%
Express Mail	11.2503	9.9497	106,789	\$1,201.408	\$1,062.520	13.1%
Periodicals In-County	0.0979	0.0974	855,493	\$83.759	\$83.358	0.5%
Periodicals Nonprofit	0.1881	0.1872	2,021,446	\$380.274	\$378.455	0.5%
Periodicals Classroom	0.2692	0.2679	52,857	\$14.227	\$14.159	0.5%
Periodicals Regular	0.2927	0.2899	7,200,226	\$2,107.292	\$2,087.230	1.0%
Standard A Regular	0.2407	0.1806	38,737,214	\$9,323.730	\$6,996.871	33.3%
Standard A ECR	0.1594	0.0801	31,907,618	\$5,087.267	\$2,556.438	99.0%
Standard A Nonprofit	0.1450	0.1243	11,216,215	\$1,626.259	\$1,394.400	16.6%
Standard A Nonprofit ECR	0.1163	0.0778	2,715,772	\$315.901	\$211.306	49.5%
Standard B Parcel Post	3.1547	2.9294	379,007	\$1,195.637	\$1,110.267	7.7%
Standard B Bound Printed	1.2271	0.9142	482,080	\$591.546	\$440.739	34.2%
Standard B Special Rate	1.5895	1.5083	207,869	\$330.406	\$313.531	5.4%
Standard B Library	1.7593	1.7132	28,541	\$50.213	\$48.897	2.7%
Registered	9.1146	7.4411	11,071	\$100.905	\$82.378	22.5%
Insured	2.4969	1.7465	43,338	\$108.210	\$75.690	43.0%
Certified	2.0606	1.8396	266,612	\$549.372	\$490.448	12.0%
COD	4.7301	4.7120	3,634	\$17.191	\$17.125	0.4%
Return Receipts	1.8502	1.3047	212,127	\$392.471	\$276.759	41.8%
Money Orders	1.0436	0.7193	210,609	\$219.785	\$151.495	45.1%
Total				\$64,665.868	\$42,153.528	53.4%

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T41-10. Please refer to your testimony at page 98, Table 13, where you estimate that consumers of Standard A ECR Mail would receive benefits of \$3,075.5 million as a result of adopting your Ramsey price rather than the "R97-1 Index price." At page 87, lines 14-15, you state that "[t]he volume of Standard A ECR Mail is noticeably greater under Ramsey pricing than under prices obtained from the R97-1 Markup Index."

- a. Who are the consumers that you believe would receive these benefits?
- b. Are Standard A ECR mailers member of the "extremely competitive" advertising industry to which you refer at page 88, lines 2-4 of your testimony?
- c. If not, please explain in detail why not.
- d. If so, are they private firms for which, using your rationale at page 88, lines 4-8, no account need be taken in establishing Ramsey prices, because changes in price lead to "an equal reduction in economic cost, yielding no net change in overall economic efficiency?"

RESPONSE:

- a. In general, the consumers considered in my testimony are mailers. Therefore, the beneficiaries of the decrease in Standard A ECR mail rates are the users of this mail service, principally advertisers. However, the demand curve for Standard A ECR mail reflects the benefits that this product provides to others involved in its use, namely the businesses that use advertising mail and the households or businesses that benefit from the receipt of advertising mail.

- b and c. Yes.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
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- d. No, because Standard A ECR mail is not priced at marginal cost. Therefore, movements toward marginal cost ~~increase~~ economic efficiency, balanced against the impact on Postal Service net revenues as measured by the Ramsey leakage factor k.

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NAA/USPS-T41-11. Please refer to your testimony at page 104, where you discuss "ECSI Considerations for Periodicals Mail."

- a. Please confirm that you did not consider ESCI (educational, cultural, scientific and informational) value to the recipient of any other class or subclass.**
- b. If you are unable to confirm, please explain why.**

RESPONSE:

a and b. Confirmed. My focus on the ECSI considerations of Periodicals Mail was based on my view that both the Postal Service and the Postal Rate Commission give considerable weight to this issue in their pricing of Periodicals Mail.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
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NAA/USPS-T41-12. Please refer to the testimony of USPS Witness Mayes, USPS-T-32, page 18, lines 5-20, where she provides a hypothetical example of two mail pieces with identical volume variable cost but one incurs specific fixed cost. Assume that there are no relevant user costs and both pieces have the same elasticity (and cross elasticity if relevant).

- a. Please confirm that both pieces will be charged the same Ramsey price despite the fact that one incurs specific costs and the other does not.**
- b. If you are unable to confirm (a), please explain how specific fixed costs are accounted for in your estimates of Ramsey prices.**

a and b. Confirmed. If two products have the exact same marginal cost (i.e., volume variable cost per piece) and the exact same demand elasticity, then they will have the same Ramsey price, regardless of any differences in specific fixed costs between the two products. However, the Ramsey price of the product with specific fixed costs might be adjusted upward if the revenues generated at the Ramsey price are less than the incremental costs (which include specific fixed costs) of the product.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T41-13. Please refer to page 53 of your testimony. Do you believe that the Postal Service's estimates of volume variable are, or are a proxy for, the marginal costs of an efficient producer of postal services? Please explain.

RESPONSE:

I believe the Postal Service's estimates of volume variable costs are a measure of the actual marginal costs of the Postal Service. As I discussed in my testimony, citing the R87-1 testimony of Professor William Baumol, it is the actual marginal costs of the Postal Service which are the relevant measure to be used in postal rate-making.

Furthermore, I have some difficulty interpreting the notion of the "efficient provider of postal services." Is this so-called "efficient provider" subject to the same rules and regulations as the Postal Service, bound by the same contracts, and obligated to provide the same level of service? If so, I see no reason why their costs would be different from the actual Postal Service. If not, I see no relevance of considering the costs of a hypothetical firm that operates under different conditions from the firm whose prices are being set in this regulatory proceeding.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T41-14. Please refer to your testimony at page 10, Table 1, where you provide your estimate of 0.0864 for the Standard ECR subclass for "After-Rates Price Ramsey Pricing." Please refer to Library References I-156, to the spreadsheet R00Data.wk4, worksheet "BR Data, Column T, which contains a column labeled "PRC (BR) attributable/PC." The entry for Standard A ECR is \$0.080120.

- a. Please confirm that the cited data in LR-I-156 are the cost data for the test year using the PRC attribution methodology and used by you to compute what you label "After Rates Price (R97-1 Index)" and "R2000-1 price" using the markup identified as "R2000-1 markup" in Table 10 of your direct testimony.
- b. If you are unable to confirm (a), please provide the attributable costs and markups you did use.
- c. If you are able to confirm (a), please confirm that at a "R2000-1 Price" of 0.1594, Standard A ECR would pay a rate with a 7.838 percent mark-up over attributable costs using what you label "2001 Test Year attributable costs as calculated by the Postal Service using the PRC costing methodology."
- d. If you are unable to confirm (c), please provide the correct figure with explanation.

RESPONSE:

a and b. Confirmed.

c. and d. Not confirmed. At a price of \$0.1594 and an attributable cost per piece of \$0.08012, Standard A ECR mail has a mark-up of 99.0 percent, as presented in my Table 10. You may be thinking of the mark-up of the Ramsey price of \$0.0864 over an attributable cost of \$0.080120. This mark-up is 7.838 percent.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T41-15. Please refer to your testimony at page 87, lines 2-4, where you state that the cross elasticity of Standard A Regular with First Class letters means that some of the volume from Standard A Regular that otherwise would be lost as a result of a rate increase would be regained by migration to First Class letters.

- a. Did you consider the possibility of similar migrations between Standard A Regular and ECR?**
- b. If so, please explain how. If not, please explain why not.**
- c. Did you consider the possibility that some of the volume of ECR Mail that would otherwise be lost from ECR rate increases would be regained by migration to First Class?**
- d. If so, please explain how. If not, please explain why not.**
- e. In your testimony at page 101, Table 14A, you estimate that the change in price (as compared with Before Rates) to implement Ramsey prices for Standard A ECR is a 42.2% cut in prices and an increase of 7.8% for First Class letters. Did you consider that these rates would encourage migration from First Class Mail to ECR?**
- f. If so, please explain how. If not, please explain why not.**

RESPONSE:

a through f. My testimony is based on the demand equations estimated by Mr. Thress (USPS-T-7) and Dr. Musgrave (USPS-T-8). Mr. Thress does not include a cross-price elasticity between Standard A ECR mail and Standard A Regular mail or First-Class letter mail. Therefore, I did not consider the shifts of mail posited in your question since such shifts are inconsistent with the demand equations used in my testimony.

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TO INTERROGATORIES OF NAA**

NAA/USPS-T41-16. Witness Mayes, at USPS-T-32, page 21, lines 3-4, stated that the relatively low price elasticity of demand for single piece First Class letters and workshared letters may be due to the Private Express Statutes. See also her response to NAA/USPS-T32-8.

- a. Did you take this possibility into account in calculating your Ramsey prices?**
- b. If so, please explain how. If not, please explain why not.**

a and b. I did not take any explicit account of the Private Express Statutes in the calculation of my Ramsey prices. My Ramsey prices are based on the estimated elasticities of demand which may to some degree be influenced by the Private Express Statutes. However, the relevant demand elasticities for pricing are those expected to prevail in the Test Year, during which time the Private Express Statutes will continue to be in force.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
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NAA/USPS-T41-17. Please refer to your testimony at page 105, where you state that the changes in your estimates of Ramsey prices for R2000-1 as compared with R97-1 Ramsey prices are explained in part by changes in demand elasticity.

- a. Did you consider whether the changes in demand elasticity were statistically significant?**
- b. If so, please provide all details of the analysis. If not, please explain why not.**

RESPONSE:

a and b. For my testimony, I did not investigate the statistical significance of the change in any estimated elasticities between R97-1 and R2000-1. The statistical significance of the change is not relevant to the Ramsey prices or volumes which, like all other prices and volumes considered in this case, are based on the point estimates of the R2000-1 elasticities.

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TO INTERROGATORIES OF NAA**

NAA/USPS-T41-18. Please refer to LR-I-156, page 9, where you state that "R97-1 Index prices" are calculated to satisfy a markup condition, whereby "the new mark-ups will all be the same multiple of the old markups, thereby maintaining relative mark-ups." The variable "m" is undefined on page 9. However on page 2, "m" is defined as "marginal cost (equal to Postal Service volume variable cost per piece plus mailer user cost)." Please also refer to your testimony at page 66, lines 3-15, which describes a process of generating "PRC recommended R97-1 markups" based on "GFY 2001 attributable costs." Table 10, page 69, provides estimates of "R2000-1 price" and "R2000-1 markup." The prices in Table 10 appear to be identical to column 1 of Table 3, page 13, labeled "R97-1 Index price."

- a. Please confirm that "m" on page 9 has the same definition as on page 2. If you cannot confirm, please explain.
- b. Please confirm that you use the term "R97-1 Index price" synonymously with "R2000-1 price." If you cannot confirm, please explain.

RESPONSE:

- a. Confirmed. "m" refers to marginal cost throughout LR-I-156.
- b. The R2000-1 price presented in Table 10 is identical to the R97-1 Index price discussed later in my testimony.

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TO INTERROGATORIES OF NAA**

NAA/USPS-T41-19. Please refer to Library Reference LR-I-149. This contains a column under "markup comparison" entitled "Replic. PRC R2000-1." Please reconcile this column with your calculated "R2000-1 markup" in Table 10, page 69 of your testimony, including your figure comparable to the 54.2% for "Total Mail and Services" in LR-I-149.

RESPONSE:

The table accompanying my response to NAA/USPS-T41-9 shows my calculation of the R2000-1 overall mark-up over attributable costs is 53.4 percent. The slight difference between this figure and the 54.2 percent figure cited in your question is due to (1) my use of before-rates attributable costs per piece and (2) the 54.2 percent figure is based on calculations including some mail products not considered in my testimony.

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NAA/USPS-T41-20. Please refer to your direct testimony at page 45, line 24 to page 46, line 12, and page 87, line 24 to page 88, line 6, where you conclude that Ramsey pricing need not take account of the effect of postal prices on private enterprise competitors, in particular those of Standard A ECR Mail. In developing your Ramsey rates, did you make use of any information regarding the cost structures or pricing practices of competitors? If so, please explain what information you used and how it used it.

RESPONSE:

I have no detailed information on the cost structure of Postal Service competitors. It is my view that these firms operate in competitive markets where marginal cost pricing is likely.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T41-21. Please refer to your testimony at page 106, column 4, labeled "marginal cost change." Please provide all necessary data to reproduce the data in this column.

RESPONSE:

The marginal cost change is equal to the percentage difference between the marginal costs used in my R2000-1 testimony reported in Table 7 at page 55 and the marginal costs used in my R97-1 testimony reported in Table 7 at page 40 (Docket No. R97-1, USPS-T-31).

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF OCA

OCA/USPS-T41-1. Please refer to your response to interrogatory MOAA/USPS-T41-3. You state, "An equal across-the-board rate increase approach does not take account of changes in relative costs which will generally lead to rates that are not economically efficient."

- (a) Would you agree that an attempt to minimize deviations from an "equal across-the board rate increase approach" in order to mitigate rate increases for categories of mail that have experienced relatively larger increases in volume variable costs "will generally lead to rates that are not economically efficient"? If not, why not?
- (b) Would you agree that a ten-year history of attempting to mitigate rate increases for categories of mail that have experienced relatively larger increases in volume variable costs will almost certainly "lead to rates that are not economically efficient"? If not, why not?

RESPONSE:

a. I do not completely agree with the point made in your interrogatory because efficient pricing needs to take account of both cost and demand considerations. My response to MOAA/USPS-T41-3 focused on changes in relative costs only. Putting demand considerations aside, I stated that an equal across-the-board rate increase will generally lead to rates that are not economically efficient. However, taking account of demand elasticity differences, it may be the case that movements toward equal across-the-board rate increases could be economically efficient even when there have been changes in relative costs. For example, suppose there is a mail product that currently has a mark-up that is greater than its Ramsey mark-up. If this product experiences a large increase in costs, assigning it an average rate increase will tend to lower its mark-up (since the percentage cost increase exceeds the percentage price increase). In this case, movement toward equal across-the-board rate increases would raise economic efficiency.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF OCA

- b. A ten-year history of mitigating rate increases (i.e., relative rate increases less than the product's relative cost increases) can increase economic efficiency if the resulting decrease in the product mark-up moves the mark-up closer to the Ramsey mark-up.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF OCA

OCA/USPS-T41-2. Please refer to your response to interrogatory GCA/USPS-T41-60(b). You state, "Products can be substitutes without being price substitutes. It may be the case that any substitution between First-Class letters and electronic alternatives is based on service characteristics and not price."

- (a) Would you agree that there will be at least one consumer on the price margin (i.e., "on the fence") between using First Class Mail and using an electronic alternative during the period that proposed rates are in effect? If not, why not?
- (b) Are you suggesting that all consumers who switch from First Class Mail to electronic alternatives do so without comparing future costs and benefits of such a switch? If not, what point are you trying to make?
- (c) Are you suggesting that *all* consumers contemplating a switch from First Class Mail to electronic alternatives would do so without taking account of the expected future price path of First Class Mail? If not, what point are you trying to make?
- (d) Please provide citations to the economic literature that support the point you are trying to make.

RESPONSE:

a. Yes.

b and c. The point I was making in GCA/USPS-T41-60(b) is simply that the emergence of electronic alternatives may not have a meaningful effect on the price elasticity of First-Class letters. It may be the case that while there are some consumers who move to electronic alternatives due to an increase in the price of letters, there may not be many consumers who do so. Put differently, my point is that any cross-price elasticity between First-Class letters and electronic alternatives may be small, indicating that price considerations are not dominant in the decision of consumers to substitute electronic alternatives for letter mail.

d. Evidence to support the view presented in parts b and c comes from the

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF OCA

experience of the past ten years, during which time there has been tremendous growth in fax messaging, E-mail, electronic funds transfers, and electronic data interchange, and there has not been much change in the own-price elasticity of First-Class letters.

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TO INTERROGATORIES OF OCA

OCA/USPS-T41-3. Please refer to your response to interrogatory GCA/USPS-T41-60(e). You state, "Consideration of years in the future, namely 2003 to 2008, should not be incorporated into elasticity estimates used to make forecasts for 2001 and 2002."

- (a) How should consideration of the future price path of First Class Mail be incorporated into volume forecasts for 2001 and 2002?
- (b) Are you suggesting that expectations about future prices have no effect on the current volume of First Class Mail? If not, what point are you trying to make?
- (c) Are you suggesting that volumes of First Class Mail in the years 2003 to 2008 are unaffected by prices in 2001 and 2002? If not, what point are you trying to make?
- (d) Please provide citations to the economic literature that support the point you are trying to make.

RESPONSE:

a and b. Volume forecasts for 2001 and 2002 should use the prices and price elasticities expected to prevail in 2001 and 2002. The econometric work of Thomas Thress in R97-1 and R2000-1 and the work of Dr. George Tolley before him do not use the future price of First-Class letters as a variable explaining current volume. Their work suggests that future prices do not have significant impact on the current volume of letter mail.

c. No and I did not say this in my response to GCA/USPS-T41-60(e). I said that prices in 2003 through 2008 are not included in the forecast of volumes in 2001 and 2002.

d. See the econometric work of Thomas Thress in R2000-1 and R97-1 and the work of George Tolley in the present and earlier rate cases.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF OCA

OCA/USPS-T41-4. Please refer to the response to ABA&NAPM/USPS-3.

- (a) Do you agree with the Postal Service's response to part (a) of that interrogatory? Please provide a factual foundation for your response.
- (b) Do you agree with the Postal Service's response to part (b) of that interrogatory? Please provide a factual foundation for your response.
- (c) Do you agree with the Postal Service's response to part (c) of that interrogatory? Please provide a factual foundation for your response.
- (d) Please explain why the "rate increases in First-Class worksharing of the variety proposed by the Postal Service in this proceeding" do not affect the speed with which bills and bill payments mail leaves the Postal Service.

RESPONSE:

- a. If "susceptible to electronic diversion" means potentially, but not necessarily, lost to electronic diversion some time in the future, then I agree.
- b. Yes.
- c. In its response, the Postal Service is stating that it is "appropriate for the Postal Service to raise rates for First-Class worksharing mail." I did not estimate separate prices for single-piece and workshare letters for my testimony in this case. The Ramsey price of the First-Class subclass is greater than the before-rates price, and therefore it seems reasonable for there to be some increase in the price of workshare letters.
- d. I did not make the statement addressed in your question. The Postal Service

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF OCA

may be making the point that a comparison of the before- and after-rates volume forecasts shows a relatively small change in workshare letter volume due to the proposed increase in workshare category rates. The small volume change is evidence that the rate increases are not expected to have much impact on the volume of bills and bill payments lost to electronic alternatives.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN TO
UPS INTERROGATORIES**

UPS/USPS-T41-1. Identify all instances in which you have relied on or used in your testimony in any way any FY 1999 cost, revenue, volume, or other data, and state in each such instance why you used FY 1999 data instead of data for BY 1998.

RESPONSE:

The demand elasticities used in my testimony to calculate the Ramsey prices and the Test Year volumes at the Ramsey and non-Ramsey price schedules were based on regressions estimated using volume and revenue data through PFY 1999. The volume forecasts presented in my testimony also made use of postal volumes in 1999, which served as the Base Year for these forecasts. I chose to use the same demand elasticities and Base Year volumes that were used in the volume forecasts of Dr. Tolley and Dr. Musgrave.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF UPS**

UPS/USPS-T41-2. Refer to your testimony on page 43, where you indicated that "the response of the nonpostal firm to changes in" postal prices will be equal to zero when the nonpostal firm is operating in a market with marginal cost pricing. Confirm that the accuracy of this statement depends upon the assumption that marginal costs of production do not vary with the level of output. If you do not confirm, explain.

RESPONSE:

Confirmed. If the nonpostal firm's marginal costs vary with the level of output, then changes in postal prices can lead to a change in the nonpostal firm's price. For example, suppose the price of the postal product is increased, which leads to an increase in the volume of the nonpostal firm due to a cross-price effect. If the marginal costs of the nonpostal firm increase with volume, then the nonpostal firm may respond to the increase in the postal price by increasing its own price in response to an increase in its marginal costs.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF UPS**

UPS/USPS-T41-3. Refer to your testimony on page 46, where you state that "Private firms operating in competitive markets with free entry can be expected to be pricing at marginal cost." You there employ this statement to justify your focus on "the Ramsey model without cross-elasticities of nonpostal firms."

- (a) Confirm that you are characterizing the markets in which the Postal Service, Federal Express, UPS, and other such delivery companies operate as "competitive markets with free entry." Provide a precise definition of "competitive markets with free entry," as you are using the term here.
- (b) Provide all information that you have relied upon to conclude that nonpostal firms that provide products which are substitutes for products supplied by the Postal Service set prices equal to their marginal costs of production.

RESPONSE:

a. In my view, a competitive market with free entry is one in which above normal profits of existing firms would lead to entry of new firms. It appears to me that the package delivery market is such a market, as it consists not only of the Postal Service, Federal Express, and UPS, but also a number of smaller firms, many of them recent entrants to this growing industry. Among these other firms are Airborne, RPS, Emery, DHL, TNT, and Burlington Air Express, each of which have some share of the domestic package market. There are also a few regional delivery firms such as Eastern Connection and Night Owl Express which serve only certain local markets.

b. I have no information on the marginal costs of nonpostal firms that provide products which are substitutes for Postal Service products. However, the assumption that in a largely competitive industry, firms set prices equal to marginal costs seems quite reasonable, understanding that the marginal cost of private firm includes a normal

RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF UPS

return on investment. Prices above marginal cost would create an opportunity for a competing firm to "steal" business by offering a price closer to marginal costs.

Moreover, it is well known that many private carriers offer discounted prices to select customers. *Firms might charge above marginal cost prices for some customers, while charging prices equal to marginal cost to their most price sensitive customers, i.e., customers most likely to use a competing carrier if price is set above marginal cost.*

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF UPS**

UPS/USPS-T41-4. Refer to your testimony on page 15, where you state that "postal rates must be set above marginal cost to generate revenues equal to total costs . . . "

- (a) Provide all information you have relied upon to conclude that the same is not also true for competitors of the Postal Service. Include all documents and analyses which support this conclusion.
- (b) If you do not have any such information, then explain why these suppliers "can be expected to be pricing at marginal cost" (USPS-T-41 at 46).

RESPONSE:

a. As I answered in UPS/USPS-T41-3, I have no detailed information about the cost structure of private firms competing with the Postal Service. Therefore, it is certainly possible that these firms have cost characteristics similar to the Postal Service, namely, the existence of common non-volume variable costs that cannot be assigned to individual products. However, it not clear that the degree to which this occurs for private competing firms will be the same as for the Postal Service. These firms have neither the scale (200 billion pieces of mail delivered each year, with delivery six days of week to every house and business in the nation) nor the scope (16 different subclasses of mail) of the Postal Service.

b. As I explained in my response to UPS/USPS-T41-3, it seems logical that in a largely competitive industry, firms would be pricing at marginal cost. This can occur either because marginal cost pricing in general yields a normal profit for the firm and competition prevents the firm from charging above marginal cost or because the firm selectively discounts its prices to some customers, thereby lowering price to marginal cost in cases where it faces the most competition.

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF UPS**

UPS/USPS-T41-5. Refer to your testimony on page 45, where you state that "Ramsey prices of postal products including rivalry could be less than the Ramsey prices when rivalry is not considered."

- (a) Confirm whether this statement and the discussion in the first paragraph on page 45 is meant to indicate that Ramsey prices of postal products including the effects of rivalry from UPS, Federal Express, and other competitors are likely to be less than Ramsey prices when rivalry is not considered under the conditions that prevail in today's postal delivery industry.**
- (b) If so, define the precise sense in which you are using the term "likely," and provide a complete justification for your conclusion.**

RESPONSE:

a and b. I do not say that the Ramsey pricing of postal products including the effects of rivalry is "likely" to be less than when rivalry is not considered. I merely state that under certain circumstances, the Ramsey price would be lower. Specifically, the discussion at page 45 considers the case in which 1) private firms are not pricing at marginal cost and 2) private firms respond to a change in the price of a competing postal product by changing their own price. In this case, a decline in the price of the postal product leads to a decline in the price of the non-postal alternatives. Since the price of these non-postal alternatives is assumed to be above marginal cost, a decline in their price moves the price closer to marginal cost. Since marginal cost pricing is most efficient for the economy, a decline in the price of the postal product leads to an increase in economic efficiency because it causes the competing firms to move their price closer to marginal cost. Thus, the Ramsey price of the postal product, taking account of the conditions in (1) and (2) discussed above, would be lower than if rivalry with competing firms were ignored.

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REVISED RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO UPS/USPS-T-41-6.

UPS/USPS-T41-6. Refer to your testimony on page 45, where you state, "Ultimately, the Ramsey prices of postal products are affected by cross-elasticities with nonpostal products only if the nonpostal firms are pricing above marginal cost."

- (a) Confirm that equation 8(a) on page 42 of your testimony refutes this statement in cases where the price set by nonpostal firms increases with the price of the postal product (i.e., where $dP_2/dP_1 > 0$).
- (b) Confirm that the price set by nonpostal firms can increase as the price of the postal product increases (so $dP_2/dP_1 > 0$) even when nonpostal firms set prices equal to their marginal costs of production.
- (c) If you do not confirm (a) and (b), provide a detailed explanation.

RESPONSE:

a. My testimony assumed that the nonpostal firm, like the Postal Service, had constant marginal costs in the relevant range of volume. In other words, if marginal costs are constant and the firm is pricing at marginal cost, then there will be no response by the nonpostal firm to a change in the postal price ($dP_2/dP_1 = 0$) because there is no change in the nonpostal firm's marginal cost.

If the nonpostal firm's marginal cost is not constant, as posited in UPS/USPS-T41-2, then changes in the nonpostal volume can lead to changes in the nonpostal marginal costs and changes in the nonpostal price ($dP_2/dP_1 > 0$). In that case, the Ramsey pricing equation would include the terms $E_{12}[dP_2/dP_1 \cdot P_1/P_2]$, which would be non-zero if ($dP_2/dP_1 > 0$). However, the impact of these additional terms on the Ramsey price of the postal product is still likely to be quite small. Specifically, this question suggests that $dP_2/dP_1 > 0$ (meaning that the nonpostal firm changes its price in response to a change in the Postal Service price), but that the nonpostal firm's price change reflects a change in the nonpostal firm's marginal cost, so that the firm is still pricing at marginal cost. The change in the nonpostal firm's marginal cost must be driven by a change in the firm's volume, which in turn is due to the changes in its price

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TO UPS/USPS-T-41-6.

and the price of the postal product. However, given that the nonpostal firm's price change is in the same direction as the postal product price change (e.g., $dP_2 dP_1 > 0$), the overall impact on the nonpostal firm's volume may be rather small. For example, a fall in the price of the postal product would reduce the volume of the nonpostal firm (because of the cross-price effect), but the responding fall in the price of the nonpostal product will lead to an offsetting increase in nonpostal volume. Thus, volume changes will be small and, most likely, changes in marginal cost will be small as well. Since price changes are posited to follow marginal cost changes, $dP_2 dP_1$ will also be close to zero, yielding only a small impact on the Ramsey price of the postal product.

b. Confirmed. A nonpostal firm could respond to an increase in the postal price by raising its own price while still at pricing at marginal cost. This could occur if the increase in the postal price leads to an increase in the nonpostal firm's volume (through a cross-price effect) and the increase in volume leads to an increase in marginal cost. In that case, the firm would increase its price to match the increase in marginal cost.

c. Please see above.

1 CHAIRMAN GLEIMAN: Is there any additional written
2 cross examination for Witness Bernstein? Alphonse Gastone?

3 [Laughter.]

4 MR. McKEEVER: Thank you, Mr. Chairman. John
5 McKeever for United Parcel Service. I guess we're usually
6 Gastone at the end of the lineup, but I guess we are
7 Alphonse today.

8 CROSS EXAMINATION

9 BY MR. McKEEVER:

10 Q Mr. Bernstein, I am going to hand you in a minute
11 a copy of your response to Interrogatory UPS/USPS-T41-7 and
12 I would ask if that question were asked of you today, would
13 your answer be the same?

14 A Yes, it would.

15 MR. McKEEVER: Mr. Chairman, with that, I ask that
16 Mr. Bernstein's response to Interrogatory UPS/USPS-T41-7 be
17 entered -- be admitted into evidence and reproduced in the
18 transcript as additional written cross examination of Postal
19 Service Witness Bernstein.

20 CHAIRMAN GLEIMAN: Counsel, if you would please
21 provide two copies of that interrogatory to the Court
22 Reporter, I will direct that the material be received into
23 evidence and transcribed into the record.

24 MR. McKEEVER: Thank you, Mr. Chairman.

25 [Additional Designated Written

1 Cross-Examination and Response of
2 Peter Bernstein, USP/USPS-T41-7 was
3 received into evidence and
4 transcribed into the record.]

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**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO FOLLOW-UP INTERROGATORIES OF UPS**

UPS/USPS-T41-7. In your response to UPS/USPS-T41-2, you confirm that "If the nonpostal firm's marginal costs vary with the level of output, then changes in postal prices can lead to a change in the nonpostal firm's price." Please verify that your confirmation implies that if, in fact, marginal costs do vary with output, then there are relevant elements of the Ramsey formula (i.e., $E_{12}[dP_2/dP_1 \cdot P_1/P_2]$ in equation (8a) on page 42 of USPS-T-41) that you do not account for in your estimate of Ramsey prices.

RESPONSE:

Please see my revised response to UPS/USPS-T41-6.

1 CHAIRMAN GLEIMAN: Mr. Todd?

2 MR. TODD: Mr. Chairman, David Todd on behalf of
3 the Mail Order Association of America.

4 I had hoped that Mr. McKeever would save all of
5 this, but I would like to show the witness his response to
6 UPS/USPS-T-41-8.

7 CROSS EXAMINATION

8 BY MR. TODD:

9 Q I'd ask him if his answer would be the same today
10 as it was when he filed that response?

11 A Yes, it would.

12 Q Additionally, I have shown the witness his filed
13 responses to Greeting Card Association Interrogatories
14 identified as GCA/USPS-T41, 77, 82, 83 and 87, and ask the
15 witness whether his answers to those questions would be the
16 same today?

17 A Yes, they would be.

18 MR. TODD: Thank you. I would ask that these be
19 admitted into evidence and transcribed into the record as a
20 part of his written cross examination.

21 CHAIRMAN GLEIMAN: Mr. Todd, if you would please
22 hand two copies of the five additional interrogatories that
23 you have just presented to the witness, I will direct that
24 they be entered into evidence and transcribed into the
25 record at this point as additional designated written cross

1 examination.

2 [Additional Designated Written
3 Cross Examination of Peter
4 Bernstein, UPS/USPS-T41-8,
5 GCA/USPS-T41-77, GCA/USPS-T41-82,
6 GCA/USPS-T41-83, GCA/USPS-T41-87
7 were received into evidence and
8 transcribed into the record.]

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RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO FOLLOW-UP INTERROGATORIES OF UPS

UPS/USPS-T41-8. Refer to your responses to UPS/USPS-T41-3(a) and (b). You characterize the package delivery market as "a competitive market with free entry." You also state that "it is well known that many private carriers offer discounted prices to select customers. Firms might charge above marginal cost prices for some customers, while charging prices equal to marginal costs to their most price sensitive customers. . . ." And on page 46 of USPS-T-41, you state that "Private firms operating in competitive markets with free entry can be expected to be pricing at marginal cost."

(a) If private suppliers of package delivery services do not set marginal cost prices for all of their products, then please explain why it is appropriate to focus on "the Ramsey model without cross-elasticities of nonpostal firms," as you do when estimating Ramsey prices in your testimony at page 46.

(b) If your answer to (a) involves an assertion similar to the assertion on page 46 of USPS-T-41 that "the Ramsey model without cross-elasticities of nonpostal firms is likely to yield results quite similar to those that would result from a model with nonpostal firms," provide the details of all analyses that you have performed to justify this assertion.

RESPONSE:

a. Consider the following market for package deliveries. The Postal Service competes with one (or more) private firms. There exist two types of package delivery customers. One type of customer chooses the delivery company primarily based on price. The second type of customer chooses the delivery company based on non-price considerations such as quality of service, convenience, past experience, etc. Type one customers will have a package delivery demand with a high cross-price elasticity whereas type two customers will have a package delivery demand with a very low or negligible cross-price elasticity. In this case, it is quite reasonable that the private delivery company would set a price above marginal cost for Type 2 customers (who are not basing their delivery choice on price), while providing discounts toward marginal cost pricing for type 1 customers (who are basing their delivery choice on price). Therefore, the Ramsey model without cross-price elasticities is appropriate because 1)

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO FOLLOW-UP INTERROGATORIES OF UPS**

the segment of the market that has a cross-price elasticity between the postal product and the nonpostal product (type 1 customers) is priced at marginal cost and 2) the segment of the market that does not have marginal cost pricing (type 2 customers), has no cross-price elasticity between the postal product and the nonpostal product.

b. I have no detailed information about the costs of nonpostal firms. The conditions I discuss in my response to (a) seem quite reasonable. That is, it is reasonable that different consumers have different degrees of price sensitivity in choosing a package delivery firm (i.e., cross-price elasticities that range from zero to a fairly large positive number). It also seems reasonable that the nonpostal firm (which has pricing flexibility that the Postal Service does not) would price more competitively (i.e., close to or equal to marginal cost) for those customers whose package delivery choice is based primarily on price (i.e., a high cross-price elasticity) while pricing above marginal cost for those customers whose package delivery chose is not based on price (i.e., a low or zero cross-price elasticity).

RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-77. Please refer to your response to GCA/USPS-T41-35. C. You maintain that the record between R97-1 and R2000-1 shows that changes in elasticities do not lead to wide swings in postal prices, and that 90% of the price swings with Ramsey prices are due to changes in marginal cost.

- a. To what extent (i.e., magnitudes) are the changes in prices between R97-1 and R2000-1 attenuated because you do not use pure Ramsey prices?
- b. Are you saying that only 10% of the swings in your Ramsey prices are due to changes in demand elasticities? [That is, 100% minus the 90% due to changes in marginal cost]
- c. If your answer to b. is in the negative, please explain what the correlation is between Ramsey prices and demand elasticities, both for your narrow range of price inelastic numbers and a wider band of elasticities from 0.3 to 3.0.
- d. If your answer to b. is in the negative, please state and explain what assumptions you are making about changes in the shape or steepness of your cost curves.

RESPONSE:

- a. I do not know. Neither the R97-1 nor the R2000-1 Ramsey prices were pure Ramsey prices.
- b. Actually, the 0.9 (90%) figure cited in my response to GCA/USPS-T41-35 is the correlation between the percentage change in Ramsey price and percentage change in marginal cost. The correlation-squared, or about 81 percent (actually 81.9 percent), is the more accurate measure of the fraction of the variation in the price changes that is explainable by changes in marginal cost. Given this, I am not saying that the remaining 18.1 percent of the variation in price changes is explained by changes in demand elasticity. Other factors, such as changes in the net revenue requirement and changes in mail volumes also affect the Ramsey prices and will also explain some of the variation in the price changes. My point is simply that there is a close correlation

RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

between the price changes and the cost changes, and that cost changes are by far the dominant factor influencing price changes, with elasticity impacts and other considerations having much less influence.

c. The correlation between the percentage change in the Ramsey prices and the percentage change in the demand elasticities is 0.03. The correlation-squared is less than 0.001, which means that less than 0.1 percent of the variation in the Ramsey prices is due to variation in demand elasticities between the two rate cases.

With respect to your request that I calculate the correlation using a "wider band of elasticities from 0.3 to 3.0," I do not understand what you are asking me to do.

d. It seems to me that the shape of the cost curve has nothing to do with the correlation between marginal cost changes and Ramsey pricing changes. Correlation is a mathematical measure of the degree to which any two variables move together. The two variables I examined are the percentage change in the Ramsey price and the percentage change in the marginal costs that occurred from R97-1 to R2000-1.

RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-82 Please refer to your response to GCA/USPS-T41-42. In interrogatory a., the word "purely" was inadvertently omitted as the modifier to "competitive". Please answer a. as correctly phrased.

RESPONSE:

In a purely (or perfectly) competitive environment, firms face an infinite demand elasticity for their product and, as a consequence, must price at marginal cost. Firms would not be able to engage in any pricing strategy that put price above marginal cost. For the record, however, Ramsey pricing with infinite demand elasticities would yield marginal cost pricing.

RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-83 Please refer to your response to GCA/USPS-T41-44. With respect to question a., there are several competitors in the private market for air transportation and transportation by truck, and it can be reasonably assumed that the pricing structure for there is effectively competitive. If the Postal Service had economies of scale or scope in these arenas relative to purchased transportation, why would it spend billions of dollars on outside transportation as it now does? With respect to b., there are numerous competitors in the market for long haul and short haul transportation, and almost no barriers to entry. Under such conditions, the prices charged are likely to be fully competitive. Please confirm that Ramsey pricing under such circumstances would not make sense.

RESPONSE:

With respect to the first question, I do not know why the Postal Service spends billions of dollars on outside transportation. This is not my area of expertise. With respect to the second question, under the circumstances which you present, it is likely that the elasticity of demand for purchased transportation would be very high due to the competitive nature of the industry. Ramsey pricing with a very high elasticity leads to prices that are very close to marginal cost. This result makes perfect sense to me.

RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN TO INTERROGATORIES OF GCA

GCA/USPS-T41-87 Please refer to your response to GCA/USPS-T41-53. Would you agree that some of the individual mailers in your analysis are not individual consumers in households but very large mailer organizations, e.g. publishing houses or public utilities, whose cost to mail monthly bill may be as much as 50% of the total cost of generating the bill? If you agree, is it not true that your use of uncompensated rather than compensated demand curves could have more than a "trivial" adverse impact on such organizations?

RESPONSE:

The relevant issue is not postage expenditures as a share of total cost of generating a bill, but *the change* in postage expenditures as a share of *total income* (or operating revenue in the case of a business). For most consumers, including most businesses, the change in postal expenditures is a small portion of total income. Certainly, there may be some businesses where this change is more than trivial, but overall, across all consumers whose demands make up the market demand curve, I think the impact is extremely small.

For example, within First-Class letters, there is a \$2.6 billion reduction in consumer surplus at the Ramsey prices as opposed to the R97-1 Index prices. The compensated demand curve would essentially be the demand for letter mail that would result if First-Class letter mailers, as a group, were given \$2.6 billion to compensate them for the loss of consumer surplus due to the price rise. The difference between the compensated and uncompensated demand curves for letters reflects the change in letter volume that results from the \$2.6 billion of income compensation. Thus, the relevant question is: what fraction of this \$2.6 billion of income compensation would be spent on additional First-Class letters? Very little, since expenditures on First-Class letter mail represent a small portion of the income of First-Class letter mailers. Even if mailers spent one percent of this \$2.6 billion of income compensation on additional

**RESPONSES OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA**

letters, that would only represent \$26 million of additional letter demand, or about 70 million pieces. Therefore, under this hypothetical, the consumer surplus calculation would take account of the consumer surplus impacts of an additional 70 million pieces of First-Class letter mail. Given that the total volume of letters is about 100 billion pieces, I think it is fairly obvious that the difference between the compensated and uncompensated demand curve for First-Class letters is quite small.

1 CHAIRMAN GLEIMAN: Is there anyone else?

2 [No response.]

3 CHAIRMAN GLEIMAN: If not, that brings us to oral
4 cross examination. Three parties have indicated that they
5 would like to cross examine this witness: Greeting Card
6 Association, The Mail Order Association of America, and the
7 Office of the Consumer Advocate.

8 Is there anyone else who wishes to cross examine
9 Witness Bernstein? There doesn't appear to be anyone else.

10 Mr. Todd.

11 MR. TODD: Mr. Chairman, if it might be helpful
12 for your scheduling, it is not my intention to do anything
13 but perhaps have follow-up questions this morning of Mr.
14 Bernstein.

15 CHAIRMAN GLEIMAN: Thank you, Mr. Todd.

16 That being the case, there doesn't appear to be
17 anyone else who wishes to cross examine, we will start with
18 Mr. Swendiman.

19 MR. SWENDIMAN: Good morning, Mr. Chairman,
20 members of the Commission. Alan Swendiman appearing on
21 behalf of the Greeting Card Association.

22 CROSS EXAMINATION

23 BY MR. SWENDIMAN:

24 Q Good morning, Mr. Bernstein.

25 A Good morning.

1 Q May I refer you to your response to GCA
2 Interrogatory Number 79(c).

3 A I see it.

4 Q Is it your view that Dr. Tolley's estimated own
5 price elasticities for First Class mail indicate that at the
6 present time that First Class mail is not migrating to
7 electronic alternatives because of price?

8 A Well, first of all, I think is Witness Tom
9 Thress's estimate of the elasticity, and I would say that it
10 indicates that there is not much impact of price in regards
11 to the migration of letter mail into electronic
12 alternatives.

13 Q So there is not much migration, correct?

14 A Due to price.

15 Q Due to price.

16 A There may be migration due to other factors but
17 not migration due to the price of First Class letters.

18 Q In your view, is it possible for a firm by
19 changing the price that it charges for its product to affect
20 the observed price elasticity for that product?

21 A Yes, it is possible. I mean the price, changes in
22 the price can affect the elasticity. Certainly an extremely
23 large change in the price might. The econometric model that
24 is used has the essentially constant price elasticity when
25 the price changes, but it is certainly possible under

1 different circumstances that the change in price could
2 change the price elasticity.

3 Q Let me refer you to your responses to GCA
4 Interrogatories 80(e) and the 88?

5 A And 88 was the second one?

6 Q Yes, was the second.

7 A Yes, I see them.

8 Q Referring to 80(e), you have I believe told us
9 there that you believe price cuts would have little volume
10 effect on First Class letters, even if demand curve shifts
11 inward, if the product concerned is and remains price
12 inelastic, is that correct?

13 A Yes, that is correct.

14 Q Have you studied what shape the demand curve would
15 be for First Class mail, what it would take on after
16 electronic diversion?

17 A Well, have I studied it? I have, in working with
18 Dr. Tolley and Mr. Thress. I think the simple answer is
19 that the elasticity of a curve reflects essentially its
20 slope in terms of how a change in price affects the volume
21 that is sent.

22 The shifting of the demand curve, which is what
23 may be the predominant effect of electronic diversion, just
24 is affecting the volume independent of the change in the
25 price, so holding the price constant there may be a decrease

1 in the letter volume due to electronic alternatives as
2 opposed to an elasticity effect, which is a decrease caused
3 by a change in the price, so I guess if I could use my hand,
4 a shift of a demand curve, if you can remember from my
5 testimony or elsewhere, a standard demand curve which has
6 price on one axis and quantity on the other, a shift is just
7 moving the demand curve toward the axis so the quantity is
8 lower and the change in the elasticity is some kind of a
9 tilting of the curve, so that a rise in price would have a
10 larger negative effect on volume.

11 Looking at the evidence, it appears that what has
12 happened is not a change in the slope or a change in the
13 price sensitivity of the demand for letters, but some
14 reduction in the volume due to this diversion in terms of
15 this inward shift or more accurately less of an outward
16 shift than might otherwise have occurred.

17 Q Well, if electronic diversion were to occur, help
18 me again, what shape would the --

19 A I think if it were simply a case of volume
20 disappearing, independent of price, then the shape of the
21 demand curve wouldn't change, it would just be at a lower
22 level. If you want me to draw it, I don't know if I can do
23 that.

24 MR. SWENDIMAN: It would be helpful for me.

25 THE WITNESS: Is that all right?

1 CHAIRMAN GLEIMAN: Certainly.

2 THE WITNESS: Using this?

3 CHAIRMAN GLEIMAN: Certainly.

4 THE WITNESS: We may have to go back to this
5 approach now, but that would be trouble.

6 COMMISSIONER OMAS: You might want to try it on
7 your tie.

8 THE WITNESS: Yeah, I started there and they moved
9 me elsewhere. We will try it again.

10 Is this working?

11 COMMISSIONER OMAS: Yes.

12 THE WITNESS: Okay. Let's see if I can reach.
13 Excuse me.

14 COMMISSIONER OMAS: Do you have anything to draw
15 this on?

16 THE WITNESS: I have a regular pen. A bigger pen
17 would be helpful, but I can do it maybe.

18 CHAIRMAN GLEIMAN: Why don't we wait a minute and
19 see if my colleague can fish up a marker.

20 THE WITNESS: I didn't realize that was a
21 Commissioner responsibility.

22 CHAIRMAN GLEIMAN: That is one of the things
23 Commissioners do best.

24 THE WITNESS: So we are looking at the relation
25 between the price of letters and the quantity of letters,

1 and you might have, just to keep it simple, a demand curve
2 like this and the question is whether we have had a change
3 in the price sensitivity or whether there has just been in
4 the change in the level of demand?

5 So a change in the level of demand would look
6 something like this, this inward shift. And it shows less
7 quantity, but the slope of the demand curve is the same,
8 meaning that a given change in price has the same negative
9 effect on volume, and that is essentially what might be
10 happening if there is diversion causing volume to disappear,
11 but not affecting the price elasticity.

12 The alternative hypothesis might be that the
13 demand curve has gone from something like this to something
14 like this, showing that a given change in price is now
15 having a greater negative affect on volume, a flatter slope,
16 and that would show up in a higher elasticity. This would
17 just show up in lower volume.

18 So that I think is -- does that clarify it, I
19 would hope?

20 MR. SWENDIMAN: Yes, sir.

21 THE WITNESS: Thank you. I will sit back down.

22 So the evidence appears that it is the first case
23 in terms of what is happening, as opposed to the second.

24 BY MR. SWENDIMAN:

25 Q You used the word "evidence," what evidence are

1 you referring to?

2 A The estimated demand equations of Witness Thress,
3 and I suppose comparisons with those with earlier ones of
4 Witness Thress and also Witness Tolley, which have shown
5 that the own price elasticity of letters now is pretty much
6 the same as it was, say, 10 years ago, it is in that .2
7 range, minus .2, as opposed to it being, you know, minus .4,
8 just to pick another number that is more elastic.

9 Q So you are not able to say, are you, that the
10 demand curve of First Class mail will not exhibit more price
11 elasticity after it has shifted inward owing to electronic
12 diversion?

13 A No, I am not able to say that it will. I don't
14 know, there is no evidence that says that it has. There has
15 obviously been electronic diversion for some time now of
16 some form or another, fax, e-mail, these things have been
17 around for a while. So that has been going on, and that,
18 undoubtedly, I supposed undoubtedly has reduced volume of
19 letter mail, and that has not been associated with an
20 increase in the estimated own price elasticity.

21 What happens in the future, I obviously don't
22 know.

23 Q Is it conceivable that, as the demand curve shifts
24 inward owing to electronic substitutes, that First Class
25 mail will become more price elastic?

1 A It certainly is conceivable. It is actually
2 conceivable that it could be less price elastic in that the
3 mail that you lose might be different from the mail that you
4 keep, and it could be, I mean I am just hypothesizing, that
5 after the diversion has taken whatever toll it takes, the
6 mail that remains might be not very price sensitive at all
7 and that would actually mean that the elasticity would be
8 less.

9 Another hypothesis, obviously, is that it would
10 make it more. And then there is the hypothesis that it
11 wouldn't affect the elasticity at all.

12 Q Let me refer to your answer, response to
13 Interrogatory Number 88.

14 A I see it, yeah.

15 Q Our question there was whether accountants, not
16 economists, accept the idea that marginal cost pricing can
17 be meaningfully developed from accounting data. What would
18 you tell me, or would you tell me what the basis is from
19 professional cost accounting literature to believe that
20 accountants would accept that proposition?

21 A I am not an accountant, and I am not sure what
22 accountants do exactly, to even tell you an answer there. I
23 don't know.

24 Q Can you identify any literature from cost
25 accounting that supports the view that you can use

1 accounting data to meaningfully develop marginal costs?

2 A Well, I think this article, I don't know if it --
3 what your limitation is on what can be considered, but I
4 think, understanding this article that was written by
5 Bradley, Colvin and Panzar, was how to use accounting data
6 to get marginal cost data, or how to work with the two of
7 them. But that is not what I do.

8 Q Do you know whether any of them are accountants?

9 A I don't. I don't know if they are accountants.

10 Q In responding to this interrogatory, did you
11 happen to review or look at the periodical, or textbook, I
12 should say, cited?

13 A I don't believe that I looked at that specific
14 textbook, no.

15 Q Turning to your response to GCA Interrogatory
16 Number 60.

17 A Yes.

18 Q And specifically 60(c), are you acquainted with
19 any evidence, other than the volume forecasts you refer to
20 in answering this interrogatory, that would tend to show
21 that competition between First Class mail and electronic
22 alternatives is not based, or not based in material part on
23 price?

24 A Am I aware of evidence other than essentially the
25 econometric work that is done on behalf of the Postal

1 Service, are you asking -- is that essentially what you are
2 asking?

3 Q That's correct.

4 A I don't know that I am, of any sort of rigorous
5 analysis of that. There might be, you know, I am aware of
6 various bits of anecdotal evidence, but I am not sure how
7 much weight that has.

8 Q Turning to your response to GCA Interrogatory
9 Number 41.

10 A Yes, I see it.

11 Q When you say that Ramsey pricing minimizes the
12 loss of consumer surplus, are you referring, are you not, to
13 a situation in which a firm is constrained, as the Postal
14 Service is under the Act, to recover its total costs and
15 only its total costs?

16 A Well, technically, no. You can do a Ramsey
17 pricing model that minimizes the loss of consumer surplus
18 subject to any number of constraints such as the constraint
19 that the Postal Service or the entity loses only X amount of
20 dollars, or that they lose no dollars and break even, or
21 even that they make a certain amount of dollars. I mean
22 that is just a mathematical element in the equation. So, it
23 is really a question of the constraint is raising a certain
24 amount of net revenue, and the way I set it up and the way
25 it is set up in a rate case is that that is such that the

1 net revenue leads you to having a breakeven condition. But
2 you could do the model getting you a profit or accepting a
3 loss, if you wanted to.

4 So I think my answer is no. If that -

5 Q But under whatever model you use, there is a
6 constraint or constraints involved?

7 A Yes.

8 Q So, if a firm were not constrained, let us say, to
9 recover just its total costs, but instead could cover more
10 than total costs, the same pricing techniques could, under
11 monopoly conditions, be used to maximize rather minimize
12 loss of consumer surplus; is that not correct?

13 A Well, what an unconstrained monopolist could do is
14 to attempt to maximize its profits, and to extend that, if
15 it does that, it would reduce consumer surplus, yes. It
16 does attempt to extract more consumer surplus, yes.

17 Q And a deregulated environment for an optimal
18 monopolist -- would deregulated rates move in the same
19 direction as Ramsey prices?

20 A It depends on what the nature of the deregulation
21 is, but if you just said, well, the Postal Service can
22 charge whatever rates it wants, and there's nobody saying
23 that they can't set as high a rate as they feel like, then
24 they would -- then I suppose things would move in the same
25 direction as Ramsey pricing without that constraint, yes.

1 Q Did you review Dr. Tolley's testimony on fax and
2 e-mail with regard to First Class Mail?

3 A Yes, I did.

4 Q Turning to OC Interrogatory Number 2, in your
5 answer to Interrogatory Number 2, you said that
6 cross-elasticity between First Class letters and electronic
7 alternatives is small.

8 A May be small.

9 Q May be small. Do you think this could be true in
10 two or three years from now?

11 A I think it certainly could be, yes. I mean, this
12 is not a new thing; this has been going on for some time.

13 I mean, you mentioned fax. Fax is at least ten
14 years old, so the effect of fax is not something that is
15 different.

16 Obviously there are things changing all the time.
17 Fax is almost obsolete now, it seems.

18 But, you know, this is not -- electronic diversion
19 is not something that is just happening now.

20 Q Well, were fax and e-mail as widespread ten years
21 ago as they are now?

22 A No, but I think that's, in fact, the point; that
23 we've gone through a ten-year period in which fax and e-mail
24 have gone from very little usage to quite a bit of usage.

25 And over that ten-year period, while there have

1 certainly been effects on the volume of letters, it does not
2 appear to have made letters more price-sensitive, and that's
3 essentially, I think, what ground we're covering again.

4 MR. SUENDIMAN: Mr. Chairman, I have no further
5 questions.

6 CHAIRMAN GLEIMAN: Thank you, Mr. Suendiman.
7 Office of the Consumer Advocate?

8 MR. COSTICH: Thank you, Mr. Chairman, Rand
9 Costich for the OCA.

10 CROSS EXAMINATION

11 BY MR. COSTICH:

12 Q Dr. Bernstein, I'd like to follow up on a couple
13 of questions that counsel for GCA asked you.

14 A Okay.

15 Q Do you recall your discussion about constant price
16 elasticity demand curves?

17 A Yes.

18 Q As the name implies, the elasticity doesn't change
19 as you move along that demand curve; is that correct?

20 A Right.

21 Q Could you look at page 77 of your testimony, lines
22 4-6?

23 A Yes, I see that.

24 Q Here you're talking about cross-elasticity between
25 single-piece and presorted First Class Mail?

1 A Yes.

2 Q And here you're saying that if one were to attempt
3 to change from the current demand estimating procedure to
4 one in which there is an explicit elasticity for each of the
5 two categories, you run into a technical problem; is that
6 correct?

7 A A technical problem, I'm not -- the own and
8 cross-price elasticities between single-piece and work-share
9 letters are not constant, I think is what you're asking and
10 I'm confirming.

11 Q Yes, but why is that a problem for Ramsey pricing?

12 A It's not a problem in the sense that one --
13 there's no reason why you can't have changing elasticities.

14 It becomes a more difficult mathematical problem,
15 because what you have to do is set some Ramsey prices at the
16 current elasticity, then the prices will be different, and
17 that means in this case, the elasticity will be different.

18 So you will then have to recompute the Ramsey
19 prices at the new elasticity, which again will change the
20 price again a little bit. You kind of have to go back and
21 forth, back and forth, until you reach a point in which the
22 price and the elasticity are consistent with one another.

23 It's not a theoretical problem; it's just really a
24 more difficult mechanical exercise for me, and for anyone
25 doing it.

1 Q But you can always guarantee that you will, in
2 fact, converge on a solution?

3 A I would think that you would, if the demand
4 equations are properly specified, and don't have, you know,
5 some kind of peculiar feature to it where you start heading
6 your price off to zero or off to infinity.

7 But I don't think that would be a problem. Having
8 not done it, I can't say I would guarantee it, but I would
9 pretty certain that you would converge to some consistent
10 price and elasticity condition.

11 Q There wouldn't be one of those cobweb theorem
12 effects where things diverge and you never --

13 A You know, that might be a possibility. That would
14 -- I think that would be the case if there was some
15 inconsistency in the demand equations, which I don't think
16 there are. But certainly it could happen.

17 It's not a problem with the Ramsey pricing part of
18 it. It might be a math problem of a different nature.

19 Q When the Postal Service or the Postal Service's
20 witnesses specify that demand equations have constant
21 elasticity, they're ruling out quite a few other possible
22 specifications for the demand equation; aren't they?

23 A Yes. I don't know if ruling out -- I think the
24 idea is to use the specification that does the best job of
25 explaining the mail volume.

1 And it seems that constant elasticity equations do
2 the best job, so they rule out ones that are not as good.

3 Q Have you been involved in that ruling-out process?

4 A Yes.

5 Q And you're convinced that the constant elasticity
6 does the best for projecting volumes?

7 A Of what we've looked at, yes. But, for example,
8 in this case of the single-piece and workshare, it's not a
9 constant elasticity, because in this case, a non-constant
10 elasticity does better.

11 So that it's not that we only considered that
12 approach; we just tried to find the approach that works
13 best.

14 And in the case of single-piece and workshare, the
15 shifts between these two, which is what this section of the
16 testimony talks about, it turns out that a different
17 specification does a better job of explaining the relation
18 between volume and price and discount.

19 Q Can the estimated demand equations be used to
20 estimate volumes at significantly different prices than
21 current prices?

22 A They certainly can be. I think your question is,
23 if you had a -- you know, the demand equations are estimated
24 looking at historical data.

25 And if you had a price that was way outside the

1 range of historical data, would that same demand
2 specification and demand elasticity apply?

3 And the naive answer is, yes, but it's certainly
4 conceivable that one might take some consideration of the
5 change in price and think about that somewhat differently.

6 Q Could you look at page 64 of your testimony?

7 A Yes.

8 Q At the very bottom of the page, there's a section
9 on periodicals.

10 A Yes.

11 Q You say there that the Ramsey Pricing Model would
12 yield a periodicals markup of 208.5 percent?

13 A Yes, in an unconstrained sense, yes, it would.

14 Q And then over on the next page, 65, the very last
15 line on the page, it seems that this kind of result would
16 provide little guidance to ratemakers?

17 A Yes.

18 Q Why is that?

19 A Well, I think the statement you read is that the
20 little guidance is that conceptually, if you could raise the
21 periodicals mail rate that high, you would raise so much
22 revenue from periodicals that you could essentially reduce
23 the price of every other mail product.

24 And I don't think that's going to provide the
25 Commission with much or the Postal Service with much value,

1 because we know we're not going to have a price of
2 periodicals mailed that's three or four times what it is
3 right now.

4 So, there doesn't seem to be a value in looking at
5 what you could do with other prices under those conditions.

6 Q So when you constrain the price of periodicals to
7 be no more than twice what it is --

8 A No more than a hundred-percent markup. I guess
9 the markup now is essentially zero, so you're right.

10 Q You're doing that because you have, in your mind,
11 determined that the Commission is not going to raise the
12 price any higher than that; is that what you're saying?

13 A That the Commission doesn't really have any prices
14 that it seems to have higher than 100-percent markup; that
15 there might be some subcategories.

16 But that seems to be a round number that's along
17 the upper bound of what you might see as a markup of the
18 Postal Service or of the Commission; yes, that's essentially
19 my thinking.

20 Q Okay. And it wasn't that you thought perhaps the
21 demand equations weren't really telling you the truth when
22 you got out that far?

23 A Well, you raise another point. That's another
24 issue. It's very likely that if the price of periodicals
25 was increased as that high, that it might become more

1 elastic.

2 One factor in elasticity is the amount of
3 expenditures on the product. So as Postal rates go up
4 considerably, mailers are spending more on postage, and it
5 might make it somewhat more elastic.

6 So, another interpretation -- I don't really
7 explicitly go into this -- is that at that higher price, the
8 demand for periodicals would be more elastic, and that that
9 greater elasticity would serve to limit the price increase
10 under Ramsey pricing.

11 Q Is that the way demand curves always work? As you
12 raise the price, the elasticity gets higher?

13 A No. I mean, the constant elasticity demand curve
14 doesn't have that feature. It has the feature that the
15 elasticity is constant.

16 We're not talking about the sort of ten to
17 20-percent, even 20 percent is rather larger. But, say, 10
18 percent, 20 percent rate increase that you might see, which
19 is within the same range of historical prices.

20 If you're talking about, in this case, you know,
21 100 percent, 200 percent increase, then, yes, you might see
22 a change in the elasticity, and it might be more likely that
23 it would become more elastic when you raise the price that
24 much.

25 Q Now, why do you say more likely that it would

1 become more elastic?

2 A More elastic than, say -- it's unlikely that it
3 would be less elastic, and I don't have a more likely, 51
4 percent, idea, but I'm just saying that as the price of a
5 product increases considerably, and as users of that product
6 have to expend more money on that product, there is evidence
7 that might suggest that they would become more
8 price-sensitive.

9 Q Well, couldn't we also make the point that you
10 made earlier that as the price increases, you drive away
11 your most price-sensitive consumers, and the ones that are
12 left have less --

13 A You could make that argument, yes. That's why I
14 don't -- for example, I didn't say that I think the
15 elasticity at this higher price will be some bigger number,
16 because I don't know.

17 And that's why I put in the constraint, as I
18 discussed earlier. I'm just saying that it's quite possible
19 that it would be, but it might not; you're right.

20 Q Well, I'm just a little confused. It seemed, when
21 you were talking with counsel for GCA, that you were
22 emphasizing the likelihood that when you raised the price
23 you get, or change the price --

24 A No, this wasn't -- he was talking about mail
25 leaving due to diversion, not because of a price increase,

1 but because of people using electronic alternatives.

2 That's a different situation than raising the
3 price of periodicals. And I don't have an answer.

4 I'm just saying that that's a possibility, and
5 it's certainly a possibility that if you raise the price of
6 periodicals, that the only people left will be the less
7 price-sensitive ones -- I don't know -- I mean, if you raise
8 it as high as presented there.

9 That's why I chose to leave the elasticities the
10 same, because I don't know what's going to happen with them.

11 Given that it's very inelastic already, it seems
12 that one might have the idea that, you know, there's more to
13 go on the more elastic side than on the less elastic side,
14 but I don't have an answer.

15 Q If, in fact, the demand curves have constant
16 elasticity over their entire -- what's the word?

17 A Range.

18 Q Range, there's a good -- yes, not domain, but
19 range, okay.

20 Then the Postal Service could raise its entire
21 revenue requirement from any category of mail it chose; is
22 that correct?

23 A As it matter of fact, it could, because it says
24 that there is no -- in a constant elasticity demand curve,
25 there is actually no price at which volume is zero.

1 So if you take it to the extreme, it means you
2 could charge \$60 billion for a letter, and you would send
3 one letter and you would be done. You know, one person
4 would pay \$60 billion for that letter. I don't think that's
5 likely, but --

6 Q Well, isn't that an indication that these constant
7 elasticity demand curves can't be used far from the current
8 --

9 A Well, they can't be -- certainly not at the absurd
10 example I just gave. I don't know where the point occurs at
11 which the constant elasticity demand becomes less reliable.

12 But it isn't like all of a sudden it's like it's a
13 good model, a good model, and then you get to a certain
14 price and the whole thing falls apart.

15 What happens is that the volume that actually
16 occurs at that price, might be slightly different than the
17 volume you get using the constant elasticity demand curve.

18 And as you go further and further and further and
19 further away, the volume might become -- the volume
20 difference might become greater.

21 But it's not -- you know, I don't know that anyone
22 is -- I think that other than some of the prices I have,
23 basically, I don't know that anyone is outside of that range
24 where the constant elasticity demand curve would seem to be
25 reliable.

1 Q Counsel for GCA also asked you about the behavior
2 of a profit maximizing monopolist; do you recall that?

3 A Yes.

4 Q And he asked you if a profit maximizing monopolist
5 would use Ramsey pricing; did I hear that correctly?

6 A They wouldn't. I don't think that's what he
7 asked, and they wouldn't use Ramsey pricing because Ramsey
8 pricing is constrained. There's a constraint in there.

9 They would use pricing that would make use of cost
10 and demand characteristics, of which price elasticity demand
11 is one, and they would set prices to extent that they could,
12 based on the price elasticities of demand of their different
13 products.

14 Q I'm not sure what page it appears on in your
15 testimony, but you have what you might call the simplified
16 version of the Ramsey pricing rule, the inverse elasticity
17 rule.

18 A Yes, I do.

19 Q Isn't it correct that the profit-maximizing
20 monopolist would just set K equal to one?

21 A Yes. I discuss that somewhere in there, yes. And
22 under perfect competition, the K is zero. And I think under
23 my Ramsey pricing, the K is about .1, which, for what it's
24 worth, is obviously much closer to zero than one.

25 But, yes, what you say is correct.

1 Q Can I ask you to look at the drawings that you
2 created earlier here?

3 A Yes. Yes.

4 Q In the drawing, in the upper right, you have two
5 demand curves that intersect, correct?

6 A I do. That is just how I drew in a quick sense,
7 but I can -- what I am trying to show in there is simply
8 that the one demand curve is flatter, meaning that a given
9 rise in price has a more negative effect on quantity, I
10 wasn't entirely accurate in terms of where those two curves
11 intersect.

12 Q Is it correct that straight line demand curves
13 have non-constant price elasticity?

14 A Yes, I was just doing that to keep it simple. You
15 draw a curve elasticity as well. I mean to be consistent
16 with the demand curves as they are estimated, they wouldn't
17 look like that, but I was just trying to get the point
18 across, and it is not drawn to scale.

19 Q In the other drawing that you have up there, you
20 were diagramming an inward shift of the demand curve, is
21 that correct?

22 A Yes.

23 Q Again, this may just be an accident, but the two
24 demand curves look parallel. Is that any --

25 A I think I intended them to be parallel just to say

1 that they would have the same slope.

2 Q They would be parallel then?

3 A Yes. And that one is just at a lower level of
4 volume. But, again, you know, the point I am making
5 actually is that that is showing something where we don't
6 have a change in the price sensitivity of the product, just
7 a change in the volume of a product.

8 Q Well, here again, because you have used straight
9 line demand curves, can't we say with certainty that you do
10 have a change in price sensitivity?

11 A Yes, because it is mathematically that two
12 straight line demand curves, even drawn parallel to each
13 other, have different price elasticities, and I was unaware
14 that you would know that, but I don't think that is the
15 point because I was just trying to keep the analysis simple.
16 If you want, I can redraw them with curves and show
17 essentially the same thing, but I don't think that is --

18 Q Well, my expectation is that these drawings are
19 going to show up in the transcript, so I would just like to
20 have it --

21 A Well, you are right about that, I mean it was --
22 technically, you are correct that straight line demand
23 curves are not the demand curves that are estimated for
24 First Class letters, and so my drawing was an
25 over-simplification. But I think the point that I am making

1 is still the same.

2 Q Well, that is what I would like to discuss next.
3 If you had drawn a constant elasticity demand curve, and
4 then shifted it inward, can we say with certainty what the
5 elasticity of that second demand curve would be?

6 A Well, elasticities are not, for mail, are not
7 really based on my drawings, they are based on the estimated
8 work, the work estimated demand equations. And, so, I don't
9 know exactly how I would draw it to show this effect of
10 having no change in elasticity, but that is what is
11 happening. There has not been any meaningful change in the
12 price elasticity of letters and that is what I would try to
13 draw. I am not sure how to draw that, actually, in the
14 sense that, would it just look like this picture except the
15 demand curves would be curves instead of straight lines? I
16 don't know.

17 Q Well, isn't it the case that you can't draw it if
18 you are working with constant elasticity demand curves?

19 A No, I think you can draw it. I mean it is, you
20 know, it is just two variables that you are modeling. It is
21 an equation, I am sure you can draw it.

22 Q You can certainly draw one equation, or one graph
23 up there of a constant elasticity demand curve.

24 A Yes.

25 Q That's correct. Can you draw one either side of

1 it --

2 A That has the same elasticity.

3 Q Yes.

4 A I think that you can. I don't know what -- maybe
5 I can't. But I think one could. I think it can be done.
6 It is simply a mathematical equation with a price and a
7 quantity and elasticity, and maybe it would be best to
8 generate it with a computer or something like that, instead
9 of by hand, but I don't -- I mean if you are asking me the
10 question, it is possible for a demand curve to shift without
11 changing the elasticity, the answer is it is possible and
12 that is what has happened.

13 Q Yes. But it is possible for a constant elasticity
14 demand curve to shift and still have the same elasticity?

15 A Yes.

16 Q And we can prove that mathematically?

17 A Well, I mean I can prove it, you know,
18 mathematically, yes, if you want me to, right now.

19 Q Well, not right now, but I will give you seven
20 days.

21 A I mean there is a constant term involved. This
22 isn't even what I, you know, this is -- I can do it. There
23 is a constant term. An equation might be A , which is a
24 constant, times P , which is the price to some elasticity.
25 And what we are hypothesizing is that the A value has

1 changed from a bigger number to a smaller number, and that
2 the P and E, the elasticity numbers and the price numbers,
3 are the same.

4 Now, I don't know exactly what that picture would
5 look like, but, you know, mathematically, it is just -- it
6 is essentially, you know, if you think of the volume
7 forecast approach, there is a base volume that is used to
8 make the forecast. So, what we are saying is that, due to
9 electronic diversion, the base volume of single piece
10 letters is 55 billion pieces, I don't even know the number,
11 and if there were no electronic diversion, it would be 60
12 billion pieces.

13 And once you have that base volume, which, without
14 electronic diversion would be greater, everything else in
15 the forecast is the same, that is the elasticity on price,
16 and for that matter, on the other variables, is the same.
17 So that is what I am trying to illustrate here and say that
18 what electronic diversion has done is reduce the base volume
19 that is used in making the volume forecast. In terms of
20 what that looks like as a picture, I don't -- I can't quite
21 do that.

22 THE REPORTER: You got cut off, Mr. Costich. You
23 said, well, not right now, but in the next few days?

24 THE WITNESS: In seven days, I think.

25 MR. COSTICH: He has done in less than seven days.

1 BY MR. COSTICH:

2 Q Counsel for GCA also asked you to look at your
3 response to Interrogatory OCA/USPS-T41-2. Could you look at
4 that again?

5 A Yes, I will.

6 Q In Part A of that interrogatory, you were asked,
7 essentially, if there would be at least one consumer who
8 would be indifferent between using First Class mail or an
9 electronic alternative during the period that rates --

10 A Indifference due to price, yes.

11 Q And were you assuming that the proposed rates
12 would be in effect in the period?

13 A Regardless of what rates are there, I am sure
14 there is at least one person who, if there were a slight
15 change in the rate, would make some kind of shift to or from
16 an electronic alternative and mail, and letter mail. I am
17 sure there is at least one person.

18 Q Who would do that because of a change in price?

19 A Yes. There is probably one person out there, if
20 the letter rate goes up, will respond by buying a fax
21 machine. But I don't think there are a lot of people who do
22 that.

23 Q Well, let's, if I could, ask you to concentrate on
24 folks who are considering using electronic means for paying
25 bills.

1 A Okay.

2 Q Are you familiar with any of the available
3 electronic billpaying services?

4 A Not familiar in the sense that I don't use them,
5 but I'm familiar with them in a general sense. I've read
6 about them and know something about them.

7 Q Do you know anything about the Postal Service's
8 electronic billpaying service?

9 A Not a lot. It's something that has apparently
10 come up recently, and I know only what I kind of heard in
11 conversations with people. I haven't looked at it in any
12 rigorous way, by any means.

13 Q Are you aware that people who use those electronic
14 billpaying services, pay a fee?

15 A I'm aware that, yes, many of these services
16 involve paying a fee.

17 Q Getting back to your response to OCA Interrogatory
18 2, in your response to Parts B and C, you say there may not
19 be many consumers who are prepared to shift, who are
20 indifferent.

21 A Due to price, yes.

22 Q And counsel for GCA asked you your basis for
23 making that statement, and you said it was because of the
24 demand equation estimation that's been going on for First
25 Class for quite awhile?

1 A That's the formal analysis, yes. I mean, as I
2 said, there is a lot of anecdotal evidence about people's
3 willingness to do things electronically, and, you know, a
4 lot of people don't even have direct deposit.

5 And if you don't have your paycheck deposited
6 electronically, you're certainly not going to have your
7 bills paid electronically.

8 And there are concerns about privacy and about
9 security and all these sorts of things. But I don't have
10 any -- I've seen things that say that polls show that people
11 have more confidence in payments going through the mail than
12 electronically, but I don't know, you know, how extensive
13 that work is. So I don't rely on it, and I didn't rely on
14 it in that answer.

15 Q I that answer you also said that any cross-price
16 elasticity between First Class and electronic alternatives
17 may be small; is that correct?

18 A Yes, it may be.

19 Q And it may be large?

20 A It may be small; it may be large. And if we want
21 to pursue this, it may already implicitly be included in the
22 First Class letter equation.

23 Q Well, it has to be; doesn't it?

24 A Well, in the -- you know, here this maybe should
25 be directed at Witness Thress, but since I'm here, the

1 single piece -- we're talking mainly about single-piece
2 letters, I would assume, because workshare volume is growing
3 quite a bit.

4 So, single-piece letter volume has been falling.
5 And that's measured in the demand equation with a negative
6 trend term to pick up that decline.

7 Now, conceivably one would say, well, let's not
8 put in a negative trend term, let's put in the price of
9 electronic alternatives, which is not there because nobody
10 has a measure of that price.

11 But if somebody had a measure of that price, what
12 would it look like? It would look like a negative trend.

13 So you would be replacing one negative trend in
14 the equation with another negative trend in the equation.
15 And it's not likely that replacing one negative trend with
16 another negative trend is going to change the other
17 estimated coefficients, meaning that the price elasticity
18 would probably be the same.

19 In other words, if you want, you can call the
20 negative trend in Tom Thress's equation, the price of
21 electronic alternatives, and then you would have it in
22 there.

23 And the elasticity would be what it is. He
24 doesn't do that, because he has no measure of the price of
25 electronic alternatives.

1 But my point is that I don't think it -- I don't
2 have a reason to think that that's going to affect the price
3 elasticity or cause it to be different in any meaningful way
4 from what it is right now.

5 Q If you were to explicitly include the price of
6 electronic alternatives or, to stick to the context, the
7 price of electronic billpaying, you would still leave that
8 trend term in there; wouldn't you?

9 A Maybe not. Maybe you wouldn't need it, or maybe
10 the two trends would -- you know, that's an econometric
11 question.

12 But because partly you've got volume leaving
13 single-piece because it's going into workshare, and then
14 you've got volume leaving single-piece because it might be
15 going to an electronic alternative.

16 Then you've got volume leaving single-piece
17 because people don't write letters to one another as much as
18 they used to. You know, you've got all kinds of things
19 going on.

20 And, you know, in terms of this specific question
21 that you're asking, if you put in the price of electronic
22 alternatives, my presumption is that that is a price that's
23 been going down over time, so that it is a negative trend.

24 And generally speaking, in a demand equation,
25 you're not likely to have two negative trend terms; they

1 would get in each other's way.

2 So, you know, if somebody produced a series that
3 said that this is the price of electronic alternatives, it
4 could be put into the equation and it might take the place
5 of the trend term that's in there.

6 I don't know. It's a hypothetical.

7 Q A moment ago, you were listing several possible
8 causes for that negative trend.

9 A Yes.

10 Q Including folks not writing to each other as
11 often?

12 A Right.

13 Q Shifting to presort, using electronic
14 alternatives?

15 A Yes.

16 Q Would all of the trends that are being picked up
17 by that trend term have to be negative?

18 A Well, the trend term is an aggregate, and its'
19 negative, so there are negatives and positives affecting
20 letter volume beyond, of course, price and income and
21 population, these other variables that are in there.

22 All that that equation is saying is that the
23 negatives are outweighing the positives. There may be some
24 positives; they're just not predominant.

25 I mean, what we know is that the volume of

1 single-piece letters is not growing, and that's --

2 Q So, using your favorite word, M-A-Y, it may be the
3 case that if you pull out the effect of electronic commerce,
4 that that trend term goes positive?

5 A Not likely, because I think the amount of volume
6 that that trend term is explaining, I'm going to have to
7 think about it.

8 I think it's something like six billion pieces
9 over the last five years. And I think that various work
10 that we've done suggests that there is more than just
11 electronic diversion responsible for that; that there's --
12 that that's some of it, but there's also some volume
13 shifting into workshare.

14 And so if now you're asking me to get away from
15 the term, may, I would say that the trend term is measuring
16 more than just electronic diversion.

17 I think it's measuring electronic diversion and,
18 to some extent, shifts from single-piece into workshare.

19 Q But because it's negative, you've sort of focused
20 your thinking on possible negative trends that would explain
21 that?

22 A If you look at the testimony, now we've gone from
23 Witness Thress to Witness Tolley. If you look at the
24 testimony, there's a discussion of negative and positives.

25 But, you know, just looking at the data, the

1 negatives appear to be more significant in single-piece
2 letters, and the positives appear to be more significant in
3 workshare letters.

4 And so I think that that's -- that's not to say that
5 there are no positives, but just that the net effect is
6 negative.

7 I think there has been growth in
8 business-to-business mail, and there's been growth in
9 advertising mail, and some of that may be going
10 single-piece, so there might be some positives out there.

11 But I think that the data is showing that the
12 negatives are more than the positives in single-piece.

13 Q Well, we can't argue with that; can we?

14 A Right. So, that's why I think, you know, the
15 focus is more on the negatives in terms of the discussion.

16 Q But it is a net trend and there could be positives
17 in there?

18 A Yes, it is technically, you know, we are now
19 getting into it is technically not a net trend, the term
20 that has been used, it is just a trend term, and the
21 equation that is estimated, it has a negative effect, and
22 what it is measuring is essentially all those things that
23 are not already captured by price and income, and the
24 discount, and population and consumption, or whatever else
25 is in that equation, which I don't have in front of me.

1 Q Could you turn to your response to Interrogatory
2 MOAA/USPS-T41-3?

3 A Yes, I see it.

4 Q You were asked if there had been significant
5 changes in relative ^{costs}~~cross~~, would it be the case that an
6 across the board rate increase would inevitably produce
7 uneconomic rates, is that correct?

8 A Yes.

9 Q And you said, in general, yes.

10 A I shy away from the term "inevitably" because it
11 depends where your rates are right now. But if you were at
12 the Ramsey rates, and then there were different relative
13 costs, then you had across the board increase, it would move
14 you to a less economically efficient way. And, in general,
15 what I am saying is that rates should take effect -- rate
16 changes should reflect both cost and demand factors and
17 equal across the board increases don't do that, at least not
18 explicitly.

19 Q I seem to recall an interrogatory response in
20 which you said that there might be situations in which an
21 across the board rate increase would actually move you
22 toward Ramsey pricing. Does that --

23 A There can be. It is almost two wrongs making a
24 right, but, yes.

25 Q You don't like across the board rate increases?

1 A I think if there have been significant changes in
2 costs, and you do -- across the board rate increases, at
3 least in the mechanistic sense, tend to ignore the
4 differences in relative costs, and from an economic
5 perspective, one would want to look at what is happening to
6 the costs in setting rates. I mean there are advantages to
7 across the board, it is easier, I suppose, but, you know, I
8 don't -- it is not something that would generally be
9 advocated if one was looking at the notion of taking into
10 consideration economic efficiency or just the information of
11 cost and demand.

12 Q Well, let me ask you a hypothetical.

13 A Okay.

14 Q Suppose a firm produces two products, and the firm
15 is regulated, and the prices for those two products are not
16 Ramsey prices, in fact, the price for one product is below
17 its Ramsey price and the product for the other --

18 A Is above it.

19 Q Is above its Ramsey price.

20 A Okay.

21 Q And now let's throw in relative cost change. The
22 costs for the category or the product with the price below
23 its Ramsey price are rising less rapidly than the costs of
24 the other product, the one whose price is above its Ramsey
25 price.

1 A Right.

2 Q In that situation, would an across the board rate
3 increase move both prices toward their Ramsey price?

4 A I believe that they would. Basically, in product
5 one you have got, relative to the Ramsey, you have got too
6 low a markup. So if you have a low cost increase and a
7 relatively high price increase, you are increasing the
8 markup, and, therefore, you are moving it toward the Ramsey,
9 and the opposite case would be there.

10 So, yes, that is essentially, what you are doing
11 is you have got rates that don't reflect demand, and you
12 have got rate changes that don't reflect costs, and, as I
13 said, two wrongs -- I am being a bit facetious, but you
14 would be moving yourself in that way toward the -- more
15 toward the Ramsey price. Which is why, you know, that I
16 think -- that was a question that the OCA had, and I went
17 into a little more detail than I did in my simpler response
18 to MOAA at this point, to bring that out.

19 Q So if we were to call the first product First
20 Class, and if we were to call the other product Third Class,
21 since that is a purely hypothetical product, it doesn't
22 exist.

23 A Yeah.

24 Q An across the board rate increase would have the
25 effect of moving the prices for both products toward --

1 A I am assuming that you have got the case where the
2 first product, which we are calling letters, has a smaller
3 cost increase than the third product?

4 Q Relatively speaking.

5 A Relatively speaking. Yes, it would seem that what
6 that would do would be to raise the markup on the one and
7 lower the markup on the other. I mean, you know, this is
8 two products, but, yes, I think so. I mean if, working the
9 other way, if, say, the constant, across the board rate
10 increase is 5 percent, just to pick a number, if one
11 category of costs went up 1 percent, then you would be
12 raising its markup by giving it a 5 percent cost increase.
13 And if the other product went up, costs went up 10 percent,
14 you would be lowering its markup by having a 5 percent rate
15 increase. So if that is -- that seems to be yes.

16 MR. COSTICH: Thank you. I have no further
17 questions, Mr. Chairman.

18 CHAIRMAN GLEIMAN: Is there any follow-up?

19 [No response.]

20 CHAIRMAN GLEIMAN: There is no follow-up. That
21 brings us to questions from the bench. Questions from the
22 bench? Commissioner Goldway.

23 COMMISSIONER GOLDWAY: You may not be the person
24 to answer this question, but it relates to following
25 patterns of demand within First Class single piece mail.

1 From my perspective, as the consumer, I think there are two
2 different kinds of purchases of First Class mail stamps.
3 One is your normal pattern of buying, you know, a few stamps
4 a month to pay for bills, and the other is the special
5 purchase of stamps, particularly around Christmas time, when
6 you are buying a large number of stamps for one kind of
7 mailing.

8 And my intuitive thought here is that when you are
9 spending just a few dollars a month and the increase of a
10 penny or two, or three, or four relates just to a dollar a
11 month or two dollars a month.

12 THE WITNESS: Not even.

13 COMMISSIONER GOLDWAY: Then there is no question
14 that the prices don't impact purchase. But that very same
15 price increase can cause a bigger impact if you are buying a
16 couple of hundred stamps because you want to mail to all
17 your friends and relatives, and could change your buying
18 pattern. Is there a way to separate those and measure those
19 to determine which is impacting on elasticity and which is
20 impacting on volume?

21 THE WITNESS: Well, that is a good question. How
22 might you do it? Well, one way, you might say, is demand
23 more elastic in December, I think we are talking about, you
24 know, Christmas holiday cards.

25 COMMISSIONER GOLDWAY: Right.

1 THE WITNESS: And you don't really have December
2 volume, although they do AP data, but I don't know how
3 accurate that is. They have quarterly volume, so you could
4 say, is demand more elastic in that fourth -- or, actually,
5 first quarter of the Postal year? You know, that can be
6 modeled. You could maybe do some studies of consumers and
7 whether their purchases appear to be more elastic during
8 that time.

9 I mean the one thing that prevents you from doing
10 that very accurately is that, as I understand, rates tend to
11 be changed in January. You know, if you really wanted to
12 see that, you might change rates December 1st, but then, you
13 know, that might be, you know, you might not have that much
14 interest in the answer.

15 COMMISSIONER GOLDWAY: Right. Right.

16 THE WITNESS: But, you know, I think that that is
17 -- certainly, you know, if that happened at some point, that
18 would be the best way to look at it and say, oh, well, here
19 is what happened when we raised rates December 1st, but
20 since you raise rates, or at least recently have been doing
21 it in January, you know, it might make it harder to see that
22 effect.

23 I think the only thing, as I said, is maybe you
24 could see if the price elasticity is greater in that fourth
25 quarter, which would be the Christmas time as well as other

1 times. And if it were -- but the thing is, if you saw that,
2 what would it tell you? It would tell you don't raise rates
3 before Christmas, but I think you already know that.

4 COMMISSIONER GOLDWAY: Or it might tell you to
5 have two different rates.

6 THE WITNESS: It might. It might.

7 COMMISSIONER GOLDWAY: For different kinds of
8 mailing.

9 THE WITNESS: The problem is that stamps are
10 storable. So I just say -- supposed you said, well, during
11 Christmas time, we are going to have a lower rate because it
12 is more elastic in Christmas. The problem is, why wouldn't
13 you just buy all your stamps then and just, you know, keep
14 them in a drawer and use them eight a month for the rest of
15 the year?

16 COMMISSIONER GOLDWAY: I guess you could date
17 stamps.

18 THE WITNESS: You know, you could do it, I am not
19 saying it is impossible.

20 COMMISSIONER GOLDWAY: Well, I think I think it is
21 something the intervenors here might want to think about,
22 because it seems to me, from a consumer's point of view,
23 that is an area where price sensitivity is greater than on
24 the average in the sort of base year schemes that you are
25 presenting here as part of the testimony.

1 THE WITNESS: It certainly might be, yes. But I
2 think it would be nice if one actually had evidence that
3 said it was.

4 COMMISSIONER GOLDWAY: Yes.

5 THE WITNESS: Or at least I would prefer that.

6 CHAIRMAN GLEIMAN: I actually think that there is
7 the same kind of evidence of that that, akin to what you
8 spoke of, in electronic diversion and the pluses and
9 minuses. There is a lot of anecdotal information out there
10 about people sending out fewer Christmas cards than they
11 might otherwise, paring down their list when stamps prices
12 go up. Even if they go up in January, there appears to be
13 some impact the next year from stories that I have heard and
14 read over many, many years. But, again, it is anecdotal.

15 THE WITNESS: Yes, no one is denying that there is
16 a negative effect of price. I ^{do think that it is} ~~don't think that it is~~ just a
17 question of the magnitude.

18 CHAIRMAN GLEIMAN: If I could just make sure that
19 the record is clear on one point. We don't raise rates.

20 THE WITNESS: I know, I am sorry.

21 CHAIRMAN GLEIMAN: We just make recommendations.
22 It is those other folks who decide when the rates go into
23 effect.

24 THE WITNESS: Yes.

25 CHAIRMAN GLEIMAN: I just have a very few

1 questions. They are perhaps a lot simpler, at least in my
2 mind, than some of what you have been talking about. And I
3 always enjoy hearing you talk about demand elasticities, it
4 is an education to hear from the likes of you and Dr.
5 Tolley.

6 If the Postal Service were to drop a product or
7 several products, would its scope economies be diminished?

8 THE WITNESS: We'd just give up this product --

9 CHAIRMAN GLEIMAN: Well, if they went out of the
10 Parcel Post business or they went out of Express Mail or --

11 THE WITNESS: Well, they would -- it would be, you
12 know, they would save the incremental costs and, you know, I
13 don't know what that means in terms of the scope economies
14 exactly. I mean if it had any effect in that regard it
15 would make them less, have less scope economies just because
16 they are doing less, but I think that is what incremental
17 costs are supposed to measure.

18 CHAIRMAN GLEIMAN: If the Postal Service had less
19 volume and/or fewer delivery days, and/or delivered to less
20 than the total number of delivery points, would its scale
21 economies be diminished?

22 THE WITNESS: It would seem that they would be
23 but, you know, you are losing volume, presumably you are
24 losing volume and then you are losing cost, and I don't
25 know -- I mean in theory, and we are getting into these what

1 exactly are scope and scale economies, in theory you could
2 say we are not going to delivery to some rural area out of
3 the way and actually that is going to cut a lot of costs. I
4 don't know if that's -- I am just hypothesizing -- and then
5 you could argue that it, you know, you are getting rid of
6 your high cost mail and therefore making yourself a lower
7 cost operation, but I am throwing out just a hypothetical.

8 I think if the point is less mail probably makes
9 the scale economies less, I think that is probably true in
10 that sense.

11 CHAIRMAN GLEIMAN: If the scope and/or scale
12 economies were diminished in the cases we just spoke about,
13 would it imply less efficiency on a total systemwide basis
14 for a particular provider?

15 THE WITNESS: That is a good question. It depends
16 a little bit how you define "efficiency."

17 On the one hand, you would be reducing volume,
18 reducing costs. You might say well, that wouldn't affect
19 the marginal cost of the operation, let's say, that it is
20 not like you are eliminating high cost markets or things
21 like that, so the marginal costs would be the same, so if
22 that is your measure of efficiency then there is no change.

23 On the other hand, your average cost would be
24 higher because you have got your non-marginal costs that are
25 now spread out over less volume, so those costs would be

1 higher, so by that criteria you would then be less
2 efficient, so I guess it depends what your definition is.

3 CHAIRMAN GLEIMAN: And if the mail that you lost
4 was low cost mail or low cost stops, then it would be more
5 likely to diminish your efficiency than if the mail that you
6 were losing was high cost mail or high cost stops.

7 THE WITNESS: Yes, I mean if you are left with
8 only the high cost mail and not the low cost mail, that is
9 going to make you less efficient in that way, yes.

10 CHAIRMAN GLEIMAN: Could you look at your answer
11 to UPS/USPS-T41-3, the response to Part (a)?

12 THE WITNESS: I am looking at the wrong one.

13 CHAIRMAN GLEIMAN: I'm sorry, I gave you a
14 wrong -- it's Number 4, Part (a).

15 THE WITNESS: Yes, I see it.

16 CHAIRMAN GLEIMAN: Will you look at that? In the
17 middle of the answer to Part (a) there is the "However" --
18 the sentence that starts with "However" --

19 THE WITNESS: Yes.

20 CHAIRMAN GLEIMAN: In the discussion we were
21 having just now, if I were relying on your references here
22 to scope and scale economies, then what we were just talking
23 about would be correct? You define scale and scope
24 economies here and that is what was using, in my mind at least.
25 Is that what you were talking about when you were talking

1 about scope and scale economies?

2 THE WITNESS: Essentially yes, I think.

3 CHAIRMAN GLEIMAN: Thank you. I have no further
4 questions.

5 Are there any other questions?

6 COMMISSIONER LeBLANC: Yes.

7 CHAIRMAN GLEIMAN: Sure. Commissioner LeBlanc.

8 COMMISSIONER LeBLANC: Mr. Bernstein, just a
9 clarification. In picking up on what the Chairman said, is
10 it your testimony you can be efficient or inefficient
11 whether you have economies of scale and scope or not?

12 In other words, you could be inefficient whether
13 you have economies of scale or not?

14 THE WITNESS: It is inefficient relative to what?
15 I mean that is kind of the question we are addressing.

16 One measure of efficiency is marginal cost. You
17 want to have low marginal costs because that says you can
18 pump out your product, in this case mail, without much cost.
19 Another sense of efficiency is the total costs of the
20 operation, which would include these non-marginal costs as
21 well and given the structure of the Postal Service, where it
22 has what is sometimes called institutional costs or
23 whatever, the more volume you have the more able you are to
24 spread those institutional costs over more volume.

25 You know, if you lost volume without losing

1 institutional cost, which I don't know exactly how the
2 volume costing process works, but conceivably if volume got
3 cut in half and you still had these institutional costs to
4 cover, you would have to raise rates a lot to make the
5 contribution, so --

6 COMMISSIONER LeBLANC: But forget institutional
7 for a minute. If you look at just the variable costs --

8 THE WITNESS: Yes.

9 COMMISSIONER LeBLANC: -- what you are assuming,
10 unless I'm wrong and correct me if I am wrong here, but what
11 you are assuming is that the Postal Service in this
12 particular case then is actually capturing and shedding
13 those variable costs.

14 Forget the institutional for a minute.

15 THE WITNESS: When its volume is going down?

16 COMMISSIONER LeBLANC: Correct.

17 THE WITNESS: Yes, I am assuming that it is
18 getting rid of the volume variable costs.

19 COMMISSIONER LeBLANC: Correct, but if they don't
20 do that, then what happens?

21 THE WITNESS: Well, then they are not volume
22 variable costs. They should disappear if they are. If they
23 are not then --

24 COMMISSIONER LeBLANC: Not to disagree with you
25 here, but just to make sure I am understanding you, just

1 because it is volume variable and they do not necessarily
2 capture that cost, if that volume goes away it doesn't
3 necessarily mean that it is -- it could be a lot of
4 different things, coming back to your definition of
5 efficiency, could it not?

6 THE WITNESS: Yes -- if they are strictly volume
7 variable, then the idea is that if there is less volume,
8 there is less of that cost if the cost disappears.

9 COMMISSIONER LeBLANC: I got you.

10 THE WITNESS: If it is not that, then, yes, you
11 are losing, you know, you are not shedding your costs the
12 way you want to and that can be a problem when your volume
13 goes down.

14 COMMISSIONER LeBLANC: Got it. Thank you very
15 much.

16 CHAIRMAN GLEIMAN: Follow-up to questions from the
17 bench? There don't appear to be any.

18 That brings us to redirect. Mr. Koetting, would
19 you like some time with your witness?

20 We are ready for a break in any event. We can do
21 it now or we can do it when you finish redirect if you don't
22 need any time, whichever way you want it.

23 MR. KOETTING: I would rather just have the break,
24 Mr. Chairman.

25 CHAIRMAN GLEIMAN: Right now?

1 MR. KOETTING: Yes, please.

2 CHAIRMAN GLEIMAN: Ten minutes?

3 MR. KOETTING: That's fine.

4 CHAIRMAN GLEIMAN: Okay.

5 [Recess.]

6 CHAIRMAN GLEIMAN: Mr. Koetting?

7 MR. SUENDIMAN: Mr. Chairman, just as a procedural
8 matter, I'd like to have transcribed into the record, Mr.
9 Bernstein's diagrams to which he referred in a series of
10 cross examinations.

11 I have two copies of what is designated GCA/USPS
12 T41-XE-1.

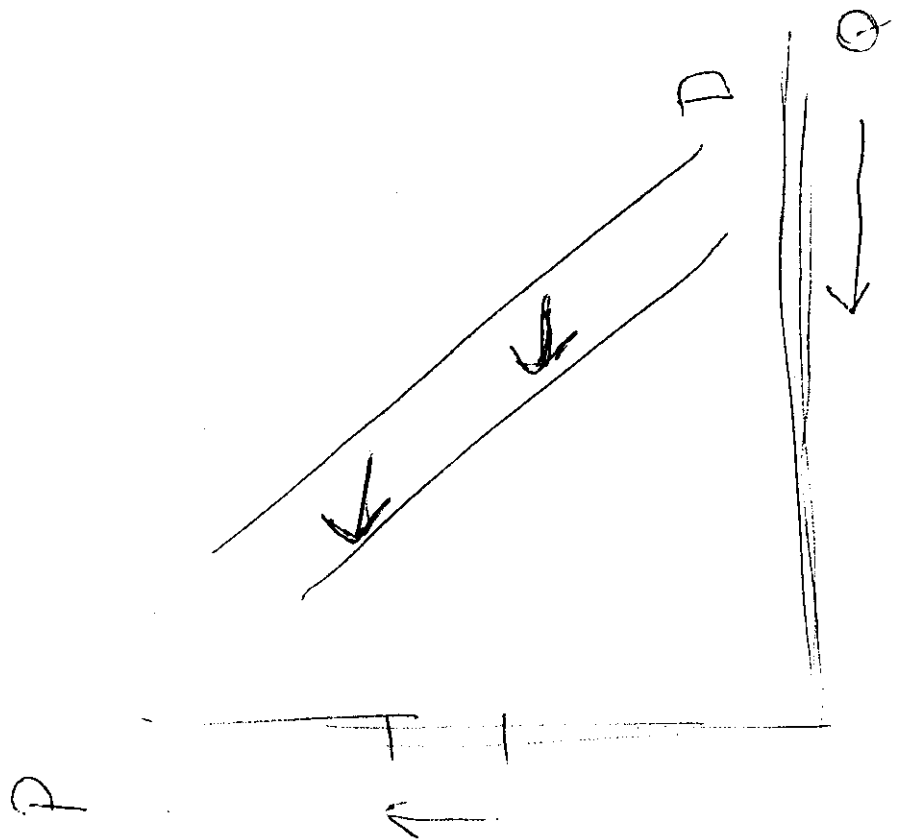
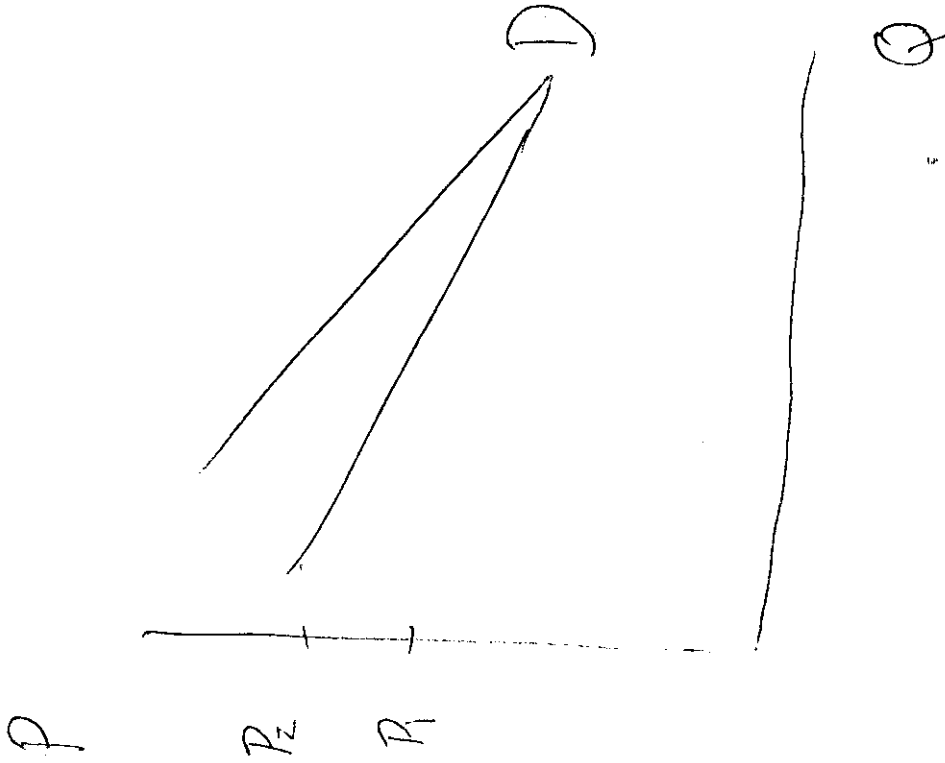
13 CHAIRMAN GLEIMAN: I just want to make sure that
14 we all agree that they're a reasonable reflection of the
15 diagrams that were discussed in some detail, and were drawn
16 up there on the chart.

17 MR. KOETTING: We have shopped them around to the
18 appropriate counsel. However, I would like to clarify that
19 the Postal Service has no objection to them being
20 transcribed, however, we wouldn't object to them being
21 entered into evidence.

22 CHAIRMAN GLEIMAN: I wasn't aware that Mr.
23 Suendiman made that request, in any event, so we'll order
24 them to be transcribed into the record, but not admitted
25 into evidence.

1 [GCA/USPS T41-XE-1 was marked for
2 identification and transcribed into
3 the record.]
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1 CHAIRMAN GLEIMAN: I actually thought that you did
2 such a good job describing those that people could read the
3 transcript and reproduce them.

4 THE WITNESS: I got in more trouble when I drew
5 it, I think.

6 CHAIRMAN GLEIMAN: Mr. Koetting?

7 MR. KOETTING: Mr. Chairman, the Postal Service
8 has no redirect. We would like to take the opportunity,
9 however, to express our gratitude to the Commission in
10 changing the order of the witnesses to allow Mr. Bernstein
11 to go first so that he could teach his class this evening,
12 and share the same wisdom that she shared this morning with
13 his students this evening.

14 CHAIRMAN GLEIMAN: I forgot all about that. Maybe
15 we should just adjourn the hearing so that those of us who
16 have to hear things three, four, or five times before they
17 sink in, can go to class tonight with Professor Bernstein,
18 as opposed to Witness Bernstein.

19 [Laughter.]

20 CHAIRMAN GLEIMAN: If there is no redirect, then
21 that completes your testimony here, Mr. Bernstein. We
22 appreciate your appearance and your contributions to the
23 record, and we thank you, and you're excused.

24 THE WITNESS: Thank you.

25 [Witness Bernstein excused.]

1 CHAIRMAN GLEIMAN: Ms. Duchek, would you like to
2 call your next witness?

3 MS. DUCHEK: The Postal Service calls Michael D.
4 Bradley.

5 CHAIRMAN GLEIMAN: Counsel, before you start, I'm
6 going to go out of order and just ask one question. So are
7 you or are you not an accountant? I was looking over there
8 trying to gauge some reaction.

9 THE WITNESS: I am not an accountant.

10 CHAIRMAN GLEIMAN: I just was kind of curious.

11 Ms. Duchek?

12 MS. DUCHEK: Thank you, Mr. Chairman.

13 Whereupon,

14 MICHAEL D. BRADLEY,
15 a witness, having been called for examination, and, having
16 been first duly sworn, was examined and testified as
17 follows:

18 DIRECT EXAMINATION

19 BY MS. DUCHEK:

20 Q Dr. Bradley, I have handed you two copies of a
21 document entitled Direct Testimony of Michael D. Bradley on
22 Behalf of United States Postal Service, designated at USPS
23 T-18.

24 Are you familiar with that document?

25 A Yes, I am.

1 Q Was it prepared by you or under your supervision?

2 A It was prepared by me.

3 Q And if you were to testify orally today, would
4 that still be your testimony?

5 A It would.

6 MS. DUCHEK: Mr. Chairman, I'm going to hand the
7 Reporter two copies of the Direct Testimony of Michael D.
8 Bradley on Behalf of the United States Postal Service, USPS
9 T-18, and I ask that they be entered into evidence.

10 CHAIRMAN GLEIMAN: Is there any objection?

11 [No response.]

12 CHAIRMAN GLEIMAN: Hearing none, if counsel would
13 provide two copies of Dr. Bradley's testimony, T-18, the
14 testimony will be received into evidence, but will not be
15 transcribed into the record.

16 [Direct Testimony of Michael D.
17 Bradley, USPS T-18, was received
18 into evidence.]

19 CHAIRMAN GLEIMAN: Dr. Bradley, have you had an
20 opportunity to examine the packet of Designated Written
21 Cross Examination -- before I get to that, let me ask about
22 Category II Library References. Old habits die hard. I
23 can't get used to asking about those.

24 We do have some Category II Library References.

25 MS. DUCHEK: That's correct, Mr. Chairman. The

1 Library References associated with Dr. Bradley's testimony
2 are Library References 84, 85, and 86. And I ask that they
3 be entered into evidence.

4 CHAIRMAN GLEIMAN: All right, so ordered; the
5 Library References in question are entered into evidence.
6 They're not transcribed into the record, however.

7 [Library References 84, 85, and 86 were
8 received into evidence.]

9 CHAIRMAN GLEIMAN: Now, Dr. Bradley, have you had
10 an opportunity to examine the packet of designated cross
11 examination that was made available to you earlier today?

12 THE WITNESS: I have.

13 CHAIRMAN GLEIMAN: And if those questions were
14 asked today, would your answers be the same?

15 THE WITNESS: They would.

16 CHAIRMAN GLEIMAN: No additions or corrections at
17 this point?

18 THE WITNESS: None, sir.

19 CHAIRMAN GLEIMAN: Counsel, if you would please
20 provide two copies of the Designated Written Cross
21 Examination of Witness Bradley to the Reporter, that
22 material will be received into evidence and transcribed into
23 the record.

24 [Designated Written Cross
25 Examination of Michael D. Bradley

1 was received into evidence and
2 transcribed into the record.]
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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 2000

Docket No. R2000-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS MICHAEL D. BRADLEY
(USPS-T-18)

Party

Florida Gift Fruit Shippers Association

Magazine Publishers of America

United Parcel Service

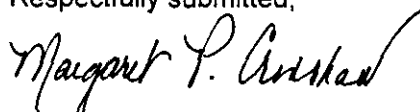
Interrogatories

FGFSA/USPS-T18-1-2, 4-13

FGFSA/USPS-T1-7 redirected to T18
MPA/USPS-T18-1, 4, 6-7, 10

FGFSA/USPS-T18-2, 13
MPA/USPS-T18-4, 10
UPS/USPS-T18-1

Respectfully submitted,



Margaret P. Crenshaw
Secretary

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS MICHAEL D. BRADLEY (T-18)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory:

FGFSA/USPS-T18-1
FGFSA/USPS-T18-2
FGFSA/USPS-T18-4
FGFSA/USPS-T18-5
FGFSA/USPS-T18-6
FGFSA/USPS-T18-7
FGFSA/USPS-T18-8
FGFSA/USPS-T18-9
FGFSA/USPS-T18-10
FGFSA/USPS-T18-11
FGFSA/USPS-T18-12
FGFSA/USPS-T18-13
FGFSA/USPS-T1-7 redirected to T18
MPA/USPS-T18-1
MPA/USPS-T18-4
MPA/USPS-T18-6
MPA/USPS-T18-7
MPA/USPS-T18-10
UPS/USPS-T18-1

Designating Parties:

FGFSA
FGFSA, UPS
FGFSA
FGFSA
FGFSA
FGFSA
FGFSA
FGFSA
FGFSA
FGFSA
FGFSA
FGFSA, UPS
MPA
MPA
MPA, UPS
MPA
MPA
MPA, UPS
UPS

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGFSa

FGFSa/USPS-T18- 1. Do you agree that the proportions of transportation capacity used by the various classes and subclasses of mail are properly determined by a sound sampling process which establishes the cubic-foot-miles that each mail category utilizes the transportation capacity? If you do not agree, please fully explain.

FGFSa/USPS-T18-1 Response:

I find this statement difficult to agree with because it seems to be implying that the proportions of transportation capacity used by the various classes and subclasses are determined by a specific sampling process. I believe that any specific sampling process has little to do with the determination of what proportion of transportation capacity is caused by any subclass of mail.

I do, however, agree that a sound sampling procedure, like TRACS, can be used to *measure* the proportions of capacity caused by the various classes and subclasses of mail.

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGFSa

FGFSa/USPS-T18- 2. Refer to page 15 of T-18.

- a. Identify when the changes from restructuring the purchased highway accounts were implemented.
- b. Are those changes reflected in the cost data for the base year, FY 1998?
- c. Are those changes reflected in the cost data for the most recent year, FY 1999?

FGFSa/USPS-T-18-2 Response:

- a. I am informed that the change took place in Fiscal Year 1997.
- b. Yes.
- c. Yes.

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGfSA

FGfSA/USPS-T18- 4. Explain why cubic-foot-miles of mail products actually transported pursuant to a purchased highway transportation contract is not essential data to be taken into account in determining the variability of the costs of purchased highway transportation

FGfSA/USPS-T18- 4 Response:

As you may be aware, the Postal Service, when contracting for highway transportation, does not purchase cubic foot-miles of what you term "actual transportation" but rather purchases cubic foot-miles of capacity. Consequently, it is changes in the cubic foot-miles of capacity that gives rise to changes in cost. In product costing terms, cubic foot-miles of capacity is known as the "cost driver" of cost. Because cubic foot-miles of capacity is the cost driver, it is sound costing practice to measure the way in which cost responds to changes in the amount of the cost driver purchased.

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGFSa

FGFSa/USPS-T18-5. Confirm that the variability analysis which you make does not reflect actual or projected mail volumes transported or to be transported. If you do not confirm, please fully explain.

FGFSa/USPS-T18-5 Response:

If the term "the variability analysis which you make" is referring to my econometric analysis, I would concur that my analysis, like those presented to and accepted by the Commission in Dockets No. R87-1 and R97-1, does not make use of actual mail volumes. It is more problematic, however, to confirm that the analysis does not "reflect" actual or projected mail volumes, as this would appear to deny any relationship between those volumes and the transportation capacity that I do use. I believe that such a relationship exists and that is why it is appropriate to use the cost driver, "cubic foot-miles" as a substitute for actual volume in the econometric analysis. Consequently, in this sense, I believe that my analysis reflects actual or projected mail volumes.

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGfSA

FGfSA/USPS-T18-6. Explain how cubic feet of mail actually or projected to be transported under purchased highway transportation contracts is reflected in the determination of the cubic feet capacity of the vehicle being contracted for.

FGfSA/USPS-T18-6:

In Docket No R97-1, Postal Service witness Young gave a complete description of how the Postal Service purchases transportation capacity. There, he explains that the Postal Service uses the mail actually or projected to be transported along with other factors in determining the capacity of the truck being contracted for. He also describes these other factors and how they influence the contracted transportation. For your convenience, I repeat the relevant portion of his testimony here (Docket No. R97-1, Tr.35/18855-57):

There are a number of considerations that go into purchasing transportation capacity, but average utilization on a segment is not one of them.

When the Postal Service purchases transportation capacity, it generally operates from an historical knowledge base. We know, for example, the requirements of downstream mail processing and delivery facilities. These requirements are determined by service commitments to customers. We also know how many containers of mail each downstream facility normally receives on the busiest day or night of the week. Finally, we know what plants can handle which types and sizes of highway equipment.

Using this historical knowledge, the Postal Service has a good idea of the times of day and days of the week for which we need maximum transportation capacity on a given route. Let me give you an example. Beginning in the evening, a BMC

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGFSa

will begin to process mail for its service area. This intra-BMC mail is sorted to containers to be loaded onto intra-BMC highway trucks. These trucks in turn will be dispatched to local processing and distribution centers (PDCs) and their large subordinate offices. Dispatch times will fall in a window of time that is determined by the downstream facilities' operating plans.

Dr. Merewitz, for the Florida Gift Fruit Shippers, describes postal transportation in terms of linehauls and backhauls, where the linehauls are outbound trips and the backhauls are inbound trips. (Tr. 22/11504). This is an oversimplification. Generally speaking, a contract contains pairs of trips. Each trip pair contains an outbound trip and an inbound trip¹. When the BMC processes mail for its service area, it is likely, particularly on its peak weekly volume day, to dispatch vehicles full, although it is certainly possible that the last dispatch of the day will be less than full. This last scheduled dispatch, called the dispatch of value, must be met since any further delay would result in mail being unavailable to meet downstream processing and delivery schedules. The same truck is likely to return in mid-morning less than full, often carrying empty equipment.

In the evening, the same activity occurs, but moving in the opposite direction. (Moreover, the actual routing may not be the same as those on the early morning "outbound" trips.) Vehicles run routes that load mail at P&DCs and other subordinate facilities, and unload at the BMCs. On the inbound peak day of the week, these vehicles typically are full on arrival at the BMC. A return trip from the BMC carries smaller volumes of mail. Generally speaking, these two routings are independent of each other. That is, a large outbound load from the BMC on Thursday night has little to do with a large inbound load to the BMC on Friday morning.

¹ The inbound trips do not necessarily retrace the path of the outbound runs. It should also be noted that there are numerous one way trips that are exceptions to this rule of thumb.

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGFSa

In some situations, the size of the truck itself is driven by factors other than mail volume. For instance, certain facilities cannot handle tractor trailers. Other facilities require special tailgate equipment to allow the truck to access the platform. Certain roadways restrict the maximum weight a vehicle may carry. Aside from these considerations, for any given routing, the Postal Service will buy as big a truck as we need to meet peak weekly volumes, since there is very little difference in cost between, for example, a 40-foot trailer and a 45-foot trailer. (Footnote included).

In addition he testified that (Docket No. R97-1, Tr. 35/18858):

The size of the truck selected by the Postal Service is not independent of other routing considerations, however. Truck size is dependent on service requirements (i.e., the processing window), the distance between and number of downstream facilities served, and the number of containers of mail expected to be transported.

Let me give you another example. An intra-BMC trip runs between the Washington BMC, the Merrifield (VA) P&DC, and the Norfolk (VA) P&DC. Suppose the transportation needs of Norfolk increase because the Norfolk P&DC begins to receive two more containers on the peak night. In the short term, this may require an extra trip, but over time, we can re-work the routing of this truck to skip a stop at the Merrifield P&DC and divert Merrifield's mail to another contract (or another trip on the same contract). That second contract (or trip) might need a bigger truck, but the first one simply alters its mileage. Total cubic feet of truck space may be increased, but the effect on cubic foot miles is complicated, because we have reduced mileage on one route and increased cube (and perhaps also mileage) on another. (Footnote omitted).

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGFA

FGFA/USPS-T18- 7. Refer to Table 3 on page 25 of T18. Identify the number of contracts and, separately the number of power only contracts, included for each accounts 53127, 53129, 53131, and 53133.

FGFA/USPS-T18- 7 Response:

ACCOUNT	# of Contracts	# of Power Only Contracts
53127	353	159
53129	13	10
53131	183	16
53133	3	0

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGFSa

FGFSa/USPS-T18- 8 Refer to page 42 of T18. Do you concur with the material quoted from the PRC Op., R97-1, Vol. 1, at 213 concerning the purchased cost of a route being a joint cost for the outhaul and the backhaul? If not, please fully explain.

FGFSa/USPS-T18- 8 Response:

I concur with the following statement made by the Commission in PRC OP, R97-1, Vol1 at 213:

Transportation services for route trip destination days are purchased jointly by routes or in other blocks specified in the HCSS contracts. In the simplest case, an outhaul from a facility and a backhaul to the same facility comprise a pair of route trip destination days that must be purchased together. The purchased cost of the route is a joint cost of the mail carried on both the outhaul and the backhaul

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGFS

FGFS/USPS -T18- 9 Do you agree with the statement that "When TRACS assigns the cost to the mail found on the truck at its destination, it is making an arbitrary division of a joint cost."? If not, please fully explain.

FGFS/USPS-T-18-9 Response:

The statement, as it is written, is easily refuted because it fails to specify *what* cost TRACS is assigning to the mail found on the truck at its destination.

In fairness, however, I believe that you were attempting to obtain my views on the Commission's statement in its Docket No. R97-1 Opinion and Recommended Decision. There, the Commission states:

When TRACS samples either the outhaul or the backhaul as a route trip destination day, the cost of the outhaul or backhaul is part of the joint cost of the route. When TRACS assigns this cost to the mail found on the truck at its destination, it is making an arbitrary division of a joint cost. (Emphasis added).

As I understand it, TRACS does not currently assign the cost of mail found on the truck at its destination. In fact, as I state in my testimony at page 43, TRACS now produces an estimate of the cubic foot-miles caused by a subclass throughout a transportation category (like intra-BMC).

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGFS

FGFS/USPS -T18- 10. The contracts for purchased transportation for Intra-BMC and Inter-BMC transportation provide for a capacity of cubic- feet miles to be provided. For each transportation mode (Intra-BMC and Inter-BMC) provide the total cubic-feet miles capacity included in the contracts which you analyzed for your testimony in this docket and, separately, in Docket No. R97-1.

FGFS/USPS -T18- 10 Response:

The following table contains the values for the cubic foot-miles included in the contracts I used in the econometric regressions for intra-BMC and inter-BMC in both Docket No. R2000-1 and Docket No. R97-1.

Transportation Type	R2000-1	R97-1
Inter-BMC	6.14487 E+11	5.70694 E+11
Intra-BMC	4.93101 E+11	3.87785 E+11

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGFA

FGFA/USPS -T18- 11. Are the cubic foot miles of contracted for capacity related to the actual mail volume to be transported under those contracts? If so, please explain how such relationship is determined.

FGFA/USPS -T18- 11 Response:

My response to FGFA/USPS-T18-6 includes an explanation of how the Postal Service determines the capacity be purchased on its contracts, including the role of volume.

Please refer to my response to that interrogatory.

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGFSa

FGFSa/USPS -T18- 12. For Intra-BMC contracts, is the capacity contracted for based on the actual or projected volume of outbound (out from the BMC) mail? If the inbound volume of mail is significantly lower than the outbound volume, does the contract provide for use of a smaller capacity on the inbound segment of the route?

FGFSa/USPS -T18- 12 Response:

The role of inbound and outbound mail was explained by witness Young (who is a Postal Service transportation purchasing expert) in his Docket No. R97-1 testimony. I repeat it here for your convenience (Docket No. R97-1, Tr. 35/18856-57):

Dr. Merewitz, for the Florida Gift Fruit Shippers, describes postal transportation in terms of linehauls and backhauls, where the linehauls are outbound trips and the backhauls are inbound trips. (Tr. 22/11504). This is an oversimplification. Generally speaking, a contract contains pairs of trips. Each trip pair contains an outbound trip and an inbound trip¹. When the BMC processes mail for its service area, it is likely, particularly on its peak weekly volume day, to dispatch vehicles full, although it is certainly possible that the last dispatch of the day will be less than full. This last scheduled dispatch, called the dispatch of value, must be met since any further delay would result in mail being unavailable to meet downstream processing and delivery schedules. The same truck is likely to return in mid-morning less than full, often carrying empty equipment.

In the evening, the same activity occurs, but moving in the opposite direction. (Moreover, the actual routing may not be the same as those on the early morning "outbound" trips.) Vehicles run routes that load mail at P&DCs and other subordinate facilities, and unload at the BMCs. On the inbound peak day of the week, these vehicles typically are full

¹ The inbound trips do not necessarily retrace the path of the outbound runs. It should also be noted that there are numerous one way trips that are exceptions to this rule of thumb.

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGSA

on arrival at the BMC. A return trip from the BMC carries smaller volumes of mail. Generally speaking, these two routings are independent of each other. That is, a large outbound load from the BMC on Thursday night has little to do with a large inbound load to the BMC on Friday morning. (Footnote in original).

Response of United States Postal Service Witness Bradley
to
Interrogatories of FGfSA

FGfSA/USPS -T18-13. In Intra-BMC transportation, where there is an imbalance between the out-bound mail volume and the in-bound mail volume, a portion of the capacity on the in-bound movement will be empty. Do you believe that the cost of an empty backhaul (in-bound) is merely a part of the cost of the out-bound movement? If your response is negative, please fully explain.

FGfSA/USPS -T18-13 Response:

I believe that when the Postal Service specifies a contract, it takes into account the factors described by witness Young in his Docket No. R97-1 testimony. Among those factors are what you describe as "inbound" and "outbound" volume. I believe that the cost of that contracted transportation is a function of all of the factors that go into determining the required capacity and the ability of the contractor to provide that capacity.

**Response of United States Postal Service Witness Bradley
to
Interrogatories of FGFSa
(Redirected from Witness Xie)**

FGFSa/USPS -T1 -7. Explain the rationale and justification for the expansion of the test data to:

- a. the capacity of the container,**
- b. the capacity of the unloaded vehicle.**

FGFSa/USPS -T1 -7 Response:

a. & b The rationale and justification for "expanding" the test data to include the empty space of the vehicle and the container were provided by the Commission in its Opinion and Recommended Decision in Docket No. R90-1. First, the Commission explained why TRACS "expands" to the capacity of the vehicle:¹

Another problem that TRACS answers is what to do with respect to the capacity in the vehicles which is not holding mail at any particular time. From time to time, proposals have been made that the costs thought to be associated with this space should be treated as institutional. The problem is particularly difficult because the capacity not holding mail can be expected to change, even on one trip. On the many contracts that involve more than one stop, mail is loaded and unloaded at various facilities. Therefore, at some points the truck may be more full than at others. See Tr. 5/1538.

With TRACS, all unused capacity is accounted for and distributed to the mail on a sampled vehicle. The sampled mail is allocated its "fair share" of empty space by multiplying a ratio

See PRC Op., R90-1, Vol. 1 at III-161-162

**Response of United States Postal Service Witness Bradley
to
Interrogatories of FGFA
(Redirected from Witness Xie)**

of the percent unloaded divided by the percent unloaded plus the percent remaining times that percent empty. The mail that is loaded on the truck further upstream is charged more.

Next, the Commission laid out why TRACS "expands" to the container:²

The analogous question of what to charge the subclass in a container when the container is not completely full is also answered. The entire cost of transporting the selected container is charged to those classes of mail sampled from the container according to the ratio of the classes' cubic-feet to the total cubic-feet of all the subclasses in the container. Tr. 5/1474.

²**See PRC Op., R90-1, Vol. 1 at III-162**

Response of United States Postal Service Witness Bradley
to
Interrogatories of MPA

MPA/USPS-T18-1. Please refer to your Testimony at page ii. Aside from your work for the Postal Service and foreign postal administrations, please itemize and describe work you have performed for transportation providers.

MPA/USPS-T18-1 Response:

To the best of my recollection, all my transportation work (except when I was employed as a dump truck driver) has been for postal administrations.

Response of United States Postal Service Witness Bradley
to
Interrogatories of MPA

MPA/USPS-T18-4 Please refer to your Testimony at pages 19-20, and at page 23. Please provide copies of – or references to – all documents on which you rely for specifying separate models for vans and tractor trailers within the intra-P&DC, intra-CSD, inter P&DC, inter-cluster and inter-area account categories.

MPA/USPS-T18-4 Response:

The decision to investigate the possibility that the van and tractor trailer portions of these accounts was based upon my specifying and testing a similar hypotheses for the intra-SCF and inter-SCF accounts in Docket No. R97-1. See Direct Testimony of Michael D. Bradley on Behalf of the United States Postal Service, USPS-T-13, Docket No. R97-1, at pages 35-40. The research relative to this hypothesis demonstrated that different variabilities were obtained for van and tractor trailer contract cost segments within the accounts and this approach was accepted by the Commission. See Opinion and Recommended Decision, Docket No. R97-1, at pages 210-211.

Because the contract cost segments listed in your question came from the intra-SCF and inter-SCF it seemed appropriate to pursue a similar approach when estimating variabilities for the new accounts.

Response of United States Postal Service Witness Bradley
to
Interrogatories of MPA

MPA/USPS-T18-6. Please refer to your Testimony at page 28, lines 14-19. Please supply the numerical values to implement the listed criteria in each of the 17 data sets.

MPA/USPS-T18-6 Response:

The approach that I take to handling unusual observations in the current analysis is the same as I took, and was accepted by the Commission, in Docket No. R97-1. This question is essentially the same as MPA/USPS-T13-2 b in Docket No. R97-1 and I refer you to that response. However, for convenience, I will reiterate the essence of that response here:¹

My identification of unusual observations was judgmental rather than statistical. That is why I have identified these observations as "unusual" rather than "outliers." Below I will describe the process that I followed to identify these observations, and it will become clear why it is not meaningful to provide exact numerical boundaries. Although such boundaries can always be provided *ex post*, they would not reflect the true method of identification.

For each analysis data set, the goal of this particular analysis was to investigate the possibility that some observations were unusual relative to that data set. Because each of the analysis data sets is quite different from the others, *a priori* numerical boundaries across data sets could not be applied in this exercise.

¹ See Docket No. R97-1, Tr. 7/3641.

Response of United States Postal Service Witness Bradley
to
Interrogatories of MPA

MPA/USPS-T18-7. Please refer to your Testimony at page 34.

- a. Please supply the results of all tests for "equation heterogeneity" that you may have applied including the "Chow test."
- b. Please provide a reference to a standard econometric textbook or other equivalent source regarding the application and interpretation of the "Chow test" in the presence of heteroskedasticity.
- c. Please explain how the presence of heteroskedastic errors affects the variances you refer to on line 15.

MPA/USPS-T18-7 Response:

- a. The tests of regression heterogeneity that I performed are presented in Table 8 on page 37 of my testimony. As explained on page 36 of my testimony, the calculations supporting those tests are presented in my Workpaper 2, "Calculation of Wald Statistics."
- b. Please see, Schmidt, Peter and Sickles, Robin, "Some Further Evidence on the Use of the Chow Test under Heteroskedasticity," Econometrica, Vol. 45, No. 5, (July 1977) at pages 1293-1298.
- c. In classical linear regression, it is assumed that the disturbance variance is constant across observations. This is known as homoskedasticity. When the disturbance

Response of United States Postal Service Witness Bradley
to
Interrogatories of MPA

variance is non-constant, we say that the regression is heteroskedastic (or sometimes heteroscedastic). Mathematically, homoskedasticity implies that:

$$E(\epsilon_i^2) = \sigma^2 \quad \text{for all } i.$$

On the other hand, heteroskedasticity implies that:

$$E(\epsilon_i^2) = \sigma_i^2.$$

This means that the variance of the disturbance may vary from observation to observation. This also means that when the data are collected into subsets, as in the instant case, the variance of the disturbances may be different across the subsets.

Response of United States Postal Service Witness Bradley
to
Interrogatories of MPA

MPA/USPS-T18-10. Please refer to your Workpaper WP-3 at page 5. Please supply the definitions of the different values taken by the following variables in HCSS:

- a. REN
- b. CONTYPE.

MPA/USPS-T18-10 Response:

- a. The variable REN refers to whether or not the contract has been renewed or is in the process of being renewed. A value for "Y" means that the contract has been renewed or is in the process of being renewed; a value for "N" means that the contract has not been renewed.
- b. The variable CONTYPE indicates whether the contract is a regular contract, an emergency contract, or a temporary contract. A value of "1" means that it is a regular contract; a value of "2" means that it is an emergency contract; a value of "4" means that it is a temporary contract.

**Response of United States Postal Service Witness Bradley
to
Interrogatories of UPS**

UPS/USPS-T18-1. *Identify all instances in which you have relied on or used in your testimony in any way FY 1999 cost, volume, or other data, and state in each such instance why you used FY 1999 data instead of data for BY 1998.*

UPS/USPS-T18-1 Response:

There are no such instances in my testimony.

1 CHAIRMAN GLEIMAN: Is there any additional written
2 cross examination for Witness Bradley?

3 Mr. McKeever?

4 MR. MCKEEVER: Thank you, Mr. Chairman.

5 CROSS EXAMINATION

6 BY MR. MCKEEVER:

7 Q Dr. Bradley, I'm going to hand you copies of your
8 answers to Interrogatories UPS/USPS T-18-5, and 6, which
9 were provided this morning.

10 Could you take a look at those answers and tell
11 me, if those questions were asked of you today, would your
12 answers still be the same?

13 A I'd be glad to.

14 [Pause.]

15 They would.

16 MR. MCKEEVER: Mr. Chairman, I move that Dr.
17 Bradley's responses to Interrogatories UPS/USPS T-18-5, and
18 6 be admitted into evidence in this proceeding, and
19 transcribed into the record. I do have two copies for the
20 Court Reporter.

21 CHAIRMAN GLEIMAN: Counsel, if you would provide
22 those copies to the Reporter, I'll direct that the material
23 be received into evidence and transcribed into the record.

24 MR. MCKEEVER: Thank you, Mr. Chairman.

25 [Additional Designated Written

1 Cross Examination of Michael D.
2 Bradley, UPS/USPS T-18-5 and 6 was
3 received into evidence and
4 transcribed into the record.]
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Response of United States Postal Service Witness Bradley
to
Interrogatories of UPS

UPS/USPS-T18-5. Refer to your answer to interrogatory MPA/USPS-T18-4.

- a. Explain the economic reasoning underlying the practice in the previous rate cases of specifying separate equations, according to truck capacity, for the Intra-P&DC, Intra-CSD, Inter-P&DC, Inter-Cluster, and Inter-Area accounts?
- b. Consider the case where the USPS chooses to increase capacity on a route, because of increased mail volume, by expanding truck capacity from a van to a tractor-trailer.
 - i. In this case, would you consider the two types of capacity to be substitutes as inputs into the production of mail movement? If not, why not?
 - ii. In this case, would you consider all of the extra costs due to the provision of greater truck capacity to be volume variable. If not, why not?
 - iii. How is this dimension of variability in costs accounted for in a system where cost variability in van trips and cost variability in tractor-trailer trips are estimated in separate equations?
- c. Confirm that your empirical model of highway transportation cost holds vehicle capacity constant when estimating volume variability. If not confirmed, explain why not.
- d. Confirm that your empirical model of highway transportation costs incorporates no variables representing the relationship between the volume of mail and the choice of vehicle capacity. If not confirmed, explain why not.
- e. Have you examined the extent to which, or frequency with which, truck capacity changes over time under a contract. Have you examined the frequency with which truck capacity changes as contracts expire and are replaced with new contracts? If so, provide the results of your analyses. If not, explain why not.

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UPS/USPS-T18-5 Response:

- a. The disaggregation of the intra-SCF and inter-SCF accounts (the Intra-P&DC, Intra-CSD, Inter-P&DC, Inter-Cluster, and Inter-Area accounts you mention in your question did not exist until this case) into their tractor trailer and van components was first done in Docket No. R97-1. Previous to that, a single econometric equation was estimated for the combined cost pool. The motivation for investigating the disaggregated approach came from two observations. First, these two cost pools had a mix of both tractor trailer and van transportation. Second, cost pools that were essentially all tractor trailer transportation had higher variabilities than cost pools that were essentially all van transportation. I explained this in my docket No. R97-1 testimony:¹

A maintained hypothesis underlying the Commission's Docket No. R87-1 analysis is that the cost-generating process within each account category is relatively homogenous. If so, a single equation can be used to estimate the variability for all costs in the account. If this hypothesis is not true, then there is more than one cost-generating process, and accurate measurement of variability may require separate identification and estimation of the individual cost generating processes. The parameters of the cost generating processes may not be the same. If they are not, a more accurate variability calculation will be accomplished through separate estimation

¹ See Direct Testimony of Michael D. Bradley on Behalf of the United States Postal Service, USPS-T-13, Docket No. R97-1, at 35.

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of the individual parameters.

This is not to say that every cost pool should be split, willy nilly, into smaller subpools in a misguided search for different variabilities. Rather, a disaggregated analysis should be followed only when there are good operational reasons to do so. In the instant case, the operational basis is the existence of substantial use of two different transportation technologies within one account. Purchased highway transportation contracts that use the tractor-trailer technology have materially higher variabilities (intra-BMC and inter-BMC) than those use straight body trucks (intra-SCF and inter-SCF).

Some contracts have just tractor trailer transportation, some just have straight body transportation and some are mixed. Because the HCSS data are collected at a more detailed level than the contract, i.e., at the contract cost segment level, the mixed contracts can be separated into their tractor trailer and straight body portions. A review of the HCSS data set reveals that only inter-SCF and intra-SCF accounts have many of both tractor trailer and straight body cost segments. Other account categories are more homogeneous. For example, box route contracts have no tractor trailers and all but one of the inter-BMC contracts specify tractor trailers.

Given that accounts that are predominantly tractor trailer transportation have a higher variability than those that specify straight body transportation, the measurement of variability might be improved by splitting, where possible, accounts into smaller technology-defined cost pools. In the inter-SCF and intra-SCF accounts there is significant heterogeneity. Furthermore, sufficient data exist to estimate separate variabilities for those contract cost segments that use straight body trucks and for those contracts that use tractor trailer contracts. If the estimated variabilities come out to be the same, such a division is unnecessary and a single equation should be used for the entire account. If the estimated variabilities are different, and make sense individually, then two variabilities for the cost pool should be calculated. In

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essence, two smaller cost pools will be formed and the variability for each will be derived from its own econometric equation.

- b.i The substitution contemplated in this hypothetical is more than just a change in cubic capacity. It reflects a change in the method of production. These two methods of production are alternatives methods in the production of mail movement.
- b.ii. The change in costs would be captured by the movement of both costs and cubic foot-miles out of one cost pool an into another. In the hypothetical, capacity and cost would be moving from a van cost pool to a tractor trailer cost pool. Because the estimated variability in the tractor trailer cost pool is higher, I would expect the switch to lead to an increase in volume variable costs.
- b.iii. The possibility that alternative methods of production can be used to move mail is captured in the formation of separate cost pools and estimation of the separate variabilities for each of those cost pools. For example, in the hypothetical, we would observe an increase in accrued cost in the "tractor trailer" cost pool and a decrease in accrued cost on the "van" cost pool. By estimating separate variabilities for each of these cost pools, the disaggregated approach applies the appropriate variability to the accrued costs in both instances.

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- c. Not confirmed. The empirical model is based upon cross-sectional data, not time series data. The variation in cost and capacity is thus across contract cost segments not through time. There is substantial variation in vehicle capacity in the cross-sectional data set. Of course, it is true that the capacity of any individual vehicle is fixed at a point in time.
- d. Confirmed.
- e. No. The database used for empirical analysis in both Docket No. R97-1 and Docket No. R2000-1 is a cross-sectional database. As explained above, this means that capacity varies across contracts, not through time. In Docket No. R87-1, I did pursue a time series analysis that generated results similar to the cross-sectional data.

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UPS/USPS-T18-6. Refer to your answer to interrogatory MPA/USPS-T18-10. Your response indicates that the variable CONTYPE in Workpaper WP-3 at page 5 denotes whether a contract is a regular contract, and emergency contract, or a temporary contract.

- a. Are these variables defines in the same manner as they are defined in the Postal Operations Manual, pages from which you attached to your response to UPS/USPS-T18-3?
- b. If not, provide a table of correspondence to these terms as defined in the Postal Operations Manual.

UPS/USPS-T18-6 Response:

- a. Please note that I did not answer UPS/USPS-T18-3. That interrogatory was redirected to the Postal Service. Nevertheless, it is my belief that the variable CONTYPE in the HCSS database defines contract type in a manner consistent with the Postal Operations Manual.
- b. Not applicable.

1 MS. DUCHEK: Mr. Chairman, those were just filed
2 this morning, and in case some parties come in late, we have
3 additional copies on the table behind us.

4 CHAIRMAN GLEIMAN: Thank you, Ms. Duchek, we
5 appreciate that. Is there any other additional designated
6 written cross examination?

7 [No response.]

8 CHAIRMAN GLEIMAN: If not, that brings us to oral
9 cross examination. Two parties have indicated that they
10 wish to cross examine, Florida Gift Fruit Shippers, and
11 McGraw Hill Companies. Is there anyone else that wishes to
12 cross examine.

13 MR. FELDMAN: Mr. Chairman, Stephen Feldman. In
14 this particular hearing, I've been asked by a group of
15 periodicals to do some oral cross examination, I would say,
16 light to moderate, of Witness Bradley.

17 I apologize. I was under the assumption that a
18 motion for oral cross pertaining to this had been filed.
19 Apparently it hasn't, so, I'll verbally ask you.

20 CHAIRMAN GLEIMAN: It may well have been filed.
21 The script that was prepared for me this morning puts all
22 that information on the table and says three parties
23 requested oral cross, but then only listed two. So I had a
24 choice of going with three or two.

25 MR. FELDMAN: In defense of the excellent staff

1 here at the Commission, I'm almost certain it wasn't filed,
2 but it's a group, just for the record, that consists of the
3 Alliance of Nonprofit Mailers, American Business Press,
4 Coalition of Religious Press Associations, Dow Jones,
5 Magazine Publishers of America, National Newspaper
6 Association, McGraw Hill Companies, and Time Warner.

7 And I thank you very much.

8 CHAIRMAN GLEIMAN: We're going to call that group
9 that you're representing, the Periodicals Coalition for
10 purposes of today's hearing, and that would put you third in
11 line for cross examining.

12 Anyone else?

13 [No response.]

14 CHAIRMAN GLEIMAN: If not, Mr. Wells, as always,
15 it's a pleasure to see you here, and I'm happy to hear that
16 it wasn't that Florida rain that you brought up here, but
17 some other rain that we've got with us today.

18 MR. WELLS: Thank you, Mr. Chairman.

19 For the record, I am Maxwell Wells appearing for
20 the Florida Gift Fruit Suppliers.

21 CROSS EXAMINATION

22 BY MR. WELLS:

23 Q Dr. Bradley.

24 A Good morning, Mr. Wells.

25 Q Would you turn to your response to our

1 Interrogatory Number 1.

2 A I have it.

3 Q If in the first part of the interrogatory in the
4 second line we changed the we changed the word "determined"
5 so that it reads "measured," would you then agree with the
6 revised statement?

7 A So the statement would be, "Do you agree that the
8 proportions of transportation capacity used by the various
9 classes and subclasses of mail are properly measured by a
10 sound sampling process which establishes the cubic foot
11 miles that each mail category utilizes the transportation
12 capacity?" Is that correct?

13 Q Yes.

14 A I guess the issue that I would want clarification
15 on in terms of measurement is to what degree does the
16 statement contemplate allocation of empty space to products.
17 I am just not clear on whether the term "capacity" used by
18 various classes and subclasses of mail includes or excludes
19 empty space.

20 Q Do you think it should include or should exclude
21 it?

22 A Well, my opinion on that follows what I would say
23 would be Postal Service and Commission practice, in that the
24 empty space is included in the capacity caused by the
25 classes and subclasses.

1 Q Are we attempting to apportion the empty space in
2 all movements, and this is directed to intra BMC and inter
3 BMC transportation?

4 A I'll try and then you let me know if I got it.

5 I think what we are trying to do is apportion the
6 capacity in intra BMC to the products that cause that
7 capacity to arise, and as part of that process all of the
8 empty space on the vehicles within the whole intra BMC
9 account would be apportioned to the products.

10 Q Would you explain how it is that unused space is
11 caused by any mail being actually transported?

12 A I'll do my best. As I understand the reasoning,
13 it goes as follows. When the Postal Service sizes its
14 trucks it does so for a variety of factors. One important
15 one might be the peak day of the week. As a result, there
16 are periods of time, either throughout the day or even on
17 days of the week where there would be empty space.

18 To the extent that the capacity of the truck is
19 jointly determined by the mail requirements for the volumes
20 being carried on that contract, one would argue that the
21 truck capacity used or unused is being caused by the volumes
22 transported on that truck.

23 Q Well, the unused capacity cannot possibly be
24 caused by mail, could it, caused by the absence of mail?

25 A No, I think -- remember, we have to think about

1 capacity as moving capacity, the fact that, you know, a
2 truck is running around the whole route and so the capacity
3 on that truck is caused by the requirements for the truck to
4 go out, the requirements for the truck to come back in, so
5 it is jointly determined by the whole needs.

6 Q In your last part of your answer, your response
7 here, you say "the proportions of capacity caused by the
8 various classes" -- do the classes of mail on the first stop
9 out from the BMC contribute to the cause of the empty space
10 on the return trip?

11 A I don't know. That is not an issue I addressed in
12 my testimony but I will take my best shot at it.

13 So what you are saying, just to make sure I got
14 it, you are saying does the -- say there is a truck going
15 out that is full, right? -- but in the morning it is going
16 out to the facilities as full but when it comes back, it is
17 empty, and I just want to make sure. I want to get the
18 hypothetical right. Go ahead.

19 Q My question is when the truck leaves the BMC,
20 let's assume that it is fully loaded.

21 A Okay.

22 Q And after the first stop, it is no longer fully
23 loaded. It has some unused space.

24 A Okay, okay.

25 Q Does the mail unloaded at the first stop

1 contribute to or in any way cause the empty space on the
2 remainder of the trip?

3 A Okay. I think I see where you are going. What
4 the mail going out causes is the capacity to be sized the
5 way it is. It doesn't cause the space to be empty after it
6 is unloaded, but it causes the Postal Service to buy the
7 truck capacity of that size, so I would agree once the truck
8 is unloaded at that first stop then the empty space arises
9 because it was unloaded.

10 Q And the mail at the first stop should not be
11 charged with any part of the emptiness for the remainder of
12 the trip, is that right?

13 A I am not agreeing with that or disagreeing with
14 that.

15 Q You don't disagree with it?

16 A I am not making any statement as to that, the
17 reason being that I think, as I understand the TRACS
18 procedure, what they are trying to do is take empty space in
19 its entirety on all trips, out and back, across the network,
20 and apportion that to the various classes of mail that are
21 carried on that transportation.

22 Q To apportion it by the cubic foot miles of mail
23 actually sampled throughout the system?

24 A Again I am not the TRACS witness. I would take,
25 subject to your assertion that that is how they do it, is

1 that is how they do it.

2 Q Do you think that that would be the proper way?

3 A Well, it's a good question. I think -- you know,
4 I think philosophically one has to think about why the empty
5 space arises and, on one hand, I think other Postal
6 witnesses and people at the Commission have said that that
7 empty space is part and parcel of running a network and that
8 it is part of the cost of doing business in transportation
9 and in that regard it should be apportioned back to the
10 classes.

11 On the other hand, if one could do a study and
12 show that the empty space is not related to the classes,
13 that the empty space is there solely for service
14 requirements -- say for First Class mail -- if there is
15 evidence to suggest that, then I could see instances where
16 you might not allocate the empty space, sure.

17 Q In your response you refer to a sound sampling
18 procedure. Do you consider that TRACS is such a sound
19 sampling procedure?

20 A Simply based upon the record -- I haven't reviewed
21 TRACS -- but based upon the record, I do, yes.

22 Q Refer to your response to the Interrogatory 4.

23 A I have it.

24 Q In you testimony on page 12 you say -- or roman
25 IV -- you say the stated purpose of your testimony is,

1 quote, "to present expected variabilities for purchased
2 highway transportation."

3 Is that the same as determining the attributable
4 portion of the cost to purchase highway transportation?

5 A I'm sorry, sir, are we on FSA-4?

6 Q It's not related directly to 4. I am coming to
7 that. What I want to establish first --

8 A Oh, oh, sorry.

9 Q -- is when you say you want to present expected
10 variabilities of purchased transportation, my question is is
11 that the same as determining the attributable portion of
12 costs of purchased highway transportation?

13 A As you know, I was looking on Number 4 when you
14 asked the question. Could you just please ask it again?
15 I'm sorry.

16 Q Well, you state that the purpose of your testimony
17 is to present expected variabilities for purchased highway
18 transportation.

19 A Okay.

20 Q My question, is that the same thing as determining
21 the attributable portion of cost of purchased
22 transportation?

23 A No, it is part of the process, but it is not the
24 same thing.

25 Q What is the difference?

1 A In determining the attributable portion of highway
2 transportation, there are two steps involved. One is to
3 determine the volume variability -- actually, there is three
4 steps involved. The first is to determine the accrued cost
5 for the accounts. The second is to determine the what I
6 call volume variability or elasticity. And the third is the
7 distribution of those costs to products. And so those three
8 together are what makes up what are called attributable
9 costs.

10 Q But the attributable costs are those cost which
11 are variable, is that correct?

12 A Volume variable.

13 Q And your testimony is to present an estimate of
14 volume variability, is that correct?

15 A Well, as we talked about in R97-1, my testimony
16 specifically estimates the variability of costs with respect
17 to changes in capacity. And, as you know, it does estimate
18 directly the volume variability, that's correct. That's
19 right. The term volume variability is used in Postal
20 context to represent the linkage from volume of mail to
21 costs that are caused by that volume. And, so, in that
22 term, it is part of the volume variability analysis, yes.

23 Q Do you agree that the attributable costs are those
24 costs which vary with changes in mail volume?

25 A Yes.

1 Q In your testimony, you use cubic foot miles of
2 purchase capacity as a proxy for the cubic foot miles of
3 mail transported?

4 A That's correct.

5 Q I refer to your response to Number 10.

6 A I have it.

7 Q There I had requested the cubic foot miles of
8 purchase capacity and you provide some numbers. Would you
9 explain what the numbers mean? In inter-BMC, you have got a
10 number 6.14487. What does that mean?

11 A I'm sorry. Yeah, it is typical of our electronic
12 age that numbers become even less decipherable. I
13 apologize. That is an extremely big number. See the E plus
14 11, that means it is 6 plus 11 zeroes, but instead of the
15 first one, two, three, four, five digits, it would be -- so
16 it would be 614487 and six digits, six zeroes. So whatever,
17 I don't know whether it is trillions. I stop at trillions,
18 but it is a big number.

19 Q And the same thing is true of each of the four
20 numbers appearing on your response.

21 A That's correct. They are all --

22 Q Is it you have to add 11 decimal -- beyond the
23 decimal point, you have 11 digits?

24 A Well, yes -- well, no, I want to be clear. It is
25 not just that there is a lot of decimal points. Actually,

1 it is like you multiply that number by one, followed by 11
2 zeroes, whatever the tens, millions of billions is, whatever
3 that is.

4 COMMISSIONER GOLDWAY: So you move the decimal
5 point?

6 THE WITNESS: I am trying to get at, it is like --
7 if it was a six, it would be millions. If it was an eight,
8 it would be billions. Maybe it is trillions or something
9 like that, it is real big.

10 Actually, could give me one minute? I am going to
11 write it down on a piece of paper and see if I can translate
12 into English for you.

13 [Pause.]

14 THE WITNESS: 614 trillion, 487 billion, that is
15 how I would translate it. And the others would be similar.
16 For example, the one below is 493 trillion, 101 billion.

17 BY MR. WELLS:

18 Q From that response then, is it correct that the
19 cubic foot miles of purchase capacity increased from R97 to
20 R2000?

21 A That's correct.

22 Q What were the reasons for the changes in purchase
23 capacity?

24 A Well, again, I am not a Postal transportation
25 person, but I would assume that it would have to do with a

1 variety of things, more facilities, as the population grows
2 and they put up more facilities, they add transportation to
3 link those facilities.

4 It may have something to do -- I have often it has
5 something to do with what is called their dispatch windows,
6 you know, how they decide when to move mail, to get the mail
7 to the customer after two days, or three days, you know,
8 they work backwards. How much time does the carrier need?
9 How much time does he need at mail processing? So, if they
10 change those, that could cause it.

11 And, in addition, it could be a change in volume.
12 Those are all factors.

13 Q But you don't know what changes were made in any
14 of the factors which you just enumerated, do you?

15 A That's correct. That's correct.

16 Q Do you know what were the actual mail volumes for
17 which transportation was purchased in either R97 analysis or
18 the R2000 analysis?

19 A No, I don't.

20 Q Do you know whether the actual mail volume using
21 inter-BMC transportation changed from R97 to R2000?

22 A I think it is pretty likely it changed, but I
23 couldn't tell you whether it went up or down.

24 Q And your answer would be the same for intra-BMC?

25 A Yes, sir.

1 Q All right. Back to your response to Number 4, you
2 say there that it is changes in cubic foot miles of capacity
3 that gives rise to changes in cost. Are there other factors
4 which would give rise to changes in cost?

5 A Yes, sir.

6 Q And what are those?

7 A It might be a change in fuel prices, that would be
8 an example of something else that could change costs. Or I
9 think if you had a change in wages for the drivers of the
10 trucks, that could do it.

11 Q Changes in the cost of the vehicles?

12 A Oh, excuse me. Another one might be the changes
13 in the cost of trucks.

14 Q Perhaps changes in the number of Postal facilities
15 that are served by the transportation network?

16 A Well, I am not so sure about that one, because
17 that probably would show up in additional cubic foot miles.

18 Q What about changes in routing to respond to
19 service requirements?

20 A Again, that would show up in cubic foot miles.

21 Q I refer you to your answer to Number 5, please.

22 A I have it.

23 Q Does your testimony describe a variability
24 analysis for purchased transportation?

25 A Yes, sir.

1 Q Does your analysis make any use of actual mail
2 volumes transported in intra-BMC or inter-BMC
3 transportation?

4 A No, sir.

5 Q Your answer states that you believe there exists a
6 relationship between actual or projected mail volumes and
7 purchase capacity.

8 A Yes.

9 Q But you don't know the actual or projected mail
10 volumes which you took into account in arriving at that
11 belief?

12 A I think I arrived at the belief deductively, not
13 inductively. Specifically, I believe that there is unlikely
14 to be an absence of a relationship between volumes and
15 capacity, because my understanding of how they build the
16 transportation network is they look at the requirements of
17 getting mail from one facility to another. And certainly
18 part of that analysis is volumes. They know how many
19 containers they have to run between two facilities. So I
20 think there is a relationship between volumes and capacity.
21 But, as I would like, you know, I make clear, I didn't
22 measure that relationship. I don't know exactly what it is.
23 I think it is positive, I think it is a direct relationship.

24 Q And you do not know from '97 to 2000, whether the
25 volume of inter-BMC increased or decreased?

1 A The volume of mail carried on the inter-BMC
2 transportation, that's right, I do not.

3 Q All you can tell us is that the cost, the number
4 of cubic foot miles capacity increased?

5 A That's correct.

6 Q And there was no actual or projected mail volume
7 that provides a basis for your belief that your analysis
8 reflects actual or projected mail volume, is there?

9 A Again, I think the accurate way to state that is I
10 think there are mail volumes in that transportation, I think
11 they do exist, but I have not measured them. I mean -- nor
12 has the Postal Service, I mean not just me, but no one has
13 measured it.

14 Q So you just do not know whether your analysis of
15 variability reflects the variability of actual mail volume,
16 do you?

17 A I would agree with you to a point. I think it
18 reflects it. I don't know that it is identical to the
19 volume variability, that's right. It is a proxy.

20 Q To what extent does your analysis take into
21 account or reflect changes in capacity purchased for factors
22 other than changes of mail volume?

23 A See, my analysis actually is measuring the
24 relationship between cost and changes in capacity, and, as I
25 make very clear, I don't do an analysis of capacity and

1 volume. So what I did in this testimony linked cost to
2 capacity. I don't have analysis of capacity to volume. As
3 I said, I don't have mail volumes.

4 Q Your analysis does not attempt to establish the
5 reason for the changes in capacity purchased?

6 A I agree.

7 Q The Gift Fruit Shippers propounded to you an
8 Interrogatory Number 3, which was redirected to the Postal
9 Service, and that was a request for data used or considered
10 for each contract entered into or renewed for a one year
11 period preceding the data of your analysis. Are you
12 familiar with the response the Postal Service made to that?

13 A Yes. You gave me this this morning.

14 Q I have previously provided your counsel with a
15 document which I have entitled FGFS/USPS-T18-XE-1. Do you
16 have a copy of that?

17 A Yes, sir.

18 Q Your response there says that there is no set of
19 data which is used to determine local contract
20 specifications. Do you have any reason to disagree with
21 that?

22 A I'm sorry. Are we talking about T18-3 again?

23 Q Yes.

24 A Okay.

25 Q The last sentence in the response.

1 A I have no information to contradict that.

2 Q Can you explain what data is used or considered in
3 the negotiation of new or renewal contracts for purchased
4 highway transportation?

5 A The best I could do for you would be to reiterate
6 what Postal Service Witness Young, who is Postal Service
7 transportation, I think he is the manager now, described in
8 R97-1. He went through those factors.

9 Q But you did not look at those data, did you?

10 A No, sir. No, sir.

11 MR. WELLS: Mr. Chairman, I have provided copies
12 of this document XE-1 for counsel, and I would like to have
13 it marked and put it as part of the record, please.

14 CHAIRMAN GLEIMAN: That would be acceptable. Has
15 it been shared with counsel?

16 MS. DUCHEK: Yes, it has, and we don't have any
17 objection, Mr. Chairman. I am just wondering, does it want
18 it transcribed into the record or put into evidence? I mean
19 it would be put into evidence at some point, I would assume,
20 anyway, it is a Postal Service response.

21 CHAIRMAN GLEIMAN: You have been invited to have
22 it entered and transcribed and entered into evidence, Mr.
23 Wells. Do you want to take the Postal Service up on its
24 gracious?

25 MR. WELLS: Well, I think in order to refer to it,

1 we need to have a transcript reference, and I would ask that
2 it be transcribed into the record.

3 CHAIRMAN GLEIMAN: All right. Then we will direct
4 that the Cross-Examination Exhibit Number 1, let's see how
5 it has been marked, it is Florida Gift Fruit Shippers
6 USPS-T18-XE-1.

7 [Cross-Examination Exhibit No.
8 FGFSA/USPS-T18-XE-1 was marked for
9 identification, received into
10 evidence and transcribed into the
11 record.]
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FGFSA/USPS-T18-XE-1

Page 1 of 1

Response of United States Postal Service
to
Interrogatories of FGFSA
(Redirected from witness Bradley)

FGFSA/USPS-T18- 3. For each purchased highway transportation contract covering each Intra-BMC and Inter-BMC transportation entered into or renewed during the 12 months immediately preceding August, 1998, provide:

- a. All data concerning mail volume, such as pieces, weight and cubic feet, actually experienced during the year before the new or renewal contract, as well as the volume projected for the period of the new or renewal contract, that was taken into consideration in determining the cubic foot capacity covered by the contract.
- b. All data concerning any changes in the frequency or timing for each trip for the transportation service to be provided pursuant to the new or renewal contract which was taken into consideration in determining the cubic foot capacity covered by the contract.
- c. All data concerning utilization of the transportation service during the year or other period prior to the new or renewal contract, or projected for the period of the contract, which was taken into consideration in determining the cubic foot capacity covered by the contract.
- d. All other data which was taken into consideration in determining the cubic foot capacity covered by the contract.

FGFSA/USPS-T18- 3 Response:

- a.-d. As explained by witness Young in Docket No. R97-1, the specification of a new or renewed contract depends upon the historical experience at the local level with a variety of factors. Consequently, there is no set of data which is used to determine local contract specifications, including cubic foot capacity or the frequency of trips.

1 BY MR. WELLS:

2 Q Dr. Bradley, do you know if there is any other
3 Postal Service witness who would have more information about
4 the data taken into account with respect to purchased
5 transportation contracts?

6 A In this, testifying in this case?

7 Q Yes.

8 A I don't know who would have more information than
9 I do, or that would have that. They don't, to my knowledge,
10 there is not an operational witness testifying this case.
11 That would be the person who would have that information, if
12 it exists.

13 Q In your answer to Number 3, you quote from
14 testimony from R97 of Postal Service Witness Young. Do you
15 know adopt that testimony as your response to this
16 interrogatory?

17 A I don't know what the word "adopt" means in this
18 regard. What my response was, it agrees with my response,
19 and that is -- I mean I accept his explanation, if that is
20 what you mean by adopt, sure.

21 Q All right. Turn to your Number 7, please.

22 A I have it.

23 Q You here give the number of contracts and the
24 number of power only contracts.

25 A Yes.

1 Q Is the number of power only contracts included in
2 the total number of contracts?

3 A Yes, sir.

4 Q All right. You didn't -- would not add the two
5 numbers together?

6 A No.

7 Q Has the number of contracts changed since your
8 analysis in R97?

9 A The number of total contracts?

10 Q Yes.

11 A I believe so.

12 Q How?

13 A You know, I just don't remember offhand, I would
14 have to go look. My recollection is that they went up, but
15 I would -- I think they went up, but that is my
16 recollection. I don't have the numbers right in front of
17 me, but I believe they went up.

18 Q You provided the same data in your testimony in
19 R97?

20 A I think I did.

21 Q All right.

22 A We could check that.

23 Q Referring to your testimony on page 43 --

24 A I have it.

25 Q -- and it's line 11, you say, "Clearly the

1 preferred approach is to distribute the jointly determined
2 volume variable cost to the classes and subclasses that
3 jointly determine the cost."

4 Does this mean that mail sampled on an outbound
5 and inbound trip should share the entire cost of the round
6 trip?

7 A I think the problem with the question is that it
8 presumes that the distribution process is done on a single
9 route trip and in fact what I am trying to suggest here is
10 the Postal Service got away from that entirely.

11 They don't do any allocations on individual routes
12 anymore to the mail on that route.

13 What they do instead is they take all of, let's
14 say, intra-BMC transportation and try to figure out the
15 proportions of all capacity that are used by the various
16 classes and subclasses, so they have gotten away from this
17 process of trying to make an arbitrary allocation on one
18 route to rather -- the way I understand it is you have a
19 network out there and you have vehicles going anywhere, and,
20 you know, you can take a snapshot of that and see what
21 proportions of the capacity is being used by the various
22 classes and subclasses in that overall snapshot.

23 Q Is it your position that the measured and
24 calculated cubic foot miles of mail sampled on the outbound
25 movement would be equally weighted with the cubic foot miles

1 of mail on the inbound movement?

2 A I am not that familiar with TRACS weights to
3 answer the question.

4 Q My question is do you believe that is the way it
5 should be?

6 A I haven't studied it, don't know. Haven't studied
7 the weights in TRACS.

8 Q Well --

9 A It is not my analysis.

10 Q If a parcel that has one cubic foot moves 100
11 miles on the outbound movement, do you believe that it
12 should have an equal weight to a same size parcel that moves
13 100 miles on the inbound movement?

14 A I am not sure what you mean by weight, and I am
15 not an accountant or a statistician, but what I think
16 sampling is trying to do is to use sampling techniques to
17 take a picture of this route today, a picture of that route
18 another day, a picture of that route another day on the idea
19 that these are representative of the day-to-day movements
20 throughout the year and so as to whether or not a data
21 observation on one route that happens to have a one cubic
22 foot parcel on that day is valid or important, yes.

23 How should it be weighted up with all the other
24 ones? Again, I would assume that depends on how many other
25 types of samples that you would take and what your

1 population percentage and all that stuff is, so yes, I think
2 it makes sense as part of a sampling process.

3 Q The measured cubic foot miles of each sample
4 parcel is properly taken into account on an equal basis,
5 would that be correct?

6 A I am not sure I understood that one. Sorry.

7 I am not sure I understood the question.

8 Q If there are two samples, and the two samples
9 measure cubic foot miles that each sample moves within the
10 system --

11 A Okay.

12 Q -- should the cubic foot miles be equally treated
13 regardless of the destination or the place where the sample
14 is taken?

15 A That really depends I think upon the sampling
16 strategy. I think whether they are equal of unequal weights
17 depends upon the sample design.

18 Q Turn to your response to Number 8.

19 A I have it.

20 Q And there you say that you concur with the quoted
21 part of the R97 opinion?

22 A Yes, sir.

23 Q In your response to Number 9, you quote an
24 additional part of the R97 opinion.

25 A Yes, sir.

1 Q Do you concur with that?

2 A If that statement were true, if I was confident
3 that statement were true, I think I would agree with it, but
4 I am not sure that my understanding of TRACS comports
5 entirely with the Commission's descriptions of TRACS there,
6 so I have a little bit of difficulty -- I am not immediately
7 clear that TRACS necessarily does assign that cost to the
8 mail found on the truck, but if it does, I would agree with
9 it, yes.

10 Q Do you know whether or not TRACS currently has
11 assigned any cost to mail which is sampled?

12 A It is my belief that it does not. It is my belief
13 that the costs have been taken out. That is my
14 understanding.

15 Q And if it does, then that would be the arbitrary
16 division of a joint cost that the Commission R97 decision
17 refers to, would it not?

18 A Well, that is a little bit of a trap, because it
19 depends how they did it and, you know, it depends how they
20 allocated the costs -- I just don't know what they did, and
21 I am a little wary of making that blanket statement without
22 details.

23 Q Turn, if you will, to your response to Number 12.

24 A I have it.

25 Q That was a two-part question there. Your response

1 addresses the first part. Can you now address the second
2 part, which read, "If the inbound volume of mail is
3 significantly lower than the outbound volume of mail, does
4 the contract provide for use of a smaller capacity on the
5 inbound segment of the route?"

6 A Actually, Mr. Wells, I intended my answer to cover
7 both parts.

8 Again, I don't do the scheduling or the
9 determination of capacity on the transportation network. I
10 did read Witness Young's testimony, and my understanding of
11 that is as follows. What he suggests is that on a
12 particular -- remember a contract runs over a whole day or
13 several days, and as I understand what he was saying, that
14 on a contract sometimes the outbound volumes in the
15 morning -- the outbound trucks and the volume could be full
16 or the inbound in the afternoon could be full, so I really
17 got the sense from that that it was the joint determination
18 of what you need to go out in the morning and what you need
19 to come back in the evening that helped determine the size
20 of the truck.

21 Now at one level you say, well, come on, wait a
22 minute -- obviously the biggest single run has got to
23 determine the biggest truck that you need, but I think it is
24 a little more complicated than that, because they do have
25 the ability to add extra trips or change routings.

1 I mean I think logic suggests in a real simple
2 case if you are just going from A to B and back to A and you
3 need a truck to carry the mail, the one that has the bigger
4 volume is going to determine the size of that truck, but I
5 think what Witness Young was trying to emphasize is that it
6 is just not that simple. They have a lot of things they
7 vary in doing capacity.

8 Q Well, if your analysis of the contracts is you
9 identify any contract where the capacity of the vehicle
10 changes, whether it is inbound or outbound?

11 A You know, I haven't looked at the details of
12 individual contracts since 1987 so I just don't know.
13 I don't know. I don't remember.

14 Q Turn to Number 13. Where there is an imbalance in
15 the mail volume outbound versus inbound, what mail should be
16 charged with the unused capacity on inbound trips?

17 A Well, I think that would depend upon, you know,
18 investigation of causality and how the empty space varies
19 with volume.

20 Q Which you did not do?

21 A No, that's right, I did not do that; that's right.

22 Q Okay, assuming that the capacity of the vehicle
23 was selected for the mail volume on the outbound trip, is
24 the cost of the unused capacity on the return trip a part of
25 joint costs, as that term was used by the Commission in R97?

1 A I would prefer being -- I am a economist, so I
2 would prefer the technical term, accounting costs, but, yes,
3 it's essentially the same, in common language.

4 Q You responded on the redirection of an
5 interrogatory propounded to Witness Xie, which is FGSFA/USPS
6 T-1-7. Would you return to that, please?

7 [Pause.]

8 A You know, I apologize, but I think I might have
9 failed to bring it with me to the stand. Sorry.

10 MS. DUCHEK: Mr. Wells, if you don't have an extra
11 copy, I have one.

12 MR. WELLS: I have it.

13 THE WITNESS: Thank you. Sorry. I have it, thank
14 you.

15 BY MR. WELLS:

16 Q Do you agree that the function and purpose of
17 TRACS is to produce a basis to measure the cubic foot miles
18 used by each mail category?

19 A I think the purpose of TRACS is to determine the
20 distribution of costs to classes and subclasses of mail.
21 That's what I think the primary purpose of TRACS is.

22 It's a distribution system, to come up with a
23 distribution key of cost to products. I think that in the
24 process of doing that, it attempts to measure the capacity
25 used, and I think it also attempts to allocate the empty

1 capacity to the classes and subclasses of mail.

2 Q With the allocation of -- is it based on a measure
3 or from the sample mail of the cubic foot miles used by each
4 mail category?

5 A Well, according to the Commission's order, unless
6 the process has changed since R90, what this says is that
7 the sample mail is allocated its, quote/quote, fair share of
8 empty space by multiplying a ratio of the percent unloaded
9 by the percent unloaded plus what remains in the truck.

10 So I interpret that as saying at each time they do
11 a TRACS test, they make an allocation to the mail that was
12 unloaded of the empty space that was on the truck.

13 Q When we take the variable cost which is determined
14 under your analysis, and then attempt to distribute that to
15 those classes of mail that use the transportation, if a
16 measured cubic foot mile use of a piece of mail is expanded
17 for the empty space in a container, does that expansion
18 cause the measure of cubic foot miles for that piece of mail
19 to be overstated?

20 A Does it cause the cubic foot miles actually used
21 by the product to be overstated?

22 Q Yes.

23 A Yes, I think so. It's larger than the cubic foot
24 miles actually used by the product, yes. It's an expansion.

25 Q Do you know what the justification is for

1 expansion of cubic foot miles of sample mail up to a
2 container size, for example?

3 A Again, this isn't really my main area, but my
4 understanding of this would be that mail that goes in an
5 empty container -- as I understand it, it's a lot easier for
6 the Postal Service to transport containers than it is
7 individually load the pieces, because roll-it-on/roll-it-off
8 is very efficient.

9 And so sometimes that containerization process
10 causes empty space. It's just that when you're trying to
11 roll stuff off for a facility, you may not have enough
12 volume to fill the container for that facility.

13 So, I think sometimes that under the
14 containerization process, the idea is that it's the mail
15 that's on the container that causes the Postal Service to
16 load that container on the truck and to drive it.

17 And the fact that it's not full is just part of
18 like the lumpiness of containers.

19 Q Do you believe that from your analysis purposes,
20 that a mail sample from a partially filled container should
21 be measured differently from a mail sample from a completely
22 filled container?

23 A Well, Mr. Wells, as you pretty clearly established
24 a few minutes ago, my analysis doesn't really have anything
25 to do with mail volumes. So that question doesn't relate to

1 my analysis whatsoever.

2 Q This relates to your response here to the
3 rationale and justification for the expansion of test data
4 as to your response to T-1-7.

5 A Yes, but I don't -- I was trying to help you with
6 the rationale and justification. I didn't want to suggest
7 that I do this analysis.

8 Q If you didn't use it and you're not knowledgeable
9 about it, why is it redirected to you?

10 A Well, that's a good question. I guess because
11 they figured that I was the one who could track it down and
12 try to get the information for you.

13 Q All right. Do you believe that the cubic foot of
14 a parcel sample from a vehicle that is 50 percent utilized
15 should be different from the same size parcel sampled from a
16 vehicle that is 100 percent utilized?

17 A I'm sorry, you are going to have to give me that
18 one more time.

19 Q Do you believe that the cubic feet of a parcel
20 sample from a vehicle that is 50 percent utilized should be
21 measured differently from the same size parcel sampled from
22 a vehicle that is 100 percent utilized?

23 A I am not quite sure what you are referring to when
24 you say "measure" -- are you saying in terms of like forming
25 a distribution key?

1 Q Well, the cubic foot miles is used to form a
2 distribution key, isn't it?

3 A Yes. You know, to tell you the truth, the way I
4 would handle this whole problem is I would compute the
5 distribution key with empty space allocated. I would
6 compute it without empty space allocated, and then see.
7 That's how I would handle the problem.

8 Q When an actual measured cubic foot miles of
9 parcels is taken under the TRACS sampling procedure, if
10 there is any expansion of that data for the emptiness of a
11 container or the emptiness of a vehicle at the time the
12 sample is taken, does that result in bias in the procedure?

13 A You are going to need to ask the TRACS witness
14 that question.

15 Q Refer to page 33 of your testimony, please.

16 A I have it.

17 Q Do you confirm that the final estimated
18 variability of purchase transportation is 98.3 percent for a
19 intra-BMC contract?

20 A Confirmed.

21 Q Do you confirm that the final estimated
22 variability of purchase transportation is 97.9 percent for
23 an inter-BMC contract?

24 A Confirmed.

25 Q Are you familiar with the utilization of vehicles

1 in intra-BMC and inter-BMC transportation?

2 A Not specifically.

3 Q Are you aware that utilization is low and on the
4 downward trend?

5 A I was aware it was low in the sense of my
6 recollection is like 50s or 60s. I haven't followed the
7 trends. I suspect you will show me though.

8 Q I have provided your counsel with two copies of a
9 response Postal Service Witness Xie made to FSA/USPS-T1-22.
10 Do you have a copy of that?

11 A I do.

12 Q If you refer to the second page of that exhibit,
13 does this reflect the utilization factors for base year '98
14 and base fiscal year '99?

15 A It says, the title says Vehicle Utilization, so I
16 would assume so.

17 Q And does this confirm that the utilization of the
18 vehicles in both inter-BMC and intra-BMC were less than 100
19 percent?

20 A Yes, sir, that it does.

21 Q And does it also reflect that the utilization
22 factors are basically declining between the two years?

23 A It certainly looks that way to me.

24 Q And how is this low utilization of vehicles
25 reflect itself in your variability analysis?

1 A It doesn't.

2 Q Shouldn't it?

3 A No, sir.

4 Q Why not?

5 A Again, what I am attempting to do is to measure
6 how cost responds to changes in capacity. That is what my
7 responsibility is, and so to the extent that the Postal
8 Service incurred additional costs in the base year, my
9 analysis is trying to determine, as you said earlier, that
10 elasticity of variability factor that goes with that cost.

11 Q And your analysis shows that there is a
12 variability in purchase capacity even though there is excess
13 purchase capacity?

14 A Well, specifically what my analysis shows is that
15 cost rises at approximately 98 percent. When the Postal
16 Service buys, say, 10 percent more capacity their cost would
17 go up by almost 10 percent -- 9.8 percent.

18 Q And you don't know why buy more capacity?

19 A Only in those general terms we discussed earlier.

20 MR. WELLS: Mr. Chairman, I would like the
21 document entitled FGFS/USPS-T18-XE-2 to be identified in
22 the record and transcribed.

23 MS. DUCHEK: That's fine, Mr. Chairman. I am
24 assuming this one is just transcribed since it is a
25 particular witness's response and she would have to adopt

1 it.

2 CHAIRMAN GLEIMAN: That's all that was asked. It
3 is so ordered.

4 [FGFSA/USPS-T18-XE-2 was marked for
5 identification and transcribed into
6 the record.]

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FGFSA/USPS-T18-~~XE~~-2

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS XIE
TO INTERROGATORIES OF FLORIDA GIFT FRUIT SHIPPERS ASSOCIATION

FGFSA/USPS-T1-22. Confirm that the TRACS data are used to estimate on a quarterly basis the percentage of capacity utilized with respect to each of the highway accounts.

(a) Provide the highway utilization factors developed for Account 53127 and 53131, for each quarter of the year covered by LR-I-52, with separate factors for the inbound and outbound movements in account 53127.

(b) Provide comparable capacity utilization data for each subsequent fiscal year.

RESPONSE.

Not confirmed. TRACS data are used to estimate on a quarterly basis distribution keys for purchased highway contracts. The data collected from TRACS can be used to estimate the requested percentage.

(a) and (b) The following table provides the requested utilization factors for each quarter in BY98 and FY99.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS XIE
TO INTERROGATORIES OF FLORIDA GIFT FRUIT SHIPPERS ASSOCIATION

CONTRACT TYPE	VEHICLE UTILIZATION				
BY98	FACCAT	PQ 1, 98	PQ 2, 98	PQ 3, 98	PQ 4, 98
INTER-BMC	1	65	62	64	63
INTER-BMC	2	74	64	68	60
INTER-BMC	3	66	74	68	53
INTRA-BMC	1	38	44	38	40
INTRA-BMC	2	76	61	56	47
INTRA-BMC	3	55	39	41	53
INTRA-BMC	4	76	74	75	73
INTRA-BMC	5	55	58	63	59
FY99	FACCAT	PQ 1, 99	PQ 2, 99	PQ 3, 99	PQ 4, 99
INTER-BMC	1	+ 66	+ 65	61	57
INTER-BMC	2	63	62	57	56
INTER-BMC	3	45	44	37	+ 63
INTRA-BMC	1	36	+ 45	+ 39	37
INTRA-BMC	2	49	53	58	+ 48
INTRA-BMC	3	41	+ 69	36	+ 57
INTRA-BMC	4	75	69	70	71
INTRA-BMC	5	- 62	50	58	49

1 MR. WELLS: I have no further questions of this
2 witness at this time.

3 CHAIRMAN GLEIMAN: Mr. Bergin, McGraw-Hill. Could
4 you give me a feel for how much time you are going to need?

5 MR. BERGIN: I would say 15 to 30 minutes.

6 CHAIRMAN GLEIMAN: If that is the case, I think we
7 are going to take a break for lunch now and come back on the
8 hour at 1 o'clock, and we will pick up with cross
9 examination by you of Witness Bradley at that point.

10 [Whereupon, at 12:13 p.m., the hearing was
11 recessed to reconvene at 1:00 p.m., this same day.]

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A F T E R N O O N S E S S I O N

[1:07 p.m.]

CHAIRMAN GLEIMAN: Mr. Bergin.

MR. BERGIN: Thank you. Mr. Chairman.

Whereupon,

MICHAEL D. BRADLEY,

the witness on the stand at the time of the recess, having
previously first duly sworn, was further examined and
testified as follows:

CROSS-EXAMINATION

BY MR. BERGIN:

Q Good afternoon, Dr. Bradley.

A Good afternoon.

Q My name is Tim Bergin, I represent the McGraw-Hill
Companies, and I have a few questions for you today. Just
so that I understand, you undertook to measure the
relationship between changes in transportation capacity and
changes in cost?

A That's correct.

Q In order to come up with estimations of volume
variability, that is the variability of cost with volume?

A My analysis is part of the -- the actual process
is to come up with volume variable costs, that is really the
ultimate goal. And volume variable costs have two parts.
One, determine the pool of costs that will be ultimately

1 distributed to products, and then, two, determine how those
2 costs will be distributed to the individual classes and
3 subclasses.

4 So my analysis is the first part of those two
5 steps, and trying to figure what, it is called a variability
6 percentage, is multiplied by the accrued costs in
7 transportation. So the parameters that I am trying to
8 estimate are those percentages that are multiplied by the
9 accrued cost pool to determine -- what that does is that
10 determines the pool of costs that are then distributed to
11 the products in the second step.

12 Q I see. And just to reiterate for a second some of
13 your testimony this morning, as I understand it, and correct
14 me if I am wrong, you do not undertake to directly measure
15 the relationship between volume changes and cost changes,
16 rather, you use a proxy, that is, changes in transportation
17 capacity?

18 A That's correct. The proxy is known, over the
19 years it has either been called a proxy or sometimes people
20 call it a cost driver. This technique arises when it is
21 difficult to measure the volumes in inactivity, whether it
22 is transportation or otherwise directly. And so, you know,
23 what people do is they measure what is called a cost driver.
24 The thing that, in this case, the Postal Service actually
25 purchases that causes costs to go up or down.

1 Q So you measure how much transportation costs
2 increase as transportation capacity increases?

3 A Specifically, yeah, it is purchased
4 transportation, it is only purchased transportation, but as
5 is purchased transportation capacity rises, as defined by
6 cubic foot miles, what I measure is the responsiveness of
7 cost to that change.

8 Q So there is an assumption that the relationship
9 between capacity and costs is about the same as the
10 relationship between changes in volume and changes in costs?

11 A Yeah. Specifically, the assumption, in that two
12 part process we were talking about, the assumption it is
13 referring to specifically occurs in the second part and it
14 is assuming that the increase in cubic foot miles per piece,
15 for, say, First Class mail, that rate of increase is equal
16 or proportional to the current amount, the average cubic
17 foot miles for a First Class piece.

18 So, if we get a piece of First Class to go up, the
19 assumption is that it adds to capacity at a rate that is
20 equal to its average cubic foot miles per piece now.

21 Q Has there ever been a study as to the validity of
22 that assumption, namely, that changes in capacity reflect
23 changes in volume on a more or less constant basis?

24 A Not to my knowledge.

25 Q Is there any reason there hasn't been a study?

1 A I think the reason there hasn't been a study is
2 because of two difficulties. The primary difficulty is the
3 volume measuring. Transportation, as I understand it, there
4 is a lot of difficulties in measuring actual volume. As I
5 understand it, it is like, say, in carriers, the mail sits
6 in the case, and so they can go and they can count it and
7 they have time. But in transportation, it is almost as if
8 -- not quite, but it is almost as if the mail is always
9 moving, so it is very difficult to stop the mail and do the
10 kind of volume counts that they would do, say, for carriers.
11 And, so, the difficulty in that data collection process I
12 think has been the main reason that such a study hasn't been
13 done.

14 Q This assumption that you make, that capacity,
15 changes in transportation capacity reflect changes in mail
16 volume in a more or less, almost one-on-one relationship?

17 A Proportional.

18 Q Right.

19 A Yes.

20 Q That reflects certain assumptions about the
21 rationality of the management of Postal transportation, does
22 it not? I mean doesn't it almost assume that the Postal
23 Service is a perfect manager, that whenever volume
24 increases, they match that in a timely fashion with a
25 proportionate ^{capacity} ~~volume~~ increase and vice versa?

1 A I don't think that proportionality necessarily
2 requires that, no.

3 Q Well, in a system that was less than perfectly
4 rational, you might go out and purchase transportation that
5 was unnecessary, and then you would have capacity costs
6 increasing while volume is not, is that fair to say?

7 A It is certainly true in an irrational system, you
8 could have -- I could envision scenarios where you had
9 capacity rising faster than volume, or you could have
10 scenarios in which capacity was rising less quickly than
11 volume.

12 Q And your assumption is that capacity will rise in
13 exact proportion to volume?

14 A Just for the record, it is really not my
15 assumption, but it is the assumption of the Postal cost
16 model that, indeed, the response in capacity to a change in
17 volume is proportional, in the way that I tried to explain
18 before, and that is specifically, as I understand it, on a
19 class basis, the response in cubic foot miles for First
20 Class is equal to the current cubic foot miles for First
21 Class. And the reason I make this distinction is I think
22 there is a difference between, say, First or Standard A or
23 Standard B. The responses don't have to be the same for all
24 those, they just have to be equal to the current proportion
25 per piece.

1 Q But, in any event, if I understand you, under this
2 model, Postal Service decisions to purchase transportation
3 or to have less transportation capacity supposedly matches
4 exactly the volume changes in the mail?

5 A I am not sure I got the question. I guess what I
6 would say is that the assumption, this proportionality
7 assumption we are talking about, would be entirely
8 consistent with a rational purchase of -- could be entirely
9 consistent with a rational purchase of transportation if --
10 if transportation needs responded in that way.

11 I will give you an example of my thinking. For
12 example, you might say, well, what about empty space, you
13 know, why would empty space go up at all? Well, it could be
14 that the volume increases come in a pattern that reflects
15 the current volume, and you know volume is uneven. And if
16 it is the unevenness in volume that causes empty space to
17 occur in the network, and I get new volume that reflects the
18 current pattern, doesn't fill in the valleys, that reflects
19 the current pattern, then it is quite possible that I would
20 have to add both utilized and unutilized capacity, because
21 the same patterns that were causing the unused capacity in
22 the old volume exist in the new volume.

23 So I am not -- that is a hypothetical, but that is
24 an example in which you would get this proportional
25 response.

1 Q Is it fair to say that if the percentages of
2 unused capacity increase, then you are not getting a
3 proportional response as assumed in your model?

4 A Here, I would like to be a little bit careful in
5 terms of what else we are holding constant, you know, the
6 old economist's term, holding everything else constant, --
7 holding everything else constant, if volume went up and the
8 percent of empty space -- was it increased or decreased?
9 Sorry.

10 Q Let's say it went up more.

11 A Okay. Went up more. In that case we would expect
12 more than 100 percent increase in volume, if empty space --
13 I mean to make it easy, if we hold everything else constant
14 and volume goes up, and they can fill in the valleys, they
15 could make use of unutilized capacity, then capacity would
16 rise less quickly than volume.

17 Q But is it fair to say that if unused capacity is
18 rising faster than increases in volume, then that cuts
19 against your proportionality assumption, namely, that
20 changes in volume and changes in capacity are closely
21 linked, at least in the hypothetical rational system?

22 A I would be hesitant to agree with that statement
23 because there may be a lot of other reasons why empty
24 capacity -- excuse me, unused capacity is changing besides
25 volume. In our discussion, we are talking about a world

1 where we are holding other things constant, but there may be
2 other reasons why, over time, unused capacity has risen.
3 Again, this is purely hypothetical, but if we had an
4 increase in the peaking pattern, for example, or something
5 like that, that could cause utilizations to fall for reasons
6 other than volume changes. But I would certainly agree, if
7 we are saying we are increasing volume and then ask the
8 question, in response to that volume change, How does empty
9 space respond?, then I would concur.

10 Q You mentioned a moment ago that it was not your
11 assumption that there is a directly proportionate
12 relationship between changes in capacity and changes in
13 volume, but, rather, that that was an assumption of the
14 Postal Service?

15 A When I said mine, I mean it wasn't -- I didn't
16 require to do my testimony or my analysis. If we go back to
17 those two parts, in the first part, we are measuring the
18 response of cost to the driver. It is in the second part
19 where we have to make an assumption about the relationship
20 between volume and the driver, in this case, capacity, and
21 that is where the assumption comes into play. It is part of
22 the process.

23 Q But that is not an assumption that you are
24 embracing, that is simply an assumption that was given to
25 you? I am trying to understand.

1 A I am not quite sure what these words "embrace" or
2 "adopt" mean.

3 Q Do you agree with the assumption?

4 A Okay. Fair enough. That's better. I would say,
5 in the absence of evidence, it is a reasonable one.

6 Q Why do you say that?

7 A Because of the years on the record. You know,
8 there's been back and forth about this assumption. If we go
9 back to -- I think I have it in my testimony -- but R84, the
10 assumption was tested not empirically but it was tested
11 through litigation and people argued and I think at that
12 point actually the Postal Service was arguing that the empty
13 space was institutional and did not vary with volume.
14 Others disagreed and I think what came out of that process
15 was an adoption of this assumption.

16 Q So you are saying that there is precedent for the
17 assumption but I guess the question was whether you as an
18 economist believe that the assumption was reasonable.

19 A Okay. I was trying to give you the basis for, you
20 know, my sense that it was reasonable, that there had been
21 discussion and I reviewed previous documents before.

22 Just based upon my personal opinion I don't think
23 it is unreasonable in the sense that -- and here is why I'll
24 say that -- it is my understanding that every year the
25 Postal Service remeasures cubic foot miles per piece.

1 In other words, they attempt to estimate the cubic
2 foot miles for First Class and then estimate the volumes,
3 and so that -- it is not like the same assumptions had to
4 hold for 20 years in terms of that proportional response, so
5 that is one reason I think it may be reasonable.

6 The second thing is we really, in doing this type
7 of work we are really talking about changes at the margin.
8 We are talking about relatively small changes in volume. We
9 are not talking about a 30 percent change in volume in the
10 response, but for a small change in volume it seems like it
11 could be a reasonable approach, yes.

12 Q Are you familiar with the interrogatories of the
13 Magazine Publishers of America that were submitted to the
14 Postal Service as an institution regarding transportation?

15 A Generally.

16 Q That is MPA/USPS 14 through 46. Do you have a
17 copy of those?

18 A No, no. I don't. Sorry.

19 [Pause.]

20 MR. BERGIN: Mr. Chairman, I would like to show
21 the witness a copy of Postal Service Response to
22 MPA/USPS-17, if I may.

23 CHAIRMAN GLEIMAN: Please proceed. Sure.

24 MR. BERGIN: Does counsel need a copy?

25 MS. DUCHEK: No.

1 BY MR. BERGIN:

2 Q Dr. Bradley, for the record, in response to
3 MPA/USPS-17(a) and (b), which asked whether the Postal
4 Service had analytical tools including computer models used
5 to ensure that overall purchased transportation costs are
6 minimized, the Postal Service responded that it had no
7 customized computer or analytical models that it uses in
8 transportation cost management.

9 First of all, is that surprising to you as an
10 economist that a transportation system as large and
11 elaborate as that of the Postal Service would not have such
12 analytical models to control costs?

13 A I would respond in this way. I would anticipate
14 that as analytical tools improve and they are developed that
15 such tools would be used.

16 I guess I would say I am not so surprised for the
17 Postal Service because I think that their approach to
18 transportation is very decentralized. I think if
19 transportation requirements were all done in Headquarters,
20 the more likely they would have a big computer model, but
21 because by tradition transportation has always been done in
22 the regions I think there people are, quote/unquote, "closer
23 to the ground" and they are more subjective, not in a bad
24 sense, but more familiar with it on a less formal basis and
25 so that probably has slowed the adoption of it than you

1 might otherwise think.

2 Q Do analytical tools of this nature exist that
3 would assist in cost minimization of the large
4 transportation system?

5 A I think so, yes.

6 Q Now this may go back to something we were
7 discussing a moment ago about your assumption between the
8 proportionality between volume changes and changes in
9 transportation capacity purchased by the Postal Service.
10 If you have a situation where transportation is
11 decentralized, for whatever reason, and there is not in use
12 some analytical models to ensure cost minimization, doesn't
13 that undercut the assumption that changes in capacity will
14 be rationally correlated directly with changes in volume,
15 that capacity will go up as volume goes up but capacity will
16 go down as volume goes down in a relatively timely fashion?

17 A I guess I would be a little careful in -- I don't
18 think I agreed with the -- I think you said "rationally
19 correlated" was your term. I think we were agreeing on the
20 proportionality term, and let me just give you a reason why
21 proportionality could be consistent with decentralization.

22 I mean I am not saying this is true, but let's
23 just suppose that transportation managers had a rule of
24 thumb which said if I have a 5 percent increase in volume,
25 I'm going to increase capacity 5 percent.

1 They don't use any analytical tools. They are not
2 rationalizing it out of a computer model, but yet -- and I
3 am not even saying that is efficient, but I am saying that
4 would be a result that could give you that proportional
5 response.

6 Q These are the decentralized managers?

7 A The transportation managers in the various -- the
8 transportation offices around the country, yes.

9 Q And what sort of current volume data do they have?

10 A I think when I say volume I am talking about it in
11 a subjective sense. You know, they have containers. My
12 understanding is they have containers. They talk to
13 facility managers.

14 I was really putting the economists' description
15 of their thought processes where, you know, that is the rule
16 of thumb, but just like people don't necessarily optimize to
17 the last cent when they go to a supermarket, I don't think
18 they actually sit down and do that calculation, but that
19 would be their behavior.

20 They follow rule of thumb behavior that generates
21 that result.

22 Q Is my understanding correct that most of the
23 purchased highway transportation contracts are four years in
24 duration?

25 A That's right.

1 Q And --

2 A Well, that is their maximum term and I think
3 "most" is a fair term, yes.

4 Q Is that a standardized term?

5 A Yes. That is, it can be for less than that, but
6 generally they are not.

7 Q And why is that?

8 A I think that the Postal Service feels it requires
9 a lot from its contractors and it feels that in terms of
10 reliability and punctuality it requires a lot from its
11 contractors, and as a result they feel that they can
12 construct a dependable network by essentially ensuring
13 contractors that the income will be there for awhile. It is
14 not that, you know, you are going to work for me today and
15 you won't be here, I won't be needing you next year, so they
16 think that by providing a longer term contract it stabilizes
17 the relationship and gives them a very dependable network.

18 Q It is good for the contractors.

19 A I don't know. I guess one issue is -- I don't
20 know. Let's think about that.

21 It is good in the sense that that gives them some
22 stability, but on the contracting side, apart from the
23 specifications side, on the contracting side this is market
24 bid and so, you know, to the extent that there's competitive
25 bidding for the contract, the advantage of that long-term

1 possibility would be embodied in the bids that contractors
2 make for it, so it is good for them in the sense of their
3 planning.

4 If there is a, quote, "efficient" market for
5 bidding for transportation contracts, the insurance value is
6 going to bid away.

7 Q Do you contend that there is an efficient --

8 A No, no, I knew you were going to ask that one.
9 No, I am not making that contention.

10 I am just saying we were speculating as to whether
11 or not it was good for the contractors and it could be. It
12 probably is. It probably is, but, you know, it is not a
13 slam dunk that it automatically is.

14 Q If the bidding market for highway transportation
15 is not very competitive and the contractors get pretty good
16 rates, maybe above competitive rates because of the lack of
17 competition or some inefficiency in the bidding process,
18 then they lock that super-competitive rate in for four
19 years.

20 Isn't that a long time in comparison with the
21 transportation, industry generally, highway contracts?

22 A I am really not in a position to make that
23 observation one way or the other.

24 Q Would it not be feasible in your view to negotiate
25 contracts of shorter duration? Two years?

1 A I think it would certainly be feasible, sure.

2 Q Would there be advantages cost-wise for the Postal
3 Service in doing that?

4 A You know, before I would make such a
5 recommendation, I think I would want to do more study of
6 what they get, what the Postal Service gets out of it, is
7 there a premium associated with it, and so on and so forth.

8 It is certainly possible but I really haven't
9 looked at it close enough to make that kind of
10 recommendation.

11 Q Do you have any knowledge as to whether the Postal
12 Service is currently studying or undertaking to reduce the
13 contracting cycle?

14 A The only thing I am aware of actually was that
15 they were trying to undertake an effort to go to more
16 negotiated and less bidded contracts, but they didn't really
17 pursue that, but I wasn't aware of any -- I am not aware
18 personally of any effort to explicitly reduce the contract
19 cycle, no.

20 Q Are you aware of any other joint undertakings by
21 the Postal Service to reduce highway transportation costs?

22 A Well, actually, I did see this interrogatory you
23 gave me, and it says they're undertaking a study of
24 transportation utilization.

25 I have never seen that study, or I don't know

1 what's in it. But presumably the point of undertaking that
2 would be to save costs, I would hope.

3 MR. BERGIN: With permission, I would like to show
4 the witness a copy of the Postal Service response to
5 MPA/USPS-40.

6 [Pause.]

7 BY MR. BERGIN:

8 Q And my interest is in Subpart B of that
9 interrogatory, if you'd like to review that and the answer?

10 [Pause.]

11 A Okay.

12 MR. BERGIN: For the record, MPA/USPS-40 asked the
13 Postal Service in Subpart B, for documentation of any and
14 all volume incentive rate discount or credit terms in effect
15 for transportation, provided the Postal Service in Base Year
16 '98, with reference to freight railroad -- and the response
17 was that there are no such rates, discounts, or terms.

18 BY MR. BERGIN:

19 Q Is it surprising to you, Dr. Bradley, that a
20 volume shipper like the Postal Service would not negotiate
21 volume discounts in its transportation contracts, at least
22 with respect to freight rail?

23 A You know, it's probably been ten years since I
24 looked at freight rail transportation and what they do
25 there. So, you know, I guess I would say that from my

1 experience with highway, one needs to be careful in jumping
2 to quick conclusions about the structure between the Postal
3 Service and its contractors.

4 I don't know if they get -- you know, what their
5 rate is compared to other private rail car rates, and if
6 they already have a preferential rate, and then there's no
7 further need for discounts, et cetera, so I just don't know.

8 Q Well, I'm talking about simply giving the Postal
9 Service or the Postal Service obtaining a better rate, the
10 more volume it ships. That's pretty basic; isn't it?

11 A As I said, I'm not really that familiar with their
12 freight rail system. I don't know what they do.

13 Q But as an economist speaking in general terms,
14 isn't it true that there is marginal cost decrease when
15 you're transporting a large volume?

16 A Yes, that is true. Generally speaking -- although
17 that with freight rail, you have to be a little bit careful,
18 because Postal Service freight rail transportation is
19 virtually 100-percent volume variable.

20 It's 99-plus, so what that says is, virtually,
21 they've pretty much exhausted all the declining marginal
22 costs associated with it, and they're pretty much down at
23 the flat part of the curve.

24 And so as a general matter in transportation, I
25 completely agree with you, but it's not so clear in freight

1 rail that they haven't already exhausted their scale
2 economies.

3 Q Does that take into account, unused capacity?

4 A Again, this is -- I'm offering this as a general
5 comment from my recollection of the variability. But I
6 really just don't remember how the structure for freight
7 rail works.

8 They may -- I'm speculating. My recollection is
9 sort of that they may buy complete vans at once, but that's
10 -- you know, this is like from ten years ago.

11 Q I'm sorry, can you explain that last comment?

12 A I shouldn't have said it. But --

13 [Laughter.]

14 THE WITNESS: My recollection is, I thought -- and
15 this could be completely wrong -- but my recollection is
16 that I thought they bought it like by the van; they
17 contracted with freight rail by the van. In other words --
18 you know, or the car, not necessarily by any utilization
19 number.

20 So, if that helps your understanding of the empty
21 capacity contracting issue, that's what I recall.

22 BY MR. BERGIN:

23 Q I'd like to turn to another aspect of your
24 testimony this morning. So let's put aside volume
25 variability. Let's assume that you're correct on that.

1 We're beyond the assumption about the relationship
2 between volume and capacity and capacity and costs, so,
3 we've got a pool of variable costs.

4 And now the question is distributing it, or
5 undertaking to fairly allocate it among various subclasses.

6 Now, in response to questions by Mr. Wells, I
7 believe you took the position that mail volumes, generally,
8 are responsible for unused capacity.

9 A Yes, in a sense. I mean, I don't want it to seem
10 foolish in the sense that something physical creates
11 something that doesn't exist.

12 What I was trying to suggest by that was that the
13 total capacity, both used and unused, is caused by mail
14 volumes. And so to the extent that there is excess capacity
15 out there, that could well be caused by the volumes; that's
16 right.

17 Q Now --

18 A Sorry. Caused in the sense that its existence is
19 there from specification of the total truck size, and the
20 fact that it's not use, the capacity is not used all the
21 time, doesn't mean it didn't arise for the purpose of
22 transporting volumes.

23 Q I think I understand what you're saying.

24 A Okay.

25 Q I don't know that I necessarily agree with it.

1 A Sure.

2 Q But my question is this: Isn't there a difference
3 between saying that mail volumes, in general, can cause
4 unused capacity, and saying that a particular subclass can
5 cause unused capacity?

6 I could understand that if you're speaking of the
7 system as a whole, as volume increases, volume of mail,
8 capacity and unused capacity will increase.

9 So my problem is with saying that a particular
10 subclass is responsible in a given proportion, or all
11 subclasses to varying proportions.

12 A I think there's some -- I have some -- you know, I
13 don't agree, but I think there's merit to the point that
14 it's certainly stronger -- and, you know again, this isn't
15 sort of the focus of what I've done, but as I said, just
16 generally, as an economist, in thinking about the Postal
17 network, I think it's probably more easy or more reasonable
18 to justify the assumption, overall, than it is for any
19 specific subclass.

20 Q For example, if I understand you correctly, one of
21 the evident reasons for the need for some unused capacity is
22 that you have peak days.

23 On a given day, the mail volume may be twice as
24 high as on other days.

25 A Right.

1 Q And so on the other days, assuming that there is
2 full capacity on the peak day, the other days, there might
3 be 50 percent capacity.

4 A Right.

5 Q So let's say there's a TRACS sample on one of the
6 low volume days.

7 A Okay.

8 Q And a certain subclass of mail is found on an
9 almost empty truck.

10 A Okay.

11 Q And so TRACS ascribes all of the unused capacity
12 on that truck to that class of mail.

13 A Okay, just one class on the truck?

14 Q Right.

15 A Okay, got it.

16 Q I have a problem because it seems to me that the
17 reason for the unused capacity is not attributable to the
18 fact that certain mail had to be on that truck on that off
19 day, but the fact that there are peaking days which account
20 for the need to buy a large sized-truck.

21 Do you disagree with that?

22 A I don't completely agree with, and let me try to
23 explain why. I think the reason I'm not comfortable with it
24 is I think you want to look at TRACS results in their
25 totality.

1 That is to say, TRACS will -- you know, it's going
2 to take snapshots. As I understand it, it's going to take
3 snapshots all over the network. And some days, it may --
4 this class may be on a relatively empty truck; some days it
5 may be on a relatively full truck.

6 And so I think trying to infer the right
7 responsibility from that class from any one observation
8 probably is not the best way to go.

9 But what one might want to do -- again, this is
10 speculation -- but think about the distribution of that
11 class and how often is it on full trucks and how often is it
12 on empty trucks, or what volume is causing the peak. Use
13 that sort of peak analysis.

14 So --

15 Q well, what if the subclass was always on an empty
16 truck because for some reason it always was transported on
17 an off-peak day?

18 Let's say it's a low-volume subclass? Are you
19 saying that the reason the Postal Service bought a truck
20 three times the size that it needs at that subclass, because
21 of that subclass or because of peak days for other classes?

22 A I don't know. I don't know whether it's that
23 subclass that caused the peak. I don't know -- you know,
24 I'd like to see a lot of observations to see how the volumes
25 -- what volumes --

1 I guess, to get back to it, it's like I'd want to
2 know what volumes were causing the peak, and to what extent
3 that peak had additional costs.

4 Q Well, I guess my broader question is not
5 quarrelling over whether one subclass or another causes the
6 unused capacity; it's my sense that it's the network as a
7 whole, the network needs that cause the Postal Service to
8 consistently maintain unused capacity.

9 Do you agree with that?

10 A I think that's a position that has merit. I don't
11 know if that's truly the case here or not.

12 But I think, certainly, when trying to wrestle
13 with this empty-space issue, you know, I think it's
14 reasonable to think about some portion of it could be
15 associated with the network.

16 If you go back in time, this used to be called
17 latent capacity, and the Postal Service advanced the view
18 that it, in fact, had capacity that was there for
19 service-related reasons only.

20 And that capacity was fixed, it was -- hence the
21 word, latent. It wasn't used for volume, and would always
22 be there.

23 And under that approach, if one accepts that to be
24 true, then those empty-space costs would not be attributed
25 to classes of mail.

1 On the other hand, if the belief is that, no,
2 empty space is not a rigid thing; it's a flexible thing, and
3 so what happens is when volume of any classes go up and go
4 down, empty space moves with it, and then I think if you
5 believe that, then it's reasonable to attribute the empty
6 space back to the classes.

7 Q I want to, for present purposes, for the sake of
8 argument, accept the notion that the costs of unused
9 capacity are volume-variable.

10 A Okay.

11 Q Let's not call them fixed. We're not talking
12 about the old latent capacity.

13 A Right.

14 Q They are volume-variable. My question is: Is it
15 correct that they nevertheless might be properly deemed
16 institutional costs because they are not caused by a
17 particular subclass?

18 They're volume-variable, they vary with the
19 volume, mail volumes, generally, but cannot be meaningfully
20 linked to particular subclasses in terms of cost causation.

21 Is that -- does that make sense to you as an
22 economist?

23 A Sorry, I have to say no, because the whole notion
24 of volume-variability and cost causality means it can be
25 linked to subclasses.

1 I think that's the basis of volume-variability, is
2 the struggle, the attempt to find causality between products
3 and costs.

4 If it can be causally linked, then it should be
5 institutional.

6 Q Isn't there a distinction between volume
7 variability analysis and the subsequent distribution
8 analysis?

9 A There is a distinction, but, remember, the two of
10 them together form the cost tracing between volume and cost.
11 And so, I mean, if in either step of that analysis you find
12 out that you can't trace a cost to product, then it
13 shouldn't go to product; it should be institutional.

14 So if it's in the first step, keep it
15 institutional; if it's in the second step -- if, in the
16 second step, you can say empty space really is not caused by
17 these products, it should not go to the products; it should
18 be institutional, but it wouldn't be volume-variable.

19 That's sort of a definition.

20 Q So, are you agreeing that there could be a
21 category of costs that does vary with volume generally, but,
22 nevertheless, is caused by the network as a whole and would
23 not be fairly attributable to particular subclasses?

24 A Okay. Here we have got to be a little bit precise
25 about what you mean by varying with volume generally. If we

1 are going to talk about costs which are traditionally known
2 as variable costs, something like labor, and they are put
3 into place and they are the same amount all the time,
4 regardless of the fluctuations in volume, I would call those
5 institutional or non-volume variable costs. Even though
6 they are variable costs in the sense they are not fixed, you
7 don't have to do them if you don't have any volume, they are
8 still not quite volume variable costs. It is a little bit
9 different than just variable.

10 Q Well, I am talking specifically in the context of
11 transportation capacity costs.

12 A Okay.

13 Q Which I think is a little different than labor for
14 some of the reasons we have been discussing, namely, the
15 need to have excess capacity or unused capacity for peaks,
16 or excess capacity because of need for frequent dispatches
17 to meet service standards, or because you make extra trips
18 in order to meet the mail processing needs, a plant needs
19 mail, all kinds of system causes for having unused capacity.

20 A Sure.

21 Q In that context, does it make sense to you that
22 the costs would be volume variable in the sense that they
23 change with volume as a whole, but, nevertheless, are more
24 attributable to the system than to a particular subclass?

25 A Okay. I think maybe I will try to explain myself

1 in a way that makes it clear. In that case we go back to
2 the two parts, put the first part aside, and the second
3 part, as we talked about earlier, the current assumption is
4 proportionality. But let's suppose that some of that
5 capacity is network capacity. Well, that would show up in
6 that second elasticity, or proportionality, not being 100
7 percent.

8 In other words, what would happen is that volume
9 went up 10 percent, that network capacity wouldn't change.
10 So, volume would go up 10 percent, but capacity would only
11 go up 5. That is how you would find additional cost not
12 going to products because, in that case, mathematically, you
13 would multiply the two elasticities together. So that
14 portion that doesn't vary with volume would not be going
15 back to products. It would go in institutional, but it
16 would not go to products.

17 Q Well, I want to assume that transportation
18 capacity increases 10 percent and costs increase 10 percent.

19 A Okay. That is the first part of the two.

20 Q And volumes is increasing 10 percent.

21 A Okay. That is the second part of the two. Then
22 you can't have costs which are, you know, volume related but
23 not varying with volume.

24 Q When you say can't have, are you talking about the
25 conventions here, the rules by which attribution has

1 commonly been made by the Postal Service?

2 A No, I am actually talking about the true
3 production process there. In other words, if we are willing
4 to agree that, quote-unquote, for our discussion those
5 assumptions are correct, what that is saying is that,
6 indeed, as volume went up 10 percent, capacity went up 10
7 percent, and if that proportionality occurs, then there is
8 no part of that additional 10 percent which was network or
9 service related or anything else. There may have been some,
10 you know, back in the early days, so to speak, before the
11 volume grew, but, you know, once you give me that, or you
12 just specify that one-on-one, then there is no give.

13 Q But does that mean that the responsibility for the
14 cost increase can be traced to particular subclasses, one
15 rather than another, as opposed to the mail as a whole?

16 A Good question. In that second step, the issue is,
17 how do you go about figuring out whether or not all classes
18 are one-on-one, or whether other individual classes in that
19 process are not one-on-one? And it is certainly possible
20 that you could have a world in which Class 1 has a different
21 proportionality in that second step than Class 2 or 3 or 4.

22 So, that is going to help determine, in the ideal
23 world, you know, if you knew both of those linkages exactly,
24 precisely, that would determine how much goes back to each
25 individual class. It doesn't have to be the case they are

1 all -- now it is easy if they are all one, right, if they
2 are proportional, and the total is proportional, then, yes,
3 it goes back directly.

4 Q But the problem is that we don't really know.

5 A That's correct. That's correct.

6 Q We simply have to track samples.

7 A I don't know, what is the question there?

8 Q In terms of trying to discern whether there can be
9 a rational distribution of these costs of unused capacity
10 among subclasses.

11 A Yeah. The only data we have are the track
12 samples, that's correct.

13 MR. BERGIN: Mr. Chairman, I have nothing further
14 at this point.

15 CHAIRMAN GLEIMAN: Mr. Feldman?

16 MR. FELDMAN: Thank you.

17 CROSS-EXAMINATION

18 BY MR. FELDMAN:

19 Q Hello again, Dr. Bradley. I am questioning you
20 today on behalf of a group of publishing associations and
21 companies. Dr. Bradley, you talk on page 15 of your
22 testimony, the direct testimony, about a restructuring of
23 purchased highway accounts. This is tied apparently to a
24 new Postal Service organizational structure. Were you
25 involved in any way in creating the new organizational

1 structure?

2 A No, sir.

3 Q You weren't consulted in any way?

4 A No. No, sir.

5 Q Without violating attorney-client privilege, may I
6 ask you approximately when you learned about this change in
7 organizational structure?

8 A I would say probably -- oh, boy, -- I guess
9 between the two cases, between R97 and R2000 at some point.
10 I guess when, you know, I went to look at the transportation
11 and there is new accounts and that kind of stuff.

12 Q So, it is your understanding at least that the new
13 accounting system was not -- well, let me ask it this way.
14 In your opinion was the new accounting system tied to the
15 need to have some sort of system of accounts for rate cases
16 or is it a system of accounts needed to simply keep track of
17 costs on an annual basis for purchased transportation?

18 A You know, this is just my opinion, but, based upon
19 the discussions and going forward, I would think that it is
20 for the latter, that the system accounts are designed for
21 them to record their costs, you know, operational costs.

22 Q Based on your prior studies of the Postal
23 transportation system, and, indeed, your assignment of
24 variabilities to various accounts in that system, and what
25 you have seen of the system in your current work, does the

1 change in system accounts in any way reflect a change in the
2 way that mail is transported from one facility to another?

3 A It didn't seem to. When I, you know, I redid the
4 analysis on the new system of accounts, it looked very much
5 like the old.

6 Q Okay. I am going to ask you a couple of
7 questions, really just definitional questions, and if you
8 are unable to answer them, it is quite all right. I may
9 address the Chair and ask that the Postal Service give us
10 written material on what probably are simply definitional
11 matters. These terms "area, cluster, process and
12 distributing center," what is an area?

13 A If you would allow me, can I go the other way,
14 because it is easier?

15 Q You can go either --

16 A Okay.

17 Q You can back up or go forward.

18 A Okay.

19 Q As long as you get to the platform.

20 A Great. A P and DC, processing and distribution
21 center is what we used to call a GMF, general mail facility,
22 you know, it is just like a mail processing plant. And the
23 customer service district, as I understand it, is the sort
24 of retail delivery area associated with that P and DC.

25 Okay. But if we think about going up a hierarchy,

1 if we add in all the other facilities within that P and DC's
2 responsibility, like maybe an air mail facility or, you
3 know, other stations, that is what makes up a cluster. So,
4 a cluster would be a broader definition, not just including
5 the P and DC, but other facilities in that general
6 geographic area.

7 And then if put clusters together, that makes an
8 area, which is I think similar to the old, if you are
9 familiar with the old, what was called divisions, Postal
10 divisions, I think that is what area is.

11 Q As far as the clusters go, do they have -- could
12 more than one P and DC be in a cluster, or are the clusters
13 -- you used the example of --

14 A One.

15 Q Of one plus, and you will have to excuse me, you
16 did name another facility, but it wasn't another PDC, it was
17 some other facility.

18 A No, it wasn't. You have pretty much gotten to the
19 depth of my knowledge on these definitions. My sense is
20 that it tends to be one, but it could be two.

21 Q Okay.

22 A But, again --

23 Q Yes. I know you are not here as a rate design
24 expert, but you are aware that in Standard A mail and in
25 periodicals mail, entry at a sectional center facility

1 affects the rates. The mailer gets a lower rate if he or
2 she, you know, buys their own transportation, trucks it to
3 the sectional center facility and then the mail is delivered
4 from there or from a facility within the SCF area.

5 A Uh-huh.

6 THE REPORTER: That's a yes.

7 THE WITNESS: Yes. Sorry. Yes.

8 BY MR. FELDMAN:

9 Q If I am a mailer with different rates, and somehow
10 I've found this truck that will carry my mail and I figured
11 out all the rate possibilities, and the cheapest way is for
12 me to, say, for a large city like Philadelphia or
13 Pittsburgh, to truck that mail, at least, into the SCF and
14 the Post Office takes it from there, which one of these
15 facilities is my good old SCF?

16 If I pull into the area, are they going to say
17 keep going down the highway? If I go to the PDC, are they
18 going to say, congratulations, you've made it? Is there a
19 correlation here?

20 A I think the P&DC would be the place that you would
21 take it if it was -- like that's what the old SCF was
22 called, so the P&DC would be the place it would go.

23 I think area is a more like administrative
24 definition; it's not a single building.

25 MR. FELDMAN: Mr. Chairman, I would like to make a

1 request for further information, if the Postal Service has
2 it, as to any literature they might have that defines these
3 terms, literature that is actually used by operations
4 personnel.

5 CHAIRMAN GLEIMAN: Ms. Duchek?

6 MS. DUCHEK: I will attempt to see if there is any
7 such literature. If there is, I hope to be able to furnish
8 it within seven days, but I'm not sure there is any.

9 MR. FELDMAN: I would appreciate the effort, thank
10 you, Ms. Duchek.

11 BY MR. FELDMAN:

12 Q In the past rate case, and perhaps in previous
13 rate cases, but I'm certain in the last rate case, you did
14 calculate variabilities for inter-SCF and intra-SCF
15 accounts.

16 A That's correct.

17 Q Have you found any -- now, I won't use the word,
18 correlation or identity, but I'll use the word similarities,
19 so please take all the latitude that that word implies --
20 have you found similarities in the variabilities between the
21 inter-SFC account, for example, and the inter-P&DC accounts,
22 and the inter-cluster accounts, for example, that appear on
23 page 16 of your testimony?

24 A Yes. Generally, the three that you mentioned,
25 inter-P&DC, inter-cluster, and inter-area, have

1 variabilities that look like the inter-SCF variability last
2 time.

3 Q And in terms of getting back to that mailer who is
4 trying to save some money and maybe get a little better
5 service, and he finds the truck and he goes right down to
6 downtown Philadelphia and he finds the P&DC, and he's in
7 that intra-P&DC account, were your findings of variability
8 for that account, this intra-P&DC, similar or in some sort
9 of statistical range that you'd feel comfortable with the
10 intra-SCF accounts?

11 A I would say that both the inter-P&DC and
12 inter-SCF, for that matter, have variabilities which are
13 either patterns or very similar for the old intra-SCF
14 account.

15 Q Okay. And I know the Postal Service is going to
16 be looking for some definitions to help us all out on these
17 phrases, but at least for the moment, as you understand it,
18 the customer service district, that intra-CSD account, is
19 that a geographical area that is, in effect, within the P&DC
20 area?

21 A That's my understanding. It relates to the retail
22 and delivery activities in that P&DC area. So that would be
23 --

24 For example, in that transportation, you might
25 have transportation from the P&DC to stations and branches

1 or AOs -- excuse me, to associate offices in that area.

2 Q Okay. If there was an increase in drop shipping
3 -- and you're familiar with that phrase?

4 A Yes.

5 Q If there was an increase in drop shipping by
6 members of a subclass, a rate subclass, so as to take
7 advantage, we'll say, of intra-SCF rates, and presumably
8 they've checked with Postal personnel and they're told where
9 to go, the right facility, whatever it's called today,
10 that's where you've got to go, and you've got to be there at
11 a certain time and so forth.

12 If that increases fairly steadily -- in other
13 words, let's say the ten percent of that subclass is doing
14 that type of drop shipping, volume-wise, this year, and next
15 year it doubles to 20 percent and by the year 2002, it's up
16 to 30 percent, do you have any --

17 What would be the -- and the volume, per se, stays
18 the same, the same number of pieces -- let's even assume
19 they weigh approximately the same, but they're now following
20 a different route into the system, what would be the effect
21 on utilized capacity for the truck routes that the pieces
22 formerly used, and the effect on the truck routes that the
23 pieces would now use, given the escalating drop shipping?

24 A I would think for the -- at least initially, the
25 utilizations on the trucks that had been carrying the

1 now-dropped-shipped mail would fall.

2 You know, probably it would be a response at some
3 point by Postal people, and they may reconfigure their
4 network. And so it's possible that the utilization could
5 valley, would fall, but maybe go back up to where it was.

6 It may not; it may stay lower, you know. So on
7 that side, I would say it probably fall, and it may come
8 back, it may not.

9 On the other side, as I understand it, this is
10 mail -- or this is trucks that now are carrying the
11 drop-shipped mail after it's been processed in the P&DC.

12 It seems to me that there should be very little
13 change on that side, because the mail was being brought by
14 the Postal Service transportation before and carried out by
15 Postal Service transportation.

16 Now it's being brought by the mailer's
17 transportation, but still being carried out by Postal
18 transportation. So that side, at least initially, would
19 seem to stay the same.

20 Q The -- we'll call it, just for the sake of this
21 question, the intra-SCF leg -- should stay the same?

22 A Right. That's the part from the facility out to
23 the like stations and branches?

24 Q Yes.

25 A That part should stay the same.

1 Q But the longer distance legs, whether it be to
2 what is now called an area facility or to a BMC, that
3 capacity should shrink?

4 A Well, you were asking about the utilization.

5 Q Well, let me say the utilization should go down?

6 A That utilization should go down, initially, and
7 then I would hope, or I would expect that through time as
8 they adjust to it, the capacity would fall to, you know,
9 whatever the right response is for their cost network.

10 And then at that point, the utilization may come
11 back up.

12 Q Yes. Before, you were discussing with counsel
13 from McGraw Hill, the four-year Postal contracts.

14 In our example of pieces of mail shifting to more
15 local Postal transportation, as opposed to the longer
16 distance transportation, would the manager -- would the
17 budget for the longer distance routes remain the same while
18 the contract was in effect, of course, while a transfer
19 volume occurred from the longer distance routes to the
20 shorter distance routes?

21 A I think that depends upon how far into the
22 four-year period they are, because the Postal Service can
23 cancel these contracts, but they have to pay an indemnity if
24 they do so.

25 So, as to whether or not they actually will cancel

1 a contract may depend upon whether it's the first year or
2 the fourth year and how big that indemnity is, and also, in
3 their minds, you know, if the volume decrease is due to
4 dropped shipping and permanent and they recognize it.

5 So I think that the actual calendar time
6 associated with the adjustment would depend upon those
7 factors.

8 Q Let's assume that the mail that's being
9 drop-shipped is a subclass of mail that might be five
10 percent of the total volume of the Postal Service.

11 A Okay.

12 Q Maybe it's ten to 15 percent of the weight, if you
13 want to look at it in terms of space and weight.

14 A Okay.

15 Q So even using weight factors, you're talking that
16 85 percent of other mail, potentially 85 percent of the
17 other volume, potentially could use this capacity.

18 If the contract isn't, as you say, cancelled,
19 would the -- does the Postal Service have the ability to
20 reduce its capacity in response to the shifting of volume?

21 A Well, first of all, about a fourth of the
22 contracts come up every year, so there is some -- it's just
23 through attrition that there's some possibility for
24 adjustment.

25 And, second of all, it's my understanding that the

1 Postal Service, within some limits, has ability to change
2 routings, consolidate routes, consolidate trips, cancel --
3 not cancel contracts, but cancel route, trips on contracts.

4 So I think they do have some ability to adjust the
5 network, even within the four-year account structure.

6 Q But wouldn't you think it might be more difficult
7 to do that in the situation where the mail migrating to
8 local transportation is a very small class of mail versus a
9 large class of mail that even in some instances on certain
10 peak days may even fill entire trailers, would that be a
11 possibility that the small class of mail, would simply its
12 disappearance from the longer routes would simply lead to a
13 little more space, empty space on trucks without any cutback
14 in the amount of capacity purchased?

15 A I think it depends on the attention that that
16 class of mail gets from the Postal Service, the importance
17 of transportation on it. Even though it is a small class,
18 they may actually be running transportation for it, so it
19 makes its service standard, so it is hard to say, really,
20 without knowing all the characteristics associated with it.

21 Q Is it your understanding that outside of the
22 Express Mail network and perhaps the Alaska network, I may
23 be missing one or two, but those are two that come to mind,
24 outside of those two dedicated networks that any of the
25 highway routes of the Postal Service are dedicated to the

1 transportation of any particular class of mail?

2 A By dedicated, you mean they carry solely one
3 class?

4 Q That's correct.

5 A I mean I guess the TRACS data could tell you but
6 my sense is generally they are mixed, that on most trucks
7 they have a variety of classes.

8 Q If we could turn to your Table 2 on page 20 of
9 your testimony.

10 A I have it.

11 Q Okay. Just a couple of brief questions here.

12 The transportation activity column which lists, if
13 I may use the word, modes like box route, intracity
14 transportation, van transportation, tractor trailer
15 transportation, did you make these matches with the type of
16 account such as intra P&DC by actually ascertaining that
17 these were the modes of transportation in and out of these
18 facilities?

19 A I think so, yes.

20 What I did was to look at, say, intra-P&DC, the
21 new intra-P&DC account and to see what types of
22 transportation were in there -- box and intra-city?

23 Q Would it be common then if intra-P&DC, let's say,
24 is roughly similar to the old intra-SCF, is that a common
25 feature that tractor trailer transportation would be used

1 for that type of relatively short distance route?

2 A Excellent question. It certainly is not common in
3 the sense that once you look at the frequency of the data,
4 there are relatively few data points in those, in that
5 activity. It happens. It happens, but it is not a common
6 event.

7 Q Now I am reaching back to your very excellent
8 R97-1 testimony and I recall -- I believe you had in that
9 testimony variability factors for not only accounts but for
10 types of vehicles, am I correct about that?

11 A Essentially if you look at Table 2, if you take
12 those first four groupings --

13 Q Yes.

14 A -- that is what I had for intra-SCF back then.

15 Q Right.

16 A So we had box, intracity, van -- which is a
17 straight-body truck, and tractor trailer.

18 Q And just so this is all in context, Table 2 comes
19 after you have made a statement that talks about the
20 estimation of 17 equations to reach variability.

21 A That's correct.

22 Q So I am not a statistician or mathematician so I
23 may misstate this, but all of these account categories and
24 all of the named transportation activities in one way or
25 another are factors in your equations, are they not?

1 A Actually, the way I would say it is for each one
2 of these 17 in Table 2 I have an equation. I do a separate
3 equation for each one of those 17.

4 Q Okay. Is the transportation activity, for
5 example, van transportation, is that what you as an
6 economist would call a variable in this situation?

7 A No. I think that is sort of what we would call
8 technology or, as you called them, mode. For boxes, the
9 variables are boxes in round miles, but for all the
10 transportation equations the variables are cubic foot miles
11 and route length.

12 Q Regardless of the mode of transportation.

13 A Right. Actually, if you look at page 21, you can
14 see it sort of looks like Green hieroglyphics there at
15 equation 1.

16 Q I see CFM --

17 A Right.

18 Q I assume that is Cubic Foot Miles.

19 A Right that is cubic foot miles and RL is Route
20 Length.

21 Q Right, okay.

22 A So that applies to all of the transportation, so
23 it would be 15 of those 17.

24 Q Okay. On page 22 you refer to DNO, and again I
25 recall that from the last case, and I don't recall what a

1 DNO is, so would you just refresh us, please?

2 A I'm sorry I didn't put the definition there. I
3 apologize for speaking in jargon.

4 A DNO is a District Network Office, and that is
5 one of those decentralized -- used to be called the
6 Transportation Management Office, TMO.

7 Q Are the 16,791 observations in the dataset that
8 you refer to on page 22, line 15, those you state are larger
9 than the number of contracts in force.

10 Is there any relationship between the number of
11 observations and the number of contracts? In other words,
12 was every -- excuse me. Was there an observation made, at
13 least one observation made for at least one contract?

14 A Yes. The relationship is as follows. Each
15 contract will have at least one observation in the dataset
16 but some have more than one.

17 Q Okay, and approximately there are how many
18 contracts outstanding?

19 A I would say around 15,000, something like that.

20 Q Now the contract cost segment referred to at the
21 bottom of page 22, which you define as a discrete part of a
22 highway contract that has its own transportation
23 specifications, its own payment type, that is not -- is that
24 the same thing as the leg of a contract that you discuss a
25 little later, where you are talking about backhauls and

1 outhauls and while there may be one contract covering a
2 route, in order to measure variability you really have to
3 look at the individual legs upon which the transportation
4 moves?

5 Is the contract cost segment an actual
6 point-to-point move of transportation or is it in fact the
7 entire mileage specified in the contract?

8 A If only it was that easy, right? The answer has
9 got to be neither, but I think we can get there.

10 Q Don't ask me. I don't know.

11 A The contract cost segment really is a way to
12 recognize that sometimes when the Postal Service lets a
13 contract it is almost like they have two contracts in one.
14 One might be the tractor trailer portion, and one might be
15 the van portion.

16 Within each of those contract cost segments you
17 have its own set of legs and movements.

18 Q Let us get onto TRACS just for a second. I know
19 you are not the primary TRACS witness.

20 It is possible -- it is possible, is it possible,
21 is it not that a TRACS sample then could sample mail on one
22 leg of a contract and not another, correct?

23 A Correct.

24 Q And in doing so, it could be in a situation where,
25 as you state here, one part of the contract is accomplished

1 by a van and the other part is accomplished by a tractor
2 trailer?

3 A I believe that is possible, yes.

4 Q On page 24, you discuss power only contracts,
5 which is essentially the contractors supplying the cab or
6 the -- when you say many BMCs' contracts are power only
7 contracts, perhaps this is in your work papers, and, if so,
8 I apologize, I don't have a notation from them, but is it
9 your -- do you have any understanding that this now, this
10 power only contract development represents a high or
11 majority proportion of the cubic capacity going in and out
12 of the BMC system?

13 A I can actually point you to a quick place you can
14 get that number.

15 Q That would be fine. Thank you very much.

16 A Yeah. If you look at my response to the Fruit
17 Gift Shippers, sorry, FGFS. Sorry.

18 Q Yes.

19 A 18-7.

20 Q Okay. So, for example, in Account 53, 127.

21 A That is intra-BMC.

22 Q Intra-BMC, we will use that, that's good. Number
23 of contracts are 353, and power only contracts are 159.

24 A Correct, 40.

25 Q So, in some segments, it is a substantial number

1 of --

2 A Particularly in intra-BMC, that is where its
3 prevalence is most.

4 Q Does the contractor, do you happen to know, does
5 the contractor who supplies the trailer get paid a flat rate
6 per trailer regardless of how much capacity is used?

7 A In this instance, it is the Postal Service.

8 Q I'm sorry. I take it -- of course, you are right.
9 The Postal Service is providing the van.

10 A Right.

11 Q The private contractor is supplying the cab.

12 A The truck, right. Right.

13 Q Or the truck. Do you know if the Postal Service
14 sets aside a certain number of trailers in this case, or do
15 they add entire trailers when volume increases or decreases,
16 they would take away entire trailers? Does it cube out, I
17 guess is the phrase that is used? Where another vehicle has
18 to be brought in.

19 A Okay. Yeah, I think the process works as follows,
20 let's say they are at the BMC and they have a fleet of their
21 own trailers, and so what happens is they probably will have
22 a yard tractor that will bring the trailer back up and, you
23 know, put it on the dock, and then they will fill that up.
24 Then the contractor will come pick it up and drive it to the
25 other -- the GMF, or, excuse me, P and DC and BMC. So that

1 is how the process works.

2 Q Let's go to Table 5 on page 31 of your testimony.
3 Just the top line, estimated variability.

4 A Yes.

5 Q Before you had a discussion with Mr. Bergin, I
6 believe about the old latent capacity concept and that some
7 costs were classified as institutional costs, these numbers,
8 these variabilities, which, in fact, as I understand it, was
9 your primary task to calculate, and they continue on Table 6
10 and Table 7, so that all the various modes or routes are
11 covered, there is some variation going from .319, which is
12 intra-PDC box, all the way to inter-BMC and intra-BMC, which
13 are close to 100 percent. These are variabilities which, in
14 effect, do leave some of the costs of providing this
15 transportation to the institutional category, correct?

16 A That's correct. In fact, since all of the
17 variabilities are less than one, their application would
18 imply some institutional cost.

19 Q Could they be more than one in some instances?

20 A In theory, they could be, but they are not.
21 Actually, here is one. There is one, I am sorry. I
22 misspoke. This is actually -- you were asking me about this
23 earlier, and that was in these what used to be intra-SCF,
24 you don't have very many tractor-trailers.

25 Q Right.

1 A Well, that is actually, in that case there is only
2 28 contract cost segments that were in intra-CSD trailer,
3 and so that one is more than one. Of course, it is very
4 little cost, so it is not -- doesn't have very much, it has
5 almost no effect.

6 Q What, I mean aside from, you know, you have got
7 your inputs and your outputs and the equation comes out to
8 what the equation comes out to, but what, in your judgment,
9 leads to what appear to be lower variabilities for the
10 inter-PDC vans, for example, inter-cluster vans, intra-PDC
11 cities, intra-PDC van? These have relatively low
12 variabilities, approximately two-thirds of 100 percent,
13 67-68 percent. When we look at intra-BMC or inter-BMC, we
14 have got close to 100 percent.

15 A Yes.

16 Q What, if any, operational reason drives those
17 variabilities, the differences in those variabilities?

18 A Okay. The variabilities reflect how costs rise as
19 capacities go up. And in the various intra categories, the
20 ones with low variabilities, that tends to be relatively
21 short-haul transportation, a lot of it is van
22 transportation. And what that allows is the Postal Service
23 has a lot of mechanisms to respond if they need more
24 capacity. They can run more trips, they can increase the
25 size of the truck, they could reroute. So, there is a lot

1 of ways that they can respond to the capacity change, and
2 there is a flexibility there. They can choose a way which
3 causes costs to go up least quickly.

4 Something like inter-BMC, for example, it is
5 pretty long-haul transportation. It is tough to run an
6 extra trip. You are already in the tractor-trailer
7 capacity, so it is tough to change truck size too much. So
8 there is a lot less flexibility, I think, as you get to
9 those inter-BMC transportation, and that is reflected by the
10 fact that cost tends to rise faster with capacity.

11 Q Does the observation that you made in the last
12 case that the local, relatively local transportation, such
13 as intra-SCF, is higher on a per cubic foot mile, does that
14 still obtain?

15 A Yes.

16 Q Let's move on to page 43. I think my colleagues
17 have covered some of the other material.

18 On page 43, you talk about new TRACS distribution
19 procedure. Is it fair to say that that was developed in
20 response to some comments by the Postal Rate Commission in
21 its docket R97-1 decision?

22 A Yes.

23 Q Was there, in your judgement, anything inherently
24 wrong with the way the Postal Service was calculating part
25 of the joint cost of a route?

1 A I would say the new approach is preferred; that I
2 think it gets directly at the causality, because it's trying
3 to measure in the large, the proportions of capacity
4 associated with each class, as opposed to this cost
5 weighting.

6 Q The new system, however, goes beyond just adding
7 up the various segments of a contract route. What it does
8 is -- or purports to do is to aggregate all of the various
9 segments into a total that then is allocated to a subclass;
10 is that correct?

11 A Within an account, it would put all the tests
12 together in all segments, and then come up with a proportion
13 for that particular subclass.

14 Q And I can address this to the TRACS witness, if
15 you prefer, but in aggregating this data, is there some sort
16 of a waiting process by which the proportionate volumes for
17 each account are adjusted?

18 A I think you probably should ask the TRACS witness.

19 Q That's perfectly fine. A last question on that
20 item I'll ask you is on page 43 and 44, and in describing
21 the new system, you use intra-BMC as an example. I take
22 that it just an example, and this new procedure, as we
23 discussed before, applies to all the accounts?

24 A That's correct.

25 Q That's just an example.

1 A Yes.

2 Q On page 51, you are discussing the purpose of
3 TRACS, and at line 10 and 11, you talk about in some
4 instances, to find the proportions required for estimating
5 distribution keys, TRACS does not have to collect piece
6 information.

7 Does that mean that in other instances it does
8 have to collect piece information?

9 A I think that's logical.

10 Q If it can do it in some instances, why can't it do
11 it in all?

12 A I think it has to do with the nature of the
13 testing process. And the best example I can relate to you
14 is the one where the truck is bed-loaded with sacks.

15 What they're doing is, they're taking a container
16 out and they're sampling one container and looking at what's
17 in there. It might be easy to measure the pieces there;
18 it's just one container.

19 But if they're getting to the whole bed of the
20 truck, counting all those pieces would be very burdensome
21 and slow the mail.

22 Q Are you aware that -- again, I'm not treating you
23 as an expert on payment of postage -- I'll use that phrase
24 -- but are you aware that every piece of mail and every item
25 of mail that contains pieces that go into a Postal truck, at

1 some point it's all prepaid postage?

2 In other words, the mail has been paid for at a
3 Postal facility somewhere.

4 A Seems reasonable to me.

5 Q You'd accept that?

6 A Sure.

7 Q Because it seems reasonable. In your discussions
8 about how to treat these different segments of contracts,
9 did anyone point out to you that the volumes being sent out
10 from various printing plants and other mailer facilities,
11 were recorded on various Postal forms, simply because the
12 mailers have -- I'm talking about bulk mailers -- have to
13 pay postage, and they have to record that on a form, so the
14 volume is there?

15 A I think I was generally aware. They're called
16 mailing statements?

17 Q In general, they're called mailing statements,
18 yes.

19 A I was generally aware of mailing statements. I
20 don't think, specifically, people mentioned to me when we
21 were trying to figure out, you know, how TRACS could work
22 for variability regression, that the mailing statements, per
23 se, were mentioned, but I'm generally aware of them.

24 Q And is there a transportation manager, if not in
25 the printing facility, in an area or management section,

1 center, nearby, who's responsible for the scheduling of
2 transportation to and from those facilities?

3 A They would be in those DNOs we talked about
4 before, the 13 regional DNOs?

5 Q Yes. So, somebody in the Postal Service is aware
6 of the destination of all of this mail that's being printed,
7 stuffed into envelopes, stamped with bulk permits and sent
8 on its way inside of trucks, correct?

9 A I'm not sure I got that one. There certainly is
10 somebody who is in charge of the transportation, making sure
11 there's enough capacity there, trucks, et cetera.

12 And there are mailing statements at the beginning.
13 But does that mean that there is somebody that knows where
14 every piece of mail is going?

15 Q Not where every piece is going in terms of the
16 address.

17 A Right.

18 Q But where every container and item, for example,
19 is going, at least on the trucks that are leaving that
20 facility, not to the addressee.

21 A No. I understand, like the destination facility.

22 Q That's right.

23 A Oh, boy. I would -- I'm not so sure. I mean,
24 certainly the containers are all labeled, and they could
25 collect that information.

1 As to whether or not, once it's going -- I mean,
2 if the truck's going to one destination, it's easier.

3 But as to whether or not they track, I don't think
4 they actually track the containers to where they go to
5 destination facilities.

6 Q But you mentioned there are labels on pallets and
7 on sacks.

8 A Sure.

9 Q It would be easier for somebody to get information
10 off of those labels than to bust open sacks or break up
11 packages that are on pallets or things like that; wouldn't
12 it?

13 A Yes. I mean, again, I think that to the extent --
14 I mean, I'm making this up, but to the extent you could put
15 a bar code, say, on each container, you could just scan
16 that.

17 Q Please go on.

18 A You could just scan each one of those, and that
19 would give you information. Presumably the bar code would --
20 might be the destination facility place. You'd scan it and
21 then you'd have the information.

22 Q Well, I don't know why you're sometimes the last
23 to know these things at the Postal Service. I think you
24 should be the first to know.

25 Page 54, you have what one might consider a strong

1 statement. You say that even if TRACS were modified to
2 provide volume estimates, problems would still remain in
3 using it to estimate volume variability regressions.

4 This is because of the fundamental mismatch
5 between HCSS data and TRACS data.

6 Professor Bradley, I have to ask you, while I
7 think you have done an excellent job in providing
8 rationalizations for the calculation of variabilities based
9 on TRACS data, isn't it very difficult to assume that there
10 is causation of cost by mail volumes when there is a
11 fundamental mismatch between the two central systems that
12 are providing all this data?

13 A Well, you've got the quote. That was a good
14 question.

15 Q It was a good quote.

16 A Yes, unfortunately. What I was referring to,
17 specifically, when I was talking about fundamental mismatch,
18 was the unit of observation. And I probably was a little
19 bit too strong, if you will.

20 What I meant by fundamental mismatch is the
21 following: HCSS, as we discussed before, is at the
22 contract, cost segment level, which has all those legs.

23 Q Yes.

24 A And, in fact, as you said, TRACS often will take
25 just one leg of HCSS. And that's what I meant by the

1 mismatch, is that to do a volume variability analysis, we'd
2 like to know the volume on the contract cost segment, and
3 all that TRACS can give us is one leg of that contract cost
4 segment, at best.

5 Q Would it be fair to state that given the
6 difficulties of using both datasets to produce a desired
7 result, that if -- and I use the word, if -- a more
8 compatible dataset than TRACS could be developed that might
9 be more compatible with, say, HCSS, that would be
10 preferable?

11 A Oh, for estimating volume variabilities?

12 Q Yes, for estimating volume variabilities?

13 A That's right. I think that's -- you said if a
14 more compatible dataset could be developed, it would be
15 preferred?

16 Q Yes.

17 A Yes.

18 Q And if, hypothetically, you were given that
19 hypothetical, unlimited budget and the power to be the king,
20 as they say, where would you start?

21 In other words, would you -- and I'm not asking,
22 you know, for details and appendix and everything else,
23 because you don't have the budget.

24 A Right.

25 Q But would you start to find a substitute or major

1 alteration for HCSS or for TRACS?

2 A I think that I would probably go to work on the
3 TRACS side of it for the purpose of variability estimation,
4 because TRACS is designed as a distribution key dataset.
5 It's not designed to do variability analysis.

6 So I think, you know, the problem with all of this
7 is being able to collect the data without stopping the mail.
8 And in some ways, that's even more important than the
9 budget, from what I'm told.

10 But if we could get around that problem, then I
11 think I'd go at it from trying to get a volume measure that
12 matched up with the HCSS data because I think it's pretty
13 good.

14 Q I mean, HCSS has legitimate functions besides its
15 triennial appearance in rate cases.

16 A That's right.

17 Q I mean, it's used, would it be fair to say, every
18 day in the Postal Service?

19 A Yes, it is.

20 Q On page 57, you have another statement which
21 states as follows, in line 13, "The current method assumes a
22 proportional relationship between volume growth and capacity
23 growth." Is that assumption correct?

24 A Well, it is an assumption. So, if it was -- I
25 would say if I had evidence to test the assumption, I would

1 no longer have to make it.

2 Q But you don't have the evidence?

3 A Right. Right.

4 Q Just another little definitional matter, on page
5 59 of your testimony, line 8, you say, "Primarily, the
6 system does not calculate the load information needed to
7 estimate the relationship between volume and capacity."
8 What does load information mean in this context, please?

9 A In this context, load information would reflect
10 the -- actually, it is defined on the previous page, page
11 58. It would include the containers, by container, number
12 of containers by container type, the percent bed loaded and
13 the number of Express Mail sacks.

14 Q So, it is not -- you are not referring to
15 individual pieces as such, but rather the containers and the
16 rolling stock and sacks.

17 A That's correct.

18 Q Sacks.

19 A That's correct.

20 Q Putting aside the very practical difficulty you
21 point out about stopping movements of the mail while
22 samplers go around measuring things, disrupting the flow of
23 the mail, affecting service standards, if somehow that could
24 be overcome, if it could be overcome, could a more accurate
25 relationship between volume and capacity be developed if

1 these samplers were dealing only with the sacks and
2 containers, as opposed to actual pieces? Is it absolutely
3 necessary for them to get to the pieces?

4 A Probably not absolutely necessary. You know,
5 preferred, because then we could put aside issues of how
6 many pieces are in the container and how many are in the
7 sacks and all that kind of stuff.

8 Q Is that something that might better be directed to
9 the TRACS witness?

10 A For distribution key estimation, absolutely.

11 Q On page 61, you have got some costs per cubic foot
12 mile for various accounts. Are these costs all in
13 relationship to the Alaska route, or are these general
14 average CFM numbers?

15 A It is the general average CFMs.

16 Q Okay. Do these appear to have increased by any
17 appreciable percentage since the last rate case?

18 A It is a little hard because of the changes in the
19 account structure, but, in general, no, I don't think the
20 costs per CFM have gone up. In some cases they have gone
21 down, I think.

22 Q Would you want to propose any hypothesis, and if
23 you wouldn't, simply say, no, I wouldn't, that will be an
24 acceptable answer. If, again, one has a relatively small
25 subclass of mail which, the volume of which has remained

1 essentially stagnant from the last rate case to this rate
2 case, and yet the purchased transportation costs are shown
3 to have gone up 4 percent, and another subclass of related
4 -- it is related material, but for regulatory reasons, it
5 pays a different rate, so these related pieces of mail, in
6 case the volume is stagnant. In the other case, the volume
7 actually is down, but the costs are up 1 percent, the volume
8 is down. The other case, the volume is slightly up, but the
9 costs are up 4 percent.

10 Given these average costs per foot mile, assuming
11 that these are roughly the same as in the last rate case, is
12 there any reason you can think of as to why a subclass of
13 mail whose volume is stagnant, or even declining, should
14 have higher transportation costs?

15 A These are, you are saying like the cost per piece
16 is going up 1 percent or total?

17 Q The cost per piece, yes, the cost per piece would
18 be a fair way to put it.

19 A The cost per piece, yeah. Nothing occurs to me,
20 you know, immediately in terms of a hypothesis. Whatever I
21 would say, I would probably just be making up anyhow.

22 Q Well, this isn't your area of expertise.

23 A Yeah.

24 Q And I don't want to dwell on it. I will just ask
25 one last question on it then. Would the identification of

1 those costs with that subclass be the result of the TRACS
2 system?

3 A It could be, it could be.

4 Q Okay.

5 A Could be.

6 Q And, therefore, to pursue some of ramifications
7 which I am not asking you about, we might also direct that
8 to the TRACS witness.

9 A You know, in particular, if the proportion -- its
10 distribution key share is changed, that would be a good
11 place to look for that issue, yes.

12 Q Yes. One final question, I believe McGraw-Hill
13 posed it to the Postal Service, and it is always an
14 interesting question. In reviewing the various accounts,
15 did you ever come across data that indicated that over \$23
16 million a year is spent supposedly to fly periodicals around
17 the country as purchased transportation?

18 A To do what with periodicals, fly them?

19 Q Fly them, use air as a mode of purchased
20 transportation.

21 A You know, I didn't actually look at air for this
22 case. Sorry.

23 MR. FELDMAN: Okay. No further questions.

24 CHAIRMAN GLEIMAN: Is there any follow-up? Mr.
25 Bergin.

FURTHER CROSS EXAMINATION

BY MR. BERGIN:

Q Dr. Bradley, to follow up Mr. Feldman's last question, I would like to show you the Postal Service response to MH/USPS-1, if I could.

A Okay.

Q Thank you.

A Sure.

CHAIRMAN GLEIMAN: Counsel, do you have a copy of that or do you need to see it?

MS. DUCHEK: I believe so. I think I have a copy.

CHAIRMAN GLEIMAN: Okay. Go ahead, Mr. Bergin.

[Pause.]

THE WITNESS: I have read it.

BY MR. BERGIN:

Q Now for the record McGraw Hill/USPS-1 requested information regarding domestic air transportation costs for periodicals in 1998.

In response the Postal Service indicated that those costs in 1998 were considerably higher than originally estimated and then on page 2 of the response is the following statement: "This share increase is thought to be the result of a commingling of periodicals flats with First Class and other mail normally routed on air transportation. The commingling may occur when mail in flat sorting

1 operations is not adequately separated between periodicals
2 and other mail. The separation can be accomplished by such
3 additional activities a sweeping flat sorting machines
4 between the processing of periodicals and other mail that
5 normally receives air transportation."

6 My question, Dr. Bradley, in these circumstances,
7 are the increased domestic air transportation costs in your
8 view as an economist caused by periodicals mail or are they
9 caused by the Postal Service as an institution?

10 A Well, first, let me make clear, I am not
11 testifying on mail processing costs in this case, so any
12 discussion of what is going on with flat sorting machines is
13 pretty much, you know, well beyond what I am doing.

14 Q Understood.

15 A So, you know, to tell you the truth, I don't know
16 that I can quickly give you an answer on this. You would
17 want to think about why this commingling -- what exactly the
18 commingling is, why it is taking place.

19 I am not sure I completely understand this notion
20 that separation can be accomplished by such "additional
21 activities" as sweeping flats sort of machines. It would
22 be hard to say just from this information, I think.

23 Q You understand that that is a Postal Service
24 operation?

25 A Oh, yes, I'm sorry. No, what I think they are

1 talking about here is after the mail comes off the machines
2 it would require somebody going over and, you know,
3 physically separating them out, but your question as I
4 understood it was is it the periodicals volume that cause
5 the air transportation or some other network issue, and you
6 know, it is very difficult to answer that question without
7 really a good understanding of why they were doing the
8 things they were doing and what was the purpose, so I am
9 really not comfortable with just making a strong statement
10 either way.

11 Q If you look further down on the same page of that
12 answer --

13 MS. DUCHEK: Mr. Chairman, well, maybe I should
14 let Mr. Bergin ask this next question, but I listened to the
15 first one and I am not even clear what this follows up to.
16 I know air transportation in general was mentioned, but this
17 is a pretty specific area and Dr. Bradley has indicated he
18 is really not familiar with this response.

19 CHAIRMAN GLEIMAN: Mr. Feldman asked a question
20 about air transportation and Dr. Bradley said that he didn't
21 have anything to do with that in this case, and I guess it
22 is a follow-up to him saying he didn't have anything to do
23 with air transportation in this case.

24 [Laughter.]

25 CHAIRMAN GLEIMAN: I think that his response to

1 Mr. Feldman that certain questions should be asked of the
2 TRACS witness and I think that this question falls into that
3 area also.

4 MR. BERGIN: Very good. Thank you, Dr. Bradley.

5 THE WITNESS: You're welcome.

6 CHAIRMAN GLEIMAN: is there any further follow-up?
7 Questions from the bench? There don't appear to be any.

8 Would you like some time for redirect?

9 MS. DUCHEK: Just five minutes.

10 CHAIRMAN GLEIMAN: How about if we do 10 minutes
11 and we will take a break?

12 MS. DUCHEK: Fine.

13 CHAIRMAN GLEIMAN: Okay.

14 [Recess.]

15 CHAIRMAN GLEIMAN: Ms. Duchek?

16 MS. DUCHEK: I have no redirect.

17 CHAIRMAN GLEIMAN: Well, if you have no redirect,
18 then, Dr. Bradley, it completes your testimony here for
19 today. We appreciate your appearance, your contributions.
20 We look forward to seeing you again in a bit.

21 THE WITNESS: Thank you.

22 CHAIRMAN GLEIMAN: Thank you, and you are excused.

23 THE WITNESS: Thank you.

24 [Witness excused.]

25 CHAIRMAN GLEIMAN: Would you like to call your

1 next witness?

2 MS. DUCHEK: Yes. The Postal Service calls John
3 Pickett.

4 Whereupon,

5 JOHN T. PICKETT,
6 a witness, having been called for examination and, having
7 been first duly sworn, was examined and testified as
8 follows:

9 CHAIRMAN GLEIMAN: Counsel.

10 DIRECT EXAMINATION

11 BY MS. DUCHEK:

12 Q Mr. Pickett, I have handed you a copy of a
13 document entitled "Direct Testimony of John T. Pickett on
14 Behalf of United States Postal Service," designated as
15 USPS-T-19. Are you familiar with that document?

16 A Yes, I am.

17 Q Was it prepared by you or under your supervision?

18 A Yes, it was.

19 Q And if you were to testify orally today, would
20 this still be your testimony?

21 A It would.

22 MS. DUCHEK: Mr. Chairman, I am going to give the
23 reporter two copies of the direct testimony of John T.
24 Pickett on behalf of United States Postal Service,
25 USPS-T-19, and I ask that it be entered into evidence.

1 CHAIRMAN GLEIMAN: Is there any objection?

2 [No response.]

3 CHAIRMAN GLEIMAN: Hearing none, I will direct
4 counsel to provide the reporter with two copies of the
5 witness' testimony, and, as is our practice, it will be
6 entered into evidence, but not transcribed into the record.

7 [Direct Testimony of John T.

8 Pickett, USPS-T-19, was received
9 into evidence.]

10 CHAIRMAN GLEIMAN: Mr. Pickett, have you had an
11 opportunity to examine the packet of designated written
12 cross-examination that was made available earlier today?

13 THE WITNESS: Yes, I have.

14 CHAIRMAN GLEIMAN: And if these questions were
15 asked of you today, would your answers be the same as those
16 you previously provided in writing?

17 THE WITNESS: Yes, they would.

18 CHAIRMAN GLEIMAN: That being the case, counsel,
19 if you would please provide two copies of the designated
20 written cross to the court reporter, the material will be
21 received into evidence and transcribed into the record.

22 [Designation of Written

23 Cross-Examination of John T.

24 Pickett, USPS-T-19, was received
25 into evidence and transcribed into

the record.]

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 2000

Docket No. R2000-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS JOHN T. PICKETT
(USPS-T-19)

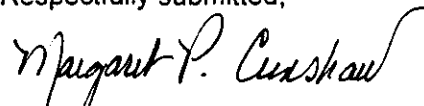
Party

United Parcel Service

Interrogatories

UPS/USPS-T19-2-3

Respectfully submitted,



Margaret P. Crenshaw
Secretary

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS JOHN T. PICKETT (T-19)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory:

UPS/USPS-T19-2

UPS/USPS-T19-3

Designating Parties:

UPS

UPS

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS JOHN T.
PICKETT (USPS-T-19) TO INTERROGATORIES OF UNITED PARCEL
SERVICE**

UPS/USPS-T19-2. Refer to page 4 of your testimony, where you state, "The Eagle contract has historically been used to operate an overnight hub and spoke network designed to meet Express Mail service commitments. Beginning in PQ 2 of FY 1998, the Postal Service began using certain Eagle planes during the daytime. These daytime Eagle 'turns' (as they are called by operations personnel) were designed to substitute for passenger air transportation, to better meet the service commitments of so-called two- and three-day mail (i.e., non-local First-Class and Priority Mail)."

(a) How long have the present contracts for the Eagle and Western networks been in effect?

(b) When do these contracts expire?

(c) How many separate contracts have been in effect for the Eagle and Western networks during the period from FY 1996 through FY 2000? Identify the time periods of operation for each contract and the identities of the contractors for both networks during this period.

(d) What percentage of total Eagle and Western network "turns" are expected to be daytime turns during the test year?

RESPONSE

(a) It is my understanding that the 10-year Eagle ANET contract has been in effect since January 10, 1994. The 8-year TNET contract has been in effect since November 20, 1992. The 6-year WNET contract has been in effect since August 28, 1999.

(b) It is my understanding that the ANET contract expires on January 9, 2004. The TNET contract expires on January 19, 2001. The WNET contract expires August 26, 2005.

(c) Eagle has been operated under the ANET and TNET contracts. The ANET contractor is Emery Worldwide. The TNET contractor is Evergreen

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS JOHN T.
PICKETT (USPS-T-19) TO INTERROGATORIES OF UNITED PARCEL
SERVICE

Aviation Ground Logistics Enterprises (EAGLE). The current WNET contractor is Kitty Hawk Aircargo. Prior to August 1999, the WNET contractor was Evergreen International. For additional details, please see the Postal Service response to UPS/USPS-T1-17.

- (d) I understand that postal operations personnel use the term "turns" in the context of WNET and EAGLE to mean daytime use of an aircraft.

Therefore, the answer, by definition, is 100 percent.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS JOHN T.
PICKETT (USPS-T-19) TO INTERROGATORIES OF UNITED PARCEL
SERVICE

UPS/USPS-T19-3. Refer to pages 1-2 of your testimony, where you describe the calculation of the network premium for the Eagle network, the Western network, and the Christmas network, and to page 5, lines 12-15, of witness Plunkett's testimony, where he states that "implementation of the Eagle Network enabled the Postal Service to provide much more reliable service for Express and Priority Mail between major markets ..." Refer also to the Commission's decision in Docket No. R97-1, at volume 1, pages 221-22, where the Commission attributed the "fixed" costs of the Eagle network exclusively to Express Mail based on witness Takis' testimony that "if Express Mail were eliminated, then the Eagle Network would be shut down, and Priority and First-Class Mail would be diverted onto commercial flights with no degradation of service quality."

(a) In your calculation of the network premium, did you consider witness Plunkett's statement that the Eagle network "enabled the Postal Service to provide much more reliable service for Express and Priority Mail between major markets"?

(b) Do you agree with this statement by witness Plunkett?

(c) How did the Eagle networks benefit to Express Mail and Priority Mail affect, if at all, your calculation of the network premium?

RESPONSE

(a) No.

(b) I have been told that the Eagle network provides more reliable intercity air transportation for any class of mail carried on it. I have not quantified the reliability of service with or without the EAGLE network.

(c) Not at all. The benefit to any class of mail carried on Eagle is not a consideration in the calculation. I am merely updating the calculations from the last case. Those calculations were made in support of witness Takis's testimony on incremental cost and witness Alexandrovich's base year transportation cost workpapers. It is my understanding that witnesses Bradley (USPS-T-22) and Kay (USPS-T-23) present similar

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS JOHN T.
PICKETT (USPS-T-19) TO INTERROGATORIES OF UNITED PARCEL
SERVICE

incremental cost testimony in this case. Witness Meehan (USPS-T-11)
presents the base year transportation cost workpapers.

1 CHAIRMAN GLEIMAN: Is there any additional written
2 cross-examination for Witness Pickett?

3 MS. DUCHEK: Mr. Chairman, Library References.

4 CHAIRMAN GLEIMAN: Well, we have some more
5 designated -- let's finish up with the designated
6 cross-examination.

7 MR. McKEEVER: Thank you, Mr. Chairman.

8 CROSS-EXAMINATION

9 BY MR. McKEEVER:

10 Q Mr. Pickett, I have just handed you a copy of your
11 responses to interrogatories UPS/USPS-T-19-4 through 13.
12 Could you take a look at those and tell me if those were
13 asked of you today, would answers be the same?

14 A Yes, they would.

15 MR. McKEEVER: Mr. Chairman, with that, I move
16 that Mr. Pickett's answers to interrogatories
17 UPS/USPS-T-19-4 through 13 be admitted into evidence and
18 transcribed into the record.

19 CHAIRMAN GLEIMAN: If you would please provide two
20 copies to the court reporter, the material will be received
21 into evidence and transcribed into the record.

22 [Additional Designation of Written
23 Cross-Examination of John T.
24 Pickett, UPS/USPS-T-19-4 through 13
25 were received into evidence and

transcribed into the record.]

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RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS PICKETT
(USPS-T-19) TO INTERROGATORIES OF UNITED PARCEL SERVICE

UPS/USPS-T19-4. Refer to the Postal Service's response to UPS/USPS-T1-17, redirected from witness Xie.

(a) Explain why Salt Lake City, UT, was added to the Eagle Network, and provide copies of any studies, memoranda, or correspondence relating to the decision to add Salt Lake City to the Eagle Network.

(b) Explain why Portland, OR, was added to the Eagle Network, and provide copies of any studies, memoranda, or correspondence relating to the decision to add Portland to the Eagle Network.

(c) Explain the reasons why Spokane, WA, was added to the Western Network on May 27, 1997, and provide copies of any studies, memoranda, or correspondence relating to the decision to add Spokane, WA, to the Western Network at that time.

(d) Explain why Billings, MT, was added to the Western Network on May 27, 1997, and provide copies of any studies, memoranda, or correspondence relating to the decision to add Billings, MT to the Western Network at that time.

(e) Explain the reasons why Boise, ID, was added to the Western Network on May 27, 1997, and provide copies of any studies, memoranda, or correspondence relating to the decision to add Boise, ID to the Western Network at that time.

RESPONSE

(a) The overnight Eagle network was expanded to Salt Lake City to provide improved overnight service for Express Mail customers in that area. I am not aware of any studies, memoranda, or correspondence on this decision.

(b) The overnight Eagle network was expanded to Portland to provide improved overnight service for Express Mail customers in that area. I am not aware of any studies, memoranda or correspondence on this decision.

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS PICKETT
(USPS-T-19) TO INTERROGATORIES OF UNITED PARCEL SERVICE

(c)-(e) The daytime and nighttime Western network was reconfigured, and expanded to Spokane, Billings and Boise for two reasons:

- (1) to maintain service for Express Mail and eliminate the need for air taxis and commercial air used to move First-Class Mail and Express Mail.
- (2) to provide improved service for Priority Mail

In response to these interrogatories I was provided with the following two documents that provide some information on the decision-making process. One document (an email) is dated 11/24/95. This document contains a list of concerns leading up to the original WNET renewal meeting. (Ultimately, the contract was not renewed.) Please note that the names of the participants as well as some origin- and destination-specific volume information have been redacted. The other document is an Executive Summary of the meeting. It should be noted that both of these documents appear to relate to a meeting that took place long before the turning (i.e. daytime use) of WNET planes began.

Attachment to Response to UPS/USPS-T19-4

Author: [REDACTED] at SEWAD002L
 Date: 11/24/95 9:53 AM
 Priority: Urgent
 TO: [REDACTED] at DECO001L
 TO: [REDACTED] at BRCA001L
 TO: [REDACTED] at ININ002L
 TO: [REDACTED] at ININ002L
 TO: [REDACTED] at WADC033L
 TO: [REDACTED] at WADC033L
 TO: [REDACTED] at DECO001L
 TO: [REDACTED]
 Subject: WNET #1

----- Message Contents -----

As agreed at the recent WNET meeting, below is a summary of our concerns discussed regarding the new WNET proposal along with your response regarding the requirements.

CONCERN:

1. The primary purpose of the new WNET is to improve the performance of Priority Mail Service performance. The aircraft departure times are much too early to capture any significant additional Priority Mail volume. Is there an opportunity to have later aircraft departure times?

RESPONSE:

Some WNET schedules were adjusted with later departure times. A major concern raised was the impact to Next Day Express Mail committed to the WNET.

As part of the Headquarters review of the requirements, we will be looking closely at opportunities for later departure times for the aircraft. Specifically, we will look to move the Express Mail to commercial aircraft where Next Day Service can be maintained.

CONCERN:

2. Aircrafts upgraded to 727-100s in the new WNET proposal. Current WNET aircrafts are operating at about 80% capacity minus the First-Class mail. Only Priority Mail volumes were submitted with the proposal and in all cases the aircraft and container capacities were severely underutilized for this single mail class. Need to get a handle on the total O&D volume by mail class planned for the WNET to justify upgrading the aircraft for Priority Mail.

RESPONSE:

[REDACTED] will be providing Headquarters the additional volumes by mail class the week of February 5.

CONCERN:

3. Proposed tender and delivery times indicate that containers will be built by the contractor instead of the Postal Service. Contractors ground handling costs are

Attachment to Response to UPS/USPS-T19-4

- exorbitant, and generally it is cheaper and beneficial for the Postal Service to build and unload containers.

RESPONSE:

Agreed to change the proposal to reflect Postal built and unloaded containers. Will request in the contract the methodology for determining the cost of contractor built/unloaded containers.

CONCERN:

- 4. "Ramp transfers to and from all commercial carriers may be required at all points". This particular clause will result in additional cost to the contract and it is not our intent to expand the whole dedicated network to transfer to commercial aircraft.

RESPONSE:

The DEN/BIL, SEA/ANC and SLC air taxi service are the only points that currently exchange mail with commercial carriers. These are the only points that should be identified in the proposed commercial requirements package. We must however associate a cost with a network/commercial transfer for these points.

CONCERN:

- 5. Why can't we use our Postal facilities at ANC, DEN, LAX, OAK, and SEA instead of incurring this additional cost in the contract?

RESPONSE:

No facility or ramp space available at ANC, DEN and SEA.

From a headquarters perspective this particular issue needs to be more clearly defined. As a side note (was not discussed at the meeting) the additional building cost of a building and ramp space has to be considered in the economics of rolling the air taxi service into the network.

CONCERN:

- 6. New WNET proposal indicates the Postal Service will provide containers. Do we currently have containers for the WNET?

RESPONSE:

No; proposed the Postal Service purchase containers. Eagle Hub personnel indicated approximate cost at about \$3500 each.

CONCERN:

- 7. The hub transfer time has 50 minutes between the last flight in (BIL/DEN 0030) and the first flight out (PHX/ABQ 0120). We need to review the arrival and departure times to/from the hub relative to container exchanges and distance from the hubs for that may provide for later leave times from origins.

RESPONSE:

_____ indicated that there are probably some adjustments that can be made to improve the scheduling. At this point we don't know what the significance of these changes.

Attachment to Response to UPS/USPS-T19-4

We first will finalize the O&D pair volume and plane types before we look at the scheduling.

CONCERN:

8. There are a great many containers that have to be downloaded and topped off at intermediate points. There are a lot of containers with less than a third (reference matrix attached) of Priority Mail which will result in additional ground handling cost and time that could be used for later leave and arrive times. Based on the Priority Mail volume submitted, the total hub volume for ABQ/PHX [REDACTED], BIL/DEN [REDACTED], GEG/PDX - [REDACTED], LAS/RNO [REDACTED], SAN/LAX [REDACTED]. On the SAN/LAX aircraft, there is [REDACTED] containers to be offloaded at LAX which can be surfaced.

RESPONSE:

Uploading and downloading is part of the current WNET operation. The upgrade to the SAN/LAX aircraft is for mail destinating these airstops. The [REDACTED] LAX containers is mail currently being dispatch via surface as a result of the aircraft operating for destinating mail.

The container and volume issue will be reviewed in-depth when the additional volumes are received by mail class.

Based on the existing WNET data, there does not appear to be significant Priority Mail volume to justify upsizing the aircraft, however, all of the volume data is not in yet. Note that the revamped network is basically to support Priority Mail and to capture this additional volume, serious consideration should be given to having the planes depart much later after the clearance time of Priority Mail. Need to look at the Express on commercial aircraft as an alternative to maintain Next Day service and look to minimize the amount of First-Class mail used as filler (excluding the BIL & ANC for this network). When we receive the final O&D pair volumes we will issue our final recommendation on the proposed WNET package.

This WNET package is a top priority and we are looking to finalize the requirements and submit to Purchasing as expeditiously as possible.

Attachment to Response to UPS/USPS-T19-4

EXECUTIVE SUMMARY

Purpose: The Pacific and Western Areas are requesting the expansion of the WNET network to improve priority service between major markets in the western United States. This expanded network would have the added advantage of combining the current network operation with a series of stand alone air taxis which have been instituted to supplement inadequate commercial lift. The result is an expanded network joining more cities utilizing larger aircraft at little additional cost.

Proposal: The request to expand the WNET is based on the need to integrate the existing network with three independent air taxis to maximize the service advantage, increase flexibility and to minimize cost. Further it responds to the request by Vice President, Allen Kane, to identify what resources would be needed for the Western Area to achieve a 95% intra-Area priority service score. The Western Area identified a need to increase both the size of the aircraft serving the network as well as the number of cities on the WNET as a essential element to achieve this objective.

Benefits: There are locations on the existing network that have inadequate lift with the current equipment utilized on the network. Increasing the size of the aircraft serving the network from DC-9's to 727-100's and DC-8's will furnish the capacity necessary to serve the added cities.

To maximize utilization of the network all of the planes on the current network serve multiple origins and destinations. The configuration of the existing network forces major origins like Seattle and Denver to have very early tender times. The smaller intermediate origins of Portland and Salt Lake City now have the later tender times. The result is that the tender times at these larger volume origins are too early to capture significant priority volumes. The new network combines Anchorage with Seattle, Spokane with Portland, Boise with Salt lake City, Billings with Denver, etc. so the larger volume origins will have the latest tender times as well as earlier delivery times. This means additional volume will be available for the WNET.

There are a number of origins (Boise, Spokane and Billings) not currently on the network which impact the Western Area's ability to achieve the 95% intra-area priority service goal. These origins do not have adequate commercial lift to achieve this level of service performance. The current dedicated air taxi service also provides capacity to move first class and Express mail. This capacity must be retained under expanded WNET. Although the mail mix would differ from the intent of the WNET contract, adding these stops would increase the reach of the WNET and thereby improve the opportunity to achieve the stated priority goal.

Attachment to Response to UPS/USPS-T19-4

Cost: The expanded WNET will increase aircraft capacity. It will increase its reach. It will create transportation flexibility because an integrated air transportation network will replace a patchwork of independent air transportation contracts. The Postal Service can obtain these benefits for an estimated increase in cost of approximately \$575,000.

Conclusion: The western part of the United States combines a unique set of circumstances, large geographic territory between major population centers, limited commercial transportation at the appropriate times and rapid growth. Unique transportation solutions are essential to achieve the desired level of service. The current WNET operation provides a partial solution to these problems but since its inception there has been a number of factors beyond the control of the Postal Service that require reexamination and modification of the WNET.

The expansion of the network, as recommended in this proposal, addresses these changed conditions in a manner that provides an integrated solution at minimal cost to the organization.

We believe the adoption and implementation of this proposal will greatly increase the Western Area's ability to achieve its service commitments both in priority as well as first class mail categories.

The estimated cost for the expanded WNET is \$45,960,395 annually. This appears to be a significant increase over the annual cost of the existing network (\$21,519,680) but one needs to consider the expanded WNET also includes the elimination of current dedicated point to point air taxis. These air taxis operate at a combined annual cost of \$11,835,490. The commercial airline annual cost to move the planned WNET volumes would be \$12,028,841. The total NET increase for the network will be \$576,384 annually.

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS PICKETT
(USPS-T-19) TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T19-5. How does the Postal Service measure utilization of the Eagle and Western networks? Provide the utilization of each of those networks separately for (i) FY1998, and (ii) FY1999.

RESPONSE

It is my understanding that the Postal Service currently uses its Dedicated Tracking System (DATS) in which utilization is recorded. These utilization figures can be deceptive as they do not reflect actual maximum carrying capacity on a given flight. As a result, a low utilization figure in DATS does not mean planes were not filled to capacity. See the responses to UPS/USPS-T22-6, 12 and 13.

(i) For FY 1998, utilization on the Eagle network was not recorded in DATS and is not available. For the Western network, utilization is available for the period January through September. For utilization rates, see the attached table.

(ii) For most of FY 1999, utilization on the Eagle network was not recorded on DATS. As a result, a utilization percentage is not available. For the Western network, utilization is listed in the attached table.

WNET Utilization Data

Attachment to Response to UPS/USPS-T19-5

01/01/98-09/11/98

	INBOUND		OUTBOUND	
	JETS	PROPS	JETS	PROPS
Jan-98	78.2	N/A	87.3	N/A
Feb-98	81.4	100.0	87.7	88.8
Mar-98	80.0	100.0	88.5	97.6
Apr-98	85.7	100.0	87.1	89.1
May-98	82.5	100.0	85.1	88.7
Jun-98	80.4	99.6	89.3	89.6
Jul-98	77.8	100.0	88.1	93.9
Aug-98	78.4	100.0	87.6	96.6
Sep-98	79.2	100.0	89.7	100.0
Average	80.4	100.0	87.8	93.0

09/12/98-08/27/99

	INBOUND		OUTBOUND	
	JETS	PROPS	JETS	PROPS
Sep-98	81.6	100.0	90.1	100.0
Oct-98	83.2	100.0	90.8	94.2
Nov-98	87.5	100.0	90.3	92.0
Dec-98	82.3	100.0	90.6	98.5
Jan-99	88.3	100.0	88.7	95.1
Feb-99	85.6	100.0	88.9	94.0
Mar-99	86.9	100.0	88.4	95.2
Apr-99	83.9	100.0	85.4	92.9
May-99	84.3	100.0	84.4	92.3
Jun-99	85.6	100.0	84.3	92.5
Jul-99	80.9	100.0	80.6	90.2
Aug-99	78.3	100.0	79.2	91.8
Average	84.0	100.0	86.8	94.1

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS PICKETT
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UPS/USPS-T19-6. Refer to the Postal Service's response to UPS/USPS-T1-17, redirected from witness Xie, regarding the Eagle and Western Networks.

(a)(i) Provide data on the maximum carrying capacity of the 727-100s used on the Eagle network. Provide this data both in terms of the cubic footage of cargo capacity available on these aircraft, and the maximum weight that they can carry.

(ii) Provide the average capacity utilization rate for this type of aircraft by accounting period for (a) FY1998, and (b) FY1999.

(b)(i) Provide data on the carrying capacity of the 727-200s used on the Eagle network. Provide this data both in terms of the cubic footage of cargo capacity available on these aircraft, and the maximum weight that they can carry.

(ii) Provide the average capacity utilization rate for this type of aircraft by accounting period for (a) FY1998, and (b) FY1999.

(c)(i) Provide data on the carrying capacity of the 727-200s used on the Western network. Provide this data both in terms of the cubic footage of cargo capacity available on these aircraft, and the maximum weight that they can carry.

(ii) Provide the average capacity utilization rate for this type of aircraft by accounting period for (a) FY1998, and (b) FY1999.

(d)(i) Provide data on the carrying capacity of the DC-9-30s used on the Western network during the period from May 27, 1997, through August 27, 1999. Provide this data both in terms of the cubic footage of cargo capacity available on these aircraft, and the maximum weight that they can carry.

(ii) Provide the average capacity utilization rate for this type of aircraft by accounting period for (a) FY1998 and (b) FY1999.

(e)(i) Provide data on the carrying capacity of the DC-9-15s used on the Western network during the period from May 27, 1997, through August 27, 1999. Provide this data both in terms of the cubic footage of cargo capacity available on these aircraft, and the maximum weight that they can carry.

(ii) Provide the average capacity utilization rate for this type of aircraft by accounting period for (a) FY1998, and (b) FY1999.

(f)(i) Provide data on the carrying capacity of the Metro III that was used on the Western network during the period from May 27, 1997, through August 27, 1999. Provide this data both in terms of the cubic footage of cargo capacity available on these aircraft, and the maximum weight that they can carry.

(ii) Provide the average capacity utilization rate for this type of aircraft by accounting period for (a) FY1998, and (b) FY1999.

(g)(i) Provide data on the carrying capacity of the Beechcraft 1900 used on the Western network during the period from May 27, 1997, through August 27, 1999. Provide this data both in terms of the cubic footage of cargo capacity available on this aircraft, and the maximum weight that it can carry.

(ii) Provide the average capacity utilization rate for this type of aircraft by accounting period for (a) FY1998 and (b) FY1999.

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS PICKETT
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RESPONSE

The following responses are based on information provided to me by postal logistics experts.

(a)(i) The carrying capacity (by weight) of a Boeing 727-100 varies from day to day and night to night and is impacted by weather, distance flown, amount of fuel carried, FAA restrictions such as air worthiness directives, and distance to alternate landing stops. All of these factors constrain to various degrees the maximum load on any given flight. The cargo area of this aircraft is composed of the main body of the aircraft which holds eight A-2 containers and the belly of the aircraft which holds non-containerized mail. Each container has a capacity of 440 cubic feet of space. The container area has 3520 cubic feet available to containers and mail. With 890 cubic feet of belly space, the total cubic capacity is 4410 cubic feet. Certain 727-100s can accommodate an additional LD-11 container with a capacity of 230 cubic feet for a total capacity of 4640 cubic feet. Certain 727-100s can accommodate 9 A-2 containers for a total of capacity of 4850 cubic feet.

(ii) Because of the variances in the maximum carrying capacity, these data are not available.

(b)(i) The maximum carrying capacity by weight of a Boeing 727-200 varies from flight to flight for the same reasons given in response to part (i)

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS PICKETT
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above. Also, 727-200s come with two types of engines, referred to in the industry as light weight and heavy weight. The difference in lift capacity exceeds 10,000 pounds depending on which engine type is used. A 727-200 can carry 12 A-2 containers (5280 cubic feet) and has additional belly space (1525 cubic feet) for a total of 6805 cubic feet. Other 727-200s have space for 11 A2 containers (4840 cubic feet) and one A1 container (370 cubic feet) plus 1525 cubic feet in the belly for a total of 6735 cubic feet.

(ii) Because of the variances in the maximum carrying capacity, these data are not available.

(c)(i) The configuration and capacity of these aircraft is the same as those discussed in part (b).

(ii) Because of the variances in the maximum carrying capacity, these data are not available.

(d)(i) As with the aircraft discussed in parts (a)-(c) the carrying capacity of DC-9-15s varies from flight to flight. DC-9-15s have 2208 cubic feet of capacity in the container area and an additional 600 cubic feet of belly space for a total of 2808 cubic feet.

(ii) Because of the variances in the maximum carrying capacity, these data are not available.

(e)(i) As with the aircraft discussed in parts (a)-(d) the carrying capacity of DC-9-30s varies from flight to flight. DC-9-30s have 3148 cubic feet of capacity in

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS PICKETT
(USPS-T-19) TO INTERROGATORIES OF UNITED PARCEL SERVICE**

the container area and an additional 898 cubic feet of belly space, for a total of 4046 cubic feet.

(ii) Because of the variances in the maximum carrying capacity, these data are not available.

(f)(i) As with the aircraft discussed in parts (a)-(e) the carrying capacity of Metro III aircraft varies from flight to flight. Metros IIIs have 625 cubic feet of capacity.

(ii) Because of the variances in the maximum carrying capacity, these data are not available.

(g)(i) As with the aircraft discussed in parts (a)-(e) the carrying capacity Beechcraft 1900 aircraft varies from flight to flight. Beechcraft 1900 has 819 cubic feet of capacity.

(ii) Because of the variances in the maximum carrying capacity, these data are not available.

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UPS/USPS-T19-7. Refer to the Postal Service's response to UPS/USPS-T1-17, redirected from witness Xie, regarding the Eagle and Western networks.

(a) Explain why the Postal Service changed equipment for the Western Network to 727-200s.

(b) Confirm that the change on August 29, 1999, from the use of DC-9s on the Western Network to 727-200s provided a substantial increase in carrying capacity for that network. If confirmed, explain the reason for this expansion of capacity; if not confirmed, explain.

(c) Provide copies of any studies, memoranda, or correspondence relating to the decision to change equipment from DC-9s to 727-200s for the Western Network at this time.

RESPONSE

Postal logistics experts involved in the management of air network operations have provided me with the following information.

- (a) The Postal Service did not change the equipment to 727-200s; the winning contractor did. The Postal Service specified the type of equipment needed to meet the network requirements such as the type and number (8) of containers that was to be moved on the network. The aircraft used was the contractor's choice to meet the requirements of the Postal Service's solicitation.
- (b) Confirmed. The increase in capacity allowed for greater efficiencies. The old WNET primarily used the A-6 air container, which is usable only on DC9s. Continuing to use A-6's would have constrained the choice of aircraft for the new WNET. A-2 containers, used on the Eagle network, are compatible with most other jet cargo aircraft used in the industry; thus, increasing the supply of aircraft for

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS PICKETT
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bidders to choose from. The switch to the A-2 container allowed for ease of transfer of containers between aircraft, a standardization of container inventory and spare parts, a standardization with daytime network operations, and a wider selection of aircraft with a potential for lower aircraft cost.

A-2 containers are compatible with 727-100s, which are larger but competitively priced with DC9s. In fact, the Postal Service has received offers to provide cargo service with 727s that were cheaper than DC9s. This reflects the fact that the cargo industry favors 727s over DC9s.

The use of 727-200s was the result of the fact that this was the aircraft that the offerors had available. In the end, the Postal Service upgraded its WNET operation without incurring an increase in costs due to aircraft considerations.

The cost and capacity aircraft issue is not all that unusual. Witness Young testified to a similar relationship with regard to purchasing highway cubic capacity in Docket No. R97-1 (Docket No. R97-1, Vol. 35 at 18887).

- (c) The Postal Service did not decide to change to a 727-200. See response to parts (a) and (b) above. No such documents are available.
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**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS PICKETT
(USPS-T-19) TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T19-8. Provide the number of pieces, the number of pounds, the number of pound-miles, and the number of cubic foot-miles for BY1998 by accounting period for the total volume of mail carried on the Eagle Network.

RESPONSE

Piece counts and cubic feet are not available. The requested pound and pound-mile data are attached. Pound-miles reflect actual miles flown by the Eagle and WNET aircraft.

Attachment to Response to UPS/USPS-T19-8

EAGLE/WNET Pounds and Pound-miles by AP for BY1998

EAGLE	AP	Pounds	Route Pound-Miles
EAGLE	1	15,797,572	23,012,051,510
	2	16,290,610	24,395,792,093
	3	15,476,704	23,421,806,551
	4	13,067,489	20,047,239,062
	5	14,309,664	21,588,127,729
	6	15,942,890	23,884,000,851
	7	16,218,165	24,671,382,234
	8	16,641,692	25,369,381,677
	9	16,411,378	24,918,085,387
	10	15,664,349	23,563,842,671
	11	15,376,470	23,049,154,383
	12	15,815,112	23,707,518,547
	13	15,750,903	23,769,936,609
WNET	1	2,891,579	2,428,605,310
	2	3,001,774	2,470,215,425
	3	2,744,092	2,236,749,916
	4	2,792,738	2,389,360,188
	5	3,254,910	2,640,478,809
	6	3,266,932	2,730,292,295
	7	3,226,342	2,637,696,208
	8	3,274,509	2,722,276,953
	9	3,143,092	2,551,944,855
	10	3,230,843	2,715,228,108
	11	3,673,383	3,493,591,565
	12	3,937,851	3,564,988,498
	13	3,107,044	2,533,110,426

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UPS/USPS-T19-9. Provide the number of pieces, number of pounds, number of pound-miles, and number of cubic foot-miles for BY1998 by accounting period for the total volume of Express Mail carried on the Eagle Network.

RESPONSE

The requested data are not available.

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(USPS-T-19) TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T19-10. Provide the number of pieces, number of pounds, number of pound-miles, and number of cubic foot-miles for BY1998 by accounting period for the total volume of mail carried on the Western Network.

RESPONSE

Piece counts and cubic feet are not available. For pounds and pound miles, please see the attachment to the response to UPS/USPS-T19-8.

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(USPS-T-19) TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T19-11. Provide the number of pieces, number of pounds, number of pound-miles, and number of cubic foot-miles for BY1998 by accounting period for the total volume of Express Mail carried on the Western Network.

RESPONSE

The requested data are not available.

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(USPS-T-19) TO INTERROGATORIES OF UNITED PARCEL SERVICE

UPS/USPS-T19-12. Describe any circumstances in which a 727-100 or a 727-200 would reach maximum capacity in terms of weight before reaching maximum capacity in terms of volumetrics (cubic feet or other similar measure).

RESPONSE

I am informed that either plane could reach maximum weight under a variety of circumstances. On any particular flight the mail carried could be of sufficient density to cause the plane to meet its maximum weight capacity. Also, under certain climatic conditions, the effective lift capacity of a plane is reduced. This may occur because of a combination of topography and airport altitude such as at Denver. The need to carry additional fuel caused by uncontrollable events such as inclement weather, or expected delays in transit, or diversion to alternate landing sites reduces the lift capacity available for mail. FAA air worthiness directives reduce the potential lift capacity of certain aircraft, because of structural concerns regarding conversion of these aircraft from passenger use to cargo use. Also, the 727-200s with light-weight engines have considerably less lift capacity than those with heavy-weight engines.

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS PICKETT
(USPS-T-19) TO INTERROGATORIES OF UNITED PARCEL SERVICE

UPS/USPS-TI9-13. Describe any circumstances in which a 727-100 or a 727-200 would reach maximum capacity in terms of volumetrics (cubic feet or other similar measure) before reaching maximum capacity in terms of weight.

RESPONSE

I am informed that one reason for flights to "cube out" is that the overall load on a particular flight is less dense than normal. This can occur with particular mailings that have low weight per cubic foot or are oddly shaped. Most of the mail on the Eagle and Western networks is containerized. This facilitates the handling of the containers at the outstation airports and the hubs. If unexpected fluctuations occur in the volume of mail to or from certain cities, the containers may not be filled to capacity. This may occur when mail is delayed arriving at a originating facility. Eagle flights originating on the West Coast leave earlier than other flights, creating tighter dispatch deadlines. Also, FAA air worthiness directives can cause some positions on some cargo aircraft to be underutilized or unutilized.

1 MR. McKEEVER: Thank you, Mr. Chairman.

2 CHAIRMAN GLEIMAN: Is there any other additional
3 designated written cross-examination?

4 [No response.]

5 CHAIRMAN GLEIMAN: If not, then, Ms. Duchek, you
6 have some Category 2 Library References.

7 MS. DUCHEK: Yes, I do, Mr. Chairman. The
8 following Library References are associated with Mr.
9 Pickett's testimony, Library Reference 55, 56, 57, 58, 59,
10 60 and 61, and I ask that they be entered into evidence.

11 CHAIRMAN GLEIMAN: Without objection, they will be
12 entered into evidence, but not transcribed into the record.

13 [Library References 55, 56, 57, 58,
14 59, 60 and 61 were received into
15 evidence.]

16 CHAIRMAN GLEIMAN: No participant has asked for
17 written cross-examination. I saw you come up there with all
18 your materials, I thought you might be a bit over-prepared.
19 Or maybe it is better to hedge your bets, and it works out
20 the right way.

21 No one asked ahead of time, does anybody in the
22 room today wish to step forward for oral cross?

23 [No response.]

24 CHAIRMAN GLEIMAN: It doesn't appear as though
25 anyone wants to cross.

1 Are there questions from the bench? Ladies and
2 gentlemen? Ladies? No.

3 [No response.]

4 CHAIRMAN GLEIMAN: If there are no questions from
5 the bench and there was no oral cross from anyone else, I
6 don't think you get a shot at doing any redirect this time.
7 We can take another 10 minute break if you would like, or we
8 can move right along.

9 As it turns out, Mr. Pickett, that completes your
10 testimony here today. We appreciate your appearance and
11 your contributions to the record. We thank you and you are
12 excused. And if you can figure out the formula for how you
13 do this and let some of your colleagues know about it, the
14 hearings will go much faster.

15 THE WITNESS: I will work on it.

16 CHAIRMAN GLEIMAN: Thank you.

17 THE WITNESS: Thank you, Mr. Chairman.

18 [Witness excused.]

19 CHAIRMAN GLEIMAN: Three down and one to go.
20 Whenever you are ready.

21 MS. DUCHEK: The Postal Service calls Karen
22 Meehan.

23 Whereupon,

24 KAREN MEEHAN,
25 a witness, having been called for examination, and, having

1 been first duly sworn, was examined and testified as
2 follows:

3 CHAIRMAN GLEIMAN: Ms. Duchek?

4 MS. DUCHEK: Thank you.

5 DIRECT EXAMINATION

6 BY MS. DUCHEK:

7 Q Ms. Meehan, I've handed you two copies of a
8 document entitled Direct Testimony of Karen Meehan on Behalf
9 of United States Postal Service, designated as USPS T-11.

10 Are you familiar with those documents?

11 A Yes.

12 Q Was that document prepared by you or under your
13 supervision?

14 A Yes.

15 Q Does it contain your errata of March 21, 2000?

16 A Yes.

17 Q And if you were to testify orally today, would
18 this still be your testimony?

19 A Yes.

20 MS. DUCHEK: Mr. Chairman, I'm going to hand the
21 Reporter two copies of the Direct Testimony of Karen Meehan
22 on Behalf of United States Postal Service, designated as
23 USPS T-11, and I ask that it be entered into evidence.

24 CHAIRMAN GLEIMAN: Is there any objection?

25 [No response.]

1 CHAIRMAN GLEIMAN: Hearing none, I'll direct
2 counsel to provide the two copies to the Reporter, and as is
3 our practice, they'll be entered into evidence, but not
4 transcribed into the record.

5 [Direct Testimony of Karen Meehan,
6 USPS T-11 was received into
7 evidence.]

8 CHAIRMAN GLEIMAN: Let's try to do it in the real
9 order this time. Do you have any Category II Library
10 References that we need to deal with?

11 MS. DUCHEK: Yes, Mr. Chairman, I do. Associated
12 with Ms. Meehan's testimony are portions of Library
13 Reference 4, portions of Library Reference 5, portions of
14 Library Reference 6, portions of Library Reference 7,
15 portions of Library Reference 9, and all of Library
16 Reference 80. The portions are as specified in the Notice
17 of the United States Postal Service regarding sponsorship of
18 Category II Library References in response to Presiding
19 Officer's Ruling Number R2000-1, #13. I can specify those
20 portions, if it's necessary.

21 CHAIRMAN GLEIMAN: I think we've incorporated your
22 notice by reference just now, so that will suffice for our
23 purposes.

24 MS. DUCHEK: And I ask that those portions and the
25 entirety of the other Library Reference be entered into

1 evidence.

2 CHAIRMAN GLEIMAN: They will be entered into
3 evidence, but not transcribed into the record.

4 [Portions of Library References
5 Numbered 4, 5, 6, 7, and 9; and
6 complete Library Reference Number
7 80 were received into evidence.]

8 CHAIRMAN GLEIMAN: Ms. Meehan, have you had an
9 opportunity to examine the packet of Designated Written
10 Cross Examination that was made available earlier today?

11 THE WITNESS: Yes.

12 CHAIRMAN GLEIMAN: And if the question were asked
13 of you today, would your answers be the same?

14 THE WITNESS: Yes, but with one change.

15 CHAIRMAN GLEIMAN: And what is that?

16 THE WITNESS: In the response to APMU/USPS
17 T-11-6(a), there is a reference to page number 44-51, and it
18 should be 49 to 51.

19 CHAIRMAN GLEIMAN: Has that change been made in
20 the packet?

21 THE WITNESS: Yes.

22 CHAIRMAN GLEIMAN: All right, if that is the case,
23 then, if counsel would provide copies, two copies of the
24 designated written cross examination, as corrected, of
25 Witness Meehan, to the Reporter, the material will be

1 received into evidence and transcribed into the record.

2 [Designated Written Cross

3 Examination of Karen Meehan was

4 received into evidence and

5 transcribed into the record.]

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

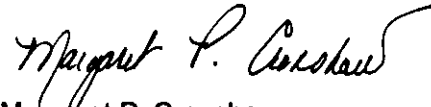
Postal Rate and Fee Changes, 2000

Docket No. R2000-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS KAREN MEEHAN
(USPS-T-11)

<u>Party</u>	<u>Interrogatories</u>
Advo, Inc.	ADVO/USPS-T11-1-2, 4-5
Association of American Publishers	AAP/USPS-T11-1-4
Association of Priority Mail Users, Inc.	APMU/USPS-T11-1-18
E-Stamp Corporation	PB/USPS-T11-7, 12a-b, 30
Newspaper Association of America	AAP/USPS-T11-2-3 ADVO/USPS-T11-1-2
Office of the Consumer Advocate	ADVO/USPS-T11-1 UPS/USPS-T11-4, 18
Pitney Bowes Inc.	PB/USPS-T11-4-8, 11, 12a-b, 13, 16-17, 19-23, 26-32 PB/USPS-T33-5 redirected to T11
United Parcel Service	ADVO/USPS-T11-1 PB/USPS-T11-6 UPS/USPS-T11-1-2, 4-5, 6b POIR No. 3, Questions 1-4 POIR No. 5, Question 6

Respectfully submitted,

A handwritten signature in black ink, reading "Margaret P. Crenshaw". The signature is written in a cursive style with a large, looping initial "M" and a long, sweeping underline.

Margaret P. Crenshaw
Secretary

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS KAREN MEEHAN (T-11)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory:

AAP/USPS-T11-1
AAP/USPS-T11-2
AAP/USPS-T11-3
AAP/USPS-T11-4
ADVO/USPS-T11-1
ADVO/USPS-T11-2
ADVO/USPS-T11-4
ADVO/USPS-T11-5
APMU/USPS-T11-1
APMU/USPS-T11-2
APMU/USPS-T11-3
APMU/USPS-T11-4
APMU/USPS-T11-5
APMU/USPS-T11-6
APMU/USPS-T11-7
APMU/USPS-T11-8
APMU/USPS-T11-9
APMU/USPS-T11-10
APMU/USPS-T11-11
APMU/USPS-T11-12
APMU/USPS-T11-13
APMU/USPS-T11-14
APMU/USPS-T11-15
APMU/USPS-T11-16
APMU/USPS-T11-17
APMU/USPS-T11-18
PB/USPS-T11-4
PB/USPS-T11-5
PB/USPS-T11-6
PB/USPS-T11-7
PB/USPS-T11-8
PB/USPS-T11-11
PB/USPS-T11-12a

Designating Parties:

AAP
AAP, NAA
AAP, NAA
AAP
Advo, NAA, OCA, UPS
Advo, NAA
Advo
Advo
APMU
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Pitney Bowes
Pitney Bowes, UPS
E-Stamp, Pitney Bowes
Pitney Bowes
Pitney Bowes
E-Stamp, Pitney Bowes

PB/USPS-T11-12b	E-Stamp, Pitney Bowes
PB/USPS-T11-13	Pitney Bowes
PB/USPS-T11-16	Pitney Bowes
PB/USPS-T11-17	Pitney Bowes
PB/USPS-T11-19	Pitney Bowes
PB/USPS-T11-20	Pitney Bowes
PB/USPS-T11-21	Pitney Bowes
PB/USPS-T11-22	Pitney Bowes
PB/USPS-T11-23	Pitney Bowes
PB/USPS-T11-26	Pitney Bowes
PB/USPS-T11-27	Pitney Bowes
PB/USPS-T11-28	Pitney Bowes
PB/USPS-T11-29	Pitney Bowes
PB/USPS-T11-30	E-Stamp, Pitney Bowes
PB/USPS-T11-31	Pitney Bowes
PB/USPS-T11-32	Pitney Bowes
PB/USPS-T33-5 redirected to T11	Pitney Bowes
UPS/USPS-T11-1	UPS
UPS/USPS-T11-2	UPS
UPS/USPS-T11-4	OCA, UPS
UPS/USPS-T11-5	UPS
UPS/USPS-T11-6b	UPS
UPS/USPS-T11-18	OCA

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Association of American Publishers**

AAP/USPS-T11-1 Page 1 to Exhibit USPS-11A of your testimony identifies C/S-3 Clerks and Mailhandlers costs (C/S-3 costs) for Bound Printed Matter (BPM) during Base Year 1998 in the amount of 134,482,000. In contrast, Appendix J of the PRC Opinion in Docket R97-1 estimates C/S-3 test year after rate costs (FY 1998) for BPM as 113,293,000. With respect to this comparison:

- (a) Please confirm that the proposed Base Year cost allocation of C/S-3 costs exceeds the PRC's estimate in R97-1 by 18.1%.
- (b) Please identify the factors, in order of importance, which contributed to the increase in base year 1998 C/S-3 costs allocated to BPM.

Response:

- (a) I confirm your amounts of \$134,482,000 and \$113,293,000, but I calculate the percentage change to be 18.7%, not 18.1%.
- (b) Although I do not know all possible causes, several factors that may have contributed to the difference between the PRC estimate and the actual C/S 3 costs are the following. Foremost, the PRC number is a projection based on 1996 data, while the Base Year amount in Exhibit USPS -11A uses actual 1998 data. Also, as my testimony points out, new studies were introduced that affected all classes of mail, including BPM. As stated on page 6 of my testimony, "Changes in mail processing variabilities and to the subclass distribution of volume-variable mail processing labor costs are presented by witnesses Bozzo, USPS-T-15, Degen, USPS-T-16, and Van-Ty-Smith, USPS-T-17." Please see the testimonies of witness Bozzo, Degen and Van-Ty-Smith for details on their work. Additionally, as my testimony points out on page 5, "the volumes used are the revised Revenue, Pieces and Weight

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Association of American Publishers**

(RPW) volumes, which are different from the FY98 volumes ... due to improvements in the RPW estimation. The revised RPW includes higher volumes and revenues for parcels. The RPW system and revised volumes are part of the testimonies of witnesses Pafford, USPS-T-4 and Hunter, USPS-T-5."

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Association of American Publishers**

AAP/USPS-T11-2 Page 27 to Exhibit USPS-11A of your testimony identifies C/S-7 City Delivery Carriers costs (C/S-7 costs) for BPM during Base Year 1998 in the amount of 57,550,000. In contrast, Appendix J of the PRC Opinion in Docket R97-1 estimates C/S-7 test year after rate costs (FY 1998) for BPM as 49,783,000. With respect to this comparison:

(a) Please confirm that the proposed Base Year cost allocation of C/S-7 costs exceeds the PRC's estimate in R97-1 by 15.6%.

(b) Please identify the factors, in order of importance, which contributed to the difference between the PRC estimate and the actual base year 1998 C/S-7 costs allocated to BPM.

Response:

(a) I confirm your amounts of \$57,550,000 and \$49,783,000, but I calculate the percentage change to be 15.5%, not 15.6%.

(b) Although I do not know all possible causes, several factors that may have contributed to the difference between the PRC estimate and the actual C/S 7 costs are the following. Foremost, the PRC number is a projection based on 1996 data, while the Base Year amount in Exhibit USPS -11A uses actual 1998 data. Also, as my testimony points out, new studies were introduced that affected all classes of mail, including BPM. As stated on page 7 of my testimony, witness Baron, USPS-T-12, presents modifications affecting Cost Segment 7, City Delivery, Street Activities. Please see the testimony of witness Baron for more details on his work. Additionally, as my testimony points out on page 5, "the volumes used are the revised Revenue, Pieces and Weight (RPW) volumes, which are different from the FY98 volumes ... due to improvements in

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Association of American Publishers**

the RPW estimation. The revised RPW includes higher volumes and revenues for parcels. The RPW system and revised volumes are part of the testimonies of witnesses Pafford, USPS-T-4 and Hunter, USPS-T-5."

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Association of American Publishers**

AAP/USPS-T11-3 Exhibit USPS-11A to your testimony at page 27 identifies C/S-7.3 City Delivery Carriers Elemental Load Street costs (C/S-7.3 costs) for BPM during Base Year 1998 in the amount of 22,082,000. In contrast, Appendix J of the PRC Opinion in Docket R97-1 estimates C/S-7.3 costs for BPM as 17,110,000. With respect to this comparison:

- (a) Please confirm that the proposed Base Year cost allocation of C/S-7 costs exceeds the PRC's estimate in R97-1 by 29%.
- (b) Please identify the factors, in order of importance, which contributed to the difference between the PRC estimate and actual 1998 C/S-7.3 costs allocated to BPM.

Response:

- (a) Confirmed.
- (b) Although I do not know all possible causes, several factors that may have contributed to the difference between the PRC estimate and the actual C/S 7.3 costs are the following. Foremost, the PRC number is a projection based on 1996 data, while the Base Year amount in Exhibit USPS -11A uses actual 1998 data. Also, as my testimony points out, new studies were introduced that affected all classes of mail, including BPM. As stated on page 7 of my testimony, witness Baron, USPS-T-12, presents modifications affecting Cost Segment 7, City Delivery, Street Activities. Please see the testimony of witness Baron for more details on his work. Additionally, as my testimony points out on page 5, "the volumes used are the revised Revenue, Pieces and Weight (RPW) volumes, which are different from the FY98 volumes ... due to improvements in the RPW estimation. The revised RPW includes higher volumes and revenues

**Response of United States Postal Service Witness Meehan
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Interrogatories of Association of American Publishers**

for parcels. The RPW system and revised volumes are part of the testimonies of witnesses Pafford, USPS-T-4 and Hunter, USPS-T-5."

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Association of American Publishers**

AAP/USPS-T11-4 Page 22 to Exhibit USPS-11A of your testimony identifies total C/S-3 costs during the base year as 17,646,123,000. With respect to this figure:

- (a) Please confirm that this figure corresponds to the total C/S-3 costs that appear on page 25 of USPS-T-17 at Table 1, part 2 of 2 (Testimony of Postal Service Witness Van-Ty-Smith).
- (b) -- Please confirm that the C/S-3 costs identified on page 22 of Exhibit USPS-11A as "other" costs are the same costs as those that result by summing the "pool volume variable" costs that are shown in Table 1 of USPS-T-17 and subtracting those pool volume variable costs from "pool total" costs on the same table. If this relationship cannot be confirmed, please explain fully what is meant by "other" costs on page 22 of Exhibit USPS-11A.
- (c) Please explain how each of the C/S-3 cost pools listed in Table 1 of USPS-T-17 correspond to the components of C/S-3 cost segments (such as Mail Processing (3.1), Window Service (3.2) and Administrative Clerks (3.3)) that appear on pages 19-22 of Exhibit USPS-11A. As part of your response, please indicate where each of the C/S-3 cost pools listed in Table 1 of USPS-T-17 is found within the C/S-3 cost segments that appear in Exhibit USPS-11A.

Response:

- (a) Confirmed.
- (b) Not confirmed. However, I do confirm that "other" is the difference between total accrued costs and volume variable costs. The information shown in the tables of USPS-T-17 are inputs into my cost segment 3, B workpapers and can be seen in my B workpapers in LR-I-80, file i_forms.xls, tab MODS-BASED and file CS03.xls, tab Inputs, lines 64 and 66. The relationship between witness Van-Ty-Smith's tables and Exhibit USPS-11A is that Witness Van-Ty-Smith's costs are inputs into my B workpapers, Cost Segment 3 spreadsheets.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Association of American Publishers**

(c) Table 1 data of witness Van-Ty-Smith can be seen in my B workpapers in LR-I-80, file i_forms.xls, tab MODS-BASED and file CS03.xls, tab Inputs, lines 64 and 66. The Cost Segment 3 workpapers show how the cost pools listed in Table 1 of USPS-T-17 correspond to the components of C/S-3 cost segments (such as Mail Processing (3.1), Window Service (3.2) and Administrative Clerks (3.3)) that appear on pages 19-22 of Exhibit USPS-11A.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of ADVO**

ADVO/USPS-T11-1. On your Workpaper B-7, please confirm that the following figures were not updated for Base Year 1998 but instead reflect Base Year 1996 results for City Carrier Letter Routes:

- (a) The Curbline and Foot Access Test (CAT/FAT) split factors.
- (b) The Possible Stops and Possible Deliveries (PPS/PPD) coverage variabilities.
- (c) The Stops Variability with Respect to Delivery Activities.
- (d) The Deviation Deliveries Variability with Respect to Pieces.
- (e) The Route Loops/Dismounts Variability with Respect to Volume.

Response:

- a) Confirmed. However, the correct CAT/FAT split factors, updated by witness Baron in Docket R97-1, USPS-LR-H-141, were mistakenly omitted from Workpaper B-7. If the correct split factors were applied to Base Year 1998 city carrier costs, total Base Year 1998 volume variable costs would increase by \$2.6 million.
- b) Confirmed, if by PPS/PPD you mean the Variabilities of Stops with Respect to Volume, and the Variabilities of Deliveries with Respect to Volume.
- c) Confirmed, if you mean the Delivery Stop Time variabilities that appear on W/S 7.0.5, lines 12-14.
- d) Confirmed.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of ADVO**

e) Confirmed.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of ADVO**

ADVO/USPS-T11-2. Please confirm the following Possible Stops coverages for Base Year 1996 and Base Year 1998. If you cannot, please provide the correct figures.

	<u>Base Year 1996</u>	<u>Base Year 1998</u>
Single Delivery Residential Stops	92.16%	92.94%
Multiple Delivery Residential Stops	96.09%	97.36%
Business And Mixed Stops	90.42%	89.92%

Response:

If by Possible Stops coverages you mean the ratio of actual to possible stops,
then your figures are confirmed.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of ADVO, Inc.**

ADVO/USPS-11-4. Please refer to your Base Year 1998 (USPS Version) Letter Carrier Route Worksheet 7.0.4.1. Please confirm that the following table accurately reflects the accrued cost factors shown in that worksheet for the following route types (note that "Foot" combines business, residential, and mixed foot routes). If you cannot confirm, please provide the correct figures.

	FOOT	BUS. MOT.	RES. CURB	RES. P&L	MIX CURB	MIX P&L
Load	49.35%	30.59%	47.64%	35.27%	35.61%	33.22%
Street Support	15.23%	16.77%	18.54%	17.79%	17.82%	12.81%
Driving Time	2.16%	27.94%	8.85%	11.23%	20.09%	18.59%
Route/Access (FAT)	32.51%	20.00%	9.30%	33.20%	20.34%	32.88%
Route/Access (CAT)	0.44%	4.70%	15.59%	2.22%	5.43%	2.27%
Collection	0.31%	0.00%	0.08%	0.29%	0.71%	0.23%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Response:

Confirmed.

Response of United States Postal Service Witness Meehan
to
Interrogatories of ADVO, Inc.

ADVO/USPS-T11-5. Please refer to the Base Year 1996 (USPS Version) Letter Carrier Route Worksheet 7.0.4.1 of USPS witness Alexandrovich, USPS-T-5, in Docket R97-1. Please confirm that the following table accurately reflects the accrued cost factors shown in that worksheet for the following route types (note that "Foot" combines business, residential, and mixed foot routes). If you cannot confirm, please provide the correct figures.

	FOOT	BUS. MOT.	RES. CURB	RES. P&L	MIX CURB	MIX P&L
Load	44.98%	15.69%	37.05%	19.78%	26.14%	24.53%
Street Support	13.32%	17.02%	13.88%	16.58%	18.23%	17.42%
Driving Time	1.93%	20.40%	6.43%	7.33%	7.95%	11.76%
Route/Access (FAT)	37.54%	38.40%	10.65%	49.43%	26.38%	38.73%
Route/Access (CAT)	1.46%	3.79%	31.51%	5.95%	17.04%	6.74%
Collection	0.76%	4.70%	0.38%	0.93%	2.26%	0.82%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Response:

Confirmed.

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

APMU/USPS-T11-1 With respect to the retroactive assessment for employee benefits of \$347 million noted on page 64 of the United States Postal Service 1998 Annual Report:

- a. Please confirm that this cost is included in your estimate of base year costs. If you do not confirm, please explain.
- b. Please identify the cost segment(s) and sub-segment(s) within which this cost is included.
- c. Please provide the key(s) (and workpaper references) used to distribute the retroactive assessment for employee benefits to products for cost segment and/or sub-segment.
- d. Please describe the methodology used (i) to determine how much of this expense was attributable and (ii) to distribute these costs to classes and subclasses in the base year, and the justification for using this methodology.

Response:

- (a) Redirected to witness Tayman.
- (b) The FY 1998 imputed interest is reflected in component 899, cost segment 20.
- (c) - (d) The cost is 100 percent institutional and thus is not distributed to products.

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

APMU/USPS-T11-2 With regard to the Postal Service's Civil Service Retirement System ("CSRS") current liability:

- a. Please confirm that the \$849 million cost that is reported on page 67 of the United States Postal Service 1998 Annual Report is the sum of sub-account 51212 costs across all labor cost segments and sub-segments. (USPS-LR-I-1, Table A-I, p. 10.) If you do not confirm, please explain and provide the dollar cost and appropriate sub-account numbers.
- b. Please confirm that account 51212 only accrues costs for employees hired before January 1, 1984. If you do not confirm, please explain and identify the latest date that a Postal Service employee could have been hired and have his retirement liability be accrued in this account.
- c. Please provide the distribution key for the total \$1,640 billion CSRS current liability costs to classes and subclasses. Please provide the calculations used to develop this distribution key.

Response:

- (a) Confirmed.
- (b) This is essentially correct. However, I am informed that the basic retirement cost of a rehired CSRS employee with a break in service would also be reflected in this account.
- (c) I believe the \$1,640 billion to which you refer is for FERS, and is actually 1,640 "million", not "billion". The expense for CSRS on page 67 of the 1998 Annual Report is \$849 million. CSRS current expenses are included in one account. However, the subaccounts from this account are included in all the personnel cost components. Therefore, there is no one single distribution

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

key. There is a distribution key for every personnel-related component in the model.

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

APMU/USPS-T11-3 With regard to the Postal Service's Federal Employees Retirement System ("FERS") current liability:

- a. Please confirm that the \$1,640 million cost that is reported on page 67 of the United States Postal Service 1998 Annual Report is the sum of sub-account 51211 and sub-account 51215 costs for all labor cost segments and sub-segments. (USPS-LR-I-1, Table A-I, p. 10.) If you do not confirm, please explain and provide the FERS current liability dollar costs and appropriate sub-account numbers for the base year.
- b. Please confirm that sub-account 51211 only accrues costs related to employees hired after December 31, 1983. If you do not confirm, please explain and identify the earliest date that new employees did not automatically participate in CSRS.
- c. Please confirm that sub-account 51215 only accrues costs related to employees hired before January 1, 1984 who voluntarily chose to join FERS. If you do not confirm, please explain.
- d. Please provide a distribution key for the total \$1,640 billion FERS current liability costs to classes and subclasses. Please provide the calculations used to develop this distribution key.

Response:

- (a) I am informed that this is correct.
- (b) I am informed that this is correct.
- (c) I am informed that this is correct.
- (d) I assume you meant to write "\$1,640 million" instead of "\$1,640 billion". With regard to the FERS current liability costs of \$1,640 million, they are handled in exactly the same way as CSRS current liability costs, as described in the response to APMU/USPS-T11-2(c).

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

APMU/USPS-T11-4 With regard to the Postal Service's current CSRS liability for employees in the Dual CSRS/Social Security system ("Dual System"):

- a. Please confirm that the \$36 million cost that is reported on page 67 of the United States Postal Service 1998 Annual Report is the sum of sub-account 51214 costs for all labor cost segments and sub-segments. If you do not confirm, please explain and provide the Dual System current liability dollar costs and appropriate sub-account numbers for the base year.
- b. Please confirm that sub-account 51214 only accrues costs related to employees hired between January 1, 1984 and January 1, 1987 who had prior government experience. If you do not confirm, please provide the correct dates and requirements for employees whose pension costs accrued within this account.
- c. Please provide a distribution key for the total \$36 million Dual System current liability costs to classes and subclasses. Please provide the calculations used to develop this distribution key.

Response:

- (a) I am informed that this is correct.
- (b) This is essentially correct. However, I am informed that account 51214 accrues costs for employees with prior government experience who were hired between January 1, 1984 and January 1, 1987. It also includes some employees who were hired after January 1, 1987, but whose previous government service time was back-counted from their actual hiring date to calculate an "official" hiring date falling within the Dual System range.
- (c) CSRS current liability costs for Dual System employees are handled in exactly the same way as CSRS current liability costs, as described in the response to APMU/USPS-T11-2(c).

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

APMU/USPS-T11-5 Please explain what "PESSA" costs are.

Response:

PESSA is an acronym for plant, equipment, servicewide, and selected administrative costs. Workpaper A-4, the "B Report", shows the distributed PESSA costs. These are treated as "Other Costs" in Workpaper A-2, the "A Report". They are distributed to "Volume Variable Costs" in the Workpaper A-4, the "B Report". The sum of the "A Report" and the redistributed "B Report" produces the "C Report", the Cost Segments and Component Report, my Exhibit USPS-11A. PESSA costs are shown on pages 69-75 of my Exhibit USPS-11A.

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

APMU/USPS-T11-6 Please identify the exhibit or workpaper and the page and column within the exhibit or workpaper where the calculations used to create the following distribution keys can be found:

- a. Component 526 - All salaries key plus other personnel costs from c/s 1-13, 16, 18, 19.
- b. Component 433 - All salaries key plus other personnel costs from c/s 1-13, 16, 18, 19. (Cost Component 433 is referenced on page 18.1 of your workpaper A-4.)

Response:

- (a) The steps involved in creating component 526 (all salaries plus other personnel costs key) are shown in LR-I-4, pp. 27-29. First, component 525 (all salaries key) is created by summing components 680, 801, 683, 639, 610, 684, 685, 1, 2, 3, 4, 7, 11, 13, 14, 15, 16, 17, 18, 25, 26, 30, 31, 32, 33, 674, 675, 676, 677, 678, 600, 601, 35, 40, 66, 421, 422, 423, 467, 468, 469, 470, 471, 41, 227, 42, 43, 45, 44, 46, 47, 48, 49, 50, 51, 52, 53, 54, 57, 58, 59, 69, 70, 74, 75, 79, 543, 545, 548, 82, 83, 84, 85, 86, 88, 89, and 194. Next, components 9, 29 and 228 are distributed on the newly created 525 key. Then, components 525, 9, 29, 228, 109, 110, 114, 173, 191, 192, 193, 195, 218, and 219 are summed to derive component 526. The same steps are repeated on pp. ⁴⁹44-51 of LR-I-4.

- (b) The steps involved in creating component 433 are shown on p. 52 of LR-I-4. First, the distribution key 431 is created by summing components 74, 79, 194, 427, and 430. Then, component 433 is created by summing the non-total class amounts from components 431 and 526. The "Other" amount in

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

component 433 is derived by subtracting the sum of the "Total Volume
Variable" amounts in components 431 and 526 from the 526 "Total Costs"
amount.

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

APMU/USPS-T11-7 a. Please confirm that distribution key 433 is used to distribute the cost sub-segment costs for cost components: 18.3.1, repriced annual leave; 18.3.1, holiday leave; 18.3.2, civil service retirement; 18.3.4, workers compensation; 18.3.5, unemployment compensation; 18.3.6, retiree health benefits; 18.3.7, annuitant life insurance; and 18.3.8, annuitant COLA/principal. If you do not confirm, please identify the correct distribution key.

b. Please provide a list of all cost segments and sub-segments for which distribution key 433 is used to attribute and distribute costs to classes and subclasses of mail.

Response:

(a) Confirmed.

(b) Distribution key 433 is used in component groupings 18.3.1, 18.3.2, 18.3.3, 18.3.4, 18.3.5, 18.3.6, 18.3.7, 18.3.8, and cost segment 20, component 1436.

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

APMU/USPS-T11-8 On page 18-8, in section 18.3.3 of USPS-LR-I-1, Summary Description of USPS Development of Costs By Segments and Components. Fiscal Year 1998, volume variable costs for certain personnel benefits are determined to be variable to the same degree as all Postal Service labor costs in base year 1988. For each of the following costs, please explain the rationale for this assumption:

- a. Accrued repriced annual leave and holiday leave adjustment costs;
- b. Current year CSRS unfunded liability costs;
- c. Prior year CSRS unfunded liability costs;
- d. Current year workers compensation costs;
- e. Unemployment compensation costs;
- f. Annuitant health benefit costs;
- g. Annuitant life insurance benefit costs; and
- h. Annuitant COLA costs.

Response:

- a. Accrued repriced annual leave and holiday leave adjustment costs in 18.3.1, are considered variable to the same degree as all postal labor costs. The rationale for this treatment is described in LR-I-1 on page 18-6, section 18.3.1.
- b. These costs, shown in cost segment 18.3.2, are considered volume variable to the same degree as all postal labor costs. The rationale for this treatment is discussed in LR-I-1 on pages 18-6 and 18-7 under Civil Service Retirement. On page 18-7, the current year CSRS unfunded liability cost is described as "the principal payment associated with the first installment due to general pay increases granted during the current year" which would imply they depend on pay raises in the current year and are variable with postal salaries.

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

- c. Ideally, the prior year CSRS unfunded liability costs would be divided into pools of dollars that reflected at least the year of retirement. The costs associated with each year could then be distributed on the total salary costs for the specific year of retirement and summed together to provide total distributed prior year CSRS unfunded liability costs. As a practical matter, this is not possible. Therefore, the best available distribution key is the current year all salaries key. Further, assuming that labor force attrition and postal hiring and resignation practices remain constant, as volume changes, so will total employment and, therefore, the number of potentially retired postal workers.
- d. Current year workers' compensation costs, shown in cost segment 18.3.4, are considered variable to the same degree as total postal labor costs. The rationale for this treatment is described in LR-I-1 on page 18-7, in the section titled, "Workers' Compensation".
- e. Unemployment compensation costs, shown in cost segment 18.3.5, are considered variable to the same degree as total postal labor costs. The rationale for this treatment is described in LR-I-1 on page 18-7 in the section titled, "Unemployment Compensation".
- f. Annuitant health benefit costs, shown in cost segment 18.3.6, are considered variable to the same degree as total postal labor costs. Ideally, annuitant health benefit costs would be divided into pools of dollars that reflected at least the year of retirement. The costs associated

Response of United States Postal Service Witness Meehan
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with each year could then be distributed on the total salary costs for the specific year of retirement and summed together to provide total distributed annuitant health benefit costs. As a practical matter, this is not possible. Therefore, the best available distribution key is the current year all salaries key. Further, assuming that labor force attrition and postal hiring and resignation practices remain constant, as volume changes, so will total employment and, therefore, the number of potentially retired postal workers receiving benefits. These costs are also discussed in LR-I-1 on pages 18-7 and 18-8 in the section titled "Annuitant Benefits".

- g. Annuitant life insurance benefit costs, shown in cost segment 18.3.7, are considered variable to the same degree as total postal labor costs. See the response to APMU/USPS-T11-8(f) above for rationale.
- h. Annuitant COLA costs, shown in cost segment 18.3.8, are considered variable to the same degree as total postal labor costs. See the response APMU/USPS-T11-8(f) above for rationale.

Response of United States Postal Service Witness Meehan
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Interrogatories of APMU

APMU/USPS-T11-9 For each of the following costs, please explain the rationale for the current methodology for distributing volume variable costs to classes and subclasses.

- a. Accrued repriced annual leave and holiday leave adjustment costs;
- b. Current year CSRS unfunded liability costs;
- c. Prior year CSRS unfunded liability costs;
- d. Current year workers compensation costs
- e. Unemployment compensation costs;
- f. Annuitant life insurance benefit costs; and
- g. Annuitant COLA costs.

Response:

Please see the response to APMU/USPS-T11-8.

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

APMU/USPS-T11-10 Please confirm that the accrued interest expenses of retirement costs found in accounts 58111 and 58114 are for liabilities accrued prior to the base year. If you do not confirm, please explain.

Response:

Confirmed for FY 1998 expenses.

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

APMU/USPS-T11-11 USPS-LR-I-1, Summary Description of USPS Development of Costs By Segments and Components, Fiscal Year 1998, indicates on page 20.5, section 20.5.3, that volume variable costs for retirement interest expenses are variable to the same degree as all Postal Service labor costs. Please explain the rationale for this assumption.

Response:

Please see the response to APMU/USPS-T11-8.

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

APMU/USPS-T11-12 Please explain how either changes in the total labor costs accrued in the base year or the mix of mail handled in the base year would affect the total interest costs found in accounts 58111 and 58114 in the base year.

Response:

Please see the response to APMU/USPS-T11-8.

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

APMU/USPS-T11-13 In USPS-LR-I-1, Summary Description of USPS Development of Costs By Segments and Components, Fiscal Year 1998, on page 18.8, section 18.3.1, annuity protection program costs are stated to be unrelated to volume. Does this statement indicate that these costs are unrelated to volume (i) in the base year only, or (ii) in any year? Please explain.

Response:

The statement to which you refer means that the costs are not treated as volume variable. As the FY 1998 Summary Description discusses FY 1998 costs and methods, the statement applies to FY 1998. However, in the base year 1998 CRA, these costs are also treated as nonvolume variable.

Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU

APMU/USPS-T11-14 a. Please explain why annuitant COLAs and annuitant health benefit costs are variable to the same degree as base year labor costs, when other costs such as annuity protection program costs are instead considered to be institutional.

b. Please provide all documents, reports and studies which you believe support your response to part "a" of this question.

Response:

(a) For the rationale of the treatment of annuitant COLAs and annuitant health benefit costs, please see my response to APMU/USPS-T11-8f. Although one could treat the annuity protection program similarly by treating it as variable with all labor, it has historically been treated as institutional. If the annuity protection program expenses were treated as volume variable, the \$8.6 million expense would be distributed over all labor and would likely have a small impact on volume variable costs.

(b) Library Reference I-1, pages 18-7 and 18-8 provides the support for my response.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU**

APMU/USPS-T11-15 Please refer to your workpaper A-4 at pages 17 through 18.1, and confirm that overtime pay costs are used to calculate Cost Component 433 - All salaries plus other personnel costs from cost segments 1-13, 16, 18, and 19. If you do confirm, please explain why they are included. If you do not confirm, please explain.

Response:

Confirmed. Overtime pay costs are part of salaries; therefore, it is proper to include them in the calculation of Component 433.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU**

APMU/USPS-T11-16 Please refer to your workpaper A-4 at pages 17 through 18.1, and confirm that the night differential costs are used to calculate Cost Component 433 - All salaries plus other personnel costs from cost segments 1-13, 16, 18, and 19. If you do confirm, please explain why they are included. If you do not confirm, please explain.

Response:

Confirmed. Night differential pay costs are part of salaries; therefore, it is proper to include them in the calculation of Component 433.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU**

APMU/USPS-T11-17 Please refer to your workpaper A-4 at pages 17 through 18.1, and confirm that holiday pay costs are used to calculate Cost Component 433 - All salary plus other personnel costs from cost segments 1-13, 16, 18, and 19. If you do confirm, please explain why they are included. If you do not confirm, please explain.

Response:

Confirmed. Holiday pay costs are part of salaries; therefore, it is proper to include them in the calculation of Component 433.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of APMU**

APMU/USPS-T11-18 Please refer to your workpaper A-4 at pages 17 through 18.1, and confirm that salary costs of non-bargaining unit employees are used to calculate Cost Component 433 - All salaries plus other personnel costs from cost segments 1-13, 16, 18, and 19. If you do confirm, please explain why they are included. If you do not confirm please explain.

Response:

Confirmed. Salaries of non-bargaining unit employees are part of salaries; therefore, it is proper to include them in the calculation of Component 433.

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-4 How many Amobile post offices@ (i.e. trucks selling stamps in urban areas) did the Postal Service operate in FY 1998?

a. Are the wages of clerks who operate mobile post offices charged to window service (cost segment 3.2)? If not, please explain the segment and component in which this expense is recorded.

Response:

I am told that there were 168 mobile self-powered post offices and 30 mobile post office trailers in FY 1998.

a. Yes. The employees who operate mobile post offices are postal employees, and they are charged to window service in cost segment 3.2.

Revised 3/21/00

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.**

PB/USPS-T11-5 During FY 1998, what were the total costs for (i) the Stamp Advisory Committee, (ii) artists who created stamp designs, and (iii) stamp distribution network personnel? In what cost segments are each of these respective costs recorded?

Response:

In FY 1998, the total cost for the Stamp Advisory Committee compensation was \$269,312. These costs are recorded in cost segments 15, 16, 18 and 20. The cost for the artists who create stamp designs was \$524,012, found in cost segments 16 and 18. Stamp distribution network personnel costs were \$13,012,831, which can be found in cost segment 18, in subaccount .150.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.**

PB/USPS-T11-6 During FY 1998, what was the total cost for operation of contract stations?

- a. What portion of the cost of contract stations was treated as (i) volume-variable, (ii) attributable, and (iii) incremental?
- b. In what cost segment are the costs for contract stations recorded?

Response:

The total cost in FY 1998 for contract stations was \$67,348,000.

- a. Contract station costs are institutional.
- b. Costs for contract stations are in cost segment 13, Miscellaneous Local Operations. A discussion of contract stations can be found in USPS-LR-I-1: Summary Description of USPS Development of Costs by Segments and Components, FY 1998.

Revised 3/21/00

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.**

PB/USPS-T11-7 How much did the Postal Service spend to print stamps in FY 1998?

- a. To what extent is the cost of printing stamps treated as (i) volume-variable, (ii) attributable, and (iii) incremental?
- b. How much did the Postal Service spend to print stamps in FY 1999?

Response:

For FY1998, the stamp printing costs were \$183,398,000 shown in Workpaper A-1, component 180, pages 71 and 72.

- a. Component 180 is fully volume variable, except for migratory bird stamps (\$231,000). Migratory bird stamp costs are institutional.
 - b. The stamp printing costs in FY 1999 were \$169,072,000.
-

Revised 3/21/00

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.**

PB/USPS-T11-8 In FY 1998, did the Postal Service use any outside contractor(s) to administer (i) stamps placed on consignment and sold through grocery stores and other retail outlets, or (ii) stamps by mail, or (iii) stamps by phone? If you answer affirmatively for any of the preceding, indicate the amount paid to any contractor(s) in FY 1998, along with the cost segment and account where such costs appear, and whether any portion of these expenses are treated as volume-variable, attributable, and incremental.

Response:

I am informed that the Postal Service used Amplex Corp. to manage the stamps on consignment program which encompasses stamps sold through grocery stores and other retail outlets. I am also informed that the Postal Service paid Amplex \$7,769,686 in FY 1998.

This cost is in Cost Segment 16, component 177, account 52359. Component 177 is 59.8 percent volume variable.

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-11 Please provide copies of all studies relating to (i) consumer habits or practices pertaining to the purchase of stamps and other window activities, or (ii) the time and effort involved in selling stamps at USPS counters, or (iii) efforts to reduce the Postal Service's cost of collecting revenues through the sale of stamps.

Response:

- (i) In Docket No. R97-1, LR-H-167 contains the results of a window service time study and econometric analysis. It includes transaction times for the purchase of stamps and window transactions. This is the only such study of which I am aware.
 - (ii) See the response to (i) above.
 - (iii) I am not aware of any studies relating to efforts to reduce the Postal Service's cost of collecting revenues through the sale of stamps.
-

Revised 3/21/00

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.**

PB/USPS-T11-12 For FY 1998, and for each of the different marketing channels which the USPS uses to sell stamps (e.g., counters, contract stations, vending machines, stamps-by-mail, consignment sales, etc.) please provide data showing the revenues collected from the sale of stamps for each channel which the Postal Service is able to identify separately.

- a. To the extent that costs are available for the different channels identified in response to preceding part a, please provide and indicate whether they are (i) volume variable, (ii) attributable, or institutional.**
- b. For all costs provided, also indicate whether (i) they are direct costs only, or (ii) all appropriate indirect and piggyback costs are included. If they are direct costs only, please indicate what the appropriate piggyback factor should be, if applicable.**

Response:

First part redirected to the Postal Service.

- a. Like revenue, costs are not available for all retail channels. The following is available. Counter service is what the Postal Service refers to as window service. My B workpapers, W/S 3.2.1 column 9 shows the cost of selling stamp at the window of \$759,673,000, of which 350,361,000 is volume variable (shown in W/S 3.2.1 column 11.) Exhibit A of my testimony, cost segment 13.1 shows contract station costs. These costs are \$67,348,000 and are institutional. I am told that vending personnel costs, including maintenance and supervisor costs, were \$54,245,804 in FY 1998, and are institutional. I am informed that the Stamps-by-mail program cost \$36 million.**

Revised 3/21/00

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.**

Consignment costs are shown in response to #8, as \$7,769,686. As stated in #8, component 177 is 59.8 percent volume variable.

- b. The counter or window service costs for selling stamps provided in part "a" is the direct cost. The piggyback factor for this is 1.45 (see Witness Smith, USPS-T-21, Attachment 10). There are two additional "piggyback" costs related to vending. The first is the cost for mileage driven of \$999,973, as provided by Retail. The second is the facility-related costs (e.g. rents, custodial, maintenance) for the space used by vending equipment. This cost is \$30,727,971 which is a product of the \$12.88 facility-related cost per square foot (see USPS-LR-I-77, page 404) and 2,385,971 square feet used for Self Service Postal Centers (as shown by witness Smith, USPS-T-21, Attachment 6.). See also the response to PB/USPS-T11-9 on vending depreciation costs. For contract stations and consignment, the costs provided are both direct and indirect.

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-13 Please provide all data used to develop the distribution key for cost segment 3.2, Window Services, shown at pp. 19-20 of USPS-11A.

- a. Page 20.1 of USPS-11A references Workpaper A-2, pages 35-36. Please explain how the data shown on these pages of Workpaper A-2 differ from, elaborate on, or provide additional detail and insight to the data shown at pp. 19-20 of USPS-11A, and explain the purpose of Workpaper A-2.

Response:

Please see witness Van-Ty-Smith's LR-I-106 Tables IV-1, IV-2, and IV-3 and my B workpaper cost segment 3.2 spreadsheets (i.e. 3.2.1, 3.2.2, 3.2.3, 3.2.4, 3.2.6, 3.2.7, and 3.2.8) for development of the distribution keys. Additionally, references to window service can be found on worksheet 3.0.1, column 3; worksheet 3.0.6; "OUTPUTS TO CRA" column 2; and "ENDNOTES" which are additional footnotes.

- a. The window service data shown in Exhibit USPS-11A and in Workpaper A-2 are identical because no further processing of these costs takes place once they are entered into the CRA model (see Workpaper A-1, pp. 15-16). The purpose of Workpaper A-2 is to show volume-variable costs exclusive of plant, equipment, servicewide, and selected administrative costs (PESSA costs).

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-16. Please refer to your response to PB/USPS-T11-12(a).

- a. Does the \$54,245,804 for vending personnel costs in FY 1998 include all personnel who service the machines? (Note: for this purpose, a service is defined as: replenish/refill items vended by the machine and/or collect revenue generated by the machine).
- b. Is the \$54,245,804 for direct personnel costs only, or does it include any applicable piggybacks?
- c. If piggybacks are not included, what is the applicable piggyback factor, and what does it cover?

Response:

- a. Yes, I am informed that this is the case.
- b. I am told that this figure, as reported by the Retail group, includes some applicable additional costs such as supervisor costs of \$4,359,664 and maintenance labor costs of \$5,424,580. This figure is a total personnel cost.
- c. Piggybacks for vending are discussed in my response to PB/USPS-T11-12(b). In addition to those listed in PB/USPS-T11-12(b), the Retail group also reported an additional \$41,700 of miscellaneous maintenance costs.

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-17. During Base Year 1998, how much did the Postal Service spend to operate its stamps-by-phone program?

- b. In what cost segment(s) were these costs recorded?
- c. Are these costs classified as volume variable?
- d. What was the amount of revenues generated by the stamps-by-phone program?

Response:

- a. Data are not collected separately for the stamps-by-phone program, so that amount is not available.
 - b. Since the data are not collected, I am not able to tell you in which cost segments the costs are recorded.
 - c. Since the data are not collected, I am not able to tell you if the costs are classified as volume variable.
 - d. Redirected to the Postal Service.
-

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-19. Please refer to your response to PB/USPS-T11-12(a).

- a. In what cost segment(s) does the Postal Service record the \$36,000,000 expense for stamps by mail?
- b. Please explain whether the Postal Service classifies the \$36,000,000 as a volume variable or institutional cost.

Response:

- a. The information is not available to break out the \$36,000,000 by cost segment, except for the \$1.3 million provided in PB/USPS-T11-10. See PB/USPS-1 for cost segment information on the \$1.3 million.
- b. Since the information cannot be broken out by cost segment, I cannot tell you if it is volume variable or institutional, other than that provided in PB/USPS-1.

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-20 Is the mailing cost to fulfill orders for stamps by mail (and any orders received via the internet) included in the \$36,000,000 expense for stamps by mail, or are any costs of registry and penalty mail in addition to the \$36,000,000?

- a. If such costs are not included in the \$36,000,000, what is your best estimate of mailing cost to fulfill stamp orders?
- b. In what cost segment(s) are such costs recorded?
- c. Are such costs classified as volume variable or institutional?

Response:

- a. I am told that the \$36 million includes an estimate of all mailing costs.
 - b. See the response to PB/USPS-T11-19(a).
 - c. See the response to PB/USPS-T11-19(b).
-

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-21. When distributing supplies of stamps and accountable paper to its retail outlets, does the Postal Service use Registered Mail?

- a. If so, what portion of the costs of registry should be charged for this internal use?
- b. Are such costs classified as volume variable or institutional?

Response:

Yes, I am told that this is the case.

- a. These Registry costs are charged to USPS Penalty Mail.
- b. These costs are classified as institutional.

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-22. When distributing supplies of stamps and accountable paper to its retail outlets, does the Postal Service use surface or air transportation?

- a. What is the cost for such transportation?
- b. In what cost segment is the cost for such transportation recorded?
- c. Is this transportation expense classified as volume variable or institutional?

Response:

I am told that when distributing supplies of stamps and accountable paper from the stamp distribution outlets to retail outlets, the supplies go out with the rest of the mail, which is carried on surface transportation, generally in trucks.

- a. The cost for this is not tracked separately typically, so the cost is not available.
- b. Since these costs typically are not tracked separately, I am not able to tell you in what cost segment the cost for such transportation is recorded, although generally, highway (i.e. truck) purchased transportation is recorded in Cost Segment 14.
- c. Since these costs are not tracked separately typically, I am not able to tell you whether the expenses are volume variable or institutional.

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-23. Please refer to your response to PB/USPS-T11-5.

- a. Are any of the costs provided in that response treated as volume variable?
- b. Has the Postal Service computed a piggyback factor for stamp distribution network personnel?

Response:

- a. Yes. Specifically, all stamp distribution network personnel costs are institutional.

As my revised response to PB/USPS-T11-5 reports, the cost for the artists who create stamp designs is not \$782,212, as stated in the original response, but is actually \$524,012. The amounts that are volume variable are below.

Account No.	Amount(\$)	Cost Segment/Component	Percentage Volume Variable
Artists			
52359	512,012	16/177	59.8
52327	12,000	18/210	0
Stamp Advisory Committee			
52101	83	16/177	59.8
52111	4,375	16/177	59.8
52174	539	16/179	0
52359	102,729	16/177	59.8
52419	2,210	16/177	59.8
52331	186	18/210	0
52454	4	18/211	0
56315	75,750	18/211	0
51401	478	18/191	0
56301	23,490	18/211	0
56805	57,596	18/211	0
56617	42	20/1437	0
52436	1,795	16/179	0
54165	35	15/168	0

Note: Component 168 = Utilities – Telephone Services

Component 1437 = Other Interest

Component 211 = Miscellaneous Expenses

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Component 210 = Supplies and Services

Component 191 = Total HQ and Field Service Unit Personnel Costs

Component 177 = Postal Supplies and Services

Component 179 = HQ Printing and Reproduction

b. No.

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-26. Please refer to your response to PB/USPS-T11-12, your statement that "W/S 3.2.1 column 9 shows the cost of selling stamp[s] at the window of \$759,673,000, of which 350,361,000 is volume variable . . ."

- a. Please explain how the Postal Service classifies the non-volume variable portion of the \$759,673,000 cost of selling stamps at windows? That is, how is the \$409,312,000 classified by the Postal Service?
- b. Please explain how the Commission classifies the non-volume variable portion of the \$759,673,000 cost of selling stamps at windows? That is, how is the \$409,312,000 classified by the PRC?

Response:

- a. It is classified as institutional.
- b. Redirected to the Postal Service.

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-27. We note that your work paper W/S 3.2.1 - Window Service VVC, on Page 3, under line 56, Stamps, Cards and Metered, contains:

Two lines (57 and 58) for Stamps, leading to Total stamps on line 59;

Two lines (60 and 61) for Cards, leading to Total cards on line 62 ; and

Three lines (63, 64, and 65) for Metered, leading to Total metered on line 66.

The first of these sets of lines, summed in column 9, produces the total cost of selling stamps at windows, which you cited in your response to PB/USPS-T11-12 (\$759,673,000). Please explain what constitutes and differentiates the data for stamps on lines 57 and 58, cards on lines 60 and 61 and metered on lines 63, 64, and 65.

Response:

Line 57 is the IOCS activity code, 5040, which is "At Window Serving a Customer – Selling Stamps.

Line 58 is the IOCS activity code, 6040, which is "Window Related Activity – Selling Stamps."

Line 60 is the IOCS activity code, 5050, which is "At Window Serving a Customer – Selling Cards."

Line 61 is the IOCS activity code, 6050, which is "Window-Related Activity – Selling Cards"

Line 63 is the IOCS activity code, 5070, which is "At Window Serving a Customer – Setting Meters"

Line 64 is the IOCS activity code, 6070, which is "Window-Related Activity – Setting Meters"

Line 65 is the IOCS activity code, 6073, which is "Window-Related Activity – Off-Site – Setting Meters."

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See LR-I-80, file CS03, tab Inputs, lines 123-129 and USPS-LR-I-1, Summary
Description of USPS Development of Costs by Segments and Components, FY1998,
Table B-2, pages B-18 and B-19 for the listing of activity codes and definitions.

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-28. How much did the Postal Service spend to print stamped envelopes in FY 1998?

- a. To what extent is the cost of printing stamped envelopes treated as (i) volume variable, (ii) attributable, and (iii) institutional?
- b. How much did the Postal Service spend to print stamped envelopes in FY 1999?
- c. Are any other costs associated with stamped envelopes? If so what are they (description/references) and how much was incurred in FY 1998?

Response:

As shown in Component 248, p. 72 of Workpaper A-1, the BY 1998 stamped envelope printing costs were \$9,123,000.

- a. Component 248 is totally volume variable.
- b. Stamped envelope printing costs were \$8,578,000 in FY 1999.
- c. Like any other envelope, stamped envelopes incur costs such as mail processing, transportation and delivery once they are mailed. Refer to Exhibit USPS-11A, pages 2, 4, 6, and 8, for other stamped envelope costs.

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-29. How much did the Postal Service spend to print stamped cards in FY 1998?

- a. To what extent is the cost of printing stamped cards treated as (i) volume variable, (ii) attributable, and (iii) institutional?
- b. How much did the Postal Service spend to print stamped cards in FY 1999?
- c. Are any other attributable costs associated with stamped cards? If so what are they (description/references) and how much was incurred in FY 1998?

Response:

As shown in Component 248, page 72 of Workpaper A-1, stamped card printing costs were \$3.2 million in BY 1998.

- a. Component 248 is totally volume variable.
 - b. In FY 1999, the stamped card printing costs were: \$3.2 million.
 - c. Like any other card, stamped cards incur costs such as mail processing, transportation and delivery once they are mailed.
-

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-30. During FY 1998 how much did the Postal Service spend on institutional costs associated with meters? In your response please address separately such costs as (i) on-site meter resetting and examinations, (ii) the meter approval process (iii) (RSE) personnel costs, (iv) any support contracting costs, such as Carnegie Mellon for security testing, or Planning Research Corp (PRC) for database consulting, or the Booz Allen contract with Merrifield. Should these contracts be no longer exist, please describe all such contracts which incurred expenses during the base FY 1998, and indicate the total amount of such expense.

Response:

Total costs incurred by the Postal Service in FY 1998 associated with meters are not available. The costs that are available, I am informed, represent costs incurred by Postage Technology Management (PTM), formerly known as Metering Technology Management, within Postal Service Headquarters. These costs totaled \$8.2 million in FY 1998. Other costs incurred by the Postal Service associated with meters include items such as time spent performing on-site meter resetting and examinations, Engineering personnel assisting in the meter evaluation and approval process, finance time in performing accounting functions such as entering meter installations and withdraws in MATS, costs associated with the acceptance and reconciliation of postage payment from meter customers, and costs associated with audits performed by the Inspection Service. The costs associated with these activities are not available, except those that witness Mayo provides for test year volume variable costs for on-site meter service, including meter access, meter resets and examinations, and meter check-in/outs, based on witness Davis' unit cost estimates. See USPS-LR-I-168, WP-32, at 4 and USPS-T-30, at 18.

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- (i) As noted above, the costs associated with on-site meter resetting and examinations are not available, except that test year special service costs are provided in USPS-LR-I-168, WP-32, at 4.
- (ii) I am informed that the costs associated with the meter approval process are included in the \$8.2 million in costs noted above except for the costs incurred relating to Engineering personnel that assist in the meter evaluation and approval process. These costs are not accounted for separately.
- (iii) I am informed that personnel costs relating to PTM of \$1 million are included in the \$8.2 million in costs noted above. As indicated above, other personnel costs are incurred by the Postal Service that are not available.
- (iv) I am informed that supporting contract costs incurred by the Postal Service, including amounts paid to Carnegie Mellon and Planning Research Corporation (PRC), are included in the \$8.2 million in costs noted above. The contract with Booz, Allen was managed by the Engineering group at Merrifield, as such these costs are not included in the \$8.2 million noted above. The costs relating to the Booz, Allen contract were \$789 thousand in FY 1998.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.**

PB/USPS-T11-31. Please identify all other institutional costs associated with meters and meter activity such as licensing, check in/check out and tracking. Examples of such programs include but are not necessarily limited to:

- (1) CMLS
- (2) MATS
- (3) any costs for IBIP
- (4) Also indicate the amount of fees paid by meter users

Response:

Except as noted in the response to PB/USPS-T11-30, costs associated with meters and meter activity are not available.

- (1) I am informed that costs associated with the operation of CMLS are included in the \$8.2 million noted in the response to PB/USPS-T11-30.
- (2) I am informed that costs associated with the operation of MATS are included in the \$8.2 million noted in the response to PB/USPS-T11-30, except for the finance time in performing accounting functions such as entering meter installations and withdraws into MATS
- (3) I am informed that costs associated with IBIP are included in the \$8.2 million noted in the response to PB/USPS-T11-30.
- (4) For information on the revenues for meters, please see the response of witness Mayo to PB/USPS-T33-4 to be filed on March 22, 2000.

Response of United States Postal Service Witness Meehan
to
Interrogatories of Pitney Bowes, Inc.

PB/USPS-T11-32. Please refer to your response to PB/USPS-T11-4.

- a. During Base Year 1998, what was the cost (including depreciation) for the 168 mobile self-powered post offices and 30 mobile post office trailers.
- b. In what cost segment(s) were these costs recorded?
- c. Are these costs classified as volume variable?

Response:

- a. I am informed that these costs are not tracked at the national level, so the costs are not available.
 - b. These costs are not tracked separately, however all postal depreciation is in Cost Segment 20.
 - c. Since these costs are not tracked separately, I cannot tell you if these costs are classified as volume variable.
-

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS MEEHAN
TO INTERROGATORY OF PITNEY BOWES
(Redirected from witness Fronk, USPS-T-33)**

PB/USPS-T33-5. For Fiscal Year 1998 please provide all Postal Service expenses incurred on account of its meter program, including but not limited to (i) the cost of check-in check-out, (ii) the cost of meter reset fees, (iii) any costs chargeable to the interest on advance deposits for CMRS accounts, and (iv) other (please specify).

RESPONSE:

Please see my response to interrogatory PB/USPS-T11-30.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of United Parcel Service**

UPS/USPS-T11-1. Refer to pages 3-9 of your testimony, where you discuss changes in the treatment of costs and the development of base year costs. Identify any instances in which the Postal Service has departed from the costing methods used by the Commission in Docket No. R97-1 that are not discussed in your testimony or in the testimony of any other Postal Service witness, describe the change, and explain why the change was made.

Response:

To the best of my knowledge, my testimony discusses, or has pointed to the witness who discusses, all changes in the treatment of costs between the Postal Service's Base Year 1996 CRA and the Postal Service's Base Year 1998 CRA.

If you are asking about the differences between the Postal Service's Base Year 1998 CRA and the Commission's Base Year 1998 cost model, it is my understanding that the Commission version of the base year model is provided in USPS-LR-I-130. It is also my understanding that a comparison of that library reference with my workpapers and exhibits will show all differences.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of United Parcel Service**

UPS/USPS-T11-2. For each change in costing method listed in response to UPS/USPS-T-11, explain all consequences of the change on Base Year 1998 costs as compared to the costs that would have resulted in the absence of the change.

Response:

Since, to the best of my knowledge, there are no changes between the Postal Service's Base Year 1996 CRA and the Postal Service's Base Year 1998 CRA that are not already discussed in my testimony (or others' testimonies), there are no consequences to explain.

If you are interested in the cost differences between the Postal Service's Base Year 1998 CRA and the Commission's Base Year 1998 model, it is my understanding that a comparison of the materials contained in USPS-LR-I-130 with my workpapers and exhibits will show all differences and the consequences of those differences.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of United Parcel Service**

UPS/USPS-T11-4. Refer to pages 8 of the Attachment to UPS/USPS-T11-4 which refers to the addition of Parcel post routes to handle packages and Priority mail in order to reduce the load on letter carriers.

- (a) Identify where the volumes carried on and the costs of these dedicated parcel routes are calculated in your workpapers.
- (b) Identify the data sources for information on the dedicated parcel routes.

Response:

- (a) As witness Kingsley responds in UPS/USPS-T10-6, the addition of parcel or priority routes is a local decision based on a variety of circumstances. She further states that the number of such routes is not tracked at the national level. However, in the In-Office Cost System, question 16B (USPS-LR-I-14, the F-45 p. 10-3) does record the route type for city carrier observations. This IOCS data underlies the costs for parcel combination and exclusive parcel routes that are shown in LR-I-80, workbook CS06&7.xls, Tab Input IOCS, line 7. The total accrued costs for these parcel route types were \$133,828,000, in BY 1998 shown in LR-I-80, CS06&7.xls, tab Input IOCS, line 7, columns 85 and 86.

Additionally, my B workpapers, W/S 7.0.5, contain an analysis of special purpose routes. These costs and methods were approved by the Commission in Docket No. R97-1 in the testimony of witness Nelson, USPS-T-19. This analysis has not been updated since that study.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of United Parcel Service**

(b) The data sources for LR-I-80, workbook CS06&7.xls, are identified in the rows or columns titled Data Sources. The contents of the data source titled "ALB107C1" can be seen in LR-I-80, i_forms.xls, tab CS07.1. Witness Nelson, USPS-T-19 in Docket No. R97-1, also includes workpapers with data sources that support his work for W/S 7.0.5. As mentioned in the response to subpart (a) above, LR-I-14 shows the route type data that are collected in IOCS. Additionally, LR-I-12 documents IOCS processing programs.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of United Parcel Service**

UPS/USPS-T11-5 Refer to witness Raymond's response to UPS/USPS-T13-5(d) which confirms that it is standard practice for a letter carrier on a park and loop route to deliver parcels only after all non-parcel mail is delivered on the loop (unless the carriers can take the parcels with them), and that the second trip around the loop is performed solely for parcels. Refer also to witness Raymond's response to UPS/USPS-T-13-5(b) which confirms that the Engineered Standards data collection instructions do not recognize that driving activities may be performed solely in support of a particular product or service or group of products or services. With those sources in mind, refer also to Table 3 on page 35 of witness Baron's testimony, USPS-T-12, which uses the Engineered Standards data to calculate new street-time percentages for each route type and activity, including driving time. Finally refer to USPS-LR-I-80, File Cs06&7.xls.

- (a) In your analyses of cost segment 6 and 7, provide by product or service all data related to instances where driving activities are performed solely in support of a particular product or service or group of products or services.
- (b) In USPS-LR-I-80, File Cs06&7.xls, Tab 7.0.4.1, you calculate driving time costs using driving time percentages contained in Table 3 on page 35 of witness Baron's testimony. After calculating the volume variable portion of driving time (or route time), you use distribution keys (unit is number of pieces) to distribute the route time variable costs to different classes of mail or groups of products or services in USPS-LR-I-80, File Cs06&7.xls, Tabs 7.0.6 and 7.0.9. Outside of this distribution of route time variable cost to different class of mail or products, do you consider driving activities that are performed solely in support of a particular product or service or group of products or services in any of your calculations? If so, do you assign the cost of these driving activities to the respective product or service or group of products or services? If not, why not?

Response:

- (a) Data relating to driving activities performed in support of particular mail products are shown in LR-I-80, File CS06&7, Tab 7.0.4.4, and in LR-I-80, i_forms, tab CS07 DK. This analysis was presented in Docket No. R97-1 in the testimony of witness Nelson, USPS-T-19, and accepted by the Commission in its Recommended Decision. The analysis has not been

**Response of United States Postal Service Witness Meehan
to
Interrogatories of United Parcel Service**

updated since that study. Witness Nelson, USPS-T-19 in Docket No. R97-1, also includes workpapers with data sources that support his work.

(b) Yes, and yes. See part (a) above. Also, the testimony of witness Nelson, USPS-T-19 in Docket No. R97-1 dealt with instances where specific mail products or services caused a dedicated delivery run for those services. In those instances, the calculation of the volume variable portion of driving time of the dedicated run is shown on LR-I-80, File CS06&7, tab 7.0.5, column D. The distribution keys for these mail product dedicated runs (i.e. individual delivery) for special purpose routes were presented in USPS-T-19 and accepted by the Commission in Docket No. R97-1 and have not been updated for this case; they are shown in LR-I-80, i_forms, tab CS07 DK, columns C and D.

Also, driving time costs on regular letter routes and special purpose routes are incremental (product specific) to Express Mail when driving for purposes of Express Mail facility drops and pick ups, as well as time to service Express Mail collection boxes. See LR-I-80, File CS06&7, W/S 7.0.4.4 for letter route detail and W/S 7.0.5 for special purpose routes.

**Response of United States Postal Service Witness Meehan
to
Interrogatories of United Parcel Service**

UPS/USPS-T11-6 Refer to USPS-LR-I-80, File Cs06&7.xls, Tabs Input LR and 7.0.4.1.

(a) Line 5 represents "Vehicle Use Factor."

- (i) What is the definition and source of the "Vehicle Use Factor"?**
- (ii) How is this factor used in your calculations?**

(b) Lines 6 and 8 both represent "Route/Access (FAT)." The two lines are not equal. Line 6 appears to be the sum of line 7, "driving time", and line 8.

- (i) Why do the lines both represent "Route/Access (FAT)"?**
- (ii) How is line 6 used in your calculations?**
- (iii) How is line 8 used in your calculations?**

Response:

(a) Redirected to the Postal Service.

(b) (i) Both lines do not represent "Route/Access (FAT)". Only line 8 does.

Line 6 is not used.

(ii) Line 6 is not used in my calculations.

(iii) Line 8 represents Route/Access (FAT). This is the percentage of city carrier street time, by letter route type, that is spent traversing the route (route time) and deviating from the course of the route to make deliveries (access time) on foot and park and loop routes. City carrier street costs by letter route type, shown on W/S 7.0.4.1, line 7, are multiplied by the Route/Access (FAT) percentages to arrive at costs for Route/Access (FAT). Costs for Route/Access (FAT) are shown on line 19 of W/S 7.0.4.1

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**Response of United States Postal Service Witness Meehan
to
Interrogatories of United Parcel Service**

UPS/USPS-T11-18. Refer to your Workpaper B, page 124 (WS 7.0.1, Summary of Cost Components), or the electronic version filed as Library Reference USPS-LR-I-80, file Cs06&7.xls, tab 7.0.1. In column 2, lines 30 and 31, Letter Route volume variable route and other costs are \$182,970,000, and Letter Route total route costs are \$2,095,146,000. In column 4, lines 30 and 31, Special Purpose Route ("SPR") volume variable route costs are \$0, and SPR total route costs are \$134,770,000.

Refer also to your Workpaper B, page 131 (WS 7.0.3, Letter & SPR Cost Summary), or USPS-LR-I-80, file Cs06&7.xls, tab 7.0.3. In column 21, line 54, total route costs (\$2,29,916,000) are calculated as the sum of total letter route costs (\$2,095,146,000) and total SPR route costs (\$134,770,000). The SPR route costs are derived from the SPR analysis, Workpaper B, page 147 (WS 7.0.5, Development of SPR Accrued and VVC by Function, or USPS-LR-I-80, file Cs06&7.xls, tab 7.0.5), which shows Route / Institutional Costs as \$134,770,000 at column 5, line 49.

- (a) Confirm that SPR volume variable route costs are \$0. If not confirmed, identify where the SPR volume variable route costs are calculated and provide total SPR volume variable route costs.
- (b) Identify the data sources used in the calculations of SPR volume variable route costs.
- (c) If the SPR volume variable route costs are zero, provide an explanation as to why this is the case. Provide any documentation, including reports or studies that support your explanation.
- (d) What other cost segments use the allocations from Cost Segments 6 and 7?

Response:

The figure that is cited for total SPR route costs (\$134,770,000) from my Workpaper B, page 147, (WS 7.0.5, Development of SPR Accrued and VVC by Function) at column 5, line 49 contains both route costs and other institutional costs. Route costs are \$84 million, derived from driving time costs only. To isolate SPR accrued route costs, do the following. Take driving time costs of \$181,813,000, (WS7.0.5 column 1 line 7) and subtract \$81,688,000 (WS 7.0.5

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**Response of United States Postal Service Witness Meehan
to
Interrogatories of United Parcel Service**

column 1, lines 31-33), which is the driving time cost for accrued access; and subtract \$16,054,000 (WS 7.0.5 column 1, line 30), relay costs, which are transferred to letter foot routes, leaving \$84,071,000 as accrued SPR route cost.

(a) Confirmed.

(b) There are no volume variable route costs.

(c) Please refer to USPS-LR-I-1, page 7-3, for a description of route time:

"Because route time corresponds generally to the time spent by the carrier traversing the course of the route without deviating to make stops, it may be visualized as the time required to cover the entire length of the Nation's city streets – a token of "readiness to serve" as distinct from the actual serving (which is represented by access time and load time).

Most of route time is therefore classified as Institutional. The only exception is driving time associated with routine looping/dismount and deviation delivery stops."

There are no routine looping/dismount and deviation delivery stops on special purpose routes. Therefore, all route time is institutional.

(d) USPS LR-I-80, file CS06&7.xls, tab 'Outputs to CS' shows that cost segments 2, 12, 13, and 20 use allocations from cost segments 6 and 7. In addition, cost segments 6 and 7 labor costs contribute to the allocations of selected cost components in cost segments 3, 11, 15, 16, and 18 that are distributed on postal labor.

Response of United States Postal Service Witness Meehan
to
Presiding Officer Information Request No. 3

POIR/USPS-1. Please confirm that the attachment includes all costs associated with the Emery Contract, and only those costs associated with the contract. If you do not confirm, please identify missing costs or costs that should be excluded from the attached spreadsheet.

Response:

Not confirmed. The attachment shows all costs associated with the unit at headquarters that oversees the Priority Mail Processing Centers, which includes most of the Emery contract costs plus additional headquarters' costs. In the attached spreadsheet, POIR No. 3, Attachment 1, the Emery contract costs are shown in account 52316.

This spreadsheet does not show an additional amount of \$20,350,623 spent on the Emery contract. This additional amount appears in LR-I-9 on page 122, under the dedicated account 52316.

Therefore, according to the LR-I-9, the Reconciliation of FY 1998 Statement of Revenue and Expenses to Audited Financial Statements and Reallocation of Expenses by Component, the total amount for the Emery contract alone was \$20,350,623 plus \$268,679,446 (both from account 52316), totaling \$289,030,069.

Attachment 1

Priority

Priority Mail Network		FY 1998 PQ 1	FY 1998 PQ 2	FY 1998 PQ 3	FY 1998 PQ 4	PFY 1998	
Personnel							
	191	827,684	827,684	827,684	1,103,579	3,588,630	
	191	604,656	351,957	358,817	354,352	1,669,782	
Subtot	191	1,432,340	1,179,641	1,186,501	1,457,930	5,258,413	CS 18
Non Personnel Accts							
54101	165	-	-	117,833	170,951	288,584	CS 15
54151	187	-	-	3,149	11,204	14,353	
54165	168	16,088	19,927	10,542	13,837	60,393	CS 15
54251	169	17,441	-	-	-	17,441	
52122	187	-	-	-	160,581	160,581	CS 16
52270	182	-	-	-	4,250	4,250	
52338	174	-	-	-	20,000	20,000	
52342	210	-	-	-	201,323	201,323	CS 18
53135	143	-	-	-	83,484	83,484	CS 14
53191	143	-	-	-	(4,550)	(4,550)	
53607	143	-	-	-	55,073	55,073	CS 14
52171	174	11,354	13,007	9,603	12,804	46,768	
52327	210	3,888	29,697	41,728	3,534	78,845	CS 18
52411	211	4,300	8,159	38,302	35,104	85,885	CS 18
54408	174	2,895	1,210	-	-	3,905	
54518	175	632	-	-	-	632	
52101	177	321	55,727	89,014	-	145,062	CS 16
52105	177	-	176,118	1,493	2,949	180,580	CS 16
52111	177	56,463	46,355	31,307	41,660	175,785	CS 16
52121	177	1,759	1,759	1,759	2,345	7,621	
52172	177	4,588	8,484	-	-	11,072	
52359	177	2,529,969	84,741,698	(64,641,438)	1,664,788	4,295,018	CS 16
52418	177	90	90	90	120	390	
52419	177	91	743	75	(85)	844	
54411	177	1,020	14,122	-	-	15,142	
52174	179	1,507	1,506	1,506	2,007	6,525	
52316	187	-	-	135,666,549	133,012,897	268,879,446	CS 16
52435	179	-	496	-	-	496	
52431	179	197	315	197	263	972	
52436	179	224	224	224	1,398	2,069	
52106	184	829,798	4,091,024	3,600,136	4,097,229	12,418,187	CS 16
52120	184	4,994	2,827	2,460	3,279	13,559	
52331	210	325	325	325	434	1,410	
52321	210	30,806	84,817	447,136	199,105	761,664	CS 18
52323	210	21,639	18,683	33,666	102,186	176,174	CS 18
56605	211	9,974	8,372	-	-	18,346	
52439	211	3,816	3,395	1,759	2,097	11,066	
52454	211	36	36	36	49	158	
56603	211	4,521	4,521	4,521	6,029	19,593	
56605	211	1,819	1,819	1,819	2,425	7,882	
56701	211	-	-	-	-	-	

Priority

Priority Mail Network		FY 1998 PQ 1	FY 1998 PQ 2	FY 1998 PQ 3	FY 1998 PQ 4	PFY 1998	
52914	213	90	90	90	120	390	
52363	220	17,367	17,367	17,367	23,157	75,259	CS 19
52367	220	35	35	35	47	153	
54330	232	12,882	12,221	11,883	9,789	46,355	
52326	210	78,485	135,760	120,312	120,777	455,334	CS 18
56817	1437	(326)	1,258	1,450	114	2,496	
Totals		4,901,027	70,679,828	76,801,010	141,520,703	293,902,567	

Allocation Summary

Cost Segment	Component	Amount
14	143	138,557
15	165	288,584
	168	60,393
Subtotal 15		348,977
16	177	4,796,427
	184	12,418,187
	187	268,840,006
Subtotal 16		286,054,620
18	191	5,256,413
	210	1,673,540
	211	85,865
Subtotal 18		7,015,818
19	211	75,259
Total Allocated		293,633,230
Total		293,902,567
Not allocated		269,337

Response of United States Postal Service Witness Meehan
to
Presiding Officer Information Request No. 3

POIR/USPS-2. Please provide a detailed description of the activities, services or supplies associated with each listed costs. For example, for account number 52316, please provide a description of the major types of activities involved, such as mail processing labor, supervision, transportation, facility related, equipment related, etc.

Response:

The F-8 which is filed in LR-I-183 gives a description of the activities, services and supplies associated with each segment. However, for convenience, here is a description of some of the largest line items.

Account 52316: This account is used to record Priority Mail Processing Center (PMPC) contract expenses, except for one time and miscellaneous costs and one-time security installation expenses, associated with the Priority Mail Processing Centers.

Account 52106 is used to record the cost of mail processing expendable equipment paid at information service centers, such as containers, trays, nutting trucks, hampers and other related items for mail processing operations.

Account 52359 is used to record the cost of miscellaneous contractual services.

Account 54101 is used to record payments to private lessors for postal space in buildings occupied under lease/rental agreements.

Response of United States Postal Service Witness Meehan
to
Presiding Officer Information Request No. 3

Account 52122 is used to record the expense for mail transport equipment (flat trays, tray lids, mail pouches, ERMCS) for use within the Priority Mail Processing Center (PMPC) network.

Also, what may be helpful is to understand where these accounts go in the CRA Cost Segment and Component report. The bottom half of the second page of POIR No. 3, Attachment 1, shows a summary of the accounts mapped into the CRA's cost segments and components. For example, the amount of \$288,584 maps into component 165, Rents, of Cost Segment 15, Building Occupancy. Page 1 shows that the amount of \$288,584 came from account 54101. The other listed components are 143, Domestic Highway Transportation; 165, Rents, 168, Communications/Phone Utilities; 177, Miscellaneous Supplies and Services; 184 Operating Equipment, Supplies and Services; 187 Expedited Mail Supplies; 191, Headquarters & Field Service Unit Personnel Costs; 210, Supplies and Professional Services; 211, Miscellaneous Expenses and 211 again, which is a typo. It should be 220, which is Training, Contract Support.

Please note that very small amounts on page 1 which do not have a cost segment notation in the last column are combined into the total at the bottom of page 2 of \$269,337.

Response of United States Postal Service Witness Meehan
to
Presiding Officer Information Request No. 3

POIR/USPS-3. For each row in the worksheet, please identify the costs that are treated as: (1) volume variable; (2) fixed but product specific to Priority mail for purposes of the incremental cost test; and (3) purely institutional.

Response:

For the easiest understanding, please refer to POIR No. 3, Attachment 1 at the bottom of page 2 called Allocation Summary. This summary shows all the accounts consolidated into the cost segments and components used by the CRA.

The amount of \$138,557 from Cost Segment 14, Transportation, was treated as follows: These costs were not assigned to Priority Mail using this spreadsheet because the expenses found within these types of transportation contracts are already available for sampling in TRACS or special studies.

The amount of \$288,584 from Cost Segment 15, Building Occupancy, was treated as follows: fixed but product specific to Priority Mail for purposes of the incremental cost test.

The amount of \$60,363 from Cost Segment 15, Building Occupancy, was treated as follows: fixed but product specific to Priority Mail for purposes of the incremental cost test.

The amount of \$4,796,427 from Cost Segment 16, Supplies and Services, was treated as follows: fixed but product specific to Priority Mail for purposes of the incremental cost test, except the amount from account 52359 of \$4,295,019.

**Response of United States Postal Service Witness Meehan
to
Presiding Officer Information Request No. 3**

This amount, which was incurred for contractors validating workload measures for the Emery contract, is 100% volume variable to Priority Mail.

The amount of \$12,418,187 from Cost Segment 16, Supplies and Services, was treated as follows: 100% volume variable to Priority Mail.

The amount of \$268,840,006 from Cost Segment 16, Supplies and Services, was treated as follows: 100% volume variable to Priority Mail.

The amount of \$5,256,413 from Cost Segment 18, Administration and Area Operations, was treated as follows: fixed but product specific to Priority Mail for purposes of the incremental cost test.

The amount of \$1,673,540 from Cost Segment 18, Administration and Area Operations, was treated as follows: fixed but product specific to Priority Mail for purposes of the incremental cost test.

The amount of \$85,865 from Cost Segment 18, Administration and Area Operations was treated as follows: fixed but product specific to Priority Mail for purposes of the incremental cost test.

The amount of \$75,259 from Cost Segment 19, General Management Systems, was treated as follows: fixed but product specific to Priority Mail for purposes of the incremental cost test.

Response of United States Postal Service Witness Meehan
to
Presiding Officer Information Request No. 3

POIR/USPS-4. (a) Please confirm that witness Meehan treats all costs that are direct contract payments to Emery as 100% volume variable. (b) Please explain the rationale for this treatment in contrast to the variabilities of less than 100% proposed for mail processing operations and the other corresponding categories of costs, such as transportation, facility, equipment and supervision incurred by the Service.

Response:

(a) Confirmed.

(b) The reason that the direct contract payments to Emery are treated as 100% volume variable is because I assumed that the Postal Service was charged under the contract on a constant per piece basis.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS MEEHAN TO
PRESIDING OFFICER'S INFORMATION REQUEST NO. 5, QUESTION 6**

6. In USPS-T-18 at page 15 witness Bradley states, "the Intra-SCF and Inter-SCF accounts no longer exist," however, in witness Meehan's W.S. 14.3 costs are recorded in these accounts. Please explain. Please also provide citations for the Inter-SCF and Intra-SCF variabilities used in these workpapers.

RESPONSE

The accounts in question were apparently not entirely removed from the accounting system and were used to record minimal proportions of accrued costs in the base year. In addition, it is clear from discussions with those involved in the roll out of the new accounts that the intention was to replace the old intra-SCF and inter-SCF accounts with the new 53600 series of accounts. These accounts are discussed in witness Bradley's testimony (USPS-T-18) at pages 14 through 19.

According to my transportation workpapers, of the \$780,882,000 in accrued costs in the intra-SCF cost pool for 1998, only \$543,000 (or 0.00069 of the cost) was booked to the old intra-SCF accounts (53121, 53122, and 53123). Of that amount, \$545,000 was from exceptional service accruals in account 53122. Of the \$451,826,000 in inter-SCF cost pool, \$2,707,000 (or 0.0060 of the cost) was booked to the inter-SCF accounts (53124, 53125, and 53126). Of this \$2.7 million, \$1,643,000 of this total was accrued in 53125, inter-SCF exceptional service.

There are four possible reasons for the appearance of costs in the old accounts: (1) One HCRID (number 79540) was still associated with the 53121 account in 1998; (2) Accruals were made to old contracts that no longer

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS MEEHAN TO
PRESIDING OFFICER'S INFORMATION REQUEST NO. 5, QUESTION 6**

appeared in the HCSS database and these old contracts continued to be associated with the old accounts; (3) Those requesting exceptional service (which is assigned by a paper-based accounting system) infrequently and erroneously used the old accounts; (4) Someone in the accounting process made data entry errors.

The variabilities for exceptional service (53122 and 53125) are 1.0000 as they have been in past cases. For accounts 53121 and 53123, a weighted average was taken of the variabilities for intra-PDC and intra-CSD variabilities shown in Table A1 on page 64 of witness Bradley's testimony. For accounts 53124 and 53126, a weighted average of the inter-PDC, inter-Cluster and inter-Area variabilities was used. See the attached table for the calculations.

**ATTACHMENT TO RESPONSE TO PRESIDING OFFICER'S INFORMATION REQUEST NO.
5, QUESTION 6**

	HCSS Total	Variability	Variable Total
Intra-PDC	\$ 562,008,573	0.680	\$ 382,165,830
Intra-CSD	\$ 146,350,711	0.390	\$ 57,076,777
Total Intra-SCF	\$ 708,359,284	0.620	\$ 439,242,607
Inter-PDC	\$ 60,809,657	0.841	\$ 51,140,922
Inter-Cluster	\$ 68,473,892	0.904	\$ 79,980,398
Inter Area	\$ 192,060,641	0.913	\$ 175,351,365
Total Inter-SCF	\$ 341,344,190	0.898	\$ 306,472,685
Source: Table A1, USPS-T-19, p. 64			
Variabilities in bold are used in witness Meehan's workpapers.			

1 CHAIRMAN GLEIMAN: Is there any additional written
2 cross examination?

3 [No response.]

4 CHAIRMAN GLEIMAN: If there is no additional
5 designated written cross examination, that will bring us up
6 to oral cross. Two parties have indicated that they wanted
7 to cross, the Association of Priority Mail Users, and United
8 Parcel Service. And I don't see anyone from APMU in the
9 room right now, so unless there is someone else who wishes
10 to cross, we'll go right to United Parcel Service.

11 Is there anyone else?

12 [No response.]

13 CHAIRMAN GLEIMAN: There doesn't appear to be.
14 Mr. McKeever, the ball is in your court.

15 MR. MCKEEVER: Thank you, Mr. Chairman.

16 CROSS EXAMINATION

17 BY MR. MCKEEVER:

18 Q Ms. Meehan, I'd like to ask you some questions
19 about city carrier street time costs, and in particular,
20 about your answers to Interrogatory UPS/USPS T-11-21.

21 A Twenty-one, okay.

22 Q All right, now, city delivery carriers serve
23 different types of routes; is that right?

24 A Yes.

25 Q And one of those is called special purpose routes?

1 A Yes.

2 Q Special purpose routes, in turn, consist of
3 different types of routes as well, is that correct?

4 A Yes.

5 Q And one of those is called exclusive parcel post
6 routes?

7 A I believe so.

8 Q Do you have Library Reference I-14 with you today?

9 A No, sir. What is that one?

10 Q You refer to it in your answer to 21(b).

11 A Right. I believe that's an IOCS?

12 Q Yes.

13 A Yes.

14 MR. McKEEVER: Mr. Chairman, with your permission,
15 I would like to present the witness with a copy of page 10-4
16 of Library Reference I-14, which is referenced in Ms.
17 Meehan's answer to UPS Interrogatory 21(b).

18 CHAIRMAN GLEIMAN: Please proceed.

19 BY MR. McKEEVER:

20 Q Now as you indicated in your interrogatory answer,
21 this page of Library Reference I-14 does indicate what
22 exclusive Parcel Post routes are, is that correct?

23 A Yes.

24 Q And the Library Reference says "Exclusive Parcel
25 Post is a regular route devoted entirely to Parcel Post

1 delivery" -- is that correct?

2 A That is what it says, yes.

3 Q And the base year 1998 total accrued costs of
4 exclusive Parcel Post routes was about \$37.4 million, I
5 believe? Go ahead --

6 A I was going to wait for you to give me a
7 reference.

8 Q Ask for a reference?

9 A Yes, sure.

10 Q Okay. Well, I can refer you to two things. One
11 is the question in Interrogatory 21 and that is 21(d), but
12 if you wanted to go back to the original source I do have
13 the Library Reference here, which is referred to in that
14 question, but can you confirm that as the question
15 indicates, that number was correct when you answered the
16 interrogatory?

17 A Yes.

18 Q Okay. Now that cost for exclusive Parcel Post
19 routes is not allocated in full to Parcel Post, is it?

20 A You are talking about the -- what is answered in
21 how the data collector would answer an IOCS?

22 Q No. I am asking when you did your base year work
23 did you allocate to Parcel Post and to Parcel Post alone the
24 \$37.4 million associated with exclusive Parcel Post routes?

25 A I believe, as my answer says, that it is not

1 available how much was assigned to the exclusive Parcel Post
2 route.

3 Q So the answer is you did not take that \$37.4
4 million and allocate it solely to Parcel Post, is that
5 correct?

6 A I guess the answer is how much was allocated is
7 not available.

8 Q And so therefore you didn't take that number and
9 allocate it exclusively to Parcel Post, is that correct?

10 A I don't know what the answer -- if you can tell if
11 all of it was allocated or not.

12 Q Okay. Isn't that cost treated together with all
13 of the other kinds of special purpose routes for purposes of
14 allocating those costs to the classes of mail?

15 A Say that one more time?

16 Q Yes. Isn't the cost of exclusive Parcel Post
17 routes like the other types of routes that are included in
18 special purpose routes treated together as a unit and
19 distributed to -- or allocated to the classes of mail in the
20 same way that special purpose routes as a whole is allocated
21 to the classes of mail?

22 A I am not sure if that is totally correct. I
23 believe the special purpose route analysis witness Nelson
24 did treat different elements of special purpose routes
25 differently.

1 Q But you are not sure then?

2 A Right.

3 Q Okay. Could you turn to your answer to

4 Interrogatory UPS/USPS-T11-23, please.

5 A Yes. Okay.

6 Q That deals with elemental load time, is that
7 correct?

8 A Yes.

9 Q And you distribute elemental load costs to the
10 various classes and subclasses of mail on the basis of
11 pieces as you indicate in your response to 23(a), is that
12 correct?

13 A Yes.

14 Q You don't use weight at all to spread those costs
15 among the different classes and subclasses of mail?

16 A Weight is not used.

17 Q Volume variable routine looping and dismount costs
18 are the only city carrier street time costs that are
19 distributed to the classes and subclasses using weight, is
20 that correct? That is in your answers to 22(a) and (c), I
21 think if you look --

22 A Right.

23 Q -- at those. Is that correct?

24 A I believe so. Let me check, if you don't mind.

25 Q Sure.

1 A That's correct.

2 Q Have you reviewed Ms. Daniel's testimony in this
3 case?

4 A No.

5 Q Not at all?

6 A No.

7 Q Are you aware that Ms. Daniel testified on page 8
8 of her testimony that, and I am quoting here, "flats and
9 parcels cost more to load than letters"?

10 A I did see you referenced that in the question.

11 Q Did you check it when you got the question?

12 A I did not go to read her testimony.

13 Q Are you aware that in her testimony on rate design
14 for Standard Mail A and First Class Mail presort Ms. Daniel
15 testified, and I am quoting here, "Costs for the elemental
16 load portion of street delivery costs are allocated on the
17 basis of weight within shape instead of on the basis of
18 pieces." That is the end of the quote.

19 Are you aware of that?

20 A Yes.

21 Q First Class mail weights from under one ounce to
22 up to 13 ounces now, is that correct?

23 A I believe so.

24 Q And Standard Mail A weighs up to but not more than
25 16 ounces?

1 A I believe that is the case.

2 Q Ms. Meehan, do you have your work papers with you?

3 A Yes, sir.

4 Q Could you turn to your Work Paper B and in
5 particular page 38?

6 A Page 38?

7 Q I believe it is 38. My copy is not 100 percent
8 clear but it is the one that contains Table 4 on it, and I
9 think it is 38.

10 A Oh -- I believe that is a different number. Let
11 me see.

12 Q Okay.

13 A Page 18 -- it looks like a 3 --

14 Q It is definitely a 3 on my copy. I wasn't sure of
15 the 8 part, but it doesn't make any difference. We are
16 talking, just to make sure we are clear, it is called Table
17 4, Revenue Pieces and Weight Adjustment System, Total
18 Pieces, Government Fiscal Year 1998.

19 Is that the page you are looking at?

20 A Yes, and at the top left it says Work Sheet 1.1.2.
21 Do you see that on the top left?

22 Q No, I'm sorry, my copy doesn't have that. Let's
23 ask you a few more questions to make sure we are looking at
24 the right page.

25 A Okay.

1 Q The first table on that page is Summary Category
2 Equals Standard A Domestic Mailing Fees. Is that correct?

3 A No.

4 Q No? Okay. Well, then regardless of what page it
5 is, let me hand you a copy of what I looking at.

6 A Okay, that's fine.

7 [Laughter.]

8 BY MR. McKEEVER:

9 Q I assure you I am told this is from your Work
10 Paper B.

11 A Okay.

12 [Pause.]

13 BY MR. McKEEVER:

14 Q Do you recognize that as being a page in your work
15 papers?

16 A Yes.

17 Q Okay.

18 A Yes.

19 Q Why don't you tell me what you have in your work
20 papers for that page?

21 A Page 77, down here at the bottom.

22 Q Okay, I do see that on my copy as well.

23 A Sorry -- okay.

24 Q Okay.

25 A There is also and RPW report on page 18, which is

1 the two page summary of this.

2 Q I see.

3 A That is what I thought you were referring to.

4 Q Okay. All right. Well, we are on the same page
5 now --

6 A Yes.

7 Q -- and I guess that is what counts. That does
8 deal, the page that I have given you now, does deal with the
9 RPW adjustment system, is that correct?

10 A Yes.

11 Q And the middle section on that page deals with
12 Parcel Post, is that correct?

13 A Yes.

14 Q If you look at the last number in the grand total
15 column of the Parcel Post section, that number is \$266.5,
16 rounded off, million, is that right?

17 A I think it is. If your copy is as bad as mine, it
18 is hard to read, but yes, I believe it is.

19 Q Okay. Now am I correct that shortly after Fiscal
20 Year 1998 ended that was the Postal Service's estimate of FY
21 1998 Parcel Post volume?

22 A The numbers that I used were the ones on the
23 two-page report, on page 17 of my B work papers. Do you
24 want me to check to see if those are the same?

25 Q Could you please?

1 A They are not the same.

2 Q What number do you show?

3 A 316148.

4 Q Okay. That is the Postal Service's --

5 A With 000.

6 Q I'm sorry?

7 A With three zeroes.

8 Q Okay. Now that is the Postal Service's official

9 estimate of Parcel Post pieces as presented in this case, is

10 that right?

11 A Yes.

12 Q Are you aware that at one point in time the Postal

13 Service had an estimate for Fiscal Year 1998 of Parcel Post

14 pieces of \$266.5 million?

15 A I don't have -- I mean I am not sure if this was

16 that number. I know that there were different numbers

17 besides this 316148.

18 Q Okay, now this page that I handed you is a page

19 from your work papers, I think you have confirmed, is that

20 right?

21 A Yes. It is an input to my work papers, yes.

22 Q Pardon me?

23 A An input to my work papers.

24 Q It is an input to your work papers.

25 A Right.

1 Q But you didn't use these numbers, is that correct?

2 A We don't use these numbers.

3 Q Okay.

4 A We use the ones on the two page report.

5 Q Okay. Why did you present these as part of your
6 work papers?

7 A I believe these may have historically been in
8 there and it may have been if these are not the same that
9 this was done earlier, these were put in earlier and just
10 were not updated when the new ones were put in.

11 Q Okay. Do you know if the 266.5 million piece
12 number was the Parcel Post estimate of pieces for FY 1998 as
13 derived solely from the domestic RPW system without the use
14 of any information from the bulk RPW system?

15 A I am not sure.

16 Q Let's take a look at the seventh column from the
17 left in the Parcel Post table, the one that is entitled Bulk
18 RPW System. Do you see that?

19 A Yes.

20 Q And that has all zeroes in it, is that correct?

21 A Yes.

22 Q And the third column, if I am reading the
23 abbreviations correctly, stands for Domestic Probability RPW
24 System, is that correct?

25 A Yes.

1 Q And that column, the one entitled "Domestic
2 Probability RPW System" actually has at the bottom a total
3 of about 284 million pieces, is that correct?

4 A Yes.

5 Q And moving to the column that is entitled
6 "Subtotal," which has a total of 284 million pieces, do you
7 see that?

8 A Yes.

9 Q Then next column over is entitled "Book Rev," I
10 take it that means "revenue," is that correct?

11 A Yes.

12 Q Book Revenue, Adjusted Total, do you see that?

13 A Yes.

14 Q Am I correct then that the subtotal of 284 million
15 in the column entitled "Subtotal" was reduced to 263 million
16 roughly by a book revenue adjustment?

17 A The 284 million was reduced to?

18 Q 262.9 or 263 million as shown in the total of the
19 Book Revenue, Adjusted Total column, is that correct?

20 A Oh, I see. I couldn't say for sure, but it seems
21 like a reasonable thing that you are saying.

22 Q But you are not really sure what that number
23 represents under the Book Revenue, Adjusted Total column?

24 A Right.

25 Q Okay. That 262.9 million number is increased by

1 3.4 million roughly to get up to the 266.5 million, is that
2 correct?

3 A That looks to be the case, yes.

4 MR. McKEEVER: Okay. That is all I have, Mr.
5 Chairman.

6 CHAIRMAN GLEIMAN: Is there any follow-up?
7 Questions from the bench?

8 [No response.]

9 CHAIRMAN GLEIMAN: Do you want some time for
10 redirect?

11 MS. DUCHEK: I think I could probably just
12 approach the witness for a minute, if that is all right.

13 CHAIRMAN GLEIMAN: Certainly. Sure. We will go
14 off the record for a minute.

15 [Recess.]

16 CHAIRMAN GLEIMAN: Ms. Duchek?

17 MS. DUCHEK: No redirect, Mr. Chairman.

18 CHAIRMAN GLEIMAN: If there is no redirect, then
19 Ms. Meehan, because that is the way I was going to pronounce
20 it, too, until other people pronounced it without the "h,"
21 that completes your testimony here today. We appreciate
22 your appearance and your contributions to the record. We
23 want to thank you, and you are excused.

24 THE WITNESS: Thank you.

25 [Witness excused.]

1 CHAIRMAN GLEIMAN: That concludes today's hearing.
2 We will reconvene tomorrow morning at 9:30. The Postal
3 Service witnesses up tomorrow are Witness Robinson, Smith
4 and Miller.

5 You all have a good afternoon and I hope you don't
6 have too much difficulty getting home.

7 [Whereupon, at 3:37 p.m., the hearing was
8 recessed, to reconvene at 9:30 a.m., Tuesday, April 18,
9 2000.]

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