

BEFORE THE
POSTAL RATE COMMISSION

RECEIVED

JUN 27 4 37 PM '00

POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

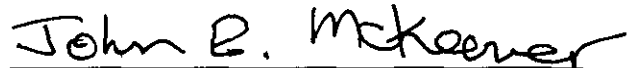
POSTAL RATE AND FEE CHANGES, 2000

DOCKET NO. R2000-1

ANSWERS OF UNITED PARCEL SERVICE WITNESS
DAVID E. M. SAPPINGTON TO INTERROGATORIES
OF PARCEL SHIPPERS ASSOCIATION
(PSA/UPS-T6-1 through 12)
(June 27, 2000)

Pursuant to the Commission's Rules of Practice, United Parcel Service hereby files and serves the answers of UPS witness David E. M. Sappington to the following interrogatories of Parcel Shippers Association: PSA/UPS-T6-1 through 12.

Respectfully submitted,



John E. McKee
William J. Pinamont
Phillip E. Wilson, Jr.
Attorneys for United Parcel Service

Piper Marbury Rudnick & Wolfe LLP
3400 Two Logan Square
18th & Arch Streets
Philadelphia, PA 19103-2762
(215) 656-3310
(215) 656-3301 (FAX)

and
1200 Nineteenth Street, NW
Washington, DC 20036-2430
(202) 861-3900

Of Counsel.

**ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T6-1

On page 40 of your testimony you state that Parcel Post's estimated attributable costs in the Test Year are 31% higher than in the Docket No. R97-1 Test Year (1998). If the Postal Rate Commission accepts the Postal Service's revenue and piece estimates for Parcel Post, rather than UPS', please confirm that the increase in Parcel post costs from the R97-1 Test Year to the current Test Year are substantially less than the 31% you cite.

Response to PSA/UPS-T6-1.

As a result of errata filed on June 22, 2000, the 31% figure you cite should now be 41%. (Parcel Post's attributable costs were \$685.9 million in the R97-1 Test Year; as indicated in Table 8 on page 19 of UPS witness Luciani's testimony (UPS-T-5), Parcel Post's attributable costs in the present Test Year are \$965.5 million when UPS's revenue and piece estimates are employed.) Under the Postal Service's proposals, Parcel Post's attributable costs using the Commission's costing methods are estimated to be \$1,082.0 in the R2000-1 test year.

**ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T6-2

On pages 40 and 41 of your testimony you state: "In contrast to the years immediately prior to the R97-1 rate case, Parcel Post volume and revenue have grown substantially in recent years, as Tables 7 and 8 show."

- (a) Please confirm that by "recent years" you mean FY 1997, 1998, and 1999.
- (b) Please confirm that FY 1997 and FY 1998 do not reflect any Parcel Post rate increases, and that FY 1999 reflects only a partial year effect of the R97-1 rate increase.
- (c) Please confirm that the volumes and revenues in your Tables for 1999 are based upon Postal Service methodology which United Parcel Service maintains is incorrect.
- (d) Please provide the United Parcel Service estimate of volume and revenue for FY 1999.
- (e) Please confirm that your statement on page 42, that "... Parcel Post volume and revenue continued to increase in 1999 even in the face of the average rate increase of more than 12% that was implemented on January 10, 1999," is predicated upon use of the Postal Service's proposed new methodology and not the United Parcel Service proposed methodology.

Response to PSA/UPS-T6-2.

- (a) Confirmed.
- (b) Confirmed.

ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION

- (c) Confirmed, as noted in the tables themselves. I did not have the information needed to present alternative figures for 1999, as I did for 1998.
- (d) I am not aware of any such estimate.
- (e) Confirmed that Parcel Post volume and revenue continued to increase in FY1999 as measured by the Postal Service's proposed new methodology. I do not have information on FY1999 Parcel Post volume and revenue as measured by the established methodology.

**ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T6-3

On page 42 of your testimony you refer to "The extremely low cost coverage Parcel Post has had in recent years. . . ."

(a) Please provide for the record your statement of these cost coverages for the years in question, and state whether they are predicated upon the Postal Service's new proposed methodology for revenue and pieces, or the United Parcel Service proposed methodology, and, furthermore, state whether the costs are based upon the Postal Service's attributable cost methodology or the PRC's cost methodology, which excludes the share of the Alaska air costs previously attributed by the Postal Service to Parcel Post.

(b) Please confirm that the FY 1998 Parcel Post revenue and attributable costs which you cite in page 43 for the Docket No. R97-1 rate case were based upon the Postal Service's old and now abandoned, revenue and piece methodology.

(c) Please confirm that the 1998 revenue and attributable costs you cite were also based upon the Postal Service's abandoned measurement methodology.

(d) Please confirm that the measurement of 1998 revenue and pieces for Parcel Post, using the Postal Service's new methodology, shows that revenues exceeded costs.

Response to PSA/UPS-T6-3.

(a) The "extremely low cost coverage" that I mention on page 42 of my testimony refers to the cost coverages that the Commission recommended for Parcel

ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION

Post in R94-1 and R97-1. The Commission recommended a 107.4% cost coverage for Parcel Post in R94-1, and a 108.0% cost coverage for Parcel Post in R97-1. Opinion and Recommended Decision, Docket No. R97-1, Appendix G, Schedule 3. These coverages are based on the Commission's cost methodology and on the Parcel Post RPW estimation methodology used in those cases.

(b) Confirmed, except that, as far as I am aware, the Docket No. R97-1 methodology has to date been "abandoned" only by the Postal Service in its present proposal to the Commission.

(c) Confirmed, except that, as far as I am aware, the Docket No. R97-1 methodology has to date been "abandoned" only by the Postal Service in its present proposal to the Commission.

(d) Confirmed.

**ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T6-4

On page 43 of your testimony you point out that the actual costs for Parcel Post, using historical measurement methodology, exceeded predicted costs for the Test Year, FY 1998, by more than 22%, and that costs exceeded revenues.

(a) Please confirm that the Postal Service's R97-1 Test Year projections for costs and revenues for Parcel Post assumed that the Parcel Post rate increases would be implemented during the course of the Test Year, FY 1998.

(b) Please confirm that no increases were implemented at any time during the Test Year.

(c) Please confirm that, while actual costs were 22% more than projected, actual revenues were also 11% more than projected, despite the fact that there were no rate increases implemented, as had been assumed.

Response to PSA/UPS-T6-4.

(a) Confirmed.

(b) Confirmed.

(c) Confirmed.

**ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T6-5

On page 43 you make the statement that “. . . with only two exceptions, Parcel Post revenues have fallen short of attributable costs in every year between FY 1989 and FY 1997.” As the source for your claim that Parcel Post revenues have fallen short of attributable costs in those years, you cite to the Postal Service’s CRA for Fiscal Years 1989-1998.

(a) Please confirm that for all of those years the Postal Service included in the attributable costs the share of the cost of air transportation of parcels in Alaska, costs that the Postal Rate Commission has consistently ruled not to be a cost that is attributable to Parcel Post.

(b) If Alaska air costs are subtracted from the Postal Service’s Parcel Post attributable costs in the CRA reports for the years cited, in which of those years did Parcel Post revenues fail to exceed attributable costs?

Response to PSA/UPS-T6-5.

(a) Confirmed that the Postal Service has allocated a greater share of Alaska air costs to Parcel Post than has the Commission.

(b) I do not have the data for 1989 to 1996 that allows me to make the suggested calculation. For 1997, a PRC version of the CRA is available and it indicates that the Parcel Post cost coverage is below 100%. That is also true for 1998.

**ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T6-6

On page 44 of your testimony, as support for your argument that Parcel Post now has a higher value of service, you cite the fact that average time for delivery has been less than four days on a fairly consistent basis since 1995. Please compare this asserted delivery performance with the delivery standards achieved by Parcel Post's principal competition, United Parcel Service.

Response to PSA/UPS-T6-6.

I do not know the delivery performance of UPS, and therefore I cannot perform the comparison that you request.

**ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T6-7

On page 45 of your testimony you say that arrangements such as the Postal Service has made with Airborne Express have made DDU Parcel Post a service that provides high value.

(a) Please explain why it is high value to the sender of the parcel when the sender has to incur the additional work and cost required to meet the DDU qualification requirements?

(b) You also allude to the fact that shippers now have the option of purchasing delivery confirmation as another feature that increases the value of Parcel Post Service. Since delivery confirmation is free to customers of United Parcel Service, the principal competitor to Parcel Post, please explain why it is a higher value of service to Parcel Post users that they can pay for a service that its competitor gives to its customers for free.

Response to PSA/UPS-T6-7.

(a) The Airborne@Home service promises that parcels will be delivered within three days. Three-day delivery is faster than Parcel Post has historically provided. The value that shippers derive from three-day delivery of their parcels may outweigh any costs associated with meeting DDU qualification requirements, especially since the sender may need only to tender the parcels to Airborne. In any event, this value must certainly outweigh the associated costs for shippers who purchase the Airborne@Home service.

ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION

(b) I doubt that any Postal Service competitor "gives to its customers for free" delivery confirmation service, or any other service feature. Rather, where there is no separate fee for such services (as in the case of the Postal Service's Priority Mail electronic delivery confirmation service), their cost is almost certainly reflected in the basic rate for the service. In any event, my point is that prior to March 14, 1999, Parcel Post shippers did not have the option to purchase Delivery Confirmation. They now have that option. An increased array of options associated with a service increases the value of the service to its customers. Thus, the value of Parcel Post service has increased compared to what it was before the added option was available, regardless of whether a competitor offers a similar service for an extra charge or includes the extra service in the base price.

ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION

PSA/UPS-T6-8.

On page 45 of your testimony you argue for higher coverage on the basis that the Postal Service's new methodology measures a substantial increase in Parcel Post volume.

(a) Is it not inconsistent for United Parcel Service to argue that the Postal Service's new measurement of parcel volume is incorrect and, at the same time, argue that the coverage for Parcel Post should be higher based upon this new methodology? Please explain any negative answer?

(b) You also state that the much higher volume revealed by the new measurement methodology "... should allay any concerns the Commission might have had in R97-1 that a sizeable increase in rates would reduce Parcel Post volumes to unacceptably low levels." If the PRC rejects the new USPS methodology and accepts the methodology proposed by UPS would that mean that PRC concerns about low volumes would not be allayed? Explain any negative answer.

(c) Please explain why the Commission should not be concerned that rate increases required to meet your recommended cost coverage, utilizing UPS' proposed attributions and measurement of systems, would cause a loss of Parcel Post volume of over 81 million parcels.

Response to PSA/UPS-T6-8.

(a) No. My testimony on page 45 at line 12 states that "*if* the new methodology [for measuring Parcel Post volume and revenue] accurately reflects Parcel

ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION

Post volume, the much higher volume it reveals should allay any concerns the Commission might have had in R97-1 that a sizeable increase in rates would reduce Parcel Post volumes to unacceptably low levels” (emphasis added). I see no inconsistency between this statement and the fact that UPS witness Sellick (in UPS-T-4) documents flaws in the Postal Service’s proposed methodology for measuring Parcel Post volume and revenue (as indicated in my testimony on page 45 at lines 11-12).

(b) No, not necessarily. If the Commission rejects the Postal Service’s new methodology for measuring Parcel Post volume and revenue, then the Commission would need to reassess the level of Parcel Post volume as it is estimated under the Commission’s preferred methodology. Note also that under the established methodology advocated by UPS witness Sellick (in UPS-T-4), Parcel Post volume increased by almost 13% and Parcel Post revenue increased by almost 7% in 1998. See Tables 7 and 8 on pages 41 and 42 of my testimony.

(c) The correct number is now 45.8 million parcels, not 81 million parcels. See Errata Filed by United Parcel Service to the Direct Testimony of UPS Witnesses Ralph L. Luciani (UPS-T-5) and David E. M. Sappington (UPS-T-6), UPS-Luciani-WP-3-1.1, filed June 22, 2000. In any event, in its consideration of the effect of a rate increase “upon the general public [and] business mail users” (39 U.S.C. §3622(b)(4)), the Commission will naturally consider a substantial reduction in volume that might arise from any recommended rate increase. However, the Commission must also fulfill “the requirement that each class of mail or type of mail service bear the direct and indirect

ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION

postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type" (39 U.S.C. §3622(b)(3)).

The 11% markup that I recommend reflects a balanced consideration of all of the criteria specified in 39 U.S.C. §3622(b).

**ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION**

PSA\UPS-T6-9

In your Table 7 you show Parcel Post volumes from 1990 through 1999. You say that Table shows that Parcel Post volumes have grown substantially in recent years which suggests". . . that Parcel Post can sustain a rate increase designed to ensure that its revenues exceed its attributable costs by a more healthy margin than the margin adopted in R97-1." (p. 40)

(a) How does the volume growth shown in your Table compare with the increase in the size of the ground parcel market during that decade?

(b) How does this growth in Parcel Post volume during that decade compare to the growth in ground parcel volume for United Parcel Service? Please document your response with data that describe the size of the ground parcel market and United Parcel Service's share of that market.

Response to PSA/UPS-T6-9.

(a)-(b) The only data that I have regarding volume growth in the ground parcel market during the 1990s is the data provided by Postal Service witness Tolley. In his testimony, witness Tolley reports that "Total ground parcel package shipments increased from just under 3 billion to 3.2 billion pieces, an increase of just under 8 percent." USPS-T-6, p. 158. In contrast, Parcel Post's volume increased from 165 million pieces in FY1992 to 267 million pieces in FY1998 (using the Postal Service's historic measurement methodology), as shown in Table 7 on page 41 of my testimony. This growth represents a 62% increase in Parcel Post volume. This substantial

ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION

increase is consistent with witness Tolley's observation that between 1992 and 1998,
"RPS and the Postal Service were able to expand their market shares" USPS-T-6,
p. 158.

ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION

PSA/UPS-T6-10

On page 3 of your testimony you discuss rate making Criterion 2, value of service. You cite elements of this criterion, such as the collection, mode of transportation and priority of delivery, and additional factors of speed and reliability and success in avoiding content damage.

(a) Please confirm that these standards are relative, that is, that they must be compared to something else in order to have meaning. Explain any negative answer.

(b) For Parcel Post please compare collection, mode of transportation, speed and reliability, the level of priority afforded in mail processing and transportation, and success in avoiding content damage with the same performance criteria of its competitor or competitors.

Response to PSA/UPS-T6-10.

(a) Confirmed, except that the comparison need not be measured relative to the value delivered by *another* service. One can conclude, for example, that if a specified delivery service increases the speed with which it delivers mail compared to what that same service formerly provided, then the value of that delivery service to its users has increased, *ceteris paribus*.

(b) I do not have data on the performance and internal operations of private competitors, so I am unable to provide the detailed comparisons that you request.

**ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T6-11

(a) On pages 4 and 5 of your testimony you discuss Criterion 4, the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters. You there say that: "High rates and large rate increases can be onerous for individual and business mailers alike, and so should be avoided whenever possible." Please rationalize this criterion with your proposed 31% increase in rates and the consequential loss of more than 81 million parcels because of the impact of your proposed rates on users.

(b) Elsewhere in that discussion of Criterion 4 on page 5 you make reference to the fact that low rates can unfairly disadvantage competitors. Is it your position that rates lower than you propose would unfairly disadvantage United Parcel Service as a competitive supplier of services? If the answer is in the affirmative, please supply the estimated loss of volume or revenue that would result from Parcel Post rates lower than you propose.

Response to PSA/UPS-T6-11.

(a) As indicated in Errata Filed by United Parcel Service to the Direct Testimony of UPS Witnesses Ralph L. Luciani (UPS-T-5) and David E. M. Sappington (UPS-T-6), UPS-T-6 page 39 and UPS-Luciani-WP-3-1.1, filed June 22, 2000, UPS's proposed Parcel Post rate increase is 24.9% and the associated volume change is 45.8 million pieces rather than 81 million pieces. In any event, as explained in my answer to

ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION

PSA/UPS-T6-8(c), the rate increase that I propose for Parcel Post reflects a balanced consideration of all of the criteria specified in § 3622(b) of the Postal Reorganization Act.

As I state on pages 4-5 of my testimony, one element of criterion 4 (§ 3622(b)(4)) suggests that large rate increases “should be avoided whenever possible” [emphasis added]. However, it is not always possible to avoid large rate increases. When the attributable costs of a service rise substantially and the cost coverage of the service is initially quite modest, rates must rise substantially in order to fulfill “the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type” (39 U.S.C. § 3622(b)(3)).

(b) When the rates for a service do not generate revenue sufficient to cover attributable costs and a reasonable share of institutional costs, those rates do not satisfy the requirement specified in 39 U.S.C. § 3622(b)(3), and in that sense unfairly disadvantage suppliers of competing services. I do not have an estimate of the loss of volume and revenue that United Parcel Service or any other supplier of substitute products will suffer if Parcel Post rates did not satisfy 39 U.S.C. § 3622(b)(3).

**ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON
TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T6-12

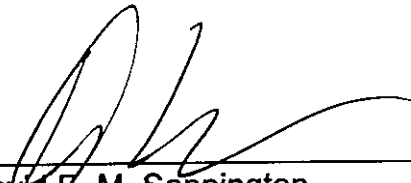
On page 6 in your discussion of Criterion 6, the degree of mail preparation, you state: "It is reasonable to pass on to a mailer some or all of the cost savings that accrue to the Postal Service because of mail preparation or transportation activities performed by the mailer." You further state: "An appropriate portion of the realized cost savings can be passed on in the form of rate discounts or more modest rate increases." Please provide your definition of what would be an "appropriate portion of the realized costs savings."

Response to PSA/UPS-T6-12.

I have not studied what is an appropriate passthrough of cost savings to mailers. Therefore, I cannot specify the particular level of passthrough that is most appropriate.

DECLARATION

I, David E. M. Sappington, hereby declare under penalty of perjury that the foregoing answers are true and correct to the best of my knowledge, information, and belief.



David E. M. Sappington

Dated: 6/27/00

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document by first class mail, postage prepaid, in accordance with Section 12 of the Commission's Rules of Practice.

John E. McKeever
John E. McKeever
Attorney for United Parcel Service

Dated: June 27, 2000
Philadelphia, Pa.