

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

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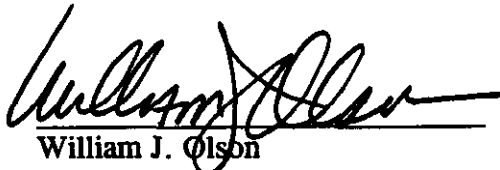
POSTAL RATE AND FEE CHANGES, 2000)

POSTAL RATE COMMISSION
DOCKET NO. R2000-1
OFFICE OF THE SECRETARY

RESPONSE OF VAL-PAK DIRECT MARKETING SYSTEMS, INC.,
VAL-PAK DEALERS' ASSOCIATION, INC., AND
CAROL WRIGHT PROMOTIONS, INC.
WITNESS JOHN HALDI TO INTERROGATORIES OF
UNITED STATES POSTAL SERVICE (USPS/VP-CW-T1-24-29)
(July 3, 2000)

Val-Pak Direct Marketing Systems, Inc., Val-Pak Dealers' Association, Inc., and Carol Wright Promotions, Inc. hereby submit responses of witness John Haldi to the following interrogatories of the United States Postal Service: USPS/VP-CW-T1-24-29, filed on June 19, 2000. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,



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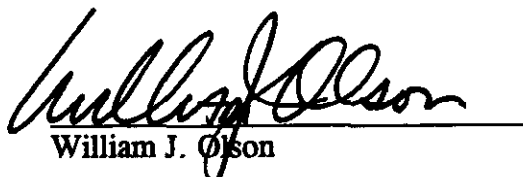
Val-Pak Direct Marketing Systems, Inc.,

Val-Pak Dealers' Association, Inc., and

Carol Wright Promotions, Inc.

CERTIFICATE OF SERVICE

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



William J. Olson

July 3, 2000

**Response of VP-CW Witness John Haldi to Interrogatory
of United States Postal Service**

USPS/VP-CW-T1-24.

- a. Please refer to page 2 of the A/P 8 Financial and Operating Statements (FOS) and confirm that the Postal Service is currently \$333.1 million below its planned net income through A/P 8 PFY 2000. Please also confirm that the A/P 9 FOS, which will be available by the deadline for answering this question, shows that the Postal Service incurred a loss of \$154 million in A/P 9 and the year-to-date plan shortfall grew to \$420.4. If you do not confirm, please explain.
- b. Please confirm that even if the Postal Service can reverse this trend of below plan results and achieve its plan for the remainder of the year, it will suffer a plan shortfall and incur a loss for FY 00, instead of the planned net income of \$100 million reflected in the response to ANM/USPS-T9-41. If you do not confirm, please explain.

Response:

- (a) Confirmed as to the FOS for A/P 8 and 9.
- (b) Confirmed if the Postal Service just achieves its plan, and no better, for the remainder of the year. I would note, however, that the Postal Service's Operating Plan for FY 2000, submitted in response to OCA/USPS-T9-27, is to incur substantial deficits during A/Ps 10-13, as shown below.

| A/P | Net Income (loss) |
|-------|-------------------|
| 10 | (\$217,474) |
| 11 | (\$237,506) |
| 12 | (\$280,979) |
| 13 | (\$348,015) |
| Total | (\$1,083,974) |

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The Postal Service's Operating Plan for FY 1999 was somewhat similar, and the FOS for A/P 13, page 4, indicates that in each of the A/Ps 10-13 the Postal Service did better than plan, with a cumulative improvement over plan of some \$344 million for those four A/Ps.

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USPS/VP-CW-T1-25.

Please refer page 33, lines 2 and 3, of your testimony, where you state that the Postal Service's capital investments in excess of depreciation should be funded through borrowing and "not through surpluses intentionally created by a deliberately excessive allowance for contingency."

- a. Is there some basis in fact for your allegation that surpluses were intentionally created to fund capital investments by deliberately inflating the contingency? If so please provide any factual support that the contingency has been deliberately inflated to fund capital investments.
- b. Please confirm that borrowing results in interest expense and adds to the cost of capital investments. If you do not confirm please explain.
- c. Please confirm that the cost of interest is borne by rate payers in the form of higher rates. If you do not confirm please explain.

Response:

- (a) At the end of FY 1993 the Postal Service's total debt subject to statutory limitation was \$9,923 million, and at the end of FY 1997 it was reduced to \$5,919 million (*see* ANM-T-1, Table 5, p. 32). During this 4-year period, the Postal Service thus reduced its debt subject to statutory limitation by \$4,004 million. During this same 4-year period, the Postal Service recorded gross capital investment of \$9,108 million, and net capital investment of \$3,969 million (net of amortization and depreciation of \$5,139 million); *see* ANM-T-1, Table 2, page 15. The Postal Service thus had net capital investment of \$3,969 million while concurrently reducing outstanding debt by \$4,004 million, for a combined total of \$7,973 million. The extent to which some of the \$7,973 million was funded by the allowance for

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contingency cannot be ascertained because the contingency becomes free cash flow which can be put to many different uses; see my response to USPS/VP-CW-T1-26(b).

- (b) Confirmed.
- (c) Not confirmed. Only if the Service were to waste the money it has borrowed would the cost of interest become a “burden” to be “borne” by the ratepayers, in the sense of an additional outlay that would not have occurred except for the borrowing. If the borrowing makes possible investments that exceed the cost of capital (which includes the interest), and most especially if the return on the investments exceeds the internal hurdle rate of 20 percent, the postal efficiency will increase and mail handling and delivery costs will decrease. Investments are amortized over the life of the investment. The revenue requirement in a Test Year includes both the amortization and the interest cost. If the annual savings exceeds this amount, then the likely effect will be to decrease the total revenue requirement facing ratepayers, including interest cost — **not** increase it.

On the contrary, if borrowing is avoided solely for the myopic purpose of reducing or eliminating interest costs, the result will be a progressive accumulation of inefficiencies that, over time, will impose enormous unnecessary costs on ratepayers, as can be observed today with the woeful

**Response of VP-CW Witness John Haldi to Interrogatory
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lack of flat sorting capacity, and shortages of space in P&DCs (overcome in part by annexes, with the inefficiencies and higher costs which they entail).

For much of the past decade, the Postal Service has delayed needed investments in automation and other efficiency improvements, not just in order to avoid borrowing but beyond that, to reduce debt and annual interest costs. This may have made the balance sheet appear less leveraged, but ratepayers today have to bear the high operating costs imposed by this policy that has put the Postal Service years behind the private sector.

**Response of VP-CW Witness John Haldi to Interrogatory
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USPS/VP-CW-T1-26.

Please refer to page 32, lines 16-19, where you state that "if the Postal Service's capital investment program were approaching the statutory cap with respect to its borrowing limit, and any shortfall in cash flow would operate to curtail that program, there could indeed be a reason for a significant contingency allowance."

- a. Is it your testimony that an appropriate use of the contingency is to fund capital investments when borrowing for capital investments is not an option? If your answer is other than yes, please reconcile your answer to your statement above.
- b. Please assume hypothetically that the Postal Service is projecting a test year before rates net income before including a RPYL and a contingency, has no available borrowing authority, and will generate insufficient cash to fully fund its capital investments. Under this scenario should the Postal Service add a contingency to create a test year net loss and then file for higher rates in order to fund its capital investments? Please explain your answer.

Is it your testimony that the Postal Reorganization Act permits the use of the contingency to fund capital investments? If your answer is other than no please provide the PRA cite supporting your position.

Response:

- (a) The point of my testimony is precisely that it is not appropriate to use an unreasonably high contingency allowance to create excess cash flow for the purpose of funding capital investments. It is, however, an entirely different matter to adjust the size of the contingency allowance to the risks, and the consequences of those risks, inherent in prevailing circumstances. Such risks have to be analyzed to distinguish two components. First is the statistical probability of a cash flow shortfall of any given size. Second is the impact of such a shortfall on the Service's operations. This impact can

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and will vary with, for example, depending on whether sufficient available borrowing authority is available to backstop a shortfall in operating cash flow and also undertake desirable and necessary investment programs.

When a statistical shortfall in cash flow has the potential of endangering the Service's investment program, which is an extraordinary risk that does not occur in years of ample borrowing authority, it is entirely appropriate to provide a somewhat larger contingency allowance than in years of lesser risk. The Postal Service has, however, not supported the extraordinarily large contingency allowance, included in the present docket, by any explicit analysis or justification.

- (b) Such a scenario has never happened, and it appears extremely unlikely, in view of the Service's extreme reluctance to invest in needed capital improvements. Under the unlikely hypothetical posited by the question, the Service is assumed (i) to be operating profitably and (ii) to have a backlog of profitable investments that would be made except for a projected shortfall in cash flow caused by the statutory borrowing limitation. Under these assumed circumstances, the Service first should ask Congress for increased borrowing authority. If that is denied, then it would have to weigh curtailment of the investment program against the desirability of a rate increase.

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The Postal Reorganization Act does not specify for what the contingency is to be used, or how it is to be used. It is generally regarded as additional revenue which is available to offset errors in forecasting, or for unforeseen unfavorable events. Suppose, however, that the forecast turns out to be accurate, and no unfavorable unforeseen events occur, or favorable events offset and outweigh whatever unfavorable events occurred. Then the additional revenue allowed for contingency will be recorded as "profit" in the Statement of Operations, and in the Statement of Cash Flows the additional revenue will represent free cash flow. I am not a lawyer, but it is my understanding that the Postal Reorganization Act does not require that the Service earmark any funds for contingency, or set up any kind of special reserve for contingency, nor to my knowledge has the Service ever done so. Moreover, I am not aware of any financial statement of the Postal Service that has ever shown any amount as being reserved for contingency. Any free cash flow that arises from the extra revenues allowed for contingency can be used (i) to pay down debt incurred for prior capital investment, (ii) fund operating deficits and extend the time between rate cases, (iii) fund current capital investment, (iv) add to working capital, or (v) be used for other purposes.

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USPS/VP-CW-T1-27.

Refer to your testimony on page 14 lines 18-20 where you state that "this clearly results in another serious mismatch, since costs of DAL-accompanied letter-shaped mail are systematically charged to letters, while revenues, pieces and weights are systematically charged to flats."

- a) In drawing this conclusion, did you consider analyzing the IOCS data files provided by witness Ramage?
- b) Would you adhere to your statement even if the data file provided by witness Ramage showed that in FY98 there are zero tallies where the shape in Field F9635 is a letter (IOCS Q22A) and the Field F135 is "Y" (indicating the employee is handling a DAL)? Please explain your response.

Response:

- (a) No.
- (b) See USPS/VP-CW-T1-2, which discusses cross-examination Exhibit VP-Moeller-XE-1 at Tr. 10/4137-38. As that cross-examination exhibit clearly demonstrates, DAL-accompanied letter-shaped mail exists, hence I have presumed that such pieces are "mailable" matter. At the same time, USPS-LR-I-14, Handbook F-45, makes no provision for recording DALs with such mail. At pages 12-10 and 12-11, under "Detached Address Card," it states that "Detached address cards are the cards that accompany **merchandise samples or flats** to be delivered by the carrier." (Emphasis added.) This statement makes no provision for a letter-shaped piece with an accompanying DAL.

**Response of VP-CW Witness John Haldi to Interrogatory
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USPS/VP-CW-T1-28.

Refer to your testimony on page 11 lines 6-11, where you state that:

[w]ithin Standard A Mail, Postal Service data systems systematically overstate the cost of letters while the cost of flats is correspondingly understated. This situation is caused by a mismatch between (i) the way the RPW system records revenue, volume and weight on the one hand and (ii) the way that the IOCS develops mail processing and city carrier in-office costs on the other.

- a) Confirm that your conclusion that letter costs are overstated assumes that the unit cost of Standard Mail A are based on RPW volumes.
- b) Confirm that the volumes used to calculate the unit cost of letters and flats are from PERMIT and not RPW (see response to interrogatory VPCW/USPS-2).

Response:

- (a) Confirmed that my testimony references RPW volumes in a number of places. Not confirmed with respect to the conclusion that the unit cost of "Letters" is overstated; see my response to USPS/VP-CW-T1-29.
- (b) Confirmed. Using PERMIT data to compute the unit cost for letters provides the unit cost of all letter-shaped pieces (which includes heavy weight letters), not the cost of letter-shaped pieces that weigh less than the breakpoint and pay the letter rate, *i.e.*, "Letters." In other words, when the unit cost is computed in this manner, it is not the appropriate unit cost for the rate category known as "Letters."

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USPS/VP-CW-T1-29.

Refer to your testimony at page 12 lines 12-13 where you state that "[f]rom a rate category perspective, the IOCS data are not correct." (Footnote omitted).

- a) Please confirm that the another [sic] way to account for the fact that some letter-shaped pieces actually pay the nonletter rate is by moving both the cost of letters greater than 3.0 or 3.5 ounces and the corresponding number of letter shaped pieces as recorded by PERMIT to the cost of nonletters.
- b) Assume for the purpose of this question that 3.5 ounces is a reasonable proxy for the breakpoint.
 - (i) Please confirm that the total cost of letter-shaped ECR pieces weighing more than 3.5 ounces is \$13,922 (in thousands) and the corresponding volumes for these pieces are 66,478,655 according to USPS LR-I-92, Section 2 pages 14-5 [sic]. If not confirmed please provide the correct numbers and the sources for these figures.
 - (ii) Please confirm that the total cost of flat-shaped ECR pieces is \$1,512,906 (in thousands) and the corresponding volumes for these pieces are 20,455,078,077 according to USPS LR-I-92, Section 2 pages 17-8 [sic]. If not confirmed, please provide the correct numbers and the sources for these figures.
 - (iii) If subparts (i) and (ii) are confirmed, please confirm that adding the cost of letters weighing more than 3.5 ounces (\$13,922) to the total cost of ECR flat-shaped mail (\$1,512,906) results in a cost of \$1,526,828 (in thousands). If subparts (i) and (ii) are not confirmed, please provide the above calculations with the numbers provided in subparts (i) and (ii).
 - (iv) Please confirm that adding the volume of letters weighing more than 3.5 ounces (66,478,655) to the total volume of ECR flat-shaped mail (20,455,078,077) results in a volume of 20,521,566,662. If subparts (i) and (ii) are not confirmed, please provide the above calculations with the numbers provided in subparts (i) and (ii).
 - (v) If subparts (iii) and (iv) are confirmed, please confirm that \$1,526,828 divided by 20,521,566,662 multiplied by 1000 is \$0.0744. If subparts (iii) and (iv) are not confirmed please calculate the quotient of the figures provided in subparts (iii) and (iv).
 - (vi) Please confirm that, according to Table 3 in USPS-T-29, [sic] the average ECR flat-shaped piece cost \$0.0740 and the average letter-shaped piece cost \$0.0685, for a difference of \$0.0054. If not confirmed, please explain.

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- (vii) Please confirm that, according to Table 3 in USPS-T-29, [sic] the average ECR letter-shaped piece weighing less than 3.5 ounces cost \$0.0678.
 - (viii) If subparts (v) and (vii) are confirmed, please confirm that the difference between the unit cost of letters weighing less than 3.5 ounces of \$0.0678 and the unit cost of flats which include the cost and volume of letters weighing more than 3.5 ounces as calculated in subpart d of \$0.0744 is \$0.0066. If subparts (v) and (vii) are not confirmed, please calculate the difference between the figures provided in subparts (vii) and (v).
 - (ix) If subparts (vi) and (viii) are confirmed, please confirm that the unit cost difference between \$0.0066 and \$0.0054 is \$0.0012. If subparts (vi) and (viii) are not confirmed please calculate the difference between the figures provided in subparts (viii) and (vi).
- c) Assume for the purpose of this question that 3.0 ounces is a reasonable proxy for the breakpoint.
- (i) Please confirm that the total cost of letter-shaped ECR pieces weighing more that [sic] 3.0 ounces is \$36,415 (in thousands) and the corresponding volumes for these pieces are 216,382,951 according to USPS LR-I-92, Section 2 pages 14-5 [sic]. If not confirmed please provide the correct numbers and the source for those figures.
 - (ii) Please also confirm that the total cost of flat-shaped ECR pieces is \$1,512,906 (in thousands) and the corresponding volumes for these pieces are 20,455,078,077 according to USPS LR-I-92, Section 2 pages 17-8 [sic]. If not confirmed please provide the correct numbers and the source for those figures.
 - (iii) If subparts (i) and (ii) are confirmed, please confirm that adding the cost of letters weighing more that 3.0 ounces (\$36,415) to the total cost of ECR flat-shaped mail (\$1,512,906) results in a cost of \$1,549,322 (in thousands).
 - (iv) Please confirm that adding the volume of letters weighing more that 3.0 ounces (216,382,951) to the total volume of ECR flat-shaped mail (20,455,078,077) results in a volume of 20,671,460,958. If subparts (i) and (ii) are not confirmed please provide the above calculations with the numbers provided in subparts a and b.
 - (v) If subparts (iii) and (iv) are confirmed, please confirm that \$1,549,322 divided by 20,671,460,958 and multiplied by 1000 is \$0.0750. If subparts (iii) and (iv) are not confirmed please calculate the quotient of the figures provided in subparts (iii) and (iv).

**Response of VP-CW Witness John Haldi to Interrogatory
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- (vi) Please confirm that, according to Table 3 in USPS-T-29, the average ECR flat-shaped piece cost \$0.0740 and the average letter-shaped piece cost \$0.0685, for a difference of \$0.0054.
 - (vii) Please confirm that, according to Table 3 in USPS-T-29, the average ECR letter-shaped piece weighing less than 3.0 ounces costs \$0.0669.
 - (viii) If subparts (v) and (viii) are confirmed, please confirm that the difference between the unit cost of letters weighing less than 3.0 ounces of \$0.0669 and the unit cost of flats which include the cost and volume of letters weighing more than 3.0 ounces as calculated in subpart (v) of \$0.0750 is \$0.0081. If subparts (v) and (vii) are not confirmed, please calculate the difference between the figures provided in subparts (vii) and (v).
 - (ix) If subparts (vi) and (viii) are confirmed, please confirm that the unit cost difference between \$0.0081 and \$0.0054 is \$0.0027. If subparts (vi) and (viii) are not confirmed, please calculate the difference between the figures provided in subparts (vi) and (viii).
- d) Please confirm the calculations in subparts b) and c) show that the letter/flat differential is overstated by at most \$0.0027. Please explain if not confirmed.

Response:

- (a) Confirmed.
- (b) (i) Confirmed for the data in USPS-LR-I-92, Section 2, pages 14-15, which show costs by one-ounce weight increment. See VP/CW-T-1, Appendix B, and my response to USPS/VP-CW-T1-18 for my reservations concerning the methodology used to determine weight-related costs by ounce increment, including the possible understatement of weight-related costs.

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- (ii) Confirmed for the data in USPS LR-I-92, Section 2, pages 17-18, which show costs by one-ounce weight increment. See VP/CW-T-1, Appendix B, and my response to USPS/VP-CW-T1-18 for my reservations concerning the methodology used to determine weight-related costs by ounce increment, including the possible understatement of weight-related costs.
- (iii) Confirmed.
- (iv) Not confirmed.
$$\begin{array}{r} 66,478,655 \\ + 20,455,078,077 \\ \hline = 20,521,556,732 \end{array}$$
- (v) I obtain the same unit cost.
- (vi) Not confirmed for USPS-T-29, Table 3, which is "Test Year Periodicals Application Costs." If the question intended to refer to USPS-T-28, Table 3, then I confirm that \$0.0740 and \$0.685 are the average unit costs for ECR "Flats" and "Letters," respectively. The difference between these two units costs is \$0.0055, not \$0.0054.
- (vii) Not confirmed for USPS-T-29, Table 3, which is "Test Year Periodicals Application Costs." If the question intended to refer to USPS-T-28, Table 3, then I confirm that \$0.0678 is the average unit cost shown there for ECR "Letters" that weigh less than 3.5 ounces.
- (viii) I do not know what is intended by the reference to "subpart d." I do confirm that the difference between \$0.0744 and \$0.0678 is \$0.0066.

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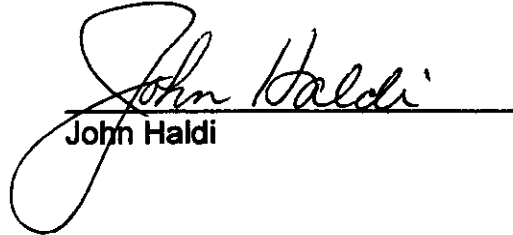
- (ix) Your arithmetic would appear to be correct.
- c)
 - (i) Confirmed for the data in USPS-LR-I-92, Section 2, pages 14-15, which show costs by one-ounce weight increment. See VP/CW-T-1, Appendix B, and my response to USPS/VP-CW-T1-18 for my reservations concerning the methodology used to determine weight-related costs by ounce increment, including the possible understatement of weight-related costs.
 - (ii) Confirmed for the data in USPS-LR-I-92, Section 2, pages 17-18, which show costs by one-ounce weight increment. See VP/CW-T-1, Appendix B, and my response to USPS/VP-CW-T1-18 for my reservations concerning the methodology used to determine weight-related costs by ounce increment, including the possible understatement of weight-related costs.
 - (iii) When I add the significant digits in the two numbers, I obtain \$1,549,321.
 - (iv) When I add the significant digits in the two numbers, I obtain a combined volume of 20,671,461,028.
 - (v) When I divided \$1,549,321 by 20,671,461,028 I obtain \$0.0749(4975).

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- (vi) Not confirmed for USPS-T-29, Table 3, which is "Test Year Periodicals Application Costs." If the question intended to refer to USPS-T-28, Table 3, then I confirm that \$0.0740 and \$0.685 are the average unit costs for ECR "Flats" and "Letters," respectively. The difference between these two units costs is \$0.0055, not \$0.0054.
- (vii) Not confirmed for USPS-T-29, Table 3, which is "Test Year Periodicals Application Costs." If the question intended to refer to USPS-T-28, Table 3, then I confirm that \$0.0669 is the average unit cost shown there for ECR "Letters" that weigh less than 3.0 ounces.
- (viii) Using the data in the question, the result is \$0.0081. Using my result in (v) above, the result is \$0.0080.
- (ix) Your arithmetic appears to be correct.
- d) Using the data cited in the references above, the arithmetic leads to this adjustment for heavy weight letters. I note that the estimated overstatement in my testimony at page A-7, Table A-2, line 10, is \$0.00291, which is not much different from the \$0.0027 adjustment obtained by your method.

DECLARATION

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


John Haldi

Dated: July 3, 2000