

BEFORE THE
POSTAL RATE COMMISSION

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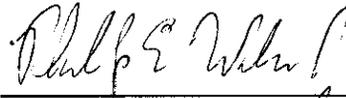
POSTAL RATE AND FEE CHANGES, 2000

DOCKET NO. R2000-1

ANSWERS OF UNITED PARCEL SERVICE WITNESS
DAVID E. M. SAPPINGTON TO INTERROGATORIES
OF PARCEL SHIPPERS ASSOCIATION
(PSA/UPS-T6-13 through 20)
(July 18, 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 the Parcel Shippers Association: PSA/UPS-T6-13 through 20.

Respectfully submitted,



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TO INTERROGATORY OF PARCEL SHIPPERS ASSOCIATION

PSA/UPS-T6-13. Please refer to your response to PSA/UPS-T6-1. Utilizing the PRC's costing methodology, and the Postal Service's revenue and piece estimates, please compare the average per piece cost for parcels in the R97-1 Test Year and in the current Test Year.

Response to PSA/UPS-T6-13:

Using the Commission's costing methodology and the Postal Service's revenue and piece estimates, Parcel Post's unit attributable costs in the R97-1 test year and in the current test year are \$3.18 (= $\$685.9 / 215.8$) and \$2.89 (= $\$1082.0 / 374.1$), respectively.

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PSA/UPS-T6-14. In your response to PSA/UPS-T6-5(b) you state that, for 1997 and 1998, a PRC version of the CRA indicates that Parcel Post cost coverage was below 100%. Please confirm that the 1997 and 1998 PRC version of the CRA to which you refer is based on the revenue and pieces derived from what you describe as the "established" methodology.

Response to PSA/UPS-T6-14:

Confirmed.

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PSA/UPS-T6-15. Please refer to your response to PSA/UPS-T6-7: In that response you say that the value shippers get from the three day delivery promise by Airborne "...may outweigh any costs associated with meeting DDU qualification requirements..." You go on to say that "...this value must certainly outweigh the associated costs for shippers who purchase the Airborne @ Home service." Please explain why this "must" be the case.

Response to PSA/UPS-T6-15:

A shipper that purchases the Airborne@Home service voluntarily chooses to incur the costs associated with the use of the service. Consequently, the value that the shipper derives from the service must exceed the associated costs that he or she incurs. If the costs associated with the Airborne@Home service exceeded the value that the shipper derives from the service, the shipper would not have purchased the service.

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PSA/UPS-T6-16.

(a) Your response to PSA/UPS-T6-7(b), on the issue of whether delivery confirmation service increases the value of service to parcel shippers, states that “An increased array of options associated with the service increases the value of the service to its customers.” Does an option which costs too much increase the value of service? Please explain any affirmative answer.

(b) You also say in response to PSA/UPS-T6-7(b) that the value of Parcel Post service is increased because of the added delivery confirmation option “...regardless of whether a competitor offers a similar service for an extra charge or includes the extra service in the base price.” Please explain how Parcel Post value of service has increased if a competitor offers the same service for free and the Parcel Post customer has to pay, *ceteris paribus*.

Response to PSA/UPS-T6-16:

(a) I am not sure what you mean by the phrase “costs too much.” An option provides value as long as there is some chance that the option will be exercised at the prevailing rates. Only if the price of the service is so high that it exceeds the value of the service to the shipper in every conceivable situation will the option to purchase the service have no value to the shipper.

(b) The central issue is whether the value of Parcel Post increases when the Delivery Confirmation option becomes available, whereas it was previously not available. Before the option is available, the Parcel Post shipper cannot purchase

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Delivery Confirmation at any price. After the option becomes available, the Parcel Post shipper can purchase Delivery Confirmation at the specified price. As long as this price is less than the value that the shipper derives from Delivery Confirmation under some conceivable circumstances, the Parcel Post shipper is better off when the Delivery Confirmation option is available than when it is not available. Therefore, the value of service that Parcel Post provides to this shipper is higher when Delivery Confirmation is available than when it is not available. These conclusions are true regardless of the array of services offered by competitors or the manner in which competitors choose to recover the costs of the services they provide.

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PSA/UPS-T6-17.

(a) In your response to PSA/UPS-T6-8 you say you see no inconsistency between your testimony that the Postal Rate Commission should not be concerned about unacceptably low volumes of parcels because the Postal Service's new methodology for volume and revenue shows much higher volume, and UPS witness Sellick's testimony that the new methodology is wrong. Please confirm that, if UPS witness Sellick is correct, then it means that there is no higher volume of Parcel Post that would serve, as you phrase it, to 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." Please explain any negative answer.

(b) Does the fact that the Postal Service's new methodology shows higher volumes mean that significant Parcel Post volumes actually increased, or, rather, that there may have been no increase in Parcel Post volumes because the measurement of prior year volumes by the old, or what you call the "established," methodology underreported volumes? Please explain your answer.

(c) In your responses to PSA/UPS-T6-8(b) you take note of the fact that, even using the "established" methodology advocated by UPS, Parcel Post volume increased by almost 13% and revenues by almost 7% in 1998. Please confirm that the increase in volume and revenue in 1998 occurred in the absence of any rate increase in Parcel Post, and therefore does not reflect the consequences of the Commission's 12% Parcel Post increase, an increase that did not take effect until Fiscal Year 1999? Please explain any negative answer.

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Response to PSA/UPS-T6-17:

(a) Before answering your question, I must point out again that my testimony on page 45 at line 12 states that “*if* the new methodology accurately reflects Parcel 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). Confirmed that if there were no increase in Parcel Post volume in FY1998, then this nonexistent Parcel Post volume increase cannot allay potential concerns about low Parcel Post volume. Any such concerns can only be allayed by actual increases in Parcel Post volume. Note, however, that even as measured under the established methodology, Parcel Post volume increased in FY1998 by almost 13% since 1997, and by 25% since 1996.

(b) As noted in my response to part (a), above, even under the established methodology Parcel Post volume increased in 1998 by almost 13% over 1997, and by 25% in just two years. Thus, the suggestion in this question that “there may have been no increase in Parcel Post volumes” under the established methodology is not the case. In any event, the new methodology may show higher volumes because Parcel Post volumes actually increased significantly. It is a theoretical possibility that the BRPW estimates are right, and that Parcel Post volume increased, but not as dramatically as the numbers suggest, because the established method underreported volumes. If this is the case, the Commission’s past actions in lowering Parcel Post coverage due to a concern over reportedly low Parcel Post volumes were based on incorrect information;

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had the Commission had the correct information, it may not have reduced Parcel Post's cost coverage to such a modest level (108%).

(c) Confirmed.

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PSA/UPS-T6-18. PSA/USPS-T6-9(b) asked you to compare the Parcel Post volume growth during the 1990s to the growth in ground parcel volume for United Parcel Service and to document your response with data describing the size of the ground parcel market and United Parcel Service's share of that market. In your response you do not specifically address the issue of UPS' share, but rather state that: "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." Did you ask United Parcel Service to supply the data that was requested and, if not, please explain why you did not.

Response to PSA/UPS-T6-18:

I did not ask United Parcel Service to supply any proprietary data, just as I did not ask any other private delivery company to do so.

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PSA/UPS-T6-19.

(a) In your response to PSA/UPS-T6-10(a) you confirmed that the standards for measuring Criterion 2, the value of service, such as the standards to which you refer in your testimony, have to be compared to something else in order to have meaning. You go on in that answer, however, to state that such comparisons 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 formally provided, then the value of that delivery service to its users has increased, *ceteris paribus*." Please confirm that your answer assumes that "all other things are equal, including the fact that the competitor's service did not also comparably improve?" Please explain any negative answer.

(b) Question PSA/UPS-T6-10(b) asked that you compare Parcel Post performance to that of its competitor or competitors. Your response was that you did not have data on the performance and internal operation of private competitors. Did you ask United Parcel Service to supply you with such data and, if not, please explain why you did not.

Response to PSA/UPS-T6-19:

(a) Confirmed. Changes in the qualities of competitors' services can affect the incremental value of service. Please see my response to USPS/UPS-T6-43 for a discussion of the incremental value of service.

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(b) I did not ask United Parcel Service to supply any proprietary data, just as I did not ask any other private delivery company to do so.

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PSA/UPS-T6-20. In your response to PSA/UPS-T6-11(b) you state that if rates for a service do not generate revenues sufficient to cover a reasonable share of institutional cost then those rates would "...unfairly disadvantage suppliers of competing services." However, you add that you do not have an estimate of the loss of volume and revenue that UPS or any other supplier might suffer if Parcel Post rates did not pay a reasonable share of institutional cost. Please explain how the Postal Rate Commission is able to know whether Parcel Post rates cover a "reasonable share of institutional costs" according to Criterion 4, if they do not know what level of Parcel Post rates will cause harm to United Parcel Service, that is, a loss of volume and/or revenue?

Response to PSA/UPS-T6-20:

Section 3622(b) of the Postal Reorganization Act directs the Commission to consider many factors as it determines a reasonable share of institutional costs for Parcel Post. These factors include Parcel Post's value of service, the effect of a rate increase on Parcel Post shippers, the alternatives available to these shippers, and the extent of mail preparation they perform. The Commission is never fortunate enough to have perfect information about all of these factors, just as it seldom has perfect information about the impact of a rate increase on competitors. Therefore, the Commission can and must rely upon the imperfect information at its disposal to determine a reasonable share of institutional costs for Parcel Post and all other mail subclasses. The Commission can still take into account the fact that the Postal Service has many artificial advantages over its private sector competitors, and that low cost

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coverages will almost inevitably lead to volume, revenue, and earnings losses for those competitors.

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.

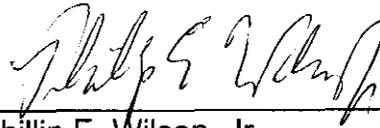


David E. M. Sappington

Dated: 7/18/00

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.



Phillip E. Wilson, Jr.
Attorney for United Parcel Service

Dated: July 18, 2000
Philadelphia, Pa.