

ORIGINAL

# Official Transcript of Proceedings

*Before the*

## UNITED STATES POSTAL RATE COMMISSION

In the Matter of:

POSTAL RATE AND FEE CHANGE

POSTAL RATE COMMISSION  
OFFICE OF THE SECRETARY

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Docket No.

R2000-1

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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 XXXI  
Wednesday, July 19, 2000

The above-entitled matter came on for hearing,  
pursuant to notice, at 9:32 a.m.

BEFORE:

HON. EDWARD J. GLEIMAN, 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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## C O N T E N T S

WITNESS	DIRECT	CROSS	REDIRECT	RECROSS
STEPHEN SELICK				
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BY MR. HOLLIES		15173		15214
DAVID E.M. SAPPINGTON				
BY MR. MCKEEVER	15216			
BY MR. MAY		15452/15528		
BY MR. KOETTING		15464/15566		
BY MR. OLSON		15472		

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## E X H I B I T S

EXHIBITS AND/OR TESTIMONY	IDENTIFIED	RECEIVED
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E X H I B I T S			
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Additional Designated Written Cross-Examination of David E.M. Sappington, PSA/UPS-T6-13, PSA/UPS-T6-14, PSA/UPS-T6-16A, PSA/UPS-T6-17A, PSA/UPS-T6-17C, PSA/UPS-T6-18, PSA/UPS-T6-19, and PSA/UPS-T6-20	15452	15452	
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## P R O C E E D I N G S

[9:32 a.m.]

CHAIRMAN GLEIMAN: Good morning. Today we continue our hearings to receive direct cases of participants other than the Postal Service in Docket R2000-1.

I want to remind everybody that we are stream-broadcasting on the Internet, and that the mikes are sensitive in that regard, and they pick up what is being said.

If you're not participating, if you'd like to have a private conversation with your consultant or your attorney or what have you, I would strongly urge you to turn your mike off, because it will pick up what you think are whispered conversations.

Having said that, is there any matter that a participant would like to address this morning?

[No response.]

CHAIRMAN GLEIMAN: If not, we have two witnesses scheduled to appear today. They are Witnesses Sellick and Sappington.

Mr. McKeever, are you prepared to introduce your first witness?

MR. MCKEEVER: Yes, Mr. Chairman, we are. United Parcel Service calls to the stand, Stephen Sellick.

1 CHAIRMAN GLEIMAN: It says on my little script  
2 that you're already under oath in this proceeding, and has  
3 been the case on numerous occasions, they've all faded  
4 together.

5 I just want to make sure; counsel, we're under  
6 oath with this witness?

7 MR. McKEEVER: That's correct, Mr. Chairman. Mr.  
8 Sellick did testify on UPS-T-2 a few days ago.

9 CHAIRMAN GLEIMAN: I'm sure that the witnesses  
10 find it offensive that I don't remember, but after seeing  
11 them for a couple of cases running, you can't remember  
12 whether you saw them last week or last case sometimes.

13 Please proceed.

14 Whereupon,

15 STEPHEN E. SELLICK,  
16 a witness, having been previously called for examination,  
17 and, having been previously duly sworn, resumed the stand,  
18 continued to be examined and continued to testify as  
19 follows:

20 DIRECT EXAMINATION

21 BY MR. McKEEVER:

22 Q Mr. Sellick, I have just handed you a copy of a  
23 document entitled Direct Testimony of Stephen E. Sellick on  
24 Behalf of United Parcel Service on Parcel Post RPW  
25 Estimates, and marked as UPS-T-4.



1 Are you familiar with that document?

2 A Yes, I am.

3 Q Mr. Sellick, that document was served on the  
4 parties on May 22 of this year. Do you have any changes to  
5 make to that document from the version that was served on  
6 May 22?

7 A I have just a few small changes. First on, page  
8 7, line 12, where it reads mail tendered in Fiscal Year 1998  
9 is attached; I'd like that to read Fiscal Year 1998 are  
10 attached.

11 Q Changing the, is, to an, are?

12 A Yes.

13 On page 12, line 7, at the end of line 7, the  
14 number, 42 appears. I'd like to strike that number, 42.

15 And on line 11, there's the sentence on that line  
16 that reads: The Postal Service has refused to supply...

17 Due to the recent provision of Library Reference  
18 403, I would like that to read: The Postal Service  
19 initially refused to supply ... so change, has, to,  
20 initially.

21 And finally, on page 14, line 2, strike the word,  
22 withheld, for the same reason I previously cited.

23 MR. McKEEVER: Mr. Chairman, those changes have  
24 been made in the two copies that I will provide to the  
25 Reporter, if and when this testimony is admitted into

1 evidence.

2 I might also point out, Mr. Chairman, that the  
3 testimony includes Exhibits A-E, however, Exhibits C and D  
4 were filed under seal, and so I would propose that I now  
5 move into evidence, the testimony, plus Exhibits A, B, and  
6 E, and then proceed separately with respect to C and D, so  
7 that they can be made part of a separate, sealed transcript.

8 CHAIRMAN GLEIMAN: I think that's a proper  
9 procedure, so if you'd move the unsealed materials at this  
10 point?

11 MR. McKEEVER: Okay.

12 BY MR. McKEEVER:

13 Q Mr. Sellick, with those changes, do you adopt as  
14 your testimony in this proceeding today, the Direct  
15 Testimony of Stephen E. Sellick on Behalf of United Parcel  
16 Service on Parcel Post RPW Estimates as set forth in the  
17 document marked UPS-T-4, and Exhibits UPS-T-4-A, B, and E?

18 A Yes.

19 MR. McKEEVER: Mr. Chairman, I move the that the  
20 Direct Testimony of Stephen E. Sellick, marked UPS-T-4, and  
21 Exhibits A, B, and E, be admitted into evidence and  
22 transcribed into the record of today's proceedings.

23 CHAIRMAN GLEIMAN: Is there any objection?

24 [No response.]

25 CHAIRMAN GLEIMAN: Hearing none, if you'd please

1 provide two copies of the corrected Direct Testimony of  
2 Witness Sellick to the Court Reporter, I'll direct that the  
3 material be transcribed into the record and received into  
4 evidence.

5 [Written Direct Testimony of  
6 Stephen E. Sellick, UPS-T-4,  
7 together with Exhibits UPS-T4-A,  
8 UPS-T4-B, and UPS-T4-E, were  
9 received into evidence and  
10 transcribed into the record.]  
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UPS-T-4

BEFORE THE  
POSTAL RATE COMMISSION

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POSTAL RATE AND FEE CHANGES, 2000

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:  
:  
:  
DOCKET NO. R2000-1

---

DIRECT TESTIMONY  
OF  
STEPHEN E. SELICK  
ON BEHALF OF  
UNITED PARCEL SERVICE  
ON PARCEL POST RPW ESTIMATES

---

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## INTRODUCTION

1  
2 My name is Stephen E. Sellick. I am a Vice President at PHB Hagler Bailly, Inc.  
3 ("PHB"), an economic and management consulting firm with principal U.S. offices in  
4 Washington, D.C.; Cambridge, Massachusetts; Los Angeles and Palo Alto, California;  
5 and New York, New York. PHB was formed through the merger of Putnam, Hayes &  
6 Bartlett, Inc. and Hagler Bailly, Inc. in 1998. I am located in PHB's Washington, D.C.  
7 office.

8 I have more than ten years of consulting experience, including a wide range of  
9 assignments in regulatory economics, cost accounting, and financial analysis of  
10 regulated industries. In addition, I have extensive experience in environmental litigation.

11 I have worked on PHB's analytical investigations of United States Postal Service  
12 ("Postal Service") costing issues since 1990. In Docket No. R90-1 and again in Docket  
13 No. R94-1, I assisted Dr. George R. Hall in the preparation of analyses and testimony  
14 regarding the attributable costs of Parcel Post, Priority Mail, and Express Mail. In  
15 Docket No. R94-1, I assisted Dr. Colin C. Blaydon in the preparation of analyses and  
16 testimony concerning the treatment of mixed mail costs in the In-Office Cost System  
17 ("IOCS"). In Docket No. MC95-1, I assisted Ralph L. Luciani in the preparation of  
18 analyses and testimony regarding the costs associated with parcels handled by the  
19 Postal Service in First Class and Standard (A) Mail and in preparing supplemental  
20 testimony regarding rate design for Standard (A) Mail parcels. In Docket No. R97-1, I  
21 presented direct testimony regarding the Postal Service's proposal to modify the costing  
22 in Cost Segment 3 to incorporate a Management Operating Data System ("MODS")

1 based approach. I also presented supplemental and rebuttal testimony in Docket No.  
2 R97-1 regarding the MODS-based approach for Cost Segment 3.

3 Since 1995, I have visited and observed the operations at a number of Postal  
4 Service facilities, including the Washington, D.C., BMC on two different occasions; two  
5 Sectional Center Facilities; two Associate Offices/Delivery Units; a HASP ("Hub and  
6 Spoke Project") facility; and an Air Mail Center.

7 I hold a B.S. in Economics from the University of Pennsylvania's Wharton School  
8 of Business and an M.A. in Public Policy Studies from the University of Chicago.

9 **PURPOSE OF TESTIMONY AND**  
10 **SUMMARY OF CONCLUSIONS**

11 I have been asked to review the Postal Service's new method of estimating  
12 revenue, pieces, and weight for Parcel Post. In so doing, I have reviewed the testimony  
13 and workpapers of Postal Service witnesses Hunter (USPS-T-5) and Pafford (USPS-T-  
14 4), as well as other relevant documents.

15 Based on my review, I have come to the following conclusions:

- 16 1. The documentation provided by the Postal Service to support its new  
17 method of estimating Parcel Post revenue, pieces, and weight for BY1998  
18 is inadequate and incomplete;
- 19 2. The Postal Service's adjusted Parcel Post volume and revenue estimates  
20 for BY1998 are untested and potentially unreliable; and

1           3.     Alternative tested, reliable, and more detailed DRPW-only estimates of  
2                 Parcel Post revenue, pieces, and weight for BY1998 are available in the  
3                 record and should be adopted in this case in lieu of the new approach until  
4                 adequate controls are put in place to insure the accuracy and reliability of  
5                 the new system.

6           I discuss my evaluation of each part of the new process by which the Postal  
7     Service estimates revenue, pieces, and weight for Parcel Post. My testimony is divided  
8     into two sections: (1) a description of the RPW system and of those subsystems used  
9     to estimate Parcel Post revenue, pieces, and weight, and (2) an evaluation of the new  
10    methodology applied to Parcel Post.

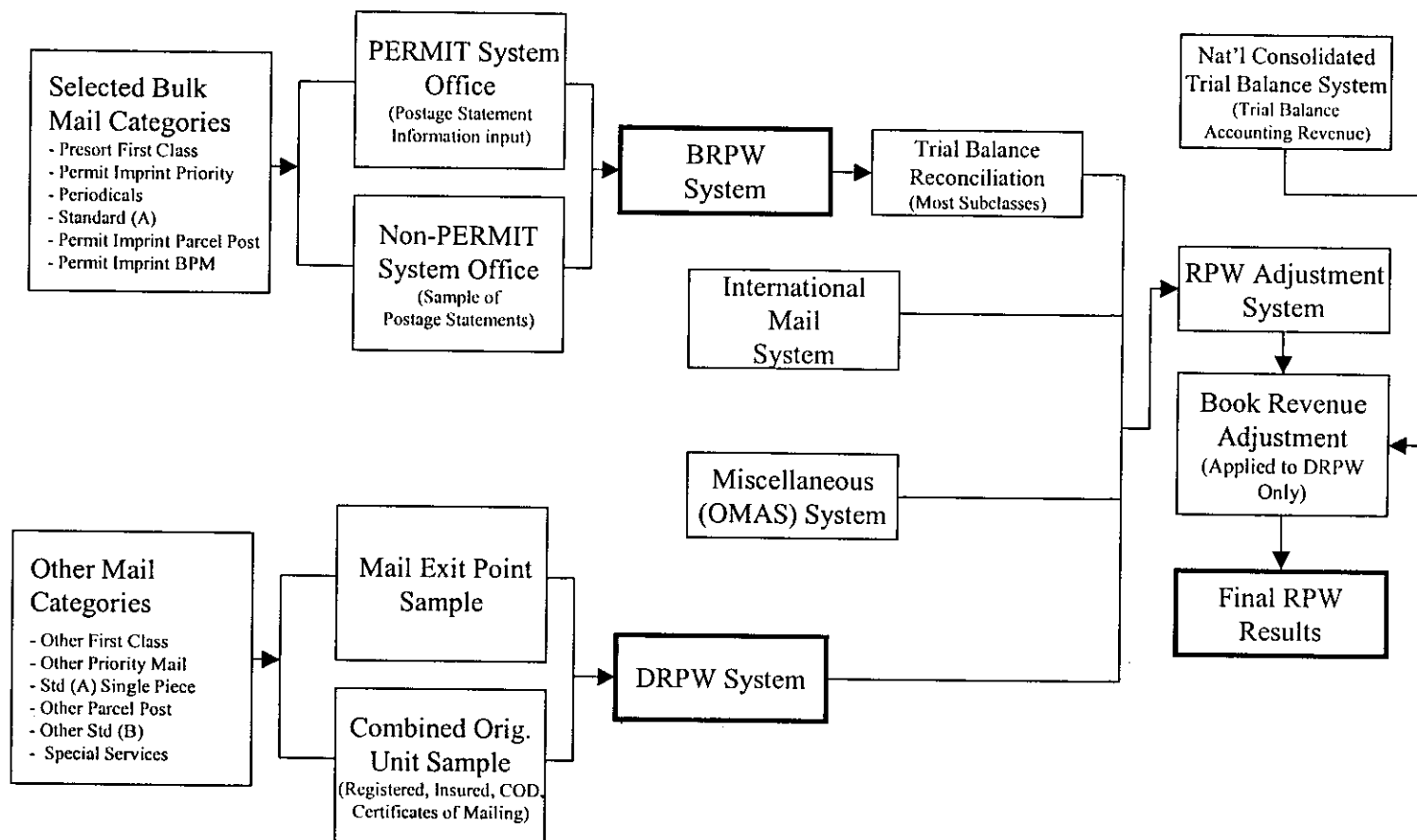
11                                   **DESCRIPTION OF THE RPW SYSTEM**

12           The Postal Service estimates revenue, pieces, and weight in its RPW system.  
13     The RPW system actually consists of four subsystems or sources: the Bulk RPW  
14     System ("BRPW"), the Domestic RPW System ("DRPW"), the International RPW  
15     System, and the Miscellaneous/OMAS System. The BRPW and DRPW subsystems  
16     together cover the vast majority of estimated postal revenue, pieces, and weight. The  
17     final step in the estimating process -- the RPW Adjustment System -- combines the  
18     revenue, piece, and weight numbers from each of the four subsystems to derive total  
19     revenue, piece, and weight estimates for each mail class and subclass.

20           A flow chart illustrating the overall RPW process as it now exists is shown below:



## RPW Flow Chart



## THE BRPW SYSTEM

1  
2       The BRPW system uses aggregated information taken from mailer-supplied  
3 postage statements to estimate revenue, pieces, and weight for certain categories of  
4 bulk mail. Prior to FY1999, those categories did not include Parcel Post. In this case,  
5 the BRPW system is used for First Class Presort Mail, permit imprint Priority Mail,  
6 Periodicals, Standard (A) Mail, permit imprint Parcel Post, and permit imprint Bound  
7 Printed Matter. This proceeding represents the first time that the Postal Service has  
8 used the BRPW system to estimate any portion of Parcel Post revenue, pieces, and  
9 weight.

10       The Postal Service first introduced BRPW-based Parcel Post estimates in its  
11 FY1999 PQ1 submission of RPW estimates to the Commission. Its FY1998 estimates  
12 of revenue, pieces, and weight for Parcel Post were initially based solely on its long  
13 established practice of sampling Parcel Post pieces as part of the DRPW sampling  
14 system. Only well after the end of FY1998 -- in June of 1999 -- did the Postal Service  
15 restate its FY1998 Parcel Post estimates using the new, "hybrid" BRPW/DRPW  
16 methodology.

17       The BRPW system is based in large part on an aggregated data extract taken  
18 from the PERMIT System data base, which is a Postal Service system for automated  
19 bulk mail acceptance and financial reporting.<sup>1</sup> A bulk mailer provides a postage

---

1. BRPW estimates are also based on a probability-based stratified sample of non-automated (non-PERMIT System) offices. However, unlike the other mail categories included in the PERMIT System, Parcel Post is not part of this sampling process.

1 statement with each mailing. The postage statement contains the total postage  
2 (revenue), pieces, and weight for the mailing, as well as the mailer's permit number, the  
3 date of the mailing, the mail class, the rate category for the mail, and, where distance-  
4 based rates apply, the appropriate zone.

5 There are different postage statement forms. For permit imprint Parcel Post, the  
6 postage statement is Form 3605. Form 3605 as used in FY1998 also reported postage  
7 (revenue), volume, and weight information for permit imprint Bound Printed Matter and  
8 for permit imprint Priority Mail. A copy of the version of Form 3605 as it existed in  
9 FY1998 is attached to my testimony as Exhibit UPS-T-4A.

10 Form 3605 was changed as of January 1999. The new form, Form 3605-PR,  
11 now reports information only for permit imprint Parcel Post. See Exhibit UPS-T-4B.  
12 This change reduces the possibility that revenue, piece, and weight information for one  
13 category of mail (permit imprint Bound Printed Matter, for example) will be erroneously  
14 reported as belonging to another category of mail (such as Parcel Post).

15 Postal Service bulk mail acceptance personnel are supposed to verify the mailer-  
16 supplied information on the postage statement to make sure it accurately reflects the  
17 volume and other characteristics of the mail that is actually presented. In the case of a  
18 PERMIT System office, a postal employee enters selected information from the postage  
19 statement into the PERMIT System data base. Proper verification by acceptance  
20 personnel of the accuracy of the information on the postage statement, and proper data  
21 entry of that information into the PERMIT System data base, is crucial to the accuracy

1 of the PERMIT System information which lies at the heart of the BRPW estimates of  
2 revenue, pieces, and weight for the covered subclasses of mail.

3 A large proportion of bulk Parcel Post mailings are verified at the mailer's plant.  
4 Tr. 13/5194 (Eggleston). In these cases, the postal employee who examines the  
5 mailing at the plant (to verify the accuracy of the information on the Form 3605 postage  
6 statements) completes another form that accompanies the mailing to the postal facility  
7 (or facilities) where the mail is physically entered into the postal system. This second  
8 form allows the postal personnel at the facilities where the mail is physically entered into  
9 the mailstream to verify that the mail actually entered into the system conforms to the  
10 information on the original postage statement. This second form, Form 8125, is entitled  
11 "Plant-Verified Drop Shipment (PVDS) Verification and Clearance." Examples of  
12 completed Form 8125s for mail tendered in FY1998 are attached to my testimony as  
13 Exhibit UPS-T-4E.

14 As stated in a Postal Service audit report, "[t]he comparison of the destination  
15 shipment to the original Form 8125 and the mailing statement, [assures] the Postal  
16 Service . . . of the integrity of the shipment . . . ." <sup>2</sup> That is because "In this system,  
17 which relies heavily on participants to provide precise information, it is crucial that all  
18 required information is provided and all program guidelines are followed." <sup>3</sup>

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2. Audit Report: Review of the Plant-Verified Drop Shipment Postage Payment System, Eastern Region (January 1993), at 6, USPS-LR-I-176 (additional material filed March 28, 2000).

3. USPS-LR-I-176, at page i.

1           The electronic postage statement data in the PERMIT System data base is  
 2 stored on computers in a number of Postal Service offices. The Postal Service's  
 3 mainframe computer in San Mateo, California, "polls" each of these offices to retrieve  
 4 the electronic postage statement data at the end of each accounting period ("AP").  
 5 Thus, all electronic postage statement data in the PERMIT System resides in one  
 6 Postal Service computer for a time after the close of each AP.<sup>4</sup>

7           The San Mateo mainframe computer aggregates the postage statement-level  
 8 data by finance number (roughly equivalent to an individual postal facility) and "Volume  
 9 Information Profile" ("VIP") Code after the conclusion of each AP. For Parcel Post, each  
 10 unique VIP Code represents a rate category and zone combination. That is, for Parcel  
 11 Post, a single VIP Code represents a particular Parcel Post rate category (e.g., Inter-  
 12 BMC, Intra-BMC, or DBMC) and zone. For example, VIP Code 4402 represents DBMC  
 13 parcels sent to zone 2.<sup>5</sup> All permit imprint Parcel Post postage statement data for each  
 14 VIP Code and finance number/facility for a single accounting period is aggregated into a

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4.   The Postal Service has suggested that this detailed postage statement-level information is not retained on the San Mateo computer. However, a Postal Service contractor apparently receives a file each AP which includes the postage statement-level data. See Objection of United States Postal Service to Interrogatory of United Parcel Service and UPS/USPS-12A-15, 35; Response to United Parcel Service Motion to Compel Responses to UPS/USPS-12A-15; and Response of United States Postal Service to Motion of United Parcel Service to Compel Production of Information and Documents in Interrogatory UPS/USPS-6 or, in the Alternative to Extend Discovery Deadline on BRPW Parcel Post Estimates (filed May 5, 2000), at 9.

5.   The first 4 in the VIP Code stands for Fourth Class -- the name formerly used to designate Standard (B) Mail -- the second 4 stands for the DBMC rate category, and the 02 stands for zone 2.

1 single record. These records are gathered for all offices and accounting periods for  
2 input into BRPW on this highly aggregated basis.

3 For each accounting period, the Postal Service takes this aggregated data and  
4 runs it through three computer programs (known as Jobs 1, 2, and 3).<sup>6</sup> During this  
5 process, the aggregated data records are checked for some very general, broad  
6 "errors." The primary types of errors that apply to Parcel Post records are as follows:

- 7 1. Error Code 2000, "Empty R, P, or W" -- records with missing revenue,  
8 piece, or weight information;
- 9 2. Error Code 2500, "Empty Revenue Per Piece or Revenue Per Pound" --  
10 records with missing revenue (postage) per piece or revenue per pound values;
- 11 3. Error Code 3000, "Revenue Tolerance Check" -- records indicating that  
12 the rate charged the mailer either (1) is lower than the lowest possible rate less 5% for a  
13 piece of the indicated type, or (2) is higher than the highest possible rate plus 5% for a  
14 piece of the indicated type;
- 15 4. Error Code 3100, "Weight Tolerance Check" -- records indicating that the  
16 mail in question has a weight per piece that either (1) is lower than the minimum weight

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6. These programs were provided in USPS-LR-I-25, Appendix A.

1 for a Parcel Post piece less 5%, or (2) is higher than the maximum weight for a Parcel  
2 Post piece plus 5%.<sup>7</sup>

3 When the computer assigns an error code to a record, that record is "flagged."  
4 The Postal Service may address a flagged record in one of the following ways:

5 • If the record "materially" affects the final results, the Postal Service may  
6 "impute" missing revenue, piece, or weight estimates based on the information that is  
7 not missing (Tr. 2/1030-32);

8 • The Postal Service may communicate with the PERMIT System office  
9 from which the data came to determine the "correct" value for that aggregated record.  
10 Tr. 2/1031-32. Any corrections, according to Postal Service Witness Hunter, must be  
11 made at the PERMIT System level (Tr. 2/1033); or

12 • If the record does not "materially" affect the final result, the record may not  
13 be corrected. Tr. 2/1030.

14 After this process is completed, the remaining records are again run through  
15 Jobs 1 through 3. USPS-LR-I-25, at 3-5. This iterative process is repeated until, in  
16 Postal Service Witness Hunter's judgment, all materially significant records have been  
17 addressed. The Postal Service does not keep any records of what changes are made  
18 to "correct" the data. Tr. 2/1033, 1036.

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7. Parcel Post records are not subjected to the Weight Tolerance Check as the computer code is presently written. It is not clear whether this represents a computer programming error, or whether it was intentional.

1           The Postal Service sometimes adjusts the data for missing records. For example,  
2   if for a particular quarter, finance office, and VIP Code there are records for two of three  
3   accounting periods but not the third, a value for the third accounting period is supplied  
4   by assuming that the missing data would be the same as the average of the data for the  
5   other two accounting periods. Tr. 2/1039-42.

6           The BRPW system includes an adjustment of the BRPW estimates for each  
7   category of mail where a revenue account is uniquely associated with the category.  
8   USPS-T-5 at 2-3; Tr. 2/1046-47. That is, where the Postal Service's accounting system  
9   separately records for a category of mail the revenue for that category (rather than  
10   recording the revenue for that type in a general revenue account), the BRPW-estimated  
11   revenue is adjusted to match the revenue in the trial balance account for the category.  
12   The volume and weight estimates for that category are then adjusted in light of the  
13   revenue adjustment.

14          It is important to note that this adjustment process changes the BRPW revenue  
15   estimate to reflect the actual revenue in the trial balance account, and not vice versa. In  
16   other words, the BRPW estimate is recognized as just that -- an estimate that could be  
17   wrong and in need of adjustment. This trial balance reconciliation process provides an  
18   important "check" on the BRPW estimates. However, since there was no unique trial  
19   balance account associated with permit imprint Parcel Post in FY1998, that check was  
20   not performed for Parcel Post in FY1998. Tr. 2/1047-48.



1           The result of this process is an estimate of permit imprint Parcel Post revenue,  
2 pieces, and weight. These estimates are used as an input into the RPW Adjustment  
3 System.

4 Not all postal facilities participate in the PERMIT System. Postage statement  
5 information for these "non-automated," non-PERMIT offices is not entered into the  
6 PERMIT System data base. In the case of Parcel Post, the FY1998 BRPW estimates  
7 were increased in the RPW Adjustment System process on the basis of a survey of ~~44~~  
8 non-PERMIT offices. The Postal Service used the results of this survey to increase the  
9 FY1998 BRPW portion of Parcel Post's revenue, pieces, and weight estimates by a  
10 "blowup" factor of 1.00920754, or by approximately one percent (equal to 2.1 million  
11 pieces and \$5.7 million in revenue). The Postal Service initially refused to supply this  
12 survey in discovery. Thus, I am not in a position to evaluate its results.

## 13 THE DRPW SYSTEM

The DRPW system is a probability sampling system not unlike a number of other Postal Service data systems (such as IOCS). Until FY1999, it was the sole source of the revenue, pieces, and weight estimates for Parcel Post. Tr. 2/731. It continues to be the sole source of the revenue, pieces, and weight estimates for a number of mail categories, including First Class Single Piece Mail, Standard (A) Single Piece Mail, Standard (B) Special Standard Mail, and Standard (B) Library Mail. All forms of Parcel Post -- whether the postage was paid by permit imprint, by stamps, or by meters -- were sampled in the DRPW system in FY1998, and continue to be sampled in DRPW. Tr. 2/745-46.

1 In the DRPW system, mail is sampled at mail exit points ("MEP") or, in the case  
2 of certain special services, combined originating units ("COU"). The data is gathered for  
3 all finance offices and is provided to Mr. Pafford electronically in unaggregated form.  
4 Blowup factors are applied to the sampled data to create population level revenue,  
5 piece, and weight estimates. The DRPW sampling plan and estimation methods are  
6 described in USPS-LR-I-27.

7 As part of the RPW Adjustment System, DRPW estimates are adjusted to reflect  
8 actual Postal Service revenues. I describe this process in more detail in the next  
9 section of my testimony.

10 THE RPW ADJUSTMENT SYSTEM

11 The RPW Adjustment System combines the estimates from the BRPW system  
12 and those from the DRPW system to produce final Government Fiscal Year ("GFY")  
13 estimates of revenue, pieces, and weight for all mail subclasses.<sup>8</sup> The process as it  
14 applies to Parcel Post is as follows:

- 15 ♦ DRPW records for machinable and non-machinable Parcel Post are  
16 combined into one category;
- 17 ♦ Permit imprint records are deleted from the DRPW data set;

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8. The RPW Adjustment System also incorporates estimates from the International RPW and the Miscellaneous/OMAS System.

- 1           ♦       The BRPW estimates are increased by multiplying them by the blowup
- 2       factor of 1.0092754219 developed in the survey of non-PERMIT System offices;
  
- 3           ♦       Total RPW revenue is reconciled to the Postal Service's Official
- 4       Accounting revenue by adjusting the DRPW results by a "Book Revenue Adjustment
- 5       Factor," described below;
  
- 6           ♦       The revenue, piece, and weight estimates from the BRPW, DRPW,
- 7       Miscellaneous/OMAS, and International RPW systems are combined; and
  
- 8           ♦       The result is converted to a GFY from a PFY basis to arrive at the Postal
- 9       Service's final GFY1998 revenue, piece, and weight estimates for Parcel Post.

10           The Book Revenue Adjustment Factor is calculated as follows (figures are for  
 11       FY1998 and are derived from USPS-LR-I-30, USPS-LR-I-249, and USPS-LR-I-302):

12	Total Postal Service Trial Balance (Actual Revenue)	\$60.19 Billion
13	Less: BRPW Revenue Estimate	\$27.61 Billion
14	Less: International Revenue	\$0.91 Billion
15	Less: Miscellaneous Revenue	\$3.36 Billion
16	<b>Equals: Trial Balance for DRPW Estimates</b>	<b>\$28.31 Billion</b>
17	DRPW Revenue Estimate	\$30.01 Billion
18	Plus: COD and Registered Mail Revenue	\$0.01 Billion
19	Plus: Address Correction Revenue	\$0.05 Billion
20	<b>Equals: DRPW Revenue Estimate</b>	<b>\$30.07 Billion</b>
21	<b>Trial Balance \$28.31 Billion/DRPW Estimate of \$30.07 Billion = 0.9414</b>	

1 This Book Revenue Adjustment Factor of 0.9414 is applied to the DRPW estimates to  
2 reduce the DRPW portion of the revenue estimate for each class of mail so that the total  
3 RPW revenue estimate matches the Postal Service's actual total revenue.

4 The process by which the estimates produced by the RPW Adjustment System  
5 are "reconciled" or adjusted to the Postal Service's total trial balance revenue implicitly  
6 assumes that the BRPW estimates are correct. This implicit assumption may have  
7 been made because when the BRPW System was used only to estimate the volumes  
8 and revenues of mail associated with unique revenue accounts, the BRPW estimates  
9 already included a trial balance adjustment. In fact, Postal Service Witness Hunter's  
10 description of the BRPW System begins by defining it as a system which "provides  
11 estimates of revenue and volume totals where bulk mail categories correspond to the  
12 Postal Service's revenue accounting system." USPS-T-5 at 2. As noted, that was not  
13 the case for Parcel Post in FY1998, however.

14 **THE NEW BRPW PARCEL POST ESTIMATION**  
15 **SYSTEM IS NOT ADEQUATELY DOCUMENTED.**

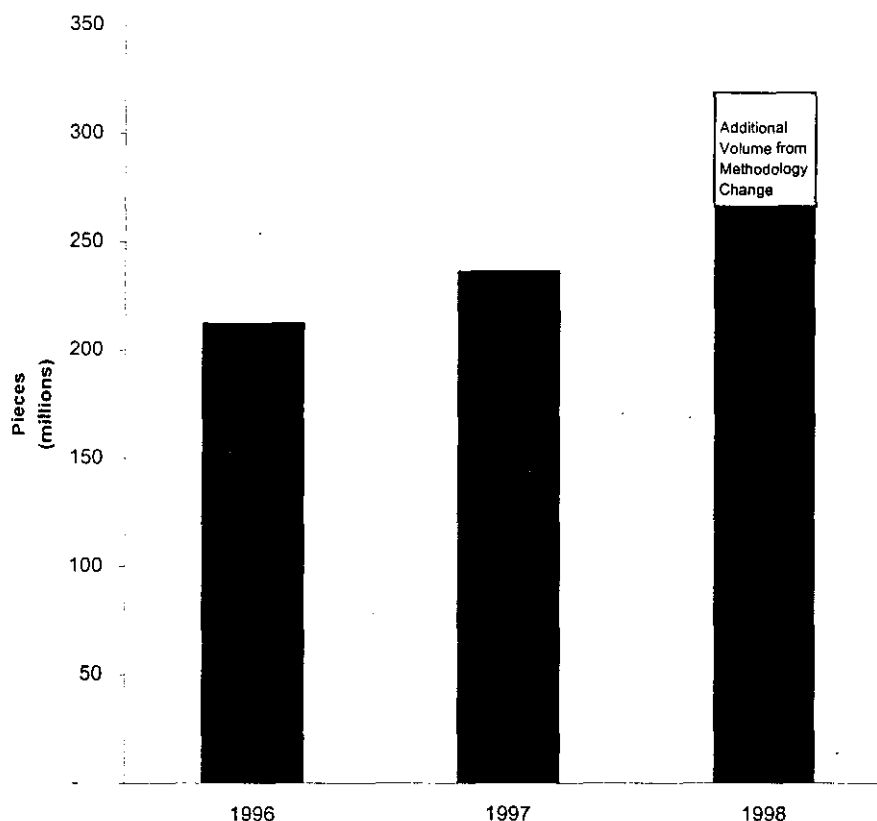
16 While the historic process of generating revenue, piece, and weight estimates for  
17 Parcel Post based solely on the DRPW system has been in place for many years, the  
18 new Parcel Post estimation process is based on a recently-created combination of the  
19 BRPW and DRPW systems. It is being used for Parcel Post for the first time in this  
20 proceeding. As a result, its implementation deserves special scrutiny, especially since  
21 one of its chief defenders -- Postal Service Witness Hunter -- testified during cross-  
22 examination that he did not have a great deal of familiarity with Parcel Post. Tr. 2/1029.

1           Switching Parcel Post from the DRPW system to the joint BRPW/DRPW system  
2 required system redesign and reprogramming. This was necessary to ensure, for  
3 example, that permit imprint Parcel Post pieces were excluded from the final DRPW  
4 estimate for Parcel Post. Without such reprogramming, permit imprint Parcel Post  
5 would be double-counted in BRPW and in DRPW.

6           The BRPW/DRPW results differ significantly from the prior DRPW-only results,  
7 as Figure 1 shows. The BRPW/DRPW approach estimates total Parcel Post volume in  
8 GFY1998 to be 316 million pieces rather than the 266 million pieces estimated by  
9 DRPW alone -- an increase of approximately 19%. This fact by itself raises a serious  
10 issue: If the new approach is more accurate, how could the long-accepted DRPW  
11 system produce such erroneous results? On the other hand, if something is not  
12 seriously wrong with the DRPW sampling system, then how can the new approach be  
13 accepted as uncritically as the Postal Service seems to have done?

FIGURE 1

## DRPW versus Hybrid Parcel Post Volume Estimates



Sources: USPS-T-11, Exhibit USPS-11C, at 4 (BY1998 Parcel Post volume); USPS-LR-I-125; USPS-LR-I-117, United States Postal Service Domestic Mail Volume History 1970-1998, at 8; United States Postal Service Cost and Revenue Analysis Fiscal Year 1998 (September 30, 1998) at 3.

- 1           There seems to have been no investigation of this substantial discrepancy
- 2   between the two systems. That is disturbing, especially since the BRPW process
- 3   cannot be fully and completely replicated.

1           The iterative process used to change the data was not documented and  
2 therefore cannot be replicated. Mr. Hunter acknowledged that he did not maintain any  
3 record of the changes he made to the aggregated BRPW data. Tr. 2/1033, 1036.  
4 Moreover, there is no way of knowing what changes were made to the unaggregated  
5 PERMIT System data before it was aggregated and sent to Mr. Hunter. Tr. 2/1032. In  
6 other words, the process used to arrive at the BRPW estimates is inherently  
7 impenetrable.

8           The Postal Service has stated that it has provided the BRPW "input" data. The  
9 data provided to date is *not* raw "input" data. Even under the Postal Service's restricted  
10 definition of "input" data, the data provided was first scrubbed by Mr. Hunter. The  
11 unscrubbed data has not been provided. Thus, the Commission and intervenors are left  
12 to speculate as to (1) how or why Mr. Hunter deemed the particular changes he made to  
13 the unscrubbed data to be necessary, (2) what those changes were, and (3) the impact  
14 of those changes on the resulting estimates. Under these circumstances, it is  
15 impossible to evaluate with any degree of confidence how reliable the aggregated  
16 postage statement data is. This is particularly disturbing in light of Mr. Hunter's  
17 acknowledged lack of experience and familiarity with Parcel Post. Tr. 2/1029.

18           Furthermore, the Postal Service's refusal to provide postage statement-level data  
19 makes it impossible to determine the reliability of the PERMIT System data on which the  
20 BRPW Parcel Post estimates are based. The high level of aggregation of the data (see  
21 Exhibit UPS-T-4C hereto, filed under seal) could hide significant errors in the PERMIT  
22 System data on which the BRPW estimates are based. As shown in Exhibit UPS-T-4C  
23 (filed under seal), even these highly aggregated records contain nonsensical results.

1 Since individual transaction-level records have not been made available, there is no  
2 way of knowing how many individual records that are used to compile the aggregated  
3 data may contain similar nonsensical information. The high level of aggregation could  
4 mask a substantial number of clearly erroneous individual records.

5 This lack of complete documentation and the potentially incorrect information in a  
6 number of the highly aggregated records undermines the credibility of the BRPW Parcel  
7 Post estimates.

8 In addition, Mr. Hunter did not investigate the adequacy of the PERMIT System  
9 data that underlies his analysis. Instead, he accepts that data completely on faith.  
10 Again, this is disturbing, since he has repeatedly admitted that he is "not a PERMIT  
11 expert." Tr. 2/946, 972, 973, 974, 979, 991, 1050.

12 Any good analyst must know the nature and limitations of the data used in his  
13 analysis. Yet, Mr. Hunter has provided estimates of revenue, pieces, and weight for a  
14 type of mail he knows little about, using data derived from a system he knows little  
15 about. That is not good analytical practice.

16 **THE BRPW PARCEL POST ESTIMATES**  
17 **ARE UNTESTED AND UNRELIABLE.**

18 A. The Postal Service Has Failed to Apply a Trial Balance Revenue  
19 Account Adjustment to the Parcel Post BRPW Estimates.

20 The Postal Service's FY1998 Parcel Post BRPW estimates are missing an  
21 important check on the reasonableness of those estimates (and, implicitly, on the  
22 accuracy of the underlying PERMIT System postage statement data): There was no



1 unique revenue account associated with permit imprint Parcel Post to reflect actual  
2 Parcel Post revenues, and therefore there was no adjustment of the BRPW Parcel Post  
3 estimates to match actual permit imprint Parcel Post revenues.

4 As shown in Exhibit UPS-T-4D (filed under seal), 64% of the revenue estimated  
5 by the BRPW system was subjected to a trial balance adjustment in FY1998. The only  
6 significant BRPW category of mail other than Parcel Post not subjected to a trial  
7 balance adjustment was First Class non-single piece precanceled stamped, and  
8 metered mail, which was also a relatively new addition to the BRPW system. Excluding  
9 that category, over 91% of the BRPW-estimated revenue was adjusted based on trial  
10 balance revenue account information.

11 The trial balance adjustment ensures that BRPW estimated revenue does not  
12 exceed or understate actual revenues. The trial balance adjustment is also used to  
13 adjust the related estimates of pieces and weight for each of the mail classes. Parcel  
14 Post BRPW estimates for FY1998 did not include this critical accuracy check.

15 In short, the Postal Service appears to have implemented its new system for  
16 estimating permit imprint Parcel Post revenue, pieces, and weight prematurely, before it  
17 had implemented necessary controls. Thus, the Parcel Post BRPW estimates are  
18 simply assumed to be correct without any external validation.

19 Moreover, the new system eliminated another adjustment process previously  
20 applied to permit imprint Parcel Post estimates when the DRPW system alone was used  
21 to estimate total Parcel Post volume and revenue -- the RPW Adjustment System's

1 Book Revenue Adjustment. In FY1998, the Book Revenue Adjustment Factor was  
2 0.94, or a downward adjustment to revenues, volumes, and weight of 6%.

3 In past years, the total Parcel Post revenue, piece, and weight estimates were  
4 adjusted by the Book Revenue Adjustment Factor because they were derived wholly  
5 from DRPW. In this proceeding, only the DRPW-based Parcel Post estimates were  
6 adjusted by the Book Revenue Adjustment Factor. Had the BRPW portion of the Parcel  
7 Post estimates been adjusted as well, the Postal Service's own Parcel Post volume and  
8 revenue estimates for FY1998 would be lower by approximately 14 million pieces and  
9 \$37 million.

10 Given the absence of any check on the hybrid BRPW/DRPW Parcel Post  
11 estimates, the Commission should not use those estimates, but should instead use the  
12 FY1998 DRPW-only estimates the Postal Service originally adopted, as contained in the  
13 record. See Tr. 2/735-38.

14 B. There Are Substantial Reasons to Question the Accuracy  
15 of the BRPW Parcel Post Estimates.

16 The BRPW error-checking process is flawed. In the weight per piece tolerance  
17 check (see pages 9-10, above), the BRPW program adds a 5% cushion to the highest  
18 possible and to the lowest possible Parcel Post weight limits before data records are  
19 error-flagged. Thus, an aggregated Parcel Post BRPW data record could show an  
20 average weight per piece of as high as 73.5 pounds before the BRPW data error  
21 checking process would flag it as erroneous, even though the maximum weight of a  
22 Parcel Post piece is 70 pounds. Tr. 2/1016. Similarly, an aggregated record could  
23 show an average weight per piece of 5% less than a pound and still not be flagged as

1 erroneous, even though the minimum weight of a Parcel Post piece is one pound. Tr.  
2 2/1018.

3 This means, for example, that heavier Standard (A) Mail pieces could be  
4 mistakenly entered into the PERMIT System data base as Parcel Post, and the BRPW  
5 system's weight check would not error-flag the record. Indeed, given the level of  
6 aggregation of the BRPW data, even lighter Standard (A) Mail pieces could be  
7 mistakenly counted as Parcel Post pieces without detection. As discussed below, there  
8 is evidence that the FY1998 data is infected by errors such as this.

9 Likewise, the revenue per piece tolerance check has a built-in 5% cushion. The  
10 FY1998 rates for a DBMC zone 2 piece ranged from a low of \$2.10 (the rate for a two  
11 pound piece) and a high of \$5.24 (the rate for a 70 pound piece), but the average rate  
12 paid (revenue per piece) in the BRPW data could be as high as \$5.50 or as low as  
13 \$2.00 before the data would be error-flagged. Again, given the level of aggregation of  
14 the BRPW data, there could be significant errors in a substantial number of individual  
15 postage statements beyond the unflagged BRPW records that would escape the BRPW  
16 data error check process.

17 The BRPW tests, by design, only flag extreme errors. The revenue tolerance  
18 and weight tolerance checks only flag those records where the average revenue per  
19 piece or the average weight per piece *for the entire aggregated record* falls outside  
20 the lowest possible or the highest possible Parcel Post weights or rates for the zone  
21 covered by the record. For example, a DBMC zone 3 record will be flagged only if the  
22 rate paid (revenue per piece) for that record is either 5% less than \$2.25 (the FY1998

1 zone 3 DBMC rate for a two pound piece) or 5% greater than \$6.79 (the FY1998 zone 3  
2 DBMC rate for a 70 pound piece). There are 69 different rates for DBMC zone 3 Parcel  
3 Post shipments. Yet, the BRPW system only checks whether a DBMC record falls  
4 below the DBMC rate for a two pound piece or above the DBMC rate for a 70 pound  
5 piece, even if the pieces covered by the record weighed anywhere within the one pound  
6 to 70 pound weight range for Parcel Post.

7 In other words, the data checks are unable to detect errors for each different  
8 weight category. If, for example, a DBMC zone 3 record correctly had an average  
9 weight of five pounds but incorrectly had a revenue per piece (rate paid) of \$6.45 -- the  
10 rate for a 60 pound piece -- the record would not be flagged.

11 On the other hand, DRPW samples already provide rate cell detail for all  
12 sampled Parcel Post pieces. When a DRPW sample is taken, the weight of the piece,  
13 the zone to which it is sent, and its rate category is known with certainty. That is not  
14 true for the aggregated BRPW data. The BRPW billing determinant data is forced to  
15 assume that the permit imprint Parcel Post zone/weight cell distribution is like that of  
16 DRPW Parcel Post. Thus, not only does BRPW provide no additional detail, but it in  
17 fact provides less detailed information than does DRPW. Response of United States  
18 Postal Service to UPS/USPS-T5-86, Tr. 21/9337-38.

19 This problem is recognized in the A.T. Kearney Data Quality Study at page 93 of  
20 the Summary Report, § 11.0, which notes that "the Postal Service's Bulk RPW system,  
21 and the related PERMIT system does not retain data on the volume of mail by weight  
22 increment . . . instead the system maintains information on the total weight, pieces, and

1 revenue associated with all mailings tendered as part of the transaction." The study  
2 further notes that this lack of data forces the Postal Service to impute volume by weight  
3 category, and that the results can vary significantly depending on the imputation  
4 methodology. It concludes by noting that "[b]ased upon this weakness, the existing  
5 costing and volume reporting systems do not provide reliable and complete estimates of  
6 mail volumes by weight."

7 I cannot emphasize enough that the level of aggregation of the BRPW records  
8 makes impossible any meaningful examination of the accuracy or reliability of the data  
9 upon which the BRPW Parcel Post estimates are based. It must be remembered that  
10 each BRPW record is an aggregation of all shipments at a facility during an Accounting  
11 Period for an entire Parcel Post rate category by zone. As my Exhibit UPS-T-4C (filed  
12 under seal) shows, this means that many records each represent numerous shipments.

13 In short, the BRPW checks provide no comfort that the data is accurate. This  
14 approach stands in stark contrast to the record-by-record editing and verification  
15 procedures performed on the DRPW data.

16 There is good reason to be concerned that the individual, non-aggregated data in  
17 the withheld PERMIT System data base upon which the BRPW system relies may be  
18 inaccurate. The audit reports of bulk mail acceptance that have been produced to date

1 (USPS-LR-I-323) contain findings that call into question the reliability of the postage  
 2 statement data that makes up the withheld PERMIT System data base.<sup>9</sup>

3 These reports reveal, for example, instances in which Postal Service employees  
 4 who accepted bulk mailings did not verify mailings at the time the mail was presented,  
 5 as required by Postal Service procedures.<sup>10</sup> Bulk Mail Acceptance Unit employees are  
 6 instructed to weigh a piece from the mailing and then the total mailing to calculate the  
 7 total number of pieces in the mailing, among other tasks. The audit reports indicate that  
 8 this was often not done. In other instances, untrained personnel performed PERMIT  
 9 System tasks.<sup>11</sup> And non-supervisory personnel used supervisory ID codes to effect  
 10 system overrides and reversals without supervisory review, contrary to required  
 11 procedures.<sup>12</sup>

12 The audit reports are not the only source of information which suggests that the  
 13 high level of aggregation in the BRPW data base masks errors in the PERMIT System  
 14 data base. While the Postal Service has repeatedly refused to produce postage

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9. The Postal Service has refused to produce a substantial number of additional bulk mail unit audit reports. United States Postal Service Objection to Interrogatory of United Parcel Service UPS/USPS-12 (April 20, 2000); United States Postal Service Answer in Opposition to Motion of United Parcel Service to Compel Production of Documents Requested in Interrogatory UPS/USPS-12, filed April 10, 2000 (May 8, 2000).

10. The bulk mail acceptance procedures in effect during FY1998 were set forth in Handbook DM-102, issued in 1989. Tr. 21/9300.

11. See, e.g., USPS-LR-I-323, at 148-49 (Postal Inspection Service, Audit Report: Financial Audit, Case No. [redacted] (November 1997), at 15-16)

12. See, e.g., USPS-LR-I-323, at 31 (Postal Inspection Service, Audit Report: Financial Audit, Case No. [redacted] (August 1998), at 18)

1 statements for BRPW permit imprint Parcel Post,<sup>13</sup> some Form 8125s have been  
2 produced. See USPS-LR-I-314, filed under seal. The information on these forms  
3 (relating to plant-verified drop shipments) is taken from postage statements; the  
4 information they contain should, by design, match that on the postage statements to  
5 which they relate. A review of the produced Form 8125s shows instances in which the  
6 mail class indicated is Standard (B) DBMC Parcel Post whereas the piece weight  
7 demonstrates that the mail cannot possibly be Parcel Post but rather must actually be  
8 Standard Mail (A). See Exhibit UPS-T-4E. This suggests that Standard Mail (A) pieces  
9 have been recorded as Standard (B) Parcel Post mail in the PERMIT system, thus  
10 infecting the BRPW estimates. Because the BRPW data checks are performed on  
11 aggregated data, errors such as these would almost certainly not be detected by the  
12 BRPW error check process.

13 The available audit reports and the limited postage statement-level data made  
14 available for review calls into serious question the integrity of the PERMIT System data  
15 base and therefore the BRPW Parcel Post estimates based on that data. In the  
16 absence of a more thorough review of the underlying data than the Postal Service has  
17 conducted (or permitted) in this case, the Postal Service's after-the-fact adjustment of

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13. See attached Objection of United States Postal Service to Interrogatory of United Parcel Service and UPS/USPS-12A-15, 35; Response to United Parcel Service Motion to Compel Responses to UPS/USPS-12A-15; and Response of United States Postal Service to Motion of United Parcel Service to Compel Production of Information and Documents in Interrogatory UPS/USPS-6 or, in the Alternative to Extend Discovery Deadline on BRPW Parcel Post Estimates (filed May 5, 2000), at 2 n.2.

1 its original DRPW-based estimates of FY1998 Parcel Post volume and revenue should  
2 not be accepted.

3 C. The Joint Use of BRPW and DRPW Leads to Possible  
4 Double-Counting For Parcel Post.

5 For most mail subclasses, RPW estimates are derived almost exclusively from  
6 one or the other of the two systems, either BRPW or DRPW. That is not true for Parcel  
7 Post.

8 As shown in Table 1, below, 33 percent of the total Parcel Post revenue estimate  
9 is derived from the DRPW system and 65 percent is derived from BRPW.<sup>14</sup> For all other  
10 major subclasses, approximately 90 percent of estimated revenue is derived from a  
11 single source, whether BRPW or DRPW. Excluding Bound Printed Matter from this  
12 calculation, over 98 percent of revenue for each subclass is derived from either BRPW  
13 alone or DRPW alone.

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14. About 2 percent of Parcel Post revenue is derived from the Miscellaneous/OMAS subsystem.



Table 1

## Revenue Source by Major Subclass

Service Category	Total Revenue	DRPW Revenue	BRPW Revenue	% DRPW	% BRPW
First Class Single Piece	22,420	22,363	0	99.7%	0.0%
First Class Presort	11,291	45	11,047	0.4%	97.8%
Priority Mail	4,186	4,159	14	99.3%	0.3%
Periodicals (except Fees)	2,052	0	2,050	0.0%	99.9%
Standard A Single Piece	124	124	0	100.0%	0.0%
Other Std A (except Fees)	13,501	0	13,435	0.0%	99.5%
Std B Parcel Post	948	309	620	32.6%	65.4%
Std B Bound Printed Mtr	428	48	380	11.2%	88.8%

1 Source: USPS-T-5, at 6-7, Table 1.

2       The heavy reliance on both systems simultaneously in the case of Parcel Post  
3 places unusual importance on ensuring that mail counted in one system is not also  
4 counted in the other. The Postal Service does not face this problem to any significant  
5 degree in any mail subclass other than Parcel Post.

6       The only way to avoid a double-count of permit imprint Parcel Post under these  
7 circumstances is for permit imprint Parcel Post observations in DRPW to be excluded  
8 from the ultimate DRPW data. Thus, ensuring that Parcel Post volume and revenue is  
9 not overstated depends heavily on the ability to identify correctly whether a particular  
10 piece of Parcel Post sampled in DRPW was paid for under a permit imprint or not, and  
11 to correctly record the payment indicia on the piece.

1           The correct assignment of the permit imprint RPW code for Parcel Post in DRPW  
2 appears to rest entirely on the response the DRPW data collector makes to only one  
3 question in the CODES RPW software.<sup>15</sup> As described in USPS-LR-I-37 (Handbook F-  
4 75, Data Collection User's Guide for Revenue, Volume, and Performance Measurement  
5 Systems) at page 3-109, the data collector must identify, for each container or mail  
6 piece, whether postage was paid by stamps, by meter, by permit imprint, by stamped  
7 envelope, or by precanceled stamp. When the Parcel Post estimates were derived  
8 entirely from the DRPW system, the accuracy of this one response was not so  
9 important: regardless of the indicia type recorded, the piece was counted in arriving at  
10 the Parcel Post estimates. Under the hybrid BRPW/DRPW system, however, if a permit  
11 imprint Parcel Post piece is incorrectly recorded as, say, a metered piece, it is  
12 incorrectly counted in both the DRPW system and in the BRPW system.

13           In short, the integrity and reliability of the Postal Service's FY1998 hybrid system  
14 rests in large part on one data collection question which, until PQ1 of FY1999, was  
15 previously of no consequence. There is no evidence that the Postal Service  
16 communicated to the DRPW data collectors that this previously unimportant question  
17 had suddenly assumed critical significance to the accuracy of the Postal Service's  
18 Parcel Post volume and revenue estimates. Indeed, since the decision to restate the  
19 FY1998 Parcel Post estimates was not made until after FY1998 was over, the data

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15. CODES is the laptop Computerized On-Site Data Entry System which is used to record mail piece information for the mail sampled and counted by DRPW data collectors during the administration of a DRPW test.

1 collectors could not possibly have been aware of this fact when they collected the  
2 FY1998 DRPW data.

3 **SUMMARY AND CONCLUSIONS**

4 The Postal Service has prematurely and unwisely altered the methodological  
5 basis upon which estimates of revenue, volume, and weight are developed for Parcel  
6 Post. Reliance on the hybrid BRPW/DRPW system proposed by the Postal Service in  
7 this case poses unacceptable risks and no benefits, particularly given the dramatic but  
8 unexplained increase in revenue, volume, and weight the new method generates. The  
9 hybrid system suffers from a number of flaws:

- 10 • It is inadequately and incompletely documented, rendering thorough  
11 investigation difficult, if not impossible;
- 12 • Unlike other BRPW mail categories, the 1998 BRPW Parcel Post  
13 estimates are not subject to a unique trial balance account adjustment.
- 14 • The existing BRPW validation checks are essentially meaningless  
15 because of the high level of aggregation of the data;
- 16 • Evidence suggests that the PERMIT System data may not be accurate;
- 17 • The new system provides less detail on the volume of mail by weight  
18 increment, rendering billing determinants less accurate than under the DRPW-  
19 only system; and

1       ♦       The reliance of the new system on the joint use of BRPW and DRPW  
2       places a new and unusual burden on the careful training and accuracy of DRPW  
3       data collectors to provide assurances that permit imprint Parcel Post is not  
4       double counted, training that could not have been conducted when the FY1998  
5       DRPW data was collected.

6       For all of these reasons, and because the tested, reliable, and more detailed  
7       DRPW-only estimates are available, I recommend that the Commission reject the  
8       FY1998 Parcel Post estimates derived from the new method and instead adopt the  
9       FY1998 DRPW-only based revenue, volume, and weight estimates for Parcel Post  
10      originally embraced by the Postal Service.

R

United States Postal Service  
**Postage Statement — Priority Mail and  
 Zoned Rate Standard Mail (B) — Permit Imprint**

EXHIBIT UPS-T-  
 Page 1 of 2

MAILER: Complete all items by typewriter, pen, or indelible pencil. If you need a receipt, prepare in duplicate.

Mailer Information	Post Office of Mailing		Mailing Date		Processing Category (DMM C050)		USPS Authorized Mailing ID Code(s)		
	Permit No.	Federal Agency Cost Code	Statement Sequence No.		<input type="checkbox"/> Letters <input type="checkbox"/> Flats <input type="checkbox"/> Machinable Parcels <input type="checkbox"/> Irregular Parcels <input type="checkbox"/> Outside Parcels				
	Permit Holder's Name and Address (Include ZIP Code)		Telephone	Receipt No.					
			Container Quantities (Fill in all that apply) 1-Fl. MM Trays _____ 2-Fl. MM Trays _____ 2-Fl. EMM Trays _____ Total Ltr. Trays _____ Flat Trays _____ Number of Sacks _____ Number of Pallets _____ Number of Other _____						
	Dun & Bradstreet No. _____		Weight of a Single Piece _____ pounds				If Bound Printed Matter, Sacking Based On <input type="checkbox"/> 10 pcs. <input type="checkbox"/> 20 lbs. <input type="checkbox"/> 1,000 cu. i		
Postage Computation	CTAS Cust. Ref. ID _____		Total Pieces		Total Weight				
	Name and Address of Individual or Organization for Which Mailing Is Prepared (If other than permit holder)		Name and Address of Mailing Agent (If other than permit holder)						
	Dun & Bradstreet No. _____		Dun & Bradstreet No. _____						
	<input type="checkbox"/> For bound printed matter (DMM E623 and E633), go to Part A on the reverse of this form. (Check if catalog bound printed matter) → <input type="checkbox"/> <input type="checkbox"/> For parcel post (DMM E622), go to Part B on the reverse of this form. (Check if bulk parcel post) → <input type="checkbox"/> <input type="checkbox"/> For destination BMC / ASF mail (DMM E652), go to Part C on the reverse of this form. <input type="checkbox"/> For Priority Mail (DMM E120), go to Part D on the reverse of this form.						Postage (From reverse side) →		
	Additional Postage Payment (Check reason) <input type="checkbox"/> Nonmachinable Surcharge (Inter-BMC Parcel Post Only) <input type="checkbox"/> Special Service (Specify)						No. Pieces _____ Rate/Fee Per Pc. _____ = \$ _____		
<b>Total Postage</b> → \$ _____									
Certification	The signature of a mailer certifies that it will be liable for and agrees to pay, subject to appeals prescribed by postal laws and regulations, any revenue deficiencies assessed on this mailing. (If this form is signed by an agent, the agent certifies that it is authorized to sign this statement, that the certification binds the agent and the mailer, and that both the mailer and the agent will be liable for and agree to pay any deficiencies.)								
	The submission of a false, fictitious, or fraudulent statement may result in imprisonment of up to 5 years and a fine of up to \$10,000 (18 USC 1001). In addition, a civil penalty of up to \$5,000 and an additional assessment of twice the amount falsely claimed may be imposed (31 USC 3802).								
	I hereby certify that all information furnished on this form is accurate and truthful, and that the material presented qualifies for the rates of postage claimed.								
Signature of Permit Holder or Agent (Both principal and agent are liable for any postage deficiency incurred.)						Telephone			
User's Use Only	Single-Piece Weight _____ pounds		Are figures at left adjusted from mailer's entries? <input type="checkbox"/> Yes <input type="checkbox"/> No						
	Total Pieces _____ Total Weight _____		If "Yes," Reason _____						
	Total Postage _____								
	Check One <input type="checkbox"/> Presort Verification Not Scheduled <input type="checkbox"/> Presort Verification Performed as Scheduled		Date Mailer Notified _____		Contact _____		By (Initials) _____		
	I CERTIFY that this mailing has been inspected concerning: (1) eligibility for postage rate claimed; (2) proper preparation (and presort where required); (3) proper completion of postage statement; and (4) payment of required annual fee.		Round Stamp (Required)						
Signature of Weigher _____						Time _____ AM _____ PM			

7.19.820

**Form 3605-R — Priority Mail and  
Zoned Rate Standard Mail (B) — Permit Imprint**

EXHIBIT UPS-T-41

Page 2 of 2

**A. Bound Printed Matter**

Post Office Finance Number

Check as applicable:

☐ Single-piece   ☐ Bulk   ☐ Catalog

Zone	Single-Piece Rate			Basic Bulk Piece Rate			Carrier Route Bulk Piece Rate			Basic & Carrier Route Bulk Pound Rate			(13) Total Postage Part A
	(1) Number of Pieces	(2) x Rate	(3) = Single-Piece Rate Postage	(4) Number of Pieces	(5) x Rate	(6) = Basic Piece Rate Charge	(7) Number of Pieces	(8) x Rate	(9) = Carrier Route Piece Rate Charge	(10) Number of Pounds	(11) Pound Rate	(12) BPM Pound Rate Charge	
Local					\$ .53			\$ .467			\$ .023		
1 & 2					.70			.637			.043		
3					.70			.637			.063		
4					.70			.637			.099		
5					.70			.637			.152		
6					.70			.637			.209		
7					.70			.637			.277		
8					.70			.637			.335		
Totals													

**B. Parcel Post**☐ Check if bulk parcel post

Zone	Inter-BMC Parcel Post			Intra-BMC Parcel Post			Total Postage Part B
	Number of Pieces	x Inter-BMC Rate	= Inter-BMC Postage	Number of Pieces	x Intra-BMC Rate	= Intra-BMC Postage	
Local							
1 & 2							
3							
4							
5							
6							
7							
8							
Totals							

**C. Destination BMC / ASF Mail**

Zone	Number of Pieces	x Destination BMC / ASF Rate	= Total Postage Part C
1 & 2			
3			
4			
5			
Totals			

**D. Priority Mail**

Zone	Presorted Pieces			Single-Piece / Residual Pieces			Total Postage Part D
	Number of Pieces	x Presorted Priority Rate	= Presorted Priority Postage	Number of Pieces	x Priority Rate	= Single-Piece Priority Postage	
Local							
1 & 2							
3							
4							
5							
6							
7							
8							
Totals							

Post Office Note Mail Arrival Time

# United States Postal Service

## Postage Statement — Parcel Post

### Permit Imprint

Permit Holder's Name and Address		Dun & Bradstreet No.		CAPS Cust. Ref. ID		Post Office of Mailing	
Telephone		Name and Address of Mailing Agent (if other than permit holder)		Dun & Bradstreet No.		Mailing Date	
Telephone		Name and Address of Individual or Organization for Which Mailing is Prepared (if other than permit holder)		Dun & Bradstreet No.		Statement Sequence No.	
Receipt No.		Total Weight		Total Pieces		Total Weight	
Permit No.		Weight of a Single Piece		Processing Category (DMM C050)		Number of Containers (Fill in all that apply)	
If Sacked or Bundled, Based on		Processing Category (DMM C050)		Number of Containers (Fill in all that apply)		Total Lb N/A	
<input type="checkbox"/> 1,000 Cu. In. <input type="checkbox"/> 20 Lbs. <input type="checkbox"/> Piece Count		<input type="checkbox"/> Flats <input type="checkbox"/> Irregular Parcels <input type="checkbox"/> Outside Parcels		<input type="checkbox"/> Machinable Parcels <input type="checkbox"/> Flat N/A <input type="checkbox"/> Irregular N/A <input type="checkbox"/> Outside N/A		Total Lb N/A Total Lb N/A Total Lb N/A	

### Mail Information

### Mailing Information

### Postage Computation (DMM P013)

### Certification

### USPS Use Only

Signature of Permit Holder or Agent (Both principal and agent are liable for any postage deficiency incurred.)		Telephone	
The signature of a mailer certifies that it will be liable for and agrees to pay, subject to appeals prescribed by postal laws and regulations, any revenue deficiencies assessed on this mailing. (If this form is signed by an agent, the agent certifies that it is authorized to sign this statement, that the certification binds the agent and the mailer, and that both the mailer and the agent will be liable for and agree to pay any deficiencies.) The submission of a false, fictitious, or fraudulent statement may result in imprisonment of up to 5 years and a fine of up to \$10,000 (18 USC 1001). In addition, a civil penalty of up to \$5,000 and an additional assessment of twice the amount falsely claimed may be imposed (31 USC 3802). I hereby certify that all information furnished on this form is accurate and truthful, that the material presented qualifies for the rates of postage claimed, and that this mailing does not contain any hazardous materials prohibited by postal regulations.			
Weight of a Single Piece Are figures at left adjusted from mailer's entries? <input type="checkbox"/> Yes <input type="checkbox"/> No			
Total Places		Total Weight	
Total Postage		Total Weight	
Check One (If applicable)		<input type="checkbox"/> Presort Verification <input type="checkbox"/> Not Scheduled <input type="checkbox"/> Presort Verification Performed as Scheduled	
I CERTIFY that this mailing has been inspected concerning: (1) eligibility for postage rate claimed; (2) proper preparation (and presort where required); (3) proper completion of postage statement; and (4) payment of required annual fee.		Verifying Employee's Signature Date Mailer Notified Contact By (Initials) Time AM PM	
Round Stamp (Required)			

**Parcel Post — Permit Imprint****A. Barcoded Inter-BMC/ASF Machinable**

Zone	Single Piece			BMC Presort			OBMC Presort			Total Postage Part A
	Number of Pieces	x Rate (Include barcoded discount)	Postage	Number of Pieces	x Rate (Include barcoded discount)	Postage	Number of Pieces	x Rate (Include barcoded discount)	Postage	
1 & 2										
3										
4										
5										
6										
7										
8										
Totals										

**B. Nonbarcoded Inter-BMC/ASF Machinable**

Zone	Single Piece			BMC Presort			OBMC Presort			Total Postage Part B
	Number of Pieces	x Rate	Postage	Number of Pieces	x Rate	Postage	Number of Pieces	x Rate	Postage	
1 & 2										
3										
4										
5										
6										
7										
8										
Totals										

**C. Inter-BMC/ASF Nonmachinable**

Zone	Single Piece			BMC Presort			OBMC Presort			Total Postage Part C
	Number of Pieces	x Rate	Postage	Number of Pieces	x Rate	Postage	Number of Pieces	x Rate	Postage	
1 & 2										
3										
4										
5										
6										
7										
8										
Totals										

**D. Local and Intra-BMC/ASF**

Zone	Barcoded			Nonbarcoded			Total Postage Part D
	No. of Pieces	x Rate (Include barcoded discount)	Postage	No. of Pieces	x Rate	Postage	
Local							
1 & 2							
3							
4							
5							
Totals							

**E. Destination Entry (DDU/DSCF/DBMC)**

Zone	Barcoded			Nonbarcoded			Total Postage Part E
	No. of Pieces	x Rate (Include barcoded discount)	Postage	No. of Pieces	x Rate	Postage	
DDU							
DSCF							
DBMC Zones 1 & 2							
DBMC Zone 3							
DBMC Zone 4							
DBMC Zone 5							
Totals							



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EXHIBIT UPS-T-4C:  
LEVEL OF DATA AGGREGATION  
AND IMPOSSIBLE RESULTS --  
FILED UNDER SEAL

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EXHIBIT UPS-T-4D:  
MAIL CLASS/SUBCLASS COVERED  
BY TRIAL BALANCE ACCOUNT,  
BRPW SYSTEM --  
FILED UNDER SEAL

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United States Postal Service  
**Plant-Verified Drop Shipment (PVDS)**  
**Verification/Clearance**

Requested in-home Delivery Date (Three-day window)  
 EXHIBIT UPS-T-4E, Page 1 c

**Plant-Verified Drop Shipment (PVDS) Verified and Paid**

☒ Origin Mailing Plant (DMU Verification) ☐ Origin Post Office (BMEU Verification)


**Part I - Mailer**

- A. Complete Part I, Items 1-8 and Part III, Item 1. Part I, Items 9-11 are optional (If an appointment is required, Item 9 may be required at time of shipment).
- B. Submit this completed form with the related shipment(s) and postage statements(s) to the Detached Mail Unit (DMU) or Business Mail Entry (BMEU) when the shipment is submitted for verification and clearance for dispatch.
- C. After the verifying employee has completed, signed, and dated this form, attach copies 2 and 3 to the left inside rear wall of the vehicle, just the rear doors. If the vehicle is to stop at multiple destination facilities to deposit mail, place the clearance documents for each stop in separate envelopes bearing the name of each entry office.

1. Mailer's Name [REDACTED]		7. Total Gross Weight of Shipment 1690	
2. Origin Plant Location (City, State, ZIP + 4) [REDACTED]		8. Type and Number of Containers <input checked="" type="checkbox"/> Pallets (with: <input type="checkbox"/> pkgs. <input type="checkbox"/> sacks <input checked="" type="checkbox"/> trays) - 6 <input type="checkbox"/> Trays (bedloaded) - 25 <input type="checkbox"/> Sacks (bedloaded) <input type="checkbox"/> Other (Describe): Wind Blinds	
3. Class of Mail <input type="checkbox"/> Periodicals <input type="checkbox"/> Standard (A) <input checked="" type="checkbox"/> Standard (B)	4. Product Name [REDACTED]	9. Drop Shipment Appointment No. 10. USPS Authorized Mailing ID Code (Optional) 555 JO.	
5. Type of Mail/Payment Method (Check all that apply) <input checked="" type="checkbox"/> Letters <input type="checkbox"/> Machinable <input type="checkbox"/> Flats <input type="checkbox"/> Automation <input type="checkbox"/> Irregular <input type="checkbox"/> Compatible <input type="checkbox"/> Permit <input type="checkbox"/> Metered <input type="checkbox"/> Stamped	6. Destination Entry Discounts Claimed (Check all that apply) <input type="checkbox"/> DDU <input checked="" type="checkbox"/> DBMC <input type="checkbox"/> DSCF <input type="checkbox"/> Zone Rates <input type="checkbox"/> Shipment includes places for delivery outside of entry office service area	11. Additional documentation attached describing mail to be off-loaded entry office (e.g., bill of lading, sack/tray/pallet listing, vehicle load diagram, etc.) <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	


**Part II - Post Office of Origin (Where Shipment is Verified)**

- A. Be sure the mailer has completed Part I, Items 1-8 and Part III, Item 1. (Part I Items 10 and 11 are optional. Item 9 may be completed after dispatch time of entry.)
- B. Complete Part II, Items 1-10. Show seal number that will be used to seal mailer's vehicle (at mailer's request) and vehicle ID number in Item 8.
- C. Retain copy 2 for your records.
- D. Give copies 1 and 3 of this completed form to the mailer for placement in the vehicle in which shipments are dispatched.
- E. After vehicle is loaded, seal vehicle with PVDS seal at mailer's request.

1. Origin Post Office (City, State, and ZIP + 4) [REDACTED]		9. USPS Employee Verifying Mail		10. Date			
2. Permit Number [REDACTED]	<input checked="" type="checkbox"/> Permit Imprint <input type="checkbox"/> Stamped <input type="checkbox"/> Meter	a. Printed Name [REDACTED]		 (Round Stamp)			
4. Single Piece Weight 0.0537	5. Total Pieces 23,049	6. Total Weight 1238				b. Signature [REDACTED]	
7. Vehicle Seal Number (except 2nd class)	8. Vehicle ID No.		c. Telephone Number [REDACTED]				

**Part III - Destination Entry Post Office or Delivery Unit**

- A. Reconcile information on this form against total volume in the shipment(s) deposited (e.g., count containers, weigh shipment, etc.)
- B. Verify that the seal number in Part II, Item 3 matched that on the seal removed from the vehicle, if the vehicle was sealed.
- C. If the seal number and shipment volume match the shipment deposited, complete Part III, Items 2-6, and accept the mail. Give copy 3 to driver requested.
- D. Retain copy 1 in your files for 1 year (along with the seal removed from the vehicle, if applicable.)
- E. If the shipment volume and/or seal number do not match: (1) hold the shipment and vehicle, and (2) call the office of origin or the district office made the appointment immediately to resolve the discrepancy. Describe any irregularities in Item 7.

1. Entry Office (City, State, ZIP + 4) [REDACTED]		7. Comments [REDACTED]	
2. USPS Receiving Employee's Signature [REDACTED]			
3. Date of Arrival 1-93	4. Time of Arrival 2:25		
5. Date of Departure 1-93	6. Time of Departure 2:35		

United States Postal Service  
**Plant-Verified Drop Shipment (PVDS)**  
**Verification/Clearance**

Requested in-home Delivery Date (Three-day window)

EXHIBIT UPS-T-4E, Page 2 of 2

Plant-Verified Drop Shipment (PVDS) Verified and Paid for at:

☒ Origin Mailing Plant  
 (DMU Verification)

☐ Origin Post Office  
 (BMEU Verification)
**Part I - Mailer**

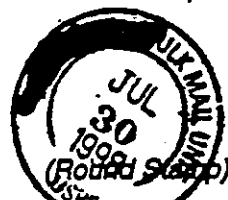
- A. Complete Part I, Items 1-8 and Part III, Item 1. Part I, Items 9-11 are optional (If an appointment is required, Item 9 may be required at time of entry.)
- B. Submit this completed form with the related shipment(s) and postage statements(s) to the Detached Mail Unit (DMU) or Business Mail Entry Unit (BMEU) when the shipment is submitted for verification and clearance for dispatch.
- C. After the verifying employee has completed, signed, and dated this form, attach copies 2 and 3 to the left inside rear wall of the vehicle, just inside the rear doors. If the vehicle is to stop at multiple destination facilities to deposit mail, place the clearance documents for each stop in separate envelopes bearing the name of each entry office.

1. Mailer's Name [REDACTED]		7. Total Gross Weight of Shipment 876	
2. Origin Plant Location (City, State) ZIP + 4 [REDACTED]		8. Type and Number of Containers <input checked="" type="checkbox"/> Pallets (with: <input checked="" type="checkbox"/> pkgs. <input type="checkbox"/> sacks <input type="checkbox"/> trays) <input checked="" type="checkbox"/> Trays (bedloaded) <input type="checkbox"/> Sacks (bedloaded) <input type="checkbox"/> Other (Describe):	
3. Class of Mail <input type="checkbox"/> Periodicals <input type="checkbox"/> Standard (A) <input checked="" type="checkbox"/> Standard (B)		4. Product Name [REDACTED]	
5. Type of Mail/Payment Method (Check all that apply) <input checked="" type="checkbox"/> Letters <input type="checkbox"/> Machineable <input checked="" type="checkbox"/> Flats <input type="checkbox"/> Automation <input type="checkbox"/> Irregular <input type="checkbox"/> Compatible <input type="checkbox"/> Permit <input type="checkbox"/> Metered <input type="checkbox"/> Stamped		6. Destination Entry Discounts Claimed (Check all that apply) <input type="checkbox"/> DDU <input type="checkbox"/> DBMC <input type="checkbox"/> DSCF <input type="checkbox"/> Zone Rates <input type="checkbox"/> Shipment includes pieces for delivery outside of entry office service area	
		9. Drop Shipment Appointment No. (May be added after verification)	
		10. USPS Authorized Mailing ID Code (Optional)	
11. Additional documentation attached describing mail to be off-loaded at entry office (e.g., bill of lading, sack/tray/pallet listing, vehicle load diagram, etc.) <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No			

**Part II - Post Office of Origin (Where Shipment is Verified)**

- A. Be sure the mailer has completed Part I, Items 1-8 and Part III, Item 1. (Part I Items 10 and 11 are optional. Item 9 may be completed after dispatch at time of entry.)
- B. Complete Part II, Items 1-10. Show seal number that will be used to seal mailer's vehicle (at mailer's request) and vehicle ID number in Item 8. Retain copy 2 for your records.
- C. Give copies 1 and 3 of this completed form to the mailer for placement in the vehicle in which shipments are dispatched.
- D. After vehicle is loaded, seal vehicle with PVDS seal at mailer's request.

1. Origin Post Office (City, State, and ZIP + 4) [REDACTED]		9. USPS Employee Verifying Mail		10. Date	
2. Permit Number [REDACTED]		3. Permit <input checked="" type="checkbox"/> Imprint <input type="checkbox"/> Stamped <input type="checkbox"/> Meter		a. Printed Name [REDACTED]	
4. Single Piece Weight 1.75		5. Total Pieces 5004		b. Signature [REDACTED]	
		6. Total Weight 876		c. Telephone Number [REDACTED]	
7. Vehicle Seal Number (except 2nd class)		8. Vehicle ID No.			

**Part III - Destination Entry Post Office or Delivery Unit**

- A. Reconcile information on this form against total volume in the shipment(s) deposited (e.g., count containers, weigh shipment, etc.)
- B. Verify that the seal number in Part II, Item 3 matched that on the seal removed from the vehicle, if the vehicle was sealed.
- C. If the seal number and shipment volume match the shipment deposited, complete Part III, Items 2-6, and accept the mail. Give copy 3 to driver, if requested.
- D. Retain copy 1 in your files for 1 year (along with the seal removed from the vehicle, if applicable.)
- E. If the shipment volume and/or seal number do not match: (1) hold the shipment and vehicle, and (2) call the office of origin or the district office that made the appointment immediately to resolve the discrepancy. Describe any irregularities in Item 7.

1. Entry Office (City, State, ZIP + 4) [REDACTED]		7. Comments [REDACTED]	
2. USPS Receiving Employee's Signature [REDACTED]			
3. Date of Arrival 8-4-98		4. Time of Arrival 0825	
5. Date of Departure 8-4-98		6. Time of Departure 1050	

1 BY MR. McKEEVER:

2 Q Mr. Sellick, I have just handed you a copy of  
3 Exhibit UPS-T4-C, entitled Level of Data Aggregation and  
4 Impossible Results, which was filed under seal on May 22,  
5 2000, as well as Exhibit UPS-T4-D, entitled Mail Class,  
6 Subclass Covered by Trial Balance Account BRPW System, also  
7 filed under seal on May 22, 2000.

8 Do you adopt those exhibits as part of your  
9 testimony today?

10 A Yes, I do.

11 MR. McKEEVER: Mr. Chairman, I move that Exhibits  
12 UPS-T4-C and UPS-T4-D be admitted into evidence, and  
13 transcribed into a separate volume of the transcript, a  
14 sealed volume.

15 CHAIRMAN GLEIMAN: Is there any objection?

16 [No response.]

17 CHAIRMAN GLEIMAN: Hearing none, if you'd provide  
18 two copies of those exhibits to the Court Reporter, I'll  
19 direct that the material be transcribed and received into  
20 evidence in a separate volume, and in the event that there  
21 is cross examination related to the sealed material, that  
22 will also appear in that same, separate volume.

23 [Exhibits Numbered UPS-T-4-C and  
24 UPS-T4-D were received into  
25 evidence and transcribed into a

sealed transcript.]

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# Official Transcript of Proceedings

*Before the*

UNITED STATES POSTAL RATE COMMISSION

**CONFIDENTIAL**

In the Matter of: POSTAL RATE AND FEE CHANGE

Docket No. R2000-1

VOLUME 31A

THE FOLLOWING DOCUMENTS ARE UNDER  
PROTECTIVE SEAL

DATE: Wednesday, July 19, 2000

PLACE: Washington, D.C.

PAGES: 15060 - 15076

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THE EXHIBITS ARE UNDER PROTECTIVE SEAL  
AND MUST BE OBTAINED THROUGH THE COMMISSION  
(PAGES 15060-15076)



1 CHAIRMAN GLEIMAN: And, if, indeed, there is cross  
2 examination on that material, as we've indicated in the  
3 past, all parties in the room who have not signed a  
4 certification will have to leave the room, and also,  
5 obviously, we will not broadcast that portion of the hearing  
6 since it relates to sealed materials.

7 Mr. Sellick, have you had an opportunity to  
8 examine the packet of Designated Written Cross Examination  
9 that was made available to you earlier today?

10 THE WITNESS: Yes, I have.

11 CHAIRMAN GLEIMAN: And if those questions were  
12 asked of you today, would your answers be the same as those  
13 you previously provided in writing?

14 THE WITNESS: Yes, they would.

15 CHAIRMAN GLEIMAN: That being the case, counsel,  
16 if I could get your assistance and if you would provide two  
17 copies that material to the Court Reporter, I'll direct that  
18 it be received into evidence and transcribed into the  
19 record.

20 MR. MCKEEVER: I will do so, Mr. Chairman.  
21 [Designated Written Cross  
22 Examination of Stephen E. Sellick  
23 was received into evidence and  
24 transcribed into the record.]  
25

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 PARCEL SERVICE  
WITNESS STEPHEN E. SELICK  
(UPS-T-4)

Party

Parcel Shippers Association

Interrogatories

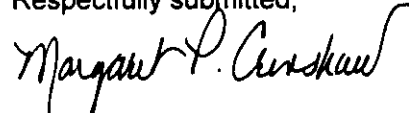
PSA/UPS-T4-1

USPS/UPS-T4-9-10, 12, 14-15, 17-18, 20-26, 29-30, 32-34

United States Postal Service

USPS/UPS-T4-1-34

Respectfully submitted,



Margaret P. Crenshaw  
Secretary

INTERROGATORY RESPONSES OF  
UNITED PARCEL SERVICE  
WITNESS STEPHEN E. SELICK (T-4)  
DESIGNATED AS WRITTEN CROSS-EXAMINATION

<u>Interrogatory</u>	<u>Designating Parties</u>
PSA/UPS-T4-1	PSA
USPS/UPS-T4-1	USPS
USPS/UPS-T4-2	USPS
USPS/UPS-T4-3	USPS
USPS/UPS-T4-4	USPS
USPS/UPS-T4-5	USPS
USPS/UPS-T4-6	USPS
USPS/UPS-T4-7	USPS
USPS/UPS-T4-8	USPS
USPS/UPS-T4-9	PSA, USPS
USPS/UPS-T4-10	PSA, USPS
USPS/UPS-T4-11	USPS
USPS/UPS-T4-12	PSA, USPS
USPS/UPS-T4-13	USPS
USPS/UPS-T4-14	PSA, USPS
USPS/UPS-T4-15	PSA, USPS
USPS/UPS-T4-16	USPS
USPS/UPS-T4-17	PSA, USPS
USPS/UPS-T4-18	PSA, USPS
USPS/UPS-T4-19	USPS
USPS/UPS-T4-20	PSA, USPS
USPS/UPS-T4-21	PSA, USPS
USPS/UPS-T4-22	PSA, USPS
USPS/UPS-T4-23	PSA, USPS
USPS/UPS-T4-24	PSA, USPS
USPS/UPS-T4-25	PSA, USPS
USPS/UPS-T4-26	PSA, USPS
USPS/UPS-T4-27	USPS
USPS/UPS-T4-28	USPS
USPS/UPS-T4-29	PSA, USPS
USPS/UPS-T4-30	PSA, USPS
USPS/UPS-T4-31	USPS
USPS/UPS-T4-32	PSA, USPS

USPS/UPS-T4-33  
USPS/UPS-T4-34

PSA, USPS  
PSA, USPS

ANSWER OF UNITED PARCEL SERVICE WITNESS SELICK  
TO INTERROGATORY OF THE PARCEL SHIPPERS ASSOCIATION

**PSA/UPS-T4-1.** Please refer to your testimony at page 18, lines 22-23, where you state: "As shown in Exhibit UPS-T-4C (filed under seal), even these highly aggregated records contain nonsensical results."

(a) Please identify the source for the aggregated data records included in Exhibit UPS-T-4C.

(b) Please state the total number of aggregated data records included in the source identified in (a).

(c) Please state the total number of aggregated data records in the source identified in (a) for which you have identified results that you believe to be "nonsensical." For each of these records, please further provide precise identifying information to allow them to be uniquely located in the source identified in (a) and a brief description of the reason you believe them to be "nonsensical."

(d) Please explain the meaning of the phrase "Does Not Include 5% Cushion" that forms part of the titles on pages 8, 9, and 10 of Exhibit UPS-T-4C.

(e) Please explain whether the aggregated data records on pages 8, 9, and 10 of Exhibit UPS-T-4C appear in the Postal Service data after the "Revenue Tolerance Check" described on page 9 of your testimony.

**Response to PSA/UPS-T4-1.**

(a) The aggregated data records included in Exhibit UPS-T-4C are from library reference USPS-LR-I-194.

ANSWER OF UNITED PARCEL SERVICE WITNESS SELICK  
TO INTERROGATORY OF THE PARCEL SHIPPERS ASSOCIATION

(b) There are approximately 2.7 million aggregated data records included in library reference USPS-LR-I-194.

(c) I included 12 Parcel Post records in Exhibit UPS-T-4C. The following table provides identifying information and a brief description of the reason I believe these records are nonsensical. These records are a subset of the Parcel Post records that meet that criterion (i.e., there are other records that contain nonsensical results). Furthermore, it is important to note that my analysis focused on Parcel Post only, a subset of the 2.7 million records provided in library reference USPS-LR-I-194. As such, the records in the table below do not include nonsensical records associated with other mail classes that may be contained in the library reference.

ANSWER OF UNITED PARCEL SERVICE WITNESS SELICK  
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AP	FINNO	VIP	RDATE	Comment
2	590994	4601	100597	Revenue per piece exceeds revenue per piece maximum limit
1	591597	4601	100597	Revenue per piece exceeds revenue per piece maximum limit
1	591274	4603	100597	Revenue per piece exceeds revenue per piece maximum limit
2	591274	4603	100597	Revenue per piece exceeds revenue per piece maximum limit
10	591848	4502	100597	Weight per piece exceeds weight per piece maximum limit
3	591829	4502	100597	Weight per piece exceeds weight per piece maximum limit
8	592113	4508	100597	Weight per piece is lower than minimum allowable weight per piece limit
9	592113	4508	100597	Weight per piece is lower than minimum allowable weight per piece limit
13	590048	4602	100597	Weight per piece is lower than minimum allowable weight per piece limit
1	590225	4601	100597	Weight per piece is lower than minimum allowable weight per piece limit
5	590225	4601	100597	Weight per piece is lower than minimum allowable weight per piece limit
8	592113	4507	100597	Weight per piece is lower than minimum allowable weight per piece limit

Given the level of aggregation of the data, it is surprising that even one aggregated record would exhibit these characteristics.

(d) The "Does Not Include 5% Cushion" refers to the 5% increase/decrease in the maximum and minimum revenue and weight limits used in the tolerance tests described in my testimony on page 9 at lines 11-14. In other words, I removed the 5% increase/decrease tolerance that the Postal Service allows for in these tests.

ANSWER OF UNITED PARCEL SERVICE WITNESS SELICK  
TO INTERROGATORY OF THE PARCEL SHIPPERS ASSOCIATION

(e) The aggregated data records on page 8 of Exhibit UPS-T-4C appear in the Postal Service data after the "Revenue Tolerance Check" because the Postal Service has the 5% adder in its tolerance test. If the 5% cushion were removed, none of these records would appear in the final Postal Service estimates. The aggregated records on pages 9 and 10 of Exhibit UPS-T-4C appear in the Postal Service data after the "Revenue Tolerance Check" because they do not fail the "Revenue Tolerance Check" or the "Weight Tolerance Check." They do not fail the "Weight Tolerance Check" for the reason given in footnote 7 on page 10 of my testimony.



**ANSWER OF UNITED PARCEL SERVICE WITNESS SELICK  
TO INTERROGATORY OF  
THE UNITED STATES POSTAL SERVICE**

**USPS/UPS-T4-1.** Refer to your testimony in the Introduction where you describe your educational background and job experience. For the purposes of this question, define the field of statistics to be the presentation, discussion and treatment of the following subject matter: measures of central tendency, measures of dispersion, statistical inference, mathematical statistics, finite population sampling, survey sampling, regression analysis, time series analysis, analysis of variance, design of experiments, and multivariate analysis.

- a. Please list the title of each academic course taken while pursuing your undergraduate and graduate degrees that related to the field of statistics. Briefly discuss, for each course, the course content and how the presentation of the identified statistical concepts were incorporated.
- b. If not mentioned in part (a), list the each [sic] course taken specifically related to finite population sampling and survey sampling. This topic area is best described as the material covered in the following textbooks: Sampling Techniques by William G. Cochran (3<sup>rd</sup> Edition, 1977, John Wiley & Sons, New York, New York), and Model Assisted Survey Sampling by Samdal et. al. (1992, Springer-Verlag, New York, New York). Also, if not discussed in part (a), briefly discuss, for each sampling course, the content as it related to treatment of such topics as population, random sampling, ratio estimation, and sources of error in surveys.

**ANSWER OF UNITED PARCEL SERVICE WITNESS SELICK  
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- c. If your background includes any course work subsequent to your two degrees that involves the subject areas identified in the body of this interrogatory or parts (a) and (b), please describe them in the terms prescribed in parts (a) and (b).
- d. Related to your job experiences, please provide, in the format of "Situation-Task-Analysis-Results" (STAR), your role in the review of any data system that involved finite population sampling or a survey of a population. In the STAR approach, describe your contribution and distinguish it from that of the task group.
- e. Related to your job experiences, please provide, using the STAR approach, your contributions, if any, in the review of finite population sampling estimation methodologies, such as stratified random sampling, ratio, and multi-stage estimators (point and variance). Distinguish your contributions from that of the task group.

**Response to USPS/UPS-T4-1.**

(a) In my undergraduate coursework at the Wharton School of the University of Pennsylvania, I completed two semesters in Statistics. Both were entitled "Introduction to Statistics" (STAT 1A and STAT 1B). The current course listing for these classes includes the following subjects: "Display of data; probability; discrete and continuous random variables; moments and descriptive measures; sampling, statistical inference and estimation; confidence intervals; hypothesis tests, regression and correlation, multiple regression, analysis of variance. Business applications."

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In my graduate coursework at the University of Chicago, I completed two courses in statistics, both of which were entitled "Statistical Methods for Policy Research" (I and II). The current course listing for these classes is reproduced below, in relevant part:

Statistical Methods for Policy Research I

"This course aims to provide a basic understanding of statistical analysis in policy research. Fundamental to understanding and using statistical analysis is the realization that data do not emerge perfect and fully formed from a vacuum. An appreciation of the provenance of the data, the way they were collected, even why they were collected, is necessary for effective analysis. Equally important is an understanding of the nature of the statistical inference being attempted; the course will distinguish between model-based and design-based inference. There will be some emphasis on sampling from finite populations and on data from survey research.

"The emphasis is on the use of statistical methods rather than on the mathematical foundations of statistics . . . . [T]he course will make no assumptions about prior knowledge, apart from arithmetic. For students with a strong technical background, the aim of the course is to increase their understanding of the reasoning underlying the methods, and deepen their appreciation of the kinds of substantive problems that can be addressed by the statistical methods being described.

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Statistical Methods for Policy Research II

"[T]his course focuses on the statistical concepts and tools used to study the association between variables. This course will introduce students to regression analysis and explore its uses in policy analysis."

(b) See my response to (a), above.

(c) I have not completed any course work in statistics other than as identified in (a), above. However, in my professional work, I deal on a daily basis with statistical and similar quantitative issues. In the postal context, I have worked extensively with sampling systems, especially the In-Office Cost System ("IOCS"), since the early 1990's, as reflected in the Introduction section of my testimony.

(d)-(e) I am not sure what this interrogatory seeks. In particular, I am not familiar with the format you describe ("Situation-Task-Analysis-Results" or "STAR"), nor are a number of individuals with statistical or sampling backgrounds with whom I checked. However, I am presently involved in several assignments for various clients which include population sampling (stratified and non-stratified) for the purpose of determining, among other things, differences between two sub-populations, the distribution of a variable of interest of several sub-populations, and the accuracy of data previously collected. My role in these assignments is to actively and directly supervise the engagement and work with my staff to develop sample design and evaluation of sample results, among other matters. I focus my efforts on how statistical analysis can

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assist clients, courts, and other decisionmakers in evaluating complex data-intensive issues.

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**USPS/UPS-T4-2.** Please refer to your testimony on page 2, line 20 where you question Parcel Post volume and revenue estimates.

- a. What is the true volume of Standard Mail (B) permit imprint Parcel Post pieces in the nation in BY1998? Please explain how you arrived at this number.
- b. Please confirm that the BRPW Standard Mail (B) permit imprint Parcel Post pieces provided by witness Hunter in Table 2 of the attachment to UPS/USPS-T5-2 is a statistical estimate with an estimated coefficient of variation of 0.97 (sic) percent. If you do not confirm please explain.
- c. Please confirm that it is your understanding the USPS could compute the number of DRPW Standard Mail (B) permit imprint Parcel Post pieces from the DRPW system for BY 1998.
- d. If you confirm part c, please confirm that this would also be a statistical estimate and that a coefficient of variation could be computed. If you do not confirm, please explain.
- e. Please confirm that Hansen, Hurwitz, and Madow in Sample Survey Methods and Theory (Vol. 1, John Wiley & Sons, New York, New York, 1953) define the bias of a survey estimate to be "difference between the expected value of the estimate and the true value being estimated." (page 17). If you do not confirm, please explain fully.
- f. Using the definition in part (e), please provide an estimate of the bias in the BRPW estimate of Standard Mail (B) permit imprint Parcel Post pieces. If you cannot

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provide, please explain if it would be possible to compute this number, and how it might be computed.

g. Using the definition in part (e) and assuming the Postal Service provided a DRPW estimate of permit imprint Parcel Post pieces, then please provide an estimate of the bias in the DRPW estimate of Standard Mail (B) permit imprint Parcel Post pieces. If you cannot provide, please explain if it would be possible to compute this number, and how it might be computed.

**Response to USPS/UPS-T4-2.**

(a) I have not made such a calculation, and it is not necessary for my testimony.

(b) Confirmed that the numbers presented by witness Hunter are an estimate and that he presents BRPW Standard Mail (B) permit imprint Parcel Post pieces as having an estimated coefficient of variation of 0.96 percent. See Tr. 2/806. I have not attempted to replicate the Postal Service's calculation, so I am not able to confirm or not confirm it. Of course, a coefficient of variation would not measure any deficiencies in the underlying data.

(c) I believe that the Postal Service could compute an estimate of permit imprint Parcel Post volume for BY1998 that is based on the DRPW sampling system.

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(d) Confirmed that the estimate referred to in (c), above, would be a statistical estimate and that a coefficient of variation could be computed.

(e) While I am not in possession of this specific book, the definition appears to be reasonable. Note that Statistics for Business and Economics, Sixth Edition (1994) McClave and Benson, at pages 1085-86, defines nonsampling errors to include "any phenomena other than sampling errors that cause a difference between an estimate and the true value of the population parameter."

(f) Note that the permit imprint Parcel Post estimate is not based on a sample, and therefore statistical bias as you have defined it is not relevant to it. In any event, I have not made this calculation, and it is not necessary for my testimony.

(g) I am not aware that the Postal Service has to date provided such an estimate, so I am not in a position to calculate an estimate of bias for it. In any event, such a calculation is not necessary for my testimony.



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**USPS/UPS-T4-3.** Refer to your testimony as it relates to the use of the words reliable, unreliable, and reliability in the following places: page 2, line 19; page 3, line 1; page 18, line 15; page 18, line 19; page 19, line 17; page 24, line 8; page 25, line 1; page 29, line 13, and page 31, line 6.

In formulating your response, please consider the following standard statistical sampling definitions as perhaps first defined by Hansen, Hurwitz and Madow (Sample Survey Methods and Theory, Vol 1., John Wiley & Sons, 1953), where they say:

"The difference between a sample result and the result from a complete count taken under the same conditions is measured by what we will refer to as the *precision* or the *reliability* of the sample result. The difference between the sample result and the true value, we call the *accuracy* of the sample survey" (pg. 10).

Answer the following questions for each identified reference.

- a. Confirm that your use of the word reliable is the same as the Hansen et. al. definition of reliability.
- b. If you are unable to confirm part (a), confirm that your use of the word reliable is the same as the Hansen et. al. definition of accuracy.
- c. If you are unable to confirm part (b), please define what you mean by reliability in terms of statistical measures that include the true value, sampling error, and bias.

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**Response to USPS/UPS-T4-3.**

(a)-(c) Not confirmed. My use of the words "reliable," "unreliable," and "reliability" are not meant to be interpreted as references to any statistical definitions or terms. Rather, as the context in which these terms are used in my testimony indicates, I am using them in their ordinary sense, as a dictionary would define them. *See, e.g., Merriam Webster's Collegiate Dictionary* (10th ed. 1997) at p. 988 ("reliable" -- "suitable or fit to be relied on").

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**USPS/UPS-T4-4.** Please refer to your testimony on page 11, lines 14-18, where you say that the BRPW estimate may be wrong, in need of adjustment, and controlling to trial balance provides a "check" on the BRPW estimates.

- a. Please confirm that if a random sample is drawn from a population such that every unit in the population has a known, non-zero probability of selection, that an estimate of the population mean and variance can be constructed from the data obtained from that survey. If not confirmed, please explain fully why not, and under what circumstances a sample estimate (point and variance) can be constructed from a population based on a survey of a population.
- b. Please confirm that one can construct a confidence interval around the estimated mean for a sample drawn as described in part (a). If not confirmed please explain why a confidence interval cannot be constructed around an estimate of a sample mean.
- c. Please confirm that the numbers produced from the BRPW system as described by witness Hunter in USPS-LR-I-26 are statistical estimates with point estimator  $Y_{st}$ , and variance estimator  $V(Y_{st})$ . If not confirmed, please explain why these estimators as presented in USPS-LR-I-26 are not accurate, and why the BRPW estimates can not be constructed from these formulae.
- d. Please confirm that your interpretation of the statistical estimator referenced in part (c) is that of a combined ratio estimate. If not confirmed please explain fully.

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- e. Please reconcile the difference between your statement on page 11 that an estimate can be wrong with that of the definition of a point estimate with estimated variance as discussed in parts (a) through (d).
- f. In reference to your use of the term 'wrong', under what circumstances is an estimate from a sample survey 'right'?
- g. Please define your use of the term 'wrong' as it relates to the confidence interval which can be constructed around the BRPW estimate(s).
- h. Please explain how an estimate taken from a sample survey can be 'wrong' given that an estimate taken from a sample survey has an estimated mean and variance.

**Response to USPS/UPS-T4-4.**

(a)-(b) The BRPW estimate for Parcel Post is not based on a random sample. Thus, these requests have little or no relevance to that estimate. In particular, to speak of a "confidence interval" in the case of a census is meaningless and it does not address the reliability of the underlying data. However, in general terms, I can confirm the statements in (a) and (b).

(c) Note that the discussion of sampling and confidence intervals in USPS-LR-I-26 is of little or no relevance to the BRPW permit imprint Parcel Post estimate

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since that estimate is not based on a sample. However, in a general sense, I confirm this statement.

(d) Confirmed that USPS-LR-I-26 presents a combined ratio estimate of Y where Y is the population revenue, volume, or weight total. For reasons discussed above, the permit imprint Parcel Post estimate is constructed differently than for other mail categories.

(e) If the data from which an estimate has been calculated is unverified and its reliability has been questioned, then the estimate itself is subject to question and may be wrong. In any event, the BRPW permit imprint Parcel Post estimate is not based on a sample.

(f) If, among other things, adequate data collection procedures are in place and the underlying data is checked and verified in a reasonable manner, then an estimate from a sample survey may be "right." Moreover, if the results of that survey are an intermediate step to another result of interest, then the survey must be conducted, and its results interpreted, in a fashion that allow those results to be used as intended. In any event, discussions concerning sample surveys are of little or no relevance to the BRPW permit imprint Parcel Post estimate since that estimate is not based on a sample.

(g) See my response to (e), above.

(h) See my response to (e), above.

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THE UNITED STATES POSTAL SERVICE**

**USPS/UPS-T4-5.** Refer to your testimony at page 12, lines 16-19, where you state, the DRPW system "... continues to be the sole source of revenue ... for a number of mail categories, including First Class Single Piece Mail, Standard (A) Single Piece Mail, Standard (B) Special Standard Mail, and Standard (B) Library Mail." Please confirm that the estimates for these categories as described in witness Pafford's testimony in footnote 2, Tables 1, 2 and 3, includes DRPW data and other source data. If you cannot confirm, please explain why you say that the estimates from these categories come exclusively from DRPW, when footnote 2 of these tables clearly indicate the presence of other source data.

**Response to USPS/UPS-T4-5.**

Footnote 2 to Mr. Pafford's Tables 1, 2, and 3 indicates that the source of the estimates for the identified categories is "DRPW (Includes other source data if any)" (emphasis added). My Table 1 at page 28 shows quite clearly that there is an extremely small, almost insignificant amount of revenue from other sources for First Class Single Piece Mail (0.3%), but that the DRPW system is essentially the sole source of the revenue estimates. The same holds true for Standard (B) Special Standard Mail, where only 0.3% of estimated revenue is derived from a non-DRPW source. See *rptwtbles.xls* filed by Postal Service witness Hunter, available at [www.prc.gov](http://www.prc.gov). For Standard (A) Single Piece Mail my Table clearly demonstrates that

**ANSWER OF UNITED PARCEL SERVICE WITNESS SELICK  
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DRPW is the sole source of revenue data. Standard (B) Library Mail estimated revenue is based entirely on DRPW. The point of my statement is in no way diminished by these small amounts derived from other sources, not including the BRPW system.

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**USPS/UPS-T4-6.** Please refer to your testimony at page 17, lines 1-3, where you claim that there was no investigation as to the discrepancy in the estimates between the methodology that incorporates BRPW estimates and the earlier methodology that did not. Please indicate the basis for your claim, including any statements by the Postal Service to this effect. Please identify specific efforts on your part of [sic] that of UPS (if necessary, check with UPS) to determine what, if any, investigation of this issue was made.

**Response to USPS/UPS-T4-6.**

My testimony on page 17 at lines 1-3 actually states in relevant part that "There seems to have been no investigation of [the] substantial discrepancy" between the DRPW-only estimate and the DRPW/BRPW estimate (emphasis added). In my review of the Postal Service's documents in this case, I found no evidence that an investigation of the substantial discrepancy between the FY1998 estimates produced by the two approaches was ever performed. Had there been such an investigation, I would have expected to see a description of it in the direct testimony of the Postal Service, given the extent of the discrepancy, or in the Postal Service's interrogatory responses, given the attention this matter received in discovery.



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**USPS/UPS-T4-7.** Please refer to your testimony at page 18, lines 9-10, where you use the term 'scrubbed'.

- a. Define the term 'scrubbed' and provide any authoritative source for your definition in statistical literature.
- b. Explain your understanding of how Mr. Hunter 'scrubbed' the input BRPW data.

**Response to USPS/UPS-T4-7.**

(a) My use of the word "scrubbed" is meant to indicate that the data was reviewed as part of a process intended to investigate and "resolve" anomalous data. The term has been widely used by the Postal Service and its witnesses both in this proceeding and in Docket No. R97-1.

(b) In his response to UPS/USPS-T5-21 (Tr. 2/831) and in oral cross-examination, among other places, Mr. Hunter described the process by which the BRPW data were reviewed and "flagged" records were "resolved." That description is very general, making it difficult to state with any degree of confidence exactly how the data was scrubbed. It appears that changes were made in PERMIT System data as a result of this process, although the Postal Service has not provided any records of the instances in which PERMIT System data were altered. See Tr. 2/1032-1033.

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**USPS/UPS-T4-8.** Please refer to your testimony at page 18, line 14-16, where you state that "it is impossible to evaluate with any degree of confidence how reliable the aggregated postage statement data is [sic]."

- a. Define what you mean by the phrase 'degree of confidence'.
- b. Confirm that this phrase (see part (a)) is a statistical term meant as the measure of the confidence interval around sample survey point estimate. If you do not confirm please explain.
- c. Relate the phrase 'degree of confidence' to the word 'reliability' used in this sentence.

**Response to USPS/UPS-T4-8.**

(a)-(c) As the context in which the term is used indicates, the terms "degree of confidence" and "reliability" as used in the sentence you cite are not used in any statistical sense. Rather, they refer to having an acceptable level of comfort that a result is sufficiently correct to be suitable to be relied upon in making decisions of the importance that the Commission is called upon to make. Since there is no way of knowing how the aggregated BRPW data was changed or how accurate the underlying, disaggregated data is, it is not possible to know whether the Parcel Post BRPW estimate is sufficiently correct to be able to rely on it in setting Parcel Post rates. Complete verification of the process and of the underlying data cannot be determined

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without being able to verify all parts of the data collection and estimation process from the point of obtaining individual postage statement data through the final Job 3 output estimates.

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**USPS/UPS-T4-9.** Please refer to your testimony at page 20, lines 11-12, where you criticize a supposed lack of adjustment to the Parcel Post estimates to a trial balance, at the same time ignoring the fact that the BRPW estimates are adjusted based on a survey of post offices as documented by witness Hunter in USPS-LR-I-230. The following sequence of questions relies upon a hypothetical survey in time t-1 where the sample size is equal to the population (i.e., a census with no sampling variance), the survey has no non-response, the measurement variable is known with certainty (no measurement error) and is the true value. The survey (census) is done to establish the relationship (ratio) between the revenue in the population and the revenue of a portion of the population. Assume for the purposes of this example that this relationship or ratio is 0.99. That is, the portion of the population represents 99% of the total revenue in the population. Assume further that the count of the population and the revenue in each population member is relatively unchanged in time t.

- a. Confirm that with the goal to have the lowest possible sampling error for the estimated revenue at time t-1, that a census is preferable to a sample. If you do not confirm, please explain.
- b. Confirm that with the goal of having the best possible revenue estimate at time t-1 that a 100 percent response rate is preferable to a response rate of less than 100 percent. If you do not, please explain.

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- c. Confirm that it is preferable to have no measurement error for the variable of interest, in this case revenue at time t-1, than to have measurement error. If you do not, please explain.
- d. Confirm that the portion of the population that represents 99% of the total revenue in the population in time t-1 is a good predictor of the population revenue in time t-1. If you are unable to confirm, provide an example demonstrating poor prediction.
- e. Confirm that if the population members and associated revenue in time t remain relatively unchanged from time t-1 that the portion of the population that represents 99% of the population in time t-1 would also be a good predictor of the population in time t. If you do not confirm please explain fully.

**Response to USPS/UPS-T4-9.**

I did not "ignor[e] the fact that the BRPW estimates [were] adjusted based on a survey of post offices." On the contrary, UPS sought that survey in discovery, but the Postal Service refused to do more than generally describe it and the "blowup factor" based on it. In any event, that is a different type of "adjustment" than the trial balance adjustment that is applied to other, non-Parcel Post BRPW estimates. In particular, the trial balance adjustment process reconciles an estimate to actual revenues and can result in increasing or decreasing the estimate to accord with actual revenues, whereas

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the survey was intended only to increase the BRPW Parcel Post estimate to reflect permit imprint volume at facilities that are not part of the PERMIT system; in no way does it act as a check on the accuracy of the BRPW estimate.

(a) If a census collects information reliably, with the same level of detail, and is compatible with other information with which it is intended to be combined, then it would be preferable to a sample with the same attributes. The evidence suggests that this is not the case for the Parcel Post BRPW estimate.

(b) Confirmed.

(c) Confirmed.

(d) Confirmed.

(e) Confirmed, subject to the nature and extent of change from time  $t-1$  to time  $t$ .

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**USPS/UPS-T4-10.** Please refer to your testimony at page 21, lines 3-9, where you state that the same factor of 0.9414 would have been applied to the BRPW estimate if it were to be book revenue adjusted.

- a. To the best of your understanding please define what you believe to be the inputs or components of the numerator of the Book Revenue Adjustment factor.
- b. To the best of you [sic] understanding please define what you believe to be the inputs or components of the denominator of the Book Revenue Adjustment factor.
- c. Show how that if [sic] the BRPW estimate were not to be treated as a census number, and therefore removed from the numerator of the Book Revenue Adjustment Factor and included in the denominator of said factor, how [sic] the same value would be derived. For the purposes of this request, use PQ 2 FY 1998.
- d. If you cannot show this requested result in part (c) please explain how you can make the statement that revenue would be lowered by \$37 million and pieces by approximately 14 million.

**Response to USPS/UPS-T4-10.**

The cited testimony does not state that "the same factor of 0.9414 would have been applied to the BRPW estimate." It states that "[h]ad the BRPW portion of the Parcel Post estimates been adjusted as well [by the Book Revenue Adjustment Factor],

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the Postal Service's own Parcel Post volume and revenue estimates for FY1998 would be lower by approximately 14 million pieces and \$37 million."

(a) The inputs for the numerator of the Book Revenue Adjustment factor are defined in LR-I-30, Appendix H.

(b) The inputs for the denominator of the Book Revenue Adjustment factor are defined in LR-I-30, Appendix H.

(c) The same value would not be derived. Removing the Parcel Post permit imprint revenue estimate from the BRPW side to the DRPW side of the Book Revenue Adjustment Factor would of course change the exact value of the Factor. By my calculation, this would change the PQ 2 FY1998 factor from 0.9213 to 0.9229. The effective Book Revenue Adjustment Factor for GFY1998 would change from 0.9414 to 0.9426.

(d) The cited testimony states that the FY1998 Parcel Post estimates "would be lower by **approximately** 14 million pieces and \$37 million" (emphasis added). The exact reductions would be 13.4 million pieces and \$35.2 million.



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**USPS/UPS-T4-11.** Please refer to your testimony at page 23, lines 16-17, where you say that . . . "not only does BRPW provide no additional detail, but it in fact provides less detailed information than does DRPW."

- a. Confirm that the USPS rate schedule effective January 10, 1999 for Standard Mail (B) Destination Entry Parcel Post defines three discount rate categories of DDU, DSCF, and DBMC. If you do not confirm, please explain fully.
- b. Please confirm that it is your understanding that the required markings beginning January 10, 1999 for DDU, DSCF, and DBMC mailpieces as described in the USPS Domestic Mail Manual 54, Chapter M, Section 3.0 included Drop Ship (D/S), DBMC Parcel Post, or DBMC PP. If you do not confirm, please explain fully.
- c. If you confirm part (b), please explain how DRPW, beginning January 10, 1999 can provide accurate estimates of DDU, DSCF, and DBMC discount categories.
- d. Confirm that beginning with the new rate schedule effective January 10, 1999, that BRPW can provide estimates at the DDU, DSCF and DBMC level. If you do not confirm, please explain fully.
- e. If you confirm part (d), please explain how the BRPW and DRPW, beginning January 10, 1999 can provide the same level of detail relating to DDU, DSCF, and DBMC discount categories.

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**Response to USPS/UPS-T4-11.**

(a) Confirmed.

(b) In the case of Parcel Post, § 3.2 of ¶ M012 of Domestic Mail Manual Issue 54 dated January 10, 1999, states that "The required marking 'Drop Ship' or 'D/S' for Parcel Post drop shipment rate mail may be placed in the postage area location specified in 3.1." That provision goes on to state that "Until January 10, 2000, mail qualifying for the DBMC rate may bear the marking 'DBMC Parcel Post' or 'DBMC PP' . . . ."

(c) My point in the statement you cite does not refer to rate category information. Rather, as stated in the sentence immediately preceding the one you cite (page 23, lines 14 to 16) and in the paragraph immediately following the sentence you cite (page 24, lines 1 to 6), my point is that the PERMIT system, and thus BRPW, "does not retain data on the volume of mail by weight increment." See the A.T. Kearney Data Quality Study, Summary Report, page 93, § 11.0 (as quoted on page 23 of my testimony at lines 19-22). This "forces the Postal Service to impute volume by weight category." UPS-T-4 at 24, lines 2-3. The DRPW system does provide that data.

(d) I have not reviewed information that would allow me to confirm this.

(e) Not applicable.

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**USPS/UPS-T4-12.** Please refer to your testimony at page 24, lines 17-18 and page 25, lines 1-2.

- a. Please identify each audit report that is referenced that attempted to provide a national estimate of the bias (bias as defined as the difference between the expected value of the estimate (audit) and the true value) in the postage statement data?
- b. If no audit report can be identified, please provide the basis for your projecting the findings to the national level. Please provide and explain the methodology and assumptions you use to make this projection.

**Response to USPS/UPS-T4-12.**

(a) The audit reports do not purport to measure "bias" in a statistical sense or on a national basis, nor have I "project[ed] the findings to the national level." Rather, there are 48 separate reports, apparently relating to 48 separate facilities. These reports "contain findings that call into question the reliability of the postage statement data that makes up the withheld PERMIT System data base." UPS-T-4, pp. 24-25 (footnote omitted). For example, here are some of the audit report findings:

1. "Customers were not always completing the Weight of a Single Piece, Total Pieces and Total Weight blocks on the front of the mailing statement. Also not completed were the Mailing Date, Processing Category, and Container Quantities

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blocks." USPS-LR-I-323 at 3, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (January 1998), at 1.

2. "The acceptance employee was not verifying the mailing by determining the single piece weight, total pieces, and total weight." USPS-LR-I-323 at 3, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (January 1998), at 1.

3. "Permit system logon ID codes have not been updated for several years and employees are using access codes that were not issued to them to manipulate data entry. Numerous instances were identified where clerks were using supervisory ID codes to approve system overrides and reversals without supervisory overview." USPS-LR-I-323 at 31, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (August 1998), at 18.

4. "The audit disclosed significant problems in the verification, acceptance and clearance of bulk mail by [redaction] BMEU." USPS-LR-I-323 at 43, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (July 1998), at 1.

5. "Observations made at a large detached mail unit (DMU) located at [redaction] determined not only was support documentation not being presented with each mailing, the mailer was not presenting a consolidated postage statement on the proper edition of Form 3602-PV, for all Plant-Verified Drop Shipment (PVDS) mailings (Section P750.2.7, DMM). Postal acceptance clerks were not reconciling the support

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documentation to postage statements during the acceptance procedures." USPS-LR-I-323 at 45, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (July 1998), at 3.

6. "Review of mailing statements for current mailers at [redaction] revealed that postal employees were completing the forms for the customers but were not always verifying weights and piece counts. For those mailing statements where the customer completed computations, verifications were not always performed." USPS-LR-I-323 at 79, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (August 1998), at 5.

7. "We concluded that the acceptance employee did not know what mail was being loaded on to the vehicle. . . . Postal employees made no attempt, either by counting or estimating, to determine whether the volume of mail matched the amount listed on mailing statements. . . . Residual pieces were not examined or verified to the mailing statements." USPS-LR-I-323 at 110, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (September 1998), at 2.

8. "Our review identified weaknesses in every aspect of bulk mail acceptance including employee training, equipment and manuals, maintenance of trust fund balances, verification and acceptance procedures, and clearance procedures." USPS-LR-I-323 at 195, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (April 1998), at 13.

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9. "The postal acceptance clerk was improperly completing the mailer's section of both the postage statement and the Plant-Verified drop Shipment Verification/Clearance Document (Form 8125). The postal clerk's responsibility should have been to verify the accuracy of the data on these statements, not to generate the information. Omission and errors in the clerk's verifications could go undetected. Numerous other potential problems were also observed. The mailer was not numbering the postage statements as required under their AMS [Alternate Mailing Systems] agreement and a review of the mailer's trust account transaction history identified two double postings of the same postage statements resulting in an overcharge of [redaction] in postage." USPS-LR-1-323 at 219, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (May 1998), at 9.

10. "During the audit, we ran transaction histories for a sample of 50 accounts. We identified inaccuracies in 25 permit imprint mailers' accounts." USPS-LR-1-323 at 253, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (December 1997), at 10.

11. "Of the 1311 First Class, Standard-A and B mailing statements and CASS/MASS Summary Reports reviewed, 69 mailings (5%) were identified that contained various errors." USPS-LR-1-323 at 316, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (July 1998), at 8.

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12. "There were 26 mailings presented during Accounting Period 12. . . .

There was no weigher verification completed on the statements presented. Nine of the statements were not fully completed by the customers, lacking essentials including number of pieces, piece weight, and total weight. Three of the mailings were presented on outdated forms." USPS-LR-1-323 at 340, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (August 1998), at 3.

13. "Verification procedures were not performed; mailing statements were not entered timely; significant differences existed in major trust accounts; records were not maintained properly; bulk mailings were dispatched without proper verification; an unauthorized scale was utilized; and funds were left in canceled permit accounts." USPS-LR-1-323 at 391, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (April 1998), at 18.

14. "Pre-sort verifications were not completed....Only one employee had received adequate training to conduct pre-sort verifications. This clerk was assigned to Tour 2. Business mail deposited between the hours of 5:30 PM and 9 AM was not verified, and was no longer on-site when the Tour 2 clerk arrived. Postage statements were left for the Tour 2 clerk, who signed and round dated the statements, even though he had never seen the mail." USPS-LR-1-323 at 402, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (August 1998), at 4.

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Also, there are many other audit reports that the Postal Service has refused to produce. Given the fact that the reports that have been produced raise serious questions about the accuracy of postage statement data, one should be skeptical about relying on postage statement information in the absence of an investigation that attempts to provide a national estimate of bias.

(b) I have not attempted to project the audit report findings to the national level, and that is not necessary for my testimony. See my response to (a), above.



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**USPS/UPS-T4-13.** Please refer to your testimony at page 25, lines 7-8, where you state that the audit reports indicate that BMAU personnel often do not do tasks such as deriving the total number of pieces in a mailing correctly.

- a. Please identify each audit report that attempted to quantify the effect and/or estimate of the bias (defined as the difference between the expected value of the estimate (audit) and the true value) of these incorrectly applied procedures.
- b. If no audit report can be identified, please provide the basis for your projecting the findings to the national level. Please provide and explain the methodology you use to make this projection.

**Response to USPS/UPS-T4-13.**

(a)-(b) See my response to USPS/UPS-T4-12.

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**USPS/UPS-T4-14.** Please refer to your testimony at page 29, lines 13-15, where you question the reliability of the estimates because of the heavy reliance upon "one data collection question" in the CODES RPW data collection instrument.

- a. Please provide any evidence which would [indicate] a change in difficulty beginning in FY1998 or thereafter for data collectors to distinguish between a permit and stamped/metered mailpiece.
- b. Please provide any estimates of bias that you are aware of regarding the effect of mis-recording permit indicia.

**Response to USPS/UPS-T4-14.**

(a) I am not aware of any "change in difficulty beginning in FY1998 or thereafter for data collectors to distinguish between a permit and stamped/metered mailpiece." That is not the point of the sentence to which you refer. Rather, I am observing: (1) that the consequence of accurately answering this data collection question assumes much more importance when a hybrid BRPW/DRPW system is used to estimate Parcel Post volume; and (2) that there is no evidence that the greater importance of the question, which previously was not very important, was ever communicated to the data collectors.

- (b) I am not aware of any such estimates.

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**USPS/UPS-T4-15.** Refer to your testimony on page 14, lines 11-22, where you compute a GFY 98 Book Revenue Adjustment Factor as derived from USPS-LR-I-30, USPS-LR-I-249, and USPS-LR-I-302.

- a. Please provide specific paragraph and page number citations from any USPS documentation that indicates that the BY 1998 estimates were developed using a "GFY" Book Revenue Adjustment Factor of 0.9414.
- b. Please confirm that as provided in LR-I-30 (Section 2. System Methodology/Process Flow) GFY RPW data are developed by summing quarterly RPW data. If you do not confirm, please explain fully.

**Response to USPS/UPS-T4-15.**

(a) Book Revenue Adjustment Factors are applied quarterly. For FY1998, the factors were approximately 0.77 for Q0, 0.92 for Q2, 0.91 for Q3, and 1.12 for Q5. Mathematically, these figures result in an implicit factor of 0.9414 for the entire FY1998 year, even though that implicit factor is never actually used. I presented the "annual" equivalent of the quarterly figures to more easily convey the overall effect of the Book Revenue Adjustment Factor on the revenue, pieces, and weight estimates.

- (b) Confirmed.

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**USPS/UPS-T4-16.** Refer to your testimony at page 15, lines 1-3, where you state that the "Book Revenue Adjustment Factor of 0.9414 is applied to DRPW estimates to reduce the DRPW portion of the revenue estimate for each class of mail so that the total RPW revenue estimate matches the Postal Service's actual total revenue."

a. Please confirm that LR-I-23 contains the quarterly Book Revenue Adjustment Factors used to develop the quarters (PQs 0, 2, 3, and 5) that were summed to produce USPS GFY 98 RPW data.

b. Please confirm that the GFY 98 Book Revenue Adjustment Factor of 0.9414 does not correspond to any of the quarterly Book Revenue Adjustment Factors provided in LR-I-23 which were used to develop the quarters that were summed to produce USPS GFY 98 RPW data.

**Response to USPS/UPS-T4-16.**

(a) Confirmed that the quarterly Book Revenue Adjustment Factors appear in the file FACTORS.TXT in the subdirectory "Data" of USPS-LR-I-23.

(b) Confirmed. As described in my response to USPS/UPS-T4-15, I used the data and programs provided in USPS-LR-I-30, USPS-LR-I-249, and USPS-LR-I-302 to calculate the implicit annual Book Revenue Adjustment Factor of 0.9414 for GFY1998. The quarterly Book Revenue Adjustment Factors I calculate in that process are the

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same as those presented in USPS-LR-I-23. Accordingly, the "GFY 98 Book Revenue Adjustment Factor" I calculate is consistent with USPS-LR-I-23.

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**USPS/UPS-T4-17.** Please refer to page 9 of your testimony at lines 6-16, and to page 10 at lines 1-2, where you identify four "primary types of errors that apply to [permit imprint] Parcel Post records" labeled in the BRPW system documentation USPS-LR-I-25/R2000-1 as EFLAG values 2000 (empty R, P or W), 2500 (empty revenue per piece or pound), 3000 (revenue tolerance) and 3100 (weight tolerance). Please also refer to the four BRPW Job-2 output files provided in USPS-LR-I-194/R2000-1 for the four postal quarters of FY 1998.

- a. Please confirm that the four files contain approximately 2.7 million records for all mail categories for the FY 1998 period. If you are unable to confirm, please explain fully.
- b. Please confirm that the four files contain approximately 32,000 permit imprint Parcel Post records for the FY 1998 period (excluding empty VIP 44444 records). If you are unable to confirm, please explain fully.
- c. Please confirm that of the total permit imprint Parcel Post records counted in part (b), fewer than 60 records were flagged for one of the four primary types of errors for the FY 1998 period. If you are unable to confirm, please explain fully.
- d. Please confirm that the revenue and volume totals for the flagged records identified in part (c) are \$3,048.49 and 463 pieces, respectively. If you are unable to confirm, please explain fully.

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- e. Please confirm that the records identified in part (c) were dropped from downstream processing in Job 3 of the BRPW jobstream.

**Response to USPS/UPS-T4-17.**

- (a) Confirmed.
- (b) Confirmed.
- (c) Confirmed.
- (d) Confirmed.
- (e) Confirmed.

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**USPS/UPS-T4-18.** Please refer to page 9 of your testimony at lines 6-16 and to page 10 at lines 1-2 where you identify the four "primary types of errors that apply to Parcel Post records" labeled in the BRPW system documentation USPS-LR-I-25/R2000-1 as EFLAG values 2000 (empty R, P or W), 2500 (empty revenue per piece or pound), 3000 (revenue tolerance) and 3100 (weight tolerance). Please also refer to page 30 of your testimony at lines 14-15 where you state that "[t]he existing BRPW validation checks are essentially meaningless because of the high level of aggregation of the data."

- a. Please confirm that the referenced Parcel Post records are permit imprint Parcel Post.
- b. Please confirm that this statement applies to the EFLAG error code 2000, used to identify raw PERMIT System input data records with a missing revenue, piece (volume) or weight value.

**Response to USPS/UPS-T4-18.**

- (a) Confirmed.
- (b) I am not sure what you mean by "this statement." Note, however, that these EFLAG codes are not applied to "raw PERMIT System input data," but rather to aggregated BRPW data records. If your point is that the level of aggregation has no



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bearing on a record which is missing revenue, piece (volume), or weight information, I  
agree.

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**USPS/UPS-T4-19.** Please refer to the results of the two audit reports described on page 25 of your testimony in footnotes 11 and 12, and to lines 12-13 of that page where you state: "The audit reports are not the only source of information which suggests that the high level of aggregation in the BRPW data base [sic] masks errors in the Permit System data base [sic]."

- a. Please provide the number of times "parcel" or "parcels" is explicitly referred to in the two audit reports.
- b. Please provide the number of times "Parcel Post" is explicitly referred to in the two audit reports.
- c. Please provide the number of times "permit imprint" is explicitly referred to in the two audit reports.
- d. Please provide the number of times "permit imprint Parcel Post" is explicitly mentioned in the two audit reports.
- e. Please provide the revenue, volume or weight for any permit imprint Parcel Post bulk mailing cited in either of the two audit reports.

**Response to USPS/UPS-T4-19.**

(a)-(d) The term "permit imprint fees" is referred to a few times in the November 1997 report. Otherwise, I do not believe that the two cited audit reports use the words "parcel," "parcels," "Parcel Post," "permit imprint," or "permit imprint Parcel Post." The

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sections of the audit reports referred to in my testimony discuss "business mail entry" and "bulk mail acceptance" and the PERMIT System in general, which necessarily may include permit imprint Parcel Post. The quoted portion of my testimony refers to all of the audit reports that were compelled to be produced by the Postal Service and that are part of USPS-LR-I-323. I refer to the two cited reports as illustrative examples. The 48 redacted audit reports appear to follow a Postal Inspection Service format with a standard scope. The level of detail in the question may perhaps be found in the underlying auditors' workpapers, which the Postal Service has not provided.

(e) The sections of the audit reports in question discuss systematic concerns (e.g., use of untrained personnel and non-supervisory use of supervisor override codes) and, unfortunately, do not quantify the impact of those observed problems.

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**USPS/UPS-T4-20.** Please refer to your statement at the bottom of page 17 regarding BRPW replication.

- a. Please confirm that you have replicated completely the permit imprint Parcel Post BRPW estimates (within rounding error).
- b. If you are unable to confirm, please identify by revenue, pieces and weight your divergence from the permit imprint Parcel Post BRPW estimates in absolute terms and on a percentage basis.

**Response to USPS/UPS-T4-20.**

(a) Confirmed that the BRPW estimates provided by the Postal Service using the data provided by the Postal Service have been replicated.

(b) Not applicable.

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**USPS/UPS-T4-21.** Please refer to page 6 of your testimony at lines 10-14 where you state that the new postage statement form 3605-PR "... reduces the possibility that revenue, piece, and weight information for one category of mail ... will be erroneously reported as belonging to another category of mail ...."

- a. Please identify, explain, and provide copies of any evidence you have to support this statement and quantify both the reduced possibility of erroneous reporting and the volume, pieces or weight affected.
- b. Identify any postal operating or financial reporting procedural handbooks and manuals, including the DMM, that support of your statement.

**Response to USPS/UPS-T4-21.**

(a)-(b) I believe it is a logical conclusion that, since the new form is for one type of mail only (i.e., permit imprint Parcel Post) and the old form was for up to three types of mail (i.e., Parcel Post generally, Bound Printed Matter, and Priority Mail), mailer and postal acceptance personnel confusion and incorrect data entry are much less likely with the new form. Unfortunately, no data is available to quantify the reduced possibility of erroneous reporting.

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**USPS/UPS-T4-22.** Please refer to USPS-LR-I-194/R2000-1 and to page 10 of your testimony at lines 12-13 where you restate witness Hunter's assertion that "[i]f the [failed edit] record does not 'materially' affect the final result, the record may not be corrected. Tr. 2/1030."

- a. Please confirm that such records for the permit imprint Parcel Post mail category are dropped from processing in Job 3 of the BRPW jobstream.
- b. Please confirm that no revenue, pieces or weight data are imputed for permit imprint Parcel Post under the BRPW for the FY 1998 period exclusive of any blowup factors used in the BRPW.

**Response to USPS/UPS-T4-22.**

- (a) Confirmed.
- (b) Not confirmed. Missing AP information does appear to be imputed for Parcel Post in certain instances.

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**USPS/UPS-T4-23.** Please refer to page 26 of your testimony at lines 5-9 where you state that the piece weight found on Forms 8125 "demonstrates" and "suggests that Standard Mail (A) pieces have been recorded as Standard (B) Parcel Post in the PERMIT system ...."

- a. Please confirm that you believe the volume and weight information shown on a Form 8125 is more accurate than the volume and weight information required on the postage statement that computes the mailer's postage. Please explain fully.
- b. Please confirm that you believe the Postal Service should change its bulk mail acceptance procedures to use Form 8125 information for official financial recordation and documentation purposes in place of bulk mail postage statements such as Form 3605-PR which is used for permit imprint Parcel Post mailers. Please explain fully.
- c. Please confirm that you identify no means by which mailing requirements would allow a mailer to compute postage for a Standard Mail (A) mailing at a lower Standard Mail (B) rate for the FY 1998 period. If not confirmed, please explain fully.
- d. Please confirm that there are no DMM or other Postal Service manual or handbook references of which you are aware that specify what postage statement might be used by the mailer of a Standard Mail (A) mailing for which postage might be computed at a lower Standard Mail (B) rate. If not confirmed, please explain fully.

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- e. Please identify, explain and provide copies of any evidence you have that counts or quantifies such incorrect recordation for the FY 1998 period.
- f. Please confirm that you have no reason to expect that incorrect recordation of Standard Mail (A) as Standard Mail (B) is any more likely than recordation of Standard Mail (B) as Standard Mail (A). If not confirmed, please explain fully and provide any evidence to support your explanation.

**Response to USPS/UPS-T4-23.**

(a) Not confirmed. My testimony to which you refer states that "A review of the produced Form 8125s shows instances in which the mail class indicated is Standard (B) DBMC Parcel Post whereas the piece weight demonstrates that the mail cannot possibly be Parcel Post but rather must actually be Standard Mail (A). . . . This suggests that Standard Mail (A) pieces have been recorded as Standard (B) Parcel Post mail in the PERMIT system, thus infecting the BRPW estimates." I have observed that the information on certain Form 8125s, which is supposed to match the information on the postage statements to which they relate, suggests that volume and weight information has been inaccurately entered into the PERMIT System. Unfortunately, the Postal Service has not produced the postage statements which correspond to the produced Form 8125s. (In fact, it has refused to produce all but two or three 1999 postage statements.) There are two possibilities: (1) The information on the Form



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8125 matches that on the postage statement to which it relates. In that case, errors on the produced Form 8125s reflect errors on postage statements, so that the postage statement information entered into the PERMIT System data base is wrong; (2) The information on one form does not match that on the other form. In that case, the information on the postage statement that is entered into the PERMIT System data base may or may not be wrong, but, in any event, there is no assurance that the information on the postage statement accurately reflects the characteristics of the mail that is actually physically entered into the mailstream when the Form 8125 is presented to the Postal Service with that mail.

(b) Not confirmed. I have made no such statement. Note that Form 3605-PR indicates that it was not available until January 1999.

(c) Not confirmed. See § 341 of the Domestic Mail Classification Schedule.

(d) I have not done an exhaustive search of the entire Domestic Mail Manual or of all Postal Service manuals or handbooks. However, see, e.g., Domestic Mail Manual Issues 52 (July 1, 1997) and 53 (January 1, 1998), § P750, ¶ 2.7.

(e) The level of aggregation of the information provided by the Postal Service has made such an analysis impossible. The Postal Service has refused to provide the disaggregated data which might make such an analysis possible.

(f) There is insufficient evidence available one way or the other that permits me to confirm or not confirm this statement. However, since the average weight of

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*Parcel Post exceeds five pounds and about sixty percent of Parcel Post volume weighs in excess of two pounds, it strikes me as unlikely that this volume could be mistaken as Standard (A) mail, which must weigh less than one pound. On the other hand, it is not as unlikely that Standard (A) parcels, which have an average weight of almost twelve ounces, may be mistaken for 16 ounce pieces, the minimum weight of a Parcel Post piece.*

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**USPS/UPS-T4-24.** Please refer to page 29 of your testimony at lines 10-12 where you state that "... if a permit imprint Parcel Post piece is incorrectly recorded as, say, a metered piece, it is incorrectly counted in both the DRPW system and in the BRPW system."

- a. Please identify, explain and provide copies of any evidence you have that counts or quantifies such incorrect recordation for the FY 1998 period.
- b. Please confirm that you have no reason to expect that any incorrect recordation in the other direction (metered recorded as permit imprint) in the DRPW, is less likely. If not confirmed, please explain fully and provide any evidence to support your explanation.

**Response to USPS/UPS-T4-24.**

(a) Unfortunately, there is no information available which permits the frequency with which this occurs to be quantified. Such a quantification may not be possible without a special study.

(b) I have no basis to confirm or not confirm this statement.

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**USPS/UPS-T4-25.** Please refer to page 30 of your testimony at lines 17-19 where you state that "[t]he new system provides less detail on the volume of mail by weight increment, rendering billing determinants less accurate than under the DRPW-only system."

- a. Please provide your understanding of how billing determinants are developed for Parcel Post.
- b. Please explain fully how and why the billing determinants are now less accurate, and quantify the level of any inaccuracy.
- c. Please provide all supporting documentation and include any computations required to quantify the level of any inaccuracy for your answer to part (b).

**Response to USPS/UPS-T4-25.**

(a) As described in the Postal Service's response to UPS/USPS-T5-86(a)-(b), "the billing determinants pull information from RPW and other data sources to develop a distribution of Parcel Post pieces to weight cell within zone for each category." Tr. 21/9337-38. As also described in that interrogatory response, the combined BRPW and DRPW Parcel Post estimates are distributed to zone based on actual information from the respective systems. BRPW includes zone information, as does DRPW, but not weight by zone, which is collected in the DRPW system, so that the estimated

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distribution of weight by zone must be based solely on information from the DRPW system.

(b)-(c) Billing determinants are less accurate under the joint BRPW/DRPW approach because the distribution of BRPW Parcel Post estimates to weight within zone are assumed to be the same as the DRPW estimates, when they may not be the same. See my response to (a), above. Previously, when the Parcel Post estimates were based entirely on DRPW, that assumption was not necessary. Furthermore, it is not clear from the information provided by the Postal Service whether the joint BRPW/DRPW method bases the BRPW distribution of weight by zone on the permit imprint data available from DRPW, the non-permit imprint data available from DRPW, or total DRPW Parcel Post. It is not possible to quantify the inaccuracy in the absence of more information than is now available, and such quantification was not necessary for my testimony.

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**USPS/UPS-T4-26.** Please refer to pages 21-22 of your testimony under section B where you criticize BRPW edit checks that apply a tolerance of 5 percent as failing to exclude BRPW records that are out of range. Please assume that in time period t-1, a BRPW record (record 1) passes the BRPW edit checks and that the record indicates an average piece weight that is 104 percent of the per-piece maximum for that category. Please also assume that in time period t, a second PERMIT System record (record 2) is subsequently reported containing a correction of the original data underlying the apparently overweight pieces in record 1, and that this record indicates a negative per piece weight of the same magnitude.

- a. Should record 1 be excluded? Please explain your answer completely.
- b. Should record 2 be excluded? Please explain your answer completely.
- c. Should record 1 and record 2 be excluded and in what time period: t or t-1? Please explain completely.
- d. Assuming both records were excluded by edit checks, what impact would you expect this to have on the quality of BRPW annual results?

**Response to USPS/UPS-T4-26.**

(a)-(d) Your example highlights both the ineffectiveness of the current regime of error checks as well as the inherent difficulty in attempting to apply meaningful error checks to aggregated data. The "extra" revenue, weight, and/or pieces in the first

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record at time t-1 (which, at 104% of maximum, would not be excluded) would overstate revenue, pieces, and/or weight, if in time period t other mailings or corrections brought record 2, in aggregate, "outside" the tolerance of the edit checks (e.g., negative 106% of tolerance). In any event, the aggregation of the records makes any edit checking process difficult and subject to error.

In your specific example, assuming the "record" is for a single shipment, the treatment should be either that both records are included or that both records are excluded. If both were included, the "net" revenue, pieces, and weight across the two periods would be "correct." If both records were excluded, "true" revenue, pieces, and weight would be mis-stated in the absence of (a) a unique trial balance account adjustment, or (b) other errors which happen to offset the result in the example. If the record is not for a single shipment, then one cannot say without more information whether and what records should be included or excluded.

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**USPS/UPS-T4-27.** Please refer to page 23 of your testimony and lines 14-16. Please explain and provide all supporting data relied upon in your claim that the DRPW permit imprint Parcel Post zone/weight distribution differs from that of the BRPW zone/weight distribution.

**Response to USPS/UPS-T4-27.**

*I have not claimed that the DRPW permit imprint Parcel Post zone/weight distribution differs from that of the BRPW zone/weight distribution. I have pointed out that the Postal Service methodology assumes that it is the same without, so far as I have seen, any supporting analysis. This concern was also expressed in the A.T. Kearney study referred to on page 23 of my testimony. Please also see my response to USPS/UPS-T4-25.*



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**USPS/UPS-T4-28. Please refer to your testimony at pages 23-24.**

- a. What imputation method do you understand that the Postal Service uses?
- b. What imputation methods have you studied? For each, please explain your understanding of their respective strengths and weaknesses, and compare each to the method applied by the Postal Service.
- c. What are the results of using these different imputation methods on the Postal Service's estimates for the FY 1998 period?

**Response to USPS/UPS-T4-28.**

(a) I have not studied the method used by the Postal Service in detail. It is not clear from the information provided by the Postal Service whether the current method bases the BRPW distribution of weight by zone on the permit imprint portion of DRPW, the non-permit imprint portion of DRPW, or total DRPW Parcel Post.

(b) I have, as would any quantitative analyst, utilized a number of "imputation methods" in my career. The particulars of any given method will vary depending on the available information, the time available to conduct an analysis, the cost of an analysis, the significance of the result, and one's expectations as to the difference made by employing alternative methods. These and other factors would need to be weighed in any particular situation. The referenced section of my testimony simply points out that using DRPW-only estimates of Parcel Post volume would provide an internally

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consistent basis for estimating weight by zone without the need for any assumptions as to how good a predictor any of the DRPW estimates are for the actual BRPW distribution.

(c) I have not attempted to determine the results under any alternative methodologies, nor is such a determination necessary to my testimony.

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**USPS/UPS-T4-29.** Please refer to your testimony at page 24, lines 7-15.

- a. Please confirm that you believe the edit checks applied to records in a sampling system should also be applied to records built upon a census of information.

Explain fully your response.

- b. Please confirm that your statement at lines 7-9 is analogous to a claim that an analysis of national results of the United States Census does not permit "any meaningful examination" of individual census response forms. Explain fully any negative response.

- c. Is it your understanding that examination of national level results based upon a census should permit meaningful examination of individual input records? Please explain fully your response.

- d. Please identify and provide copies of any other work that you or others working with you or under your supervision performed in which national level counts are used to inform estimates of the reliability of respective underlying input records.

- e. Is it your understanding that the BRPW edit checks are the sole basis on which the reliability of PERMIT System records can or should be based? Please explain fully.

- f. Are you aware of any basis beyond the BRPW edit checks that could be used to interrogate the reliability of national level BRPW results? Please explain fully.

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**Response to USPS/UPS-T4-29.**

- (a) Not confirmed. Records in a sampling system may require different edit checks than those built upon a census-based system.
- (b) Examination of the national results of the U.S. Census is not the same as an examination of individual census response forms.
- (c) It is my view that in this case, full examination of the accuracy of the aggregated BRPW results cannot be undertaken without an examination of the underlying input records.
- (d) I cannot recall any such instances.
- (e) No. My understanding is that the PERMIT System has certain built-in checks which attempt to limit the input of information into the system. The input of a supervisor code allows for the override of those checks; as documented in previously cited audit reports, however, non-supervisors have used, without approval, supervisory codes to override checks.
- (f) Not in the absence of disaggregated data.

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**USPS/UPS-T4-30.** Please refer to your testimony at pages 25-26. Please explain each response in detail:

- a. Please identify the sequence in which you understand that Forms 8125 and postage statements are completed.
- b. Is it your understanding that PERMIT System records are based on Forms 8125?
- c. Is it your understanding that PERMIT System records are based on postage statements?
- d. If a postage statement and a Form 8125 are inconsistent, which should be used as input for the PERMIT System?
- e. Is it your understanding that Form 8125 is the basis on which mailers' postage charges are based?

**Response to USPS/UPS-T4-30.**

(a) My understanding is that the postage statement is completed prior to the completion of Form 8125.

(b) No.

(c) My understanding is that, for permit imprint Parcel Post records, the PERMIT System is based on postage statements.

(d) The point is that the information on both sets of forms should be consistent, and the existence of an inconsistency indicates a data problem. If in the

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process of completing a Form 8125 an error is discovered in the information entered on the related postage statement (and therefore in the information entered into the PERMIT System), the PERMIT System data should be corrected.

(e) No.

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**USPS/UPS-T4-31.** Please explain your page 10 reference, lines 14-15, where you state that "... the remaining records are again run through Jobs - through 3." Please describe fully your understanding of this process.

**Response to USPS/UPS-T4-31.**

In his interrogatory responses and on oral cross-examination, as well as (I understand) during the BRPW technical conference, Mr. Hunter described an "iterative" process by which Jobs 1 through 3 were run, any aborts or material eflags were resolved to the operator's satisfaction, and then the programs (Jobs 1 through 3) were run again until they ran without aborting and material eflags were all resolved to the operator's satisfaction.

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**USPS/UPS-T4-32.** Please refer to footnote No. 7 on page 10 of your testimony pertaining to the Error Code 3100 weight tolerance test. Please refer also to your Exhibit UPS-T-4C, and please refer also to the line of code pertaining to the EFLAG=3100 check which begins with an ELSE IF statement in the Job 2 program code on page A23 of Attachment A to USPS-LR-I-25/R2000-1.

- a. Please confirm that: (i) four records reported by the BRPW for the FY 1998 period are identified by you on page 8 of your exhibit as having a revenue per piece above the maximum revenue per piece limit (but within the 5% tolerance); (ii) these records total to 50 pieces of permit imprint Parcel Post; and (iii) this volume is approximately one one-hundred-thousandth of one percent (0.00001%) of the total GFY 1998 Parcel Post volume (all indicia combined) shown in Table 2 of witness Hunter's and witness Pafford's testimonies. If not confirmed, please explain fully.
- b. Please confirm that: (i) two records reported by the BRPW for the FY 1998 period are identified by you on page 9 of your exhibit as having a weight per piece above the maximum weight limit; (ii) these records total to 389 pieces of permit imprint Parcel Post; and (iii) this volume is approximately one ten-thousandth of one percent (0.0001%) of the total GFY 1998 Parcel Post volume (all indicia combined) shown in Table 2 of witness Hunter's and witness Pafford's testimonies. If not confirmed, please explain fully.



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- c. Please confirm that: (i) six records reported by the BRPW for the FY 1998 period are identified by you on page 10 of your exhibit as having a weight per piece under the one pound minimum weight limit; (ii) these records total to 22,669 pieces of permit imprint Parcel Post; and (iii) this volume is approximately seven thousandths of one percent (0.007%) of the total GFY 1998 Parcel Post volume (all indicia combined) shown in Table 2 of witness Hunter's and witness Pafford's testimonies. If not confirmed, please explain fully.
- d. Please confirm that changing the coding statement from an ELSE IF to an IF (only) enables the Job 2 program to flag a record with a weight per piece value outside the weight limit range plus 5%.
- e. Please confirm that the 44 large volume records shown on pages 2-7 of your exhibit that have been mixed in with the 12 failed records shown on pages 8-10 of this same exhibit carried an Error Code value of 0 (no errors found) indicating that each record passed all absolute and relative measure edit checks programmed into the BRPW code for the FY 1998 period. If not confirmed, please explain fully.
- f. Please refer to the bottom of page 1 of your exhibit where you state that "[t]he minimum possible weight for Parcel Post is one pound per piece." Please confirm that no bulk mail piece weighing less than one pound can be mailed at Parcel Post rates.

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**Response to USPS/UPS-T4-32.**

- (a) Confirmed.
- (b) Confirmed.
- (c) Confirmed.
- (d) Confirmed.
- (e) Confirmed that the 44 large volume records shown are not flagged for any errors.

- (f) Not confirmed. See § 341 of the Domestic Mail Classification Schedule.

The statement in my testimony which you cite refers to the weight limit shown in the master rate tables in USPS-LR-I-194, which reflect a minimum weight of one pound per piece for Parcel Post.

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**USPS/UPS-T4-33.** Please refer to page 11 of your testimony at lines 17-18 in which you state that "[t]his trial balance reconciliation process provides an important 'check' on the BRPW estimates."

- a. Please confirm that you believe the 1.009208 (rounded) factor was not constructed for temporary use until a permanent AIC for permit imprint Parcel Post is established. Please explain your answer.
- b. Please confirm that during the FY 1999 period, the Postal Service replaced the interim period factor with a factor tied to the newly established AIC 223 trial balance revenue account.

**Response to USPS/UPS-T4-33.**

(a) I am unaware of whether the 1.009208 factor was "constructed for temporary use." My testimony is based on its use during the FY1998 period.

(b) Confirmed that at some point during FY1999, the Postal Service implemented a newly established trial balance revenue account for Parcel Post.

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**USPS/UPS-T4-34.** Please refer to page 12 of your testimony at lines 6-8 where you proclaim that the BRPW estimates were increased based on a "...survey of 42 non-PERMIT offices". Please also refer to Attachment A of USPS-LR-I-230/R2000-1.

- a. Please confirm that it is your understanding that the population surveyed was of size 42. If not confirmed, please explain fully.
- b. Please confirm that the count of offices reporting non-zero revenue in the survey shown in Attachment A is 9,799. If not confirmed, please explain fully.
- c. Please confirm that the factor of 1.009208 (rounded) is constructed as shown in the handwritten formula shown at the bottom of Attachment A. If not confirmed, please explain fully.

**Response to USPS/UPS-T4-34.**

(a) Not confirmed. My understanding is that a survey was conducted to develop the 1.009208 (rounded) factor to "account for residual non-automated office activity." See USPS-LR-I-230, page 1. I inferred from the response to USPS/UPS-T5-4 (Tr. 2/811), which provides a table entitled "FY 1998 BRPW non-automated office segment," that there were 42 non-automated permit imprint sites for permit imprint Parcel Post. Unfortunately, the Postal Service has not yet produced the details of the survey.

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(b) I can confirm that the sum of the "Freq" column in Attachment A (Appendix A, page 5) to USPS-LR-I-230 appears to be 9,799. The documentation provided in USPS-LR-I-230 does not describe Attachment A in any detail, so I cannot confirm that this represents the count of offices reporting non-zero revenue in the survey, as you suggest.

(c) I can confirm that the result of the handwritten formula shown at the bottom of Attachment A to USPS-LR-I-230, using the numbers in Attachment A, results in the 1.009208 (rounded) factor.

1 CHAIRMAN GLEIMAN: Is there any additional written  
2 cross examination for this witness?

3 [No response.]

4 CHAIRMAN GLEIMAN: There doesn't appear to be any.  
5 That brings us to oral cross examination. Two parties have  
6 requested oral examination of this witness, the Parcel  
7 Shippers Association and United States Postal Service.

8 Does anyone else wish to cross examine the  
9 witness?

10 [No response.]

11 CHAIRMAN GLEIMAN: If not, Mr. May, you may begin  
12 when you're ready.

13 BY MR. MAY:

14 Q Good morning, Mr. Sellick.

15 A Good morning.

16 Q From pages 19 through 30 of your testimony, you  
17 discuss three problems that you believe indicate that, as  
18 you say, the BRPW Parcel Post estimates are untested and  
19 unreliable.

20 Before -- and I'd like to ask you about those  
21 three reasons, but before doing that, just for clarification  
22 purposes, there are two basic systems for determining  
23 revenue pieces and weight, the DRPW and the BRPW; is that  
24 correct?

25 A Those are the two primary systems, yes.

1 Q And I believe that on page 28 of your testimony,  
2 you have a table, Table 1, and you there itemize the various  
3 service categories.

4 And then you have what percentage of those  
5 revenues are counted by the DRPW system, and what percentage  
6 by the BRPW system; isn't that correct?

7 A Yes, that's correct.

8 Q Now, on that table, I see that there are three  
9 categories which are, for all practical purposes, 100  
10 percent DRPW:

11 First Class single-piece, which is 99.7 percent;  
12 Priority Mail, 99.3 percent, and Standard A-single, 100  
13 percent; is that correct?

14 A Yes, it is.

15 Q And so those three categories are basically almost  
16 entirely single-piece categories; are they not?

17 A In large part. Priority Mail obviously has some  
18 bulk mailing component to it, but, yes, in large part, those  
19 are single-piece categories.

20 Q And when you have a single piece, you don't fill  
21 out a form, any kind of Postal forms?

22 A That's correct.

23 Q And, therefore, they do have to have a different  
24 system for counting revenue pieces and weight for those  
25 kinds of mail, because there is no form you can go to, and

1 you have to have a sampling system; is that correct?

2 A I can't -- as I sit here, now, I can't think of an  
3 alternative way that one could count those.

4 I do note, though, that the bulk classes,  
5 including Parcel Post, permit imprint Parcel Post, and, I  
6 believe, other components of First Class, until recently,  
7 were estimated solely by the DRPW system as well.

8 So a sample system can be used for and has been  
9 used for bulk mailings, as well as for single-piece mail.

10 Q Yes. The question I asked you is, in the case of  
11 single-piece, there is no alternative, is there, except to  
12 do the DRPW sampling system?

13 A Like I said, I haven't contemplated all the  
14 possible alternatives, but the sampling system using DRPW is  
15 the system that's in place, and I can't think of any  
16 alternatives at the moment.

17 Q Now, in the case of Parcel Post, for example, you  
18 do have a category of mail that has both single pieces in it  
19 and bulk pieces; isn't that correct?

20 A Yes, that's true.

21 Q I mean, a lot of it. We always talk about Aunt  
22 Minnie going down and waiting at the Post Office to mail her  
23 parcel, and there's no form filled out; is there, for that  
24 case?

25 A In most cases, I don't believe so, no.



1 Q And so in this particular case, the Postal Service  
2 proposes in this proceeding to utilize a revenue piece and  
3 weight count that is a combination of both DRPW and BRPW; is  
4 that correct?

5 A That's right; they want for the first time to  
6 combine the two systems for estimating Parcel Post volume.

7 Q And so they propose to count the Aunt Minnie  
8 parcels for which there are no forms, by using the DRPW  
9 sampling system, and then to count the bulk parcels by using  
10 the BRPW system, and then combining them; isn't that  
11 basically what they've done?

12 A Basically correct, although strictly speaking, it  
13 would be more correct to say that the BRPW system is  
14 counting only permit imprint Parcel Post.

15 I believe there could be bulk Parcel Post mailings  
16 by other than permit imprint, which would be captured  
17 through the DRPW system.

18 But I believe the majority of bulk would be  
19 captured through BRPW.

20 Q And the total amount of parcels, do you have an  
21 estimate of how many of the parcels of the total parcels  
22 covered are parcels that would be deemed to be single-piece  
23 parcels, what percentage, roughly?

24 A I don't know as I have developed an estimate to  
25 that effect, and I suspect it's somewhere in the record, but

1 I don't recall that offhand.

2 Q You don't know whether it would roughly correspond  
3 with the percentage of parcels that have been counted in  
4 this case by using the DRPW system?

5 A I suspect it would, for the most part, with the  
6 exception that I mentioned that BRPW is measuring only  
7 permit imprint Parcel Post, and I don't know the exact  
8 incidence of the alternative.

9 Q But you have proposed in this case that the -- let  
10 us assume, subject to the record verifying it, that the  
11 approximately two-thirds of the parcel volumes that are  
12 bulk, be nevertheless counted by a system, DRPW, that is  
13 fundamentally used to count single-piece mail and not bulk  
14 mail; is that correct?

15 Isn't that what you're proposing in this case?

16 A I am certainly proposing that all of Parcel Post  
17 be estimated as it has been for, as far as I know, all  
18 previous years, by using the DRPW system only.

19 Q Even --

20 A And I --

21 Q Excuse me.

22 A I'm sorry. I do think, though, it would be a  
23 mischaracterization to say that DRPW is, by design, only a  
24 single-piece counting system, because that's not the case.

25 As I mentioned, it has been in previous years in

1 previous proceedings, used for counting all of Parcel Post  
2 and other bulk classes as well.

3 Q Well, with the exception of Parcel Post, I mean,  
4 your own table here suggest that the categories of mail for  
5 which DRPW is predominantly used are predominantly  
6 single-piece categories of mail; isn't what your table  
7 shows?

8 A The table does show that, although as I think I  
9 mention elsewhere in my testimony, the First Class metered  
10 and precanceled stamp category is also a recent addition to  
11 the -- is recently estimated by BRPW and was previously  
12 estimated by DRPW.

13 So that's also -- that's another. It's only  
14 because of the recent changes that that's the case.  
15 Historically, that has not been the case.

16 Q Now, the reason you want to use the DRPW, as  
17 opposed to the BRPW, for not just the single-piece parcels,  
18 but for the bulk shipped parcels is -- I guess the reasons  
19 are the three reasons you elaborate on in pages 19 through  
20 30 of your testimony; is that correct?

21 A The reasons, I'd say, in general, are those  
22 elaborated in my testimony, yes.

23 Q Now, first, I'd like to ask you to turn to page 19  
24 of your testimony. And the first reason you argue there is  
25 that the Postal Service has failed to apply a trial balance

1 revenue account adjustment to the Parcel Post BRPW  
2 estimates. That's at lines 18 and 19.

3 A That's correct.

4 Q Now in FY 1998 there wasn't a separate trial  
5 balance revenue account for Parcel Post that would have  
6 allowed a trial balance revenue account using the usual  
7 system and the Postal Service performed an adjustment using  
8 the results from a 1997 census of post office revenues.

9 A Well, it's correct that there was not a unique  
10 trial balance account for permit imprint for Parcel Post in  
11 Fiscal Year 1988. That is correct.

12 It is also correct that the Postal Service  
13 performed an adjustment of the permit imprint Parcel Post  
14 results from the PERMIT system offices using a special study  
15 that was based on Fiscal Year 1997, Quarter 2 data.

16 However, I don't believe that the special study --  
17 let's just refer to it as a special study -- is a  
18 replacement for the trial balance adjustment.

19 In most of the other PERMIT or BRPW categories  
20 there is a sample component to the estimate for nonautomated  
21 offices.

22 The special study is essentially a replacement for  
23 that sample component that adjusts for nonautomated offices.  
24 These other classes of mail that have the sample component  
25 also have for the most part a trial balance adjustment, so

1 those are really two separate adjustments or factors that  
2 are taken into account. They aren't substitutes for each  
3 other.

4 Q Yes, they couldn't use it for '98. They didn't  
5 have a separate trial balance.

6 A That is correct. There was no trial balance  
7 account.

8 Q So they had to try to use something else. You  
9 find it inadequate but they did have to try to use  
10 something.

11 A That is what I am trying to say. They aren't  
12 substitutes for each other.

13 The special study was a substitute for the sample  
14 of nonautomated offices that is present for other classes.

15 There was no substitute or nothing at all to  
16 attempt to reconcile, because as you say it wasn't possible  
17 to reconcile to any kind of exogenous trial balance account.

18 Q Good. Now would you refer to your answer to the  
19 Postal Service's Interrogatory 33.

20 In that answer they asked, the Postal Service  
21 asked you to confirm that during the Fiscal Year 1999 the  
22 Postal Service replaced the interim period factor with a  
23 factor tied to the newly-established AIC 223 trial balance  
24 revenue account, and your answer was confirmed, that at some  
25 point during FY 1999 the Postal Service implemented a

1 newly-established trial balance revenue for Parcel Post,  
2 correct?

3 A Yes. That is correct.

4 Q So the Postal Service had the ability to perform  
5 the trial balance adjustment for the Postal Service BRPW  
6 estimates for FY 1999, whereas they did not have the ability  
7 in FY '98.

8 A That is correct.

9 Q So the objection that you have concerning the FY  
10 1998 trial balance doesn't apply to FY 1999, does it?

11 A There was a trial balance account available and I  
12 believe it was used for Fiscal Year 1999, yes.

13 Q Now as a result of the Commission's Order Number  
14 1294, if you use actual FY '99 cost data in the Postal  
15 Service's test year forecasts to the extent feasible, the  
16 base year has effectively been changed from FY 1998 to FY  
17 1999, has it not?

18 MR. McKEEVER: Objection, Mr. Chairman. I don't  
19 believe there has been any ruling that there's a new base  
20 year in this proceeding.

21 I believe that is an issue before the Commission  
22 but to say it has effectively been changed I think is not  
23 accurate.

24 I am not sure it is essential to Mr. May's line of  
25 questioning, but in any event I do object to the question as

1 it stands.

2 CHAIRMAN GLEIMAN: I think you can probably ask  
3 your question by changing one little word in there, Mr. May,  
4 because the Commission has indeed not made any decisions  
5 with respect to the base year.

6 BY MR. MAY:

7 Q Well, to the extent the Postal Service follows the  
8 Commission's order and makes an attempt to utilize FY 1999  
9 data for Parcel Post, is it not the case that your objection  
10 disappears because they can use -- because the trial balance  
11 account would have been utilized for FY 1999 data?

12 A Certainly if they use a trial balance account the  
13 observation that they didn't use a trial balance account  
14 would no longer be the case.

15 However, I think all of the filings of the Postal  
16 Service pursuant to the Commission's Order or request I  
17 don't believe are in yet. I haven't yet -- I know we have  
18 been looking. I don't believe I have yet seen results that  
19 actually use the 1999 volume data. I haven't finished a  
20 review of all of that.

21 Finally, because there wasn't a trial balance  
22 adjustment for the permit imprint Parcel Post in 1998 I  
23 haven't reviewed or attempted to review that process  
24 independently so I don't know that there wouldn't be  
25 concerns about how that was implemented or anything to that

1 effect. It is just something I didn't investigate, but it  
2 certainly is true if they use a trial balance adjustment in  
3 1999 then I couldn't say that they didn't use a trial  
4 balance adjustment.

5 Q Thank you. Now going on to the second problem you  
6 identify for the use of the BRPW system, which is on page 21  
7 of your testimony under caption capital "B" there, you say  
8 there are substantial reasons to question the accuracy of  
9 the BRPW Parcel Post estimates, correct?

10 A Yes. That is correct.

11 Q Now in your testimony you discuss problems you  
12 have found in some BRPW data records, and in your sealed  
13 exhibit, UPS-T4C, and I am not going to identify privileged  
14 information in the question, but in that sealed exhibit you  
15 list 12 Parcel Post records for which you have located  
16 problems, is that not correct?

17 A I do list 12 of the records for which problems  
18 were identified, yes.

19 These are 12 of the aggregated records as used in  
20 the BRPW process, yes.

21 Q Now I believe you have confirmed a Postal Service  
22 interrogatory asking you to confirm that there are  
23 approximately 32,000 what they call "nonempty," meaning  
24 filled out, permit imprint Parcel Post records in the FY  
25 1998 data provided by the Postal Service.



1 I think again that is your -- that was an answer  
2 to a question that was originally provided under seal but  
3 today I gather that has been put in the record, I believe,  
4 because it is deemed that the answer is not divulging any  
5 information that is under seal.

6 MR. MCKEEVER: Mr. Chairman, my understanding is  
7 that although the Postal Service originally insisted that  
8 the interrogatories themselves be filed under seal, after I  
9 think a review of the interrogatories since we had sent them  
10 to the Postal Service ahead of time for them to make that  
11 determination and the answers were filed under seal, my  
12 understanding is that the Postal Service has agreed with  
13 respect to that interrogatory, if we are talking about the  
14 same one, that it no longer need be kept under seal.

15 For some reason or other it no longer sees that  
16 particular information as confidential. However, I think it  
17 is really up to the Postal Service counsel to confirm that.

18 CHAIRMAN GLEIMAN: Mr. Hollies?

19 MR. HOLLIES: We designated all of Mr. Sellick's  
20 responses to Postal Service interrogatories and none of them  
21 were retained, as it were, under seal because, yes, upon  
22 reviewing the combination of the questions and the answers  
23 we did not believe that it touched upon those concerns which  
24 dictated sealed conditions.

25 MR. MCKEEVER: I think that answers Mr. May's

1 question, Mr. Chairman.

2 MR. MAY: It does, so we can freely refer to  
3 this -- your response to this interrogatory.

4 CHAIRMAN GLEIMAN: Thank you, gentlemen.

5 MR. McKEEVER: Mr. Chairman, may I ask Mr. May  
6 what interrogatory he is referring to?

7 MR. MAY: Yes, I am referring to the Postal  
8 Service's Interrogatory T-4-17(b).

9 BY MR. MAY:

10 Q That interrogatory says, "Please confirm that the  
11 four files contained approximately 32,000 permit imprint  
12 Parcel Post records for the FY 1998 period excluding empty  
13 VIP 44444 records" and your response is "Confirmed."

14 So you have confirmed that there were  
15 approximately 32,000 of these records, is that correct?

16 A That is correct.

17 Q So the 12 records that you identified in your  
18 exhibit represent an error rate of about four-tenths of one  
19 percent subject to the math?

20 A Subject to the math I will except that  
21 calculation.

22 I would note, however, and as I think I have  
23 pointed out in my testimony, that there's a couple of  
24 factors that really make it surprising that there are any,  
25 any records at all that meet the criteria that I set for

1 putting these records into the exhibit.

2 The BRPW data is extremely aggregated, as we have  
3 discussed. Each individual record represents all of the  
4 mailings for a particular accounting period for a particular  
5 finance number for a particular what is called VIP code,  
6 which is the equivalent basically of a rate category and  
7 zone combination, so given that level of aggregation as well  
8 as the difficulty in doing any kind of error checks at all  
9 on the BRPW data, which I have discussed in my testimony, I  
10 am not surprised that there were relatively few records that  
11 were found to meet that criteria.

12 Q And apparently however there were more records  
13 than just the 12 you mentioned, because in an answer to a  
14 PSA interrogatory you indicated that the 12 was a subset of  
15 the records you had identified.

16 That's Parcel Shippers' Interrogatory to you  
17 Number 1.

18 A Yes, the 12 were a subset of the records.

19 Q And how many records did you identify exactly out  
20 of the 32,000 that had problems?

21 A I don't recall the exact number. I believe there  
22 were about 160 records that failed the Postal Service's  
23 so-called e-flag tests and there were an additional number  
24 that failed when you remove what I describe as the cushions  
25 in the e-flag tests and apply the weight e-flag test, which

1 was inadvertently avoided in the Postal Service's  
2 programmings, but I don't recall the exact number. It was  
3 somewhere in the hundreds, I believe.

4 Q Perhaps it will help you to refer you to your  
5 response to Postal Service Question 17(c) -- 17(c) said,  
6 "Please confirm that of the total permit imprint Parcel Post  
7 records counted in Part B, the 32,000, fewer than 60 records  
8 were flagged for one of the four primary types of errors for  
9 the FY 1998 period."

10 Your response was, "Confirmed."

11 A Yes, I'm sorry. There were 60 that meet the  
12 Postal Service e-flag criteria but as I mentioned, the  
13 programming in the Postal Service's I believe it is Job 2  
14 resulted in the permit imprint Parcel Post records not being  
15 subjected to the weight e-flag tests, so there would be  
16 additional records that would fail if that check were  
17 actually turned on and there would be further records that  
18 would fail if you removed the 5 percent cushions on the  
19 revenue and weight tests that I mentioned in my testimony.

20 Q Well, but how many more do you think there would  
21 be?

22 A I think it is something in the order of several  
23 hundred but I don't know what the exact number is as I sit  
24 here now.

25 Q Well, even if it were 300 it would still mean that

1 the error rate was less than 1 percent, would it not?

2 A The error rate -- that would be subject to check  
3 on the calculation -- yes, that might be the error rate for  
4 these extremely aggregated records for which we have a very  
5 limited ability to perform any kind of checks at all.

6 Q Now I believe you have also indicated in a  
7 response to the Postal Service's Interrogatory 17(e) that  
8 the 12 records that you identified as erroneous were all  
9 removed in the data cleansing process so that they did not  
10 end up affecting the final BRPW estimate for Parcel Post, is  
11 that correct?

12 A That is correct.

13 By the nature of the programming those records  
14 would be removed from the final estimates.

15 Q Now I would like to examine the third problem you  
16 say you found with the use of the BRPW, and that testimony  
17 about that begins on page 27 of your testimony.

18 A Okay.

19 Q And you define the third problem there, it's in  
20 caps, the joint use of BRPW and the DRPW leads to possible  
21 double counting for Parcel Post.

22 A That's correct, yes.

23 Q Now, you there posit a possible type of error in  
24 which, as you say on page 29, a permit imprint Parcel Post  
25 piece is incorrectly recorded as a metered piece. That is

1 one type of error possibly, is that correct?

2 A That is an example I cited as a possible error,  
3 yes.

4 Q Now, as a result of that kind of error, the piece  
5 would not be removed from the DRPW system, correct, even  
6 though its permit would be counted under the BRPW system?

7 A That's correct. In that circumstance, the piece  
8 would effectively be counted, not just that single piece,  
9 but because DRPW is a sample system, the blow-up of that  
10 single piece would be counted, as would the individual piece  
11 in the BRPW system.

12 Q Yeah, so they get -- the same pieces get counted  
13 in both systems, that is the double counting?

14 A That's correct.

15 Q Now, the error that you have identified occurs  
16 when the DRPW data collector indicates whether the postage  
17 is paid by stamps, by meter, by permit imprint, by stamp  
18 envelope or by pre-canceled stamps. He has got a sheet he  
19 checks, isn't that -- saying what is the indicia on this?

20 A It is actually a response he or she makes into a  
21 laptop computer. But, yes, it is where they have to record  
22 the indicia of the mail piece that is being sampled at that  
23 point in time.

24 Q So, in your example, that data collector might  
25 make a mistake and record the permit imprint Parcel Post

1 piece as a metered piece?

2 A That's correct.

3 Q Now, isn't it also case that the DRPW data  
4 collectors will be collecting data on metered pieces of  
5 Parcel Post?

6 A Certainly, yes.

7 Q And if we suppose that the data collectors  
8 sometimes make a mistake and record a permit piece as a  
9 metered piece, isn't it reasonable to suppose they will  
10 sometimes make a mistake and record a metered piece as a  
11 permit piece?

12 A I just wanted to refer myself to my interrogatory  
13 response to Postal Service T-4-24. There is no way to  
14 really quantify the incidence of that and I don't know which  
15 way the direction might be. There could be potential for  
16 bias in one way or the other, but I am not in a position to  
17 confirm that one way or the other.

18 Q Well, other than you can confirm that it is  
19 reasonable to assume that mistakes can occur in both  
20 directions, is it not?

21 A I wouldn't rule out that mistakes could occur in  
22 both directions, no.

23 Q Okay. Now, won't a metered piece, if that  
24 happens, if a metered piece is misidentified by the DRPW  
25 data collector, and it is mistakenly recorded as a permit

1 piece, will it not be the case then that that piece will be  
2 removed from the DRPW system? It won't be in there because  
3 he has recorded it as a permit piece, but because it is not  
4 a permit piece, there will be no permit record for the BRPW  
5 system, is that right?

6 MR. MCKEEVER: Mr. Chairman, may I ask that the  
7 question be repeated? I believe that in the middle of the  
8 question, counsel reversed some of the facts he gave at the  
9 beginning of the question. But I could be wrong, I may have  
10 missed it.

11 BY MR. MAY:

12 Q The question is, if, in the case of a data  
13 collector who makes a mistake in the other direction, the  
14 data collector misidentifies a permit piece as a metered  
15 piece? Excuse me, misidentifies a metered piece as a permit  
16 piece.

17 A Yes, I understand your question -- or I  
18 understand.

19 Q Well, in that case, then it won't be recorded in  
20 the DRPW system, correct?

21 A If a piece is recorded as being permit imprint in  
22 the DRPW system, it would be excluded from the ultimate DRPW  
23 portion of Parcel Post estimates.

24 Q Now, it won't be included in the BRPW system  
25 either, will it, because it is not a permit piece?



1           A     If the BRPW system counts only for Parcel Post,  
2     permit imprint Parcel Post.

3           Q     And this is not a permit entry, right?

4           A     By your hypothesis, yes.

5           Q     So it won't get counted anywhere?

6           A     Under the scenario you have constructed, I believe  
7     that would be the case, yes.

8           Q     So, in this instance, that would result in an  
9     under-counting of parcels, would it not?

10          A     I am just trying to make sure as far as the  
11     balance adjustments go, but I think that, again, under the  
12     scenario you have constructed, I believe that would be the  
13     case.

14               MR. MAY:   That's all, Mr. Chairman.

15               CHAIRMAN GLEIMAN:   Mr. Hollies?

16                               CROSS-EXAMINATION

17               BY MR. HOLLIES:

18          Q     Good morning, Mr. Sellick.   I am Ken Hollies on  
19     behalf of the Postal Service.

20          A     Good morning.

21          Q     For purposes of this cross-examination, when I  
22     refer to an interrogatory response, it will be one of those  
23     directed to you in your UPS-T-4 capacity by the Postal  
24     Service, unless I specifically indicate otherwise.   That is  
25     just to set up a shorthand.

1 A I understand.

2 Q In the introduction to your testimony, you present  
3 a quite impressive description of your involvement in Postal  
4 Service costing issues dating back to 1990, is that correct?

5 A I will accept your characterization of it, but,  
6 yes.

7 Q And your background with PHB Hagler Bailly, Inc.  
8 has involved primarily economic and management consulting,  
9 is that right?

10 A The firm has described itself as being economic  
11 and management consultants, and I describe my background as  
12 being part of that, yes. I have worked primarily in highly  
13 quantitative litigation oriented situations where there has  
14 been a lot of data and clients have needed people to review  
15 that data, understand the systems behind it and things of  
16 that nature.

17 Q In this docket, would it be fair to characterize  
18 your testimony as supporting use of permit imprint Parcel  
19 Post volume as derived from the DRPW rather than, as  
20 proposed by the Postal Service, the BRPW system?

21 A I guess in a narrow sense, yes, although I would  
22 say it is more just that the Parcel Post estimates as a  
23 whole should be derived by the DRPW system rather than the  
24 new hybrid system that uses both BRPW and DRPW.

25 Q Does DRPW or BRPW provide a higher estimate of

1 Parcel Post permit imprint mail volumes?

2 A I have not seen -- I don't believe anyway, I don't  
3 believe I have seen a separate estimate of permit imprint  
4 Parcel Post from the DRPW system, so I can't say.

5 Q Do you agree that the BRPW estimate of permit  
6 imprint Parcel Post volume is based largely upon information  
7 that the Postal Service claims is consistent with postage  
8 statements?

9 A I believe that is the case. To the extent that  
10 the Postal Service claims or believes that the system in --  
11 the data in BRPW, which is derived from the PERMIT System  
12 data, which is itself meant to be an electronic version of  
13 the postage statement data, then, yes. Although I do note  
14 that there are a series of audit reports and whatnot that I  
15 reference in my testimony that suggest that the PERMIT  
16 System itself may not always accurately reflect information  
17 on the postage statements that are meant to be input there.

18 Q Do you understand that postage statements are the  
19 basis for financial transactions between the Postal Service  
20 and respective mailers?

21 A Yes, I believe so. I understand that the postage  
22 statements are present to the Postal Service and used as the  
23 basis for, as I said, basis for entry into the PERMIT  
24 System, which is itself used for the revenue and financial  
25 transactions between the mailers and the Postal Service.

1           Q     If you were a mailer, would you want your postage  
2 statements to be accurate?

3           A     I guess it depends on the motives one -- I  
4 wouldn't want to impute ill motives to mailers, but it is  
5 certainly possible that mailers in the abstract could have  
6 an incentive or an interest to, for various reasons, not to  
7 necessarily have accurate postage statements, but -- so I  
8 don't know as I would necessarily agree with that statement.  
9 I am not suggesting duplicity or anything, but just  
10 abstractly, intellectually, in answer to that question,  
11 would be not necessarily.

12          Q     Well, if you assume that criminal penalties might  
13 attach for under-reporting the volume that you mail, would  
14 you want your postage statements to be accurate?

15          A     I would certainly want my personal postage  
16 statements to be accurate, yes. I note, though, that the  
17 Postal Service has a whole series of requirements as far as  
18 the verification of the information on the postage  
19 statements to make sure that that information is correct,  
20 although, as I said, the audit reports suggest that those  
21 verification and acceptance procedures aren't followed in  
22 all instance. So, implicitly, the Postal Service believes  
23 that there is reason that the postage statement information  
24 should be checked and verified.

25          Q     If you, again as a mailer, were faced with a

1 hypothetical, that is, that you under-report the postage  
2 that is due, as opposed to over-report and pay the postage  
3 that is due, which would you prefer?

4 A In the abstract, it is difficult to answer.

5 Q Well, would you rather pay less or more?

6 A I suspect, -- in general, I suspect one would  
7 rather pay less. But there may be instances where there  
8 could be reason to -- on a revenue basis, there may be  
9 instances, however, where incentives could be to overstate  
10 the number of parcels or the number of pieces that one has  
11 in order to receive some kind of bulk discount, for example.  
12 Again, abstract, in the abstract, that possibility could  
13 exist.

14 Q Does that last observation perhaps pertain to a  
15 situation where there is a volume minimum?

16 A It could pertain to a situation where there is a  
17 volume minimum, yes.

18 Q Can you think of any other business incentive that  
19 a mailer might have to over-report the number of pieces on a  
20 postage statement?

21 A I haven't explicitly attempted to consider all the  
22 possibilities, but none occur to me right now.

23 Q Could you please refer to Interrogatory 1 from the  
24 Postal Service, part (a)?

25 A I have that.

1 Q I see that you list sampling, statistical  
2 inference and estimation, and confidence intervals as part  
3 of your undergraduate Intro to Stat course. I see also that  
4 you had some discussion of sampling from finite populations  
5 in your Stat Methods for Policy Research I class. In your  
6 responses to parts (d) and (e) of this interrogatory, you  
7 say you have worked with clients on population sampling,  
8 sample design and evaluation of sample results. I believe  
9 that you also say that you "actively and directly supervise  
10 my staff to develop sample design, among other matters." Do  
11 you see these references?

12 A Yes, I do.

13 Q Would you say that you have a good educational  
14 background in statistics?

15 A My educational background in statistics is what it  
16 is presented to be in the interrogatory response you cite.  
17 Yeah, I don't necessarily want to characterize it one way or  
18 the other.

19 Q Would you characterize it as a poor educational  
20 background in statistics?

21 A I don't think I would characterize it as a poor  
22 background, no.

23 Q Would you also say that you have a professional  
24 background in statistics?

25 A In the sense that I work with statistical issues

1 and colleagues -- and work with colleagues who work with  
2 statistical issues in my profession, if that is a definition  
3 that would be acceptable to you, I think, yes.

4 Q That is what I had in mind. What about sampling,  
5 do you have a background in sampling then?

6 A Again, some of the course work I list included  
7 elements of sampling. I work -- some of my work involves  
8 sampling of various populations for a variety of generally  
9 litigation related purposes. So I have worked with sampling  
10 and with colleagues to work with sampling. Again, if that  
11 -- if that meets your definition.

12 Q I am not being tricky here. I am asking simple  
13 questions. So would you say that you are reasonably well  
14 versed then in statistics?

15 A I would say -- again, I don't particularly like  
16 characterizing it one way or another. I work with  
17 statistics and I guess it depends on who you are comparing  
18 me to, I suppose. But I think I am reasonably well versed  
19 in statistics, yes.

20 Q Well, you do make some points based on statistical  
21 analysis in your testimony, do you not?

22 A If you would refer me to the points you have in  
23 mind, I could comment on those specifically.

24 Q Well, are the DRPW and BRPW systems in any way  
25 statistically based?

1           A     The DRPW system is a statistically based sample  
2 system. The BRPW system, for many classes or subclasses of  
3 mail, has a sample or statistical component to it. However,  
4 for the permit imprint Parcel Post portion of BRPW it is  
5 primarily a count, it doesn't have a sample component to it.  
6 I am not sure I would conceive of the permit imprint Parcel  
7 Post portion of the BRPW estimates as necessarily being  
8 statistical in nature.

9           Q     But you would agree that there is a component to  
10 BRPW other than the census based on PERMIT System input, is  
11 that correct?

12           MR. McKEEVER: Mr. Chairman, may I ask that the  
13 question be repeated? I wasn't sure whether counsel was  
14 limiting it to Parcel Post or generally.

15           MR. HOLLIES: We can limit that to Parcel Post.

16           MR. McKEEVER: May I ask that the question be  
17 repeated, Mr. Chairman.

18           MR. HOLLIES: Could we please have it read back?

19           [The reporter read the record as requested.]

20           THE WITNESS: For permit imprint Parcel Post in  
21 BRPW -- so there is the count or census component to it.  
22 There is the special study we talked about before, but I  
23 don't, to the extent that that was a one-time sample I guess  
24 you could say there was a sample component to permit imprint  
25 Parcel Post, but it is really -- it is somewhat different



1 from the typical approach in BRPW.

2 BY MR. HOLLIES:

3 Q Earlier in our discussion you indicated you had  
4 not seen anything that reported DRPW based permit imprint  
5 Parcel Post volumes, is that correct?

6 A I did say that and I don't recall I had seen  
7 anything to that effect.

8 Q I would like to take a moment and distribute  
9 copies of a portion of a response to an interrogatory  
10 provided by Witness Pafford earlier.

11 These are copies of pages 712 and 713 in the  
12 transcript.

13 [Pause.]

14 BY MR. HOLLIES:

15 Q For the sake of clarity, this is a response to  
16 Interrogatory UPS/USPS-T4-6, and it states -- it is very  
17 brief so I will read it -- "Refer to Tables 1, 2 and 3 of  
18 your testimony. Provide in the same format as and for each  
19 of the same categories of mail shown in Tables 1, 2 and 3  
20 that part of the revenue piece and weight estimates that are  
21 derived solely from the DRPW system" -- and the response  
22 reads simply, "The attached tables provide DRPW estimates  
23 and their estimated confidence intervals."

24 MR. McKEEVER: Mr. Chairman, it would have been  
25 helpful if the question had been supplied as well as a copy

1 of the answer, but I think I have it in mind. I am not sure  
2 how long I will be able to keep it in mind if counsel  
3 intends to ask a number of questions on it.

4 CHAIRMAN GLEIMAN: Well, counsel, why don't you  
5 repeat the question one more time just to see if we can get  
6 it to sink in a little bit better.

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

8 BY MR. HOLLIES:

9 Q "Refer to Tables 1, 2 and 3 of your testimony.  
10 This is the T4 testimony which was DRPW focused. Provide in  
11 the same format as and for each of the same categories of  
12 mail shown in Tables 1, 2 and 3 that part of the revenue  
13 piece and weight estimates that are derived solely from the  
14 DRPW system."

15 [Pause.]

16 BY MR. HOLLIES:

17 Q Table 1 of that response, for example, reports  
18 Fiscal Year 1998 DRPW revenue estimates and associated  
19 confidence limits by mail category including Parcel Post.

20 Do you see that?

21 A Yes, I do, and if I am not mistaken, just so I am  
22 understanding the exhibit correctly, this is for the DRPW  
23 portion of estimates provided from Tables 1, 2 and 3 from  
24 witness -- I believe it was the same tables in Witness  
25 Hunter's and Witness Pafford's testimony, which means, if I

1 am not -- just to make sure I understand -- that this is the  
2 non-permit imprint portion of Parcel Post, that that is the  
3 estimate that appears here.

4 Q That is my understanding, but we won't be going  
5 quite that far.

6 Do you see the CV for DRPW Parcel Post estimate is  
7 2.15 percent?

8 A I see that, yes.

9 Q Could you define CV for us?

10 A Coefficient of Variation is a measure of the -- I  
11 guess you could say the accuracy of the estimate, the extent  
12 to which it could be higher or lower, and there is a precise  
13 statistical definition which I don't have in mind at this  
14 moment, to be honest.

15 I think it might be -- well, I don't want to guess  
16 at this point. I can't recall specifically.

17 Q Would the CV of 2.15 percent shown in this table  
18 comprise a 68 percent, 95 percent or 99 percent confidence  
19 interval?

20 MR. McKEEVER: Objection, Mr. Chairman. He is  
21 asking the witness what the Postal Service had in mind when  
22 it put that CV down in here, but we do know that the Postal  
23 Service shows in this table 95 percent confidence intervals  
24 but whether that is what the Postal Service intended that CV  
25 to represent would be an assumption, and other than that I

1 can't see how the witness can possibly speculate on what CV  
2 the Postal Service intended to use in that column.

3 I suggest counsel ask Mr. Pafford.

4 CHAIRMAN GLEIMAN: Counsel?

5 MR. HOLLIES: Mr. Chairman, I am asking the  
6 witness a very straightforward statistical question which  
7 has been mischaracterized by counsel.

8 We have established that the witness has some  
9 statistical background and we are trying to test that, and I  
10 believe it is appropriate cross examination.

11 MR. MCKEEVER: Mr. Chairman, he asked which CV --  
12 this CV, what confidence limit -- level it is associated  
13 with. That calls for speculation on his part.

14 CHAIRMAN GLEIMAN: Having established that it  
15 requires speculation on his part, let's see if he is willing  
16 to speculate a bit. The Commission can give appropriate  
17 value.

18 I think these tests are interesting. I will have  
19 to keep them in mind for other witnesses from other parties  
20 including the Postal Service when they appear.

21 MR. HART: Thank you, Mr. Chairman. I do believe  
22 that these very tests have been applied to a number of  
23 Postal Service witnesses.

24 BY MR. HOLLIES:

25 Q Do you have the question in mind or --

1 A It would be useful if you could repeat it for me.

2 Q Okay. Would the CV of 2.15 percent comprise a 68  
3 percent, 95 percent, or 99 percent confidence interval?

4 A I don't -- without making reference to other  
5 materials I couldn't answer that right here.

6 Q Can you give me a definition of confidence  
7 interval?

8 A If you give me a moment, I believe I can.

9 [Pause.]

10 CHAIRMAN GLEIMAN: There will be a blue book exam  
11 later for everybody in the room.

12 [Laughter.]

13 [Pause.]

14 THE WITNESS: I don't have the materials I thought  
15 I did here, so, no, I can't at this point.

16 [Pause.]

17 BY MR. HOLLIES:

18 Q Looking again at Table 1, the line for Parcel Post  
19 where we found the 2.15 percent, the next two numbers are  
20 under the Columns, respectively, of Lower 95 Percent  
21 Confidence Limit and Upper 95 Percent Confidence Limit; do  
22 you see that?

23 A Yes, I do.

24 Q Do you think that the upper and lower bounds  
25 thereby provided resemble in any sense a confidence

1 interval?

2 A The lower 95 confidence limit says that there's a  
3 less than five-percent chance that the true estimate of  
4 revenue for Parcel Post derived from the DRPW system is less  
5 than \$296 million.

6 The upper 95-percent confidence limit tells me  
7 that there is a less than five-percent chance that -- five  
8 percent or less chance that the true estimate or the true  
9 value of Parcel Post revenue is greater than \$322 million.

10 So, to that extent, it represents a 95th  
11 percentile confidence limit for the Parcel Post revenue from  
12 DRPW, or confidence interval, if you prefer.

13 Q Okay. So, taking that and running with it for a  
14 moment, again, looking at those two values, they are 296,022  
15 -- actually these are reported in units of thousands, so  
16 that would be 296,000,022, and the upper limit is  
17 322,000,089; is that correct?

18 A Yes, it is.

19 Q What is the probability that the true revenue is  
20 \$300 million?

21 MR. McKEEVER: Mr. Chairman, is Mr. Hollies asking  
22 the witness to make a calculation?

23 CHAIRMAN GLEIMAN: Mr. Hollies, are you asking the  
24 witness to make a calculation?

25 MR. McKEEVER: It sounds like one when he says

1 what is the probability that it's a number other than one  
2 shown specifically on here, but within the range of what is  
3 on here.

4 MR. HOLLIES: I guess I would prefer to have the  
5 witness answer the question. One could assume, I suppose,  
6 that finding out that \$300 million is between those two  
7 bounds, does constitute calculation, but that's the only  
8 extent to which there's calculation called for to develop an  
9 answer to this question.

10 MR. MCKEEVER: Well, I don't believe that's the  
11 question Mr. Hollies asked. He didn't ask whether \$300  
12 million fell within those bounds; he asked what is the  
13 probability that the estimate -- that the revenue is \$300  
14 million.

15 That's a quite different question.

16 CHAIRMAN GLEIMAN: Is that the question you asked,  
17 Mr. Hollies?

18 MR. HOLLIES: That is the question, and I would  
19 submit no calculation is required.

20 CHAIRMAN GLEIMAN: Without making any  
21 calculations, see if you can answer the question, please,  
22 Mr. Sellick.

23 THE WITNESS: I don't believe, without -- with the  
24 information in front of me, I don't believe I can establish  
25 a precise probability that \$300 million is the true

1 estimate.

2 Implicitly behind the sample system is a  
3 distribution of what the revenue is, and this is saying that  
4 the tails of the distribution are roughly at \$296 million  
5 and \$322 million.

6 Three hundred million would be somewhere in  
7 between. If there's a five percent on each end, then it's  
8 somewhere in the 90 percent bulk of that probability  
9 distribution \$300 million would fall.

10 But as to what exact probability would be assigned  
11 to \$300 million, I don't think I can say with this  
12 information.

13 BY MR. HOLLIES:

14 Q Thank you.

15 CHAIRMAN GLEIMAN: If I could just interject at  
16 this time, you know, cross examination exhibits can be very  
17 useful tools in fleshing out the evidentiary record. It has  
18 been the practice of the Commission, as I understand it,  
19 over the years, that participants who want to use cross  
20 examination exhibits that involve some degree of complexity,  
21 generally provide them in advance of the appearance of a  
22 witness so the witness's counsel and the witness can have an  
23 opportunity to review them.

24 And I'm not suggesting, necessarily, that this  
25 particular line of questions using the table that was



1 distributed earlier, falls within the gambit of a  
2 complicated area, but I would strongly suggest that if there  
3 is any question in the mind of the cross-examining attorney  
4 that something that he or she wishes to use might evoke  
5 responses from opposing counsel, that the material be  
6 distributed in advance. Err on the side of giving people a  
7 heads-up. It will make for a better record for everyone,  
8 both the witness and the party that is cross examining the  
9 witness.

10 MR. HOLLIES: Thank you, Mr. Chairman. I did,  
11 indeed, consider those factors. I have been listening to  
12 hearings in my office and have heard your statements to that  
13 same effect on several previous days.

14 I am done with that particular line of  
15 questioning.

16 BY MR. HOLLIES:

17 Q Mr. Sellick, in your responses to several  
18 interrogatories, including 2(a), 3, and 8, you indicate  
19 awareness that certain terms have statistical definitions,  
20 and further indicate that your use of those terms in your  
21 testimony is not intended to apply the technical statistical  
22 definitions; is that correct?

23 A I recall those responses, and I'll accept that  
24 generalization of them.

25 Q Was one of those terms, reliability?

1           A     I believe it was, but if you have a specific  
2     interrogatory in mind, I can check specifically.

3           Q     Well, it was one of those three I just identified,  
4     2(a), 3, and 8.

5                     [Pause.]

6           A     Three, I believe.

7           A     I do see inquiry about the word, reliable, or  
8     reliability, I think, in Question 3.

9           Q     Do you understand the statistical definition of  
10    reliability, at least as used in the text cited in  
11    Interrogatory 3 to you, to be synonymous with the term,  
12    precision?

13           MR. MCKEEVER:   Mr. Chairman, I'm going to object  
14    that it's beyond the scope of the testimony. Mr. Sellick  
15    specifically stated in the interrogatory response which is  
16    in the record, that he was not using the word in that sense.

17           He's also stated that the BRPW system which he is  
18    testifying on is not a statistical sampling system, so I  
19    think it's beyond the scope of his testimony.

20           CHAIRMAN GLEIMAN:   Mr. Hollies, would you repeat  
21    the question again.

22           BY MR. HOLLIES:

23           Q     Do you understand the statistical definition of  
24    reliability, at least as used in the text cited in  
25    Interrogatory 3 from the Postal Service, to be synonymous

1 with the term, precision?

2 MR. McKEEVER: Mr. Chairman, may I object also  
3 that counsel did not provide the text. I know that there is  
4 a quote from the text that equates those terms, but he did  
5 not provide the text.

6 So to ask the witness if he can verify that a text  
7 that the witness does not have equates two terms, again,  
8 clearly calls for speculation.

9 CHAIRMAN GLEIMAN: Mr. McKeever, I'm going to let  
10 the questions go ahead. If you'd like, I'll direct that Mr.  
11 Hollies venture over to the witness stand and stop by you on  
12 the way over there to show you the text of the material. If  
13 the witness can answer the questions, he'll answer them.

14 If he feels they're outside of his scope in terms  
15 of his ability to respond, then he'll let us know.

16 Would you like to see the statement, or do you  
17 feel comfortable with it?

18 THE WITNESS: The statement -- I will accept the  
19 statement, subject to accepting the statement as it is  
20 presented in the interrogatory. I can respond to it in that  
21 sense.

22 CHAIRMAN GLEIMAN: Please proceed.

23 THE WITNESS: Again, I can say that the statement  
24 as presented in or from the Hansen, Hurwitz, and Meadow  
25 book, in USPS/UPS-T4-3, does appear to treat the words,

1 precision and reliability, as being synonymous.

2 BY MR. HOLLIES:

3 Q Does that comport with your own independent  
4 understanding of the technical definition of reliability?

5 A As I said, I don't have an immediate recollection  
6 -- independent recollection of the definitions of precision  
7 and reliability to make that judgment.

8 Q Okay, thank you.

9 In your response to Number 8, you use the term,  
10 degree of confidence. Is that a technical term?

11 A Not as I used it, but I believe it can be used as  
12 such.

13 Q Interrogatory Number 2(a) references the term,  
14 true volume, referring to true Parcel Post volume.

15 Do you understand that question could be  
16 interpreted as asking a technical and statistical question?

17 A I'm not sure I interpret it as such, but if you  
18 are alluding to the sense of true in that it is asking it  
19 what the population volume as opposed to a sample volume  
20 would be, I suppose it could be.

21 Q In the third line of your response to Number 8,  
22 you use the term "acceptable level of comfort," excuse me,  
23 "acceptable level of comfort." Is that a statistical term?

24 A I did not intend it as such.

25 Q In your response to 2(b), Mr. Sellick you state

1 that the CV would not measure "any deficiencies in the  
2 underlying data." Is that your testimony?

3 A Yes, it is.

4 Q In general, for sampling systems, do measures of  
5 CV account for any deficient component in underlying data?

6 A I'm sorry, could you repeat the question?

7 Q In general, for sampling systems, do measures of  
8 CV account for any deficient component in underlying data?

9 A They could account for some deficient components  
10 in underlying data, I believe that is the case, yes.

11 Q Mr. Sellick, in Interrogatory 11, part (b), the  
12 Postal Service attempted to get your confirmation that the  
13 discount marketings beginning in January 10, 1999 included  
14 drop ship or D/S DBM Parcel -- excuse DBMC Parcel Post or  
15 DBMC PP. While that question could perhaps have been posted  
16 more specifically, you were then unable to provide the  
17 requested confirmation. Can you now confirm that those  
18 markings were permitted effective January 10, 1999?

19 A My answer to the interrogatory still represents my  
20 answer to the question.

21 MR. HOLLIES: I would like at this point, Mr.  
22 Chairman, to distribute copies of a page of the Domestic  
23 Mail Manual, and my colleague here is marking this as a  
24 cross-examination exhibit. The designation he is choosing  
25 is USPS Cross-Examination to UPS Sellick-T-4 -- I guess T-4,

1     yeah -- Exhibit 1.

2                                 [Cross-Examination Exhibit No.  
3                                 USPS/UPS-Sellick-T-4-XE-1 was  
4                                 marked for identification.]

5                 BY MR. HOLLIES:

6                 Q     Would you direct your attention there to Section  
7     M012.3.2, which is headed "Other Parcel Post Markings"?

8                 A     I see that section.

9                 Q     If you assume for a moment that this page is what  
10     it purports to be, that is, page M8 of DMM, Issue 54, does  
11     the contents of the section I referenced bear on the  
12     question I asked you a moment ago?

13                A     First, I note that this is similar -- this is the  
14     same text that I reproduced in my answer to 11(b), and I  
15     apologize, but I am going to ask you to repeat the question  
16     from a moment ago so I can have that fresh in my mind.

17                Q     Okay. Interrogatory 11(b) sought your  
18     confirmation that certain markings on mail were acceptable  
19     by a certain date. Now, the question, I will agree, could  
20     have been more articulately phrased, and I am trying to  
21     remedy that in the way I am asking now. And I am asking if  
22     Section M012.3.2, headed "Other Parcel Post Markings,"  
23     permits you to confirm part (b) of Interrogatory 11? Again,  
24     there is no trick here, I am just trying to get a simple  
25     recognition that certain markings became acceptable at a

1 certain point in time.

2 MR. McKEEVER: Mr. Chairman, if Mr. Hollies would  
3 put a comma after the word "drop ship" in Interrogatory  
4 11(b), I would be prepared to stipulate that that is the  
5 case.

6 CHAIRMAN GLEIMAN: I think Mr. Hollies is studying  
7 11(b).

8 MR. HOLLIES: I'll accept that.

9 CHAIRMAN GLEIMAN: Thank you, gentlemen. I  
10 appreciate that.

11 MR. McKEEVER: Then with the comma, I will  
12 stipulate that is correct.

13 [Discussion off the record.]

14 BY MR. HOLLIES:

15 Q Okay. We will try and make these others less  
16 painful.

17 If Parcel Post pieces are marked per this section  
18 of the Domestic Mail Manual, how do you suppose that RPW  
19 data collectors determine which discount category the piece  
20 was entered at from looking just at the mail piece?

21 MR. McKEEVER: Mr. Chairman, are we talking  
22 presently or in 1998? The question seemed to be in the  
23 present and this does deal with the Mail Manual that was  
24 effective January 10, 1999.

25 MR. HOLLIES: I could amend that question by

1 saying "beginning on January 10 and for some indeterminate  
2 period thereafter."

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

4 BY MR. HOLLIES:

5 Q Is that true? How would the RPW data collectors  
6 determine the appropriate rate category?

7 MR. McKEEVER: Mr. Chairman, may I ask that the  
8 question then be repeated in full?

9 BY MR. HOLLIES:

10 Q If Parcel Post pieces are marked per DMM Section  
11 M012.3.2 effective January 10, 1999, and the data collector  
12 is looking at pieces some time after the effective date, how  
13 do you suppose that RPW data collectors determine which  
14 discount category the piece was entered at from looking just  
15 at the mail piece?

16 A I believe my review of the RPW data collectors'  
17 manual was of a previous iteration, so I don't know as I --  
18 I don't think it would have addressed that specific  
19 question, since this arose after the addition of that  
20 manual, so I guess I don't have reference to what the data  
21 collector instructions might be to that effect.

22 Q If we assume that data collectors had difficulty  
23 identifying the appropriate rate category, could this have  
24 some impact on DRPW's ability to ascribe Parcel Post volume  
25 to the correct category?



1           A     To the extent that the DRPW information would not  
2 be able to identify that category in data collection, then  
3 it wouldn't be able to reflect that in the DRPW estimates.

4                 I'd point out though that the testimony section  
5 that T-4-11 refers to is not with respect -- is not making  
6 reference to a rate category. It is making reference to the  
7 fact that the weight-related information in BRPW is not as  
8 detailed as in DRPW.

9                 In fact, some further investigation I have done  
10 has revealed that although I think some interrogatory  
11 responses and some of the information we have seen asserts  
12 that BRPW preserves weight or accurate weight information at  
13 the rate category and zone level that it is only with  
14 respect to the rate cell distribution that BRPW is deficient  
15 relative to DRPW in estimating weight, but it turns out that  
16 the BRPW weight estimation is actually an imputation across  
17 mail class, across weight category as well as across zone  
18 and across weight cell.

19                BRPW does not have the ability to accurately  
20 associate weight with the Parcel Post estimates that they  
21 represent -- and that is what that section of testimony is  
22 meant to refer to.

23            Q     Your response to Part (d) of Interrogatory 11  
24 asked you to confirm that BRPW can provide estimates of DDU,  
25 DSCF, and DBMC levels and your response indicated you had

1 not seen information that would permit you to provide a  
2 confirmation.

3 Is that still your answer?

4 A I can't explicitly confirm it. I guess we can --  
5 the new postage statement, Form 3605PR, does have a section  
6 on it which allows for the entry of certain information for  
7 DDU and DSCF independently.

8 I don't know how that has been -- I can't confirm  
9 because I don't know how that has been implemented in the  
10 PERMIT System since that information is for 1999 and hasn't  
11 been subjected to review.

12 I guess I would also point out that the same  
13 comment I made with respect to weight would apply here as  
14 well because the postage statement only allows for entry of  
15 weight at the postage statement level -- that is, for all of  
16 the mail presented on that postage statement.

17 It does not allow for actual entry of weight at  
18 any more detailed level than the entire postage statement.

19 MR. HOLLIES: Thank you. At this point you having  
20 referenced -- thank you -- the postage statement 3605PR, I  
21 would like to distribute some copies of that.

22 [Pause.]

23 MR. McKEEVER: While Mr. Hollies is distributing  
24 that, Mr. Chairman, I might point out that this document is  
25 an exhibit to Mr. Sellick's testimony. It is Exhibit

1 UPS-T-4(b) .

2 BY MR. HOLLIES:

3 Q This is a copy of postage statement 3605PR, to  
4 which you were referring, is that correct?

5 A It appears to be, yes. This first became  
6 available in January 1999, I believe.

7 Q And it does provide the wherewithal to distinguish  
8 the DDU, DSCF, and DBMC volumes I think you have said, is  
9 that right?

10 A As I said, on the form itself it does in Section E  
11 on the back appear to provide for provision of that  
12 information.

13 I guess I should point out though that as I recall  
14 one of the -- or in several of the audit reports of the Bulk  
15 Mail Entry System and I think of the PVDS System one of the  
16 criticisms was that mailers were at times using outdated  
17 forms and obviously to the extent a mailer uses outdated  
18 forms -- this form has only recently become available --  
19 that level of detail would not be available for a mailer who  
20 is, as has happened I believe, using outdated forms.

21 [Pause.]

22 BY MR. HOLLIES:

23 Q Interrogatory 22, part (b) asked you to confirm  
24 that "exclusive of any blowup factors" there is no  
25 imputation in BRPW for permit imprint Parcel Post.

1           Your response was "Not confirmed. Missing  
2 information does appear to be imputed for Parcel Post in  
3 certain instances."

4           Is this the full explanation for your inability to  
5 confirm the question?

6           A     Yes, I mean missing AP information is imputed for  
7 Parcel Post for fiscal year 1998, and that is the reason for  
8 my not confirming that response, yes.

9           Q     Does that mean that your position is a blowup  
10 factor is the same thing as imputation of data?

11          A     I was not interpreting blowup factor there as  
12 being the same as the imputation for missing accounting  
13 periods, no.

14          Q     If a blowup factor is outside the scope of  
15 imputation, is there still imputation going on?

16          A     If you are asking that exclusive of the imputation  
17 for missing -- are you asking as to whether there is  
18 imputation outside of the imputation for missing accounting  
19 periods?

20          Q     No, I am asking you to assume that a blowup factor  
21 is not imputation, and I am asking if there is any other  
22 imputation going on.

23          A     I don't believe there is other imputation going on  
24 for permit imprint Parcel Post estimates other than that for  
25 missing accounting periods.

1           Q     Interrogatory 23, part (d), asked you to confirm  
2     that you were aware of no Postal Service reference  
3     specifying what postage statement would be used by mailers  
4     who enter Standard Mail A at lower Standard Mail B rates.  
5     Your response, while understandably indicating you could not  
6     claim to have searched every possible Postal Service source,  
7     points to Domestic Mail Manual Section P 750.2.7, which  
8     references use of a particular postage statement when Plant  
9     Verified Drop Shipment, or PVDS, is used. How do you  
10    understand that Standard Mail A entered using Standard Mail  
11    B rates is recorded in the PERMIT System?

12           A     My understanding is that it should be recorded as  
13    being still Standard A mail. I do recall seeing, not in the  
14    PERMIT System, but in the RPW or DRPW Users Manual, I  
15    believe there was an instruction specifically on this point  
16    that Standard A mail entered at Standard B rates should be  
17    recorded still as Standard A mail, which it is, it just  
18    happens to be paying a different rate.

19           MR. HOLLIES: Mr. Chairman, at this point, I would  
20    like to ask the witness to find that for us and provide it  
21    at a later date.

22           MR. McKEEVER: We would be happy to do that, Mr.  
23    Chairman.

24           CHAIRMAN GLEIMAN: Mr. Hollies, before you move  
25    on, I think the hour has arrived at which point we are going

1 to take our mid-morning break. I have a suspicion from the  
2 papers in front of you that you have a while to go yet.

3 MR. HOLLIES: Well, --

4 CHAIRMAN GLEIMAN: You can tell me otherwise if  
5 that is the case.

6 MR. HOLLIES: I am probably 85 or 90 percent of  
7 the way through.

8 CHAIRMAN GLEIMAN: Well, I think that is a low  
9 enough figure for us, given the volume of questions so far,  
10 statistically speaking, to take a 10 minute break right now.

11 [Recess.]

12 CHAIRMAN GLEIMAN: Well, Mr. Hollies, you can  
13 continue with that 10 or 15 percent of an unquantifiable  
14 number that you have left.

15 BY MR. HOLLIES:

16 Q Mr. Sellick, Interrogatory 31 from the Postal  
17 Service asked about your understanding of what you and your  
18 counsel have characterized as an "iterative" process by  
19 which jobs 1 through 3 were run. And you indicated you  
20 understood this process as one wherein "any aborts or  
21 material e-flags were resolved to the operator's  
22 satisfaction," is that correct?

23 A I believe that is essentially my response to the  
24 interrogatory, yes.

25 Q Have you reviewed the code by which jobs 1 through

1 3 were run?

2 A I have reviewed it in part myself and others under  
3 my direction have reviewed it in much more detail.

4 Q And you have, of course, discussed it with those  
5 others, right?

6 A Yes, I have.

7 Q Quite a number of potential abortions are coded in  
8 there, are they not?

9 A Yes, I believe they are.

10 Q Do you have an understanding of what a VIP code  
11 is?

12 A Yes, I do.

13 Q And what is it?

14 A It is a -- I believe it stands for Volume  
15 Information Profile code. It is a, I believe, four digit  
16 number that establishes the -- at least for Parcel Post, it  
17 establishes rate category and zone information to identify  
18 one of the aggregated BRPW records by.

19 Q Might VIP codes and their identifiers need to  
20 change when rates change?

21 A That is certainly possible, yes, if a new rate  
22 were introduced or -- I guess if it is simply a rate change,  
23 as such, I am not sure there would need to be a change in  
24 the VIP code, because that is really just, for instance, a  
25 VIP code would signify whether something was DBMC Zone 3,

1 for example. So, if that, if the DBMC Zone 3 rate changed,  
2 it would necessarily require the change of a VIP code. If a  
3 new rate category or discount, or something to that effect,  
4 were to change, then I suspect VIP codes would need to  
5 change, or be added.

6 Q So to put it perhaps more in my language, if there  
7 were a classification change, there might be a need for a  
8 VIP code change?

9 A Sure. I would imagine there would be, yes.

10 Q Okay. Assuming that VIP code changes were  
11 necessary with a change in rates, and further assuming that  
12 manually entered data, such as that from nonautomated  
13 offices, did not accurately reflect the updated VIP codes,  
14 would that be trapped by any of the abort codes?

15 A I don't recall specifically if that is one of the  
16 criteria for an abort code. Also, we focus generally, or  
17 more specifically on the Parcel Post sections of the code,  
18 although -- and the permit imprint Parcel Post sections of  
19 the code, and there are I don't believe any manual entry  
20 records for permit imprint Parcel Post since there is no  
21 sample frame to that.

22 Q Okay. But given your at least general  
23 understanding of the fact there are a variety of aborts, is  
24 that the kind of thing that might well be trapped by an  
25 abort code?



1           A     It sounds like the sort of thing that could be,  
2     yes.

3           Q     And a reasoned response on the part of a Postal  
4     analyst to such an abort would be to require examination of  
5     the data and, under my hypothetical, perhaps get it recoded,  
6     is that a fair statement?

7           A     If one of the aborts or e-flags were to flag  
8     something to the operator's attention that gave them pause  
9     or caused them to question the data, if they were to  
10    investigate it and find out it were wrong, certainly, it  
11    would be reasonable to correct that information, yes.

12          Q     So then the jobs 1 through 3 would be run again,  
13    presumably, right?

14          A     I believe so.

15          Q     On a somewhat different tack, suppose that the  
16    data itself were examined and no error was found, but an  
17    abort continued to occur, might that not indicate a coding  
18    error on the part of the BRPW analyst?

19          A     I'm sorry, a coding error in what sense, in the  
20    program itself, or are you thinking of something else?

21          Q     Yes, in the program itself.

22          A     I suppose that could, if the data were examined  
23    and found to be correct, and an abort, as opposed to an  
24    e-flag, you are drawing that distinction, an abort were  
25    still occur, then sure, an error of some sort, a programming

1 error could account for that.

2 Q And a reasonable response there might be to  
3 examine, perhaps correct the code and then run the jobs  
4 again, right?

5 A Sure. That could be a reasonable response, yes.

6 MR. HOLLIES: I have no further questions, Mr.  
7 Chairman. I guess my percentages were unnecessarily low.

8 MR. McKEEVER: It shows the danger of doing those  
9 calculations on the fly on the stand.

10 CHAIRMAN GLEIMAN: Would you like to comment on  
11 that, Mr. Hollies, or should we just call it --

12 MR. HOLLIES: I would be happy to, but I don't  
13 really think you want me to.

14 CHAIRMAN GLEIMAN: You are probably right.

15 Is there any follow-up? Are there questions from  
16 the bench?

17 COMMISSIONER LeBLANC: Yes.

18 CHAIRMAN GLEIMAN: Commissioner LeBlanc.

19 COMMISSIONER LeBLANC: Mr. Sellick, I am going to  
20 try to cut through the econometrics of it all and get it  
21 down to my level here, if you will, for just a moment. The  
22 aggregated data that you talked about, now does that affect  
23 just '98 data, or does that affect both '98 and '99 data?

24 THE WITNESS: The difficulties that I addressed as  
25 far as the aggregation go, in that it is difficult to do any

1 kind of meaningful error checks on the aggregated data, that  
2 would apply to '98 as well as 1999.

3 COMMISSIONER LeBLANC: So the error you found then  
4 could be magnified or could be lessened depending on what  
5 you found out of the data if it was unaggregated, if you  
6 will?

7 THE WITNESS: The disaggregated data, an  
8 examination of the disaggregated data could show more errors  
9 than were discovered in the aggregated data, yes, that is  
10 possible. And that would be the case in '98 or '99.

11 COMMISSIONER LeBLANC: Because I mean you found 50  
12 -- what was it, 50 million pieces or something with a  
13 difference?

14 THE WITNESS: I think that is the difference, the  
15 50 million piece difference I think you are alluding to is  
16 the difference between the total Parcel Post estimate using  
17 the old system, the DRPW only system, versus --

18 COMMISSIONER LeBLANC: Versus the new.

19 THE WITNESS: The Postal Service's new hybrid  
20 system, that's right.

21 COMMISSIONER LeBLANC: I'm sorry. You're correct.  
22 Now, on page 2 of your testimony, where you talked about the  
23 adjusted Parcel Post volume and revenue estimates by base  
24 year 1998 are untested and potentially -- potentially  
25 unreliable, was that what you were alluding to then?

1 THE WITNESS: Yes.

2 COMMISSIONER LeBLANC: Was that particular data --  
3 I mean, I'm trying to get specific here, just so I can  
4 follow what you talked about, at least in my opinion, what  
5 you talked about here and with Mr. May earlier.

6 THE WITNESS: I understand. Yes, the potentially  
7 untested -- or the untested and potentially unreliable  
8 refers, in part, to the aggregation and the types of checks  
9 that the Postal Service has applied to that data.

10 COMMISSIONER LeBLANC: Now, you say, in part.  
11 What's the other part, then?

12 THE WITNESS: In part, the testing of the data;  
13 the other part is sort of the testing of the system as a  
14 whole.

15 There have been these audit reports that we  
16 alluded to that suggest that the information, as presented  
17 on the postage statement, isn't always what goes into the  
18 PERMIT system, the computer system that they have.

19 Since the Postal Service hasn't produced any of  
20 the postage statements associated with the database itself,  
21 we haven't been able to test that particular component.

22 I said there are these audit reports out there  
23 that suggest that there are instances where the information  
24 entered into the PERMIT system hasn't been verified against  
25 the actual mailing and that sort of thing.

1           So there are other components to the system, as a  
2 whole, aside from the electronic checks that are performed  
3 on the BRPW data itself.

4           COMMISSIONER LeBLANC: So that's what you meant  
5 when you talked about adequate controls on page 3, then, at  
6 the top of the page there, the new approach until the  
7 adequate controls are put into place?

8           THE WITNESS: I think adequate controls would be  
9 -- there would be other types of adequate controls as well.

10          For instance, one of the other points in my  
11 testimony is the concern I have that the BRPW system for  
12 permit imprint Parcel Post and the non-permit imprint  
13 estimates from DRPW, are being combined.

14          These are two separate data sources that are being  
15 combined for the first time for Parcel Post here.

16          They were -- this was new programming that had to  
17 be implemented in order to put these two pieces together.

18          Basically, so that's a new approach and there are  
19 other controls, instructions to the data collectors, for  
20 example, to make sure they realize the importance of this,  
21 and there are other types of controls that one might like to  
22 see as far as the ultimate result in the total Parcel Post  
23 estimates, not just on the BRPW side.

24          COMMISSIONER LeBLANC: Now, on page 15, you talk  
25 about the new BRPW Parcel Post estimation system is not

1 adequately documented. So, again, that was unclear to me,  
2 but that goes back to what you were just talking about a  
3 minute ago; was it not, or is it further than that? I was  
4 unclear.

5 THE WITNESS: I think the undocumented, what I was  
6 referring to was, in part, the aggregation of the data; in  
7 part, that we hadn't seen the linkage as to how the ultimate  
8 aggregated data that Mr. Hunter had and ultimately used was  
9 developed from the Postal facilities and the postage  
10 statements themselves.

11 And just sort of the general lack of information  
12 about how, exactly, some of this process happened. We've  
13 been able to --

14 COMMISSIONER LeBLANC: So the lack of information  
15 refers to the process, or does it refer to a particular  
16 figure that you didn't?

17 THE WITNESS: I think it's more the process.

18 COMMISSIONER LeBLANC: Okay, that's what I was  
19 trying to clarify out of here. Okay.

20 Those two got asked. So, back on page -- I think  
21 it's 3 of your testimony where you have your flow chart.

22 THE WITNESS: Page 4, yes.

23 COMMISSIONER LeBLANC: Page 4, I'm sorry; you're  
24 correct.

25 If I'm following this correctly then, where you

1 have listed book revenue adjustment applied to the DRPW  
2 only, you are saying then that what was applied improperly  
3 to that so that that wouldn't flow further, if I understood  
4 you correctly --

5 THE WITNESS: I think -- well, the book revenue  
6 adjustment is applied only to the DRPW portion of the  
7 estimate. It assumes, implicitly, that all of the estimates  
8 coming out of the BRPW, are, by definition, correct.

9 It -- so none of those are subjected to the  
10 overall book revenue adjustment factor, and that's because  
11 most of those, most of the estimates from BRPW had their own  
12 independent, separate trial balance account adjustment.

13 As I mentioned, in 1998, permit imprint Parcel  
14 Post had no such adjustment, so it was treated differently,  
15 or it was different by virtue of the fact that that account  
16 was not available to make an adjustment.

17 And whereas, historically, all of Parcel Post  
18 estimates, because they were from DRPW, would have been  
19 subjected to the book revenue adjustment factor.

20 And I mentioned in my testimony what the -- I  
21 quantified the effect, if you took the permit imprint side  
22 out of BRPW for Parcel Post, because it didn't have its own  
23 trial balance adjustment factor, and subjected it to the  
24 book revenue adjustment factor, I quantified what the effect  
25 of that would have been.

1 COMMISSIONER LeBLANC: Okay, thank you very much.  
2 Thank you, Mr. Chairman.

3 CHAIRMAN GLEIMAN: I don't believe there are any  
4 other questions from the Bench. Is there followup to  
5 questions from the Bench?

6 [No response.]

7 CHAIRMAN GLEIMAN: If not, that brings us to  
8 redirect. Counsel, would you like some time with your  
9 witness?

10 MR. McKEEVER: Maybe two or three minutes, Mr.  
11 Chairman.

12 CHAIRMAN GLEIMAN: Certainly.

13 [Recess.]

14 CHAIRMAN GLEIMAN: Mr. McKeeever?

15 MR. McKEEVER: Thank you, Mr. Chairman

16 REDIRECT EXAMINATION

17 BY MR. McKEEVER:

18 Q Mr. Sellick, counsel for the Parcel Shippers  
19 Association asked you whether the Postal Service had the  
20 ability to make a trial balance revenue account adjustment  
21 in Fiscal Year 1999 with respect to Parcel Post; do you  
22 remember that?

23 A Yes, I do.

24 Q Can you tell me, was there a trial balance revenue  
25 account for Parcel Post in effect for all of Fiscal Year



1 1999?

2 A I don't recall if it was in effect for the entire  
3 Fiscal 1999.

4 Q Thank you.

5 Mr. Hollies asked you some questions about whether  
6 a mailer would have an incentive ever to overstate the  
7 number of pieces presented in a mailing; do you remember  
8 that?

9 A Yes, I do.

10 Q Mr. Sellick, am I correct that the postage  
11 statement in use in Fiscal Year 1998, which is an exhibit to  
12 your testimony, I believe, reported volumes for bound  
13 printed matter, Parcel Post, and Priority Mail?

14 A Yes, it did.

15 Q Suppose a mailer presented a 50-piece mailing, 40  
16 pieces of which were Parcel Post and 10 of which were  
17 Priority Mail; would the postage be less if all 50 were  
18 listed in a postage statement as Parcel Post rather than if  
19 40 had been listed as Parcel Post and 10 had been listed as  
20 Priority Mail?

21 A Yes, under that circumstance, the postage would be  
22 less than if it were presented the other way.

23 MR. McKEEVER: That's all we have, Mr. Chairman.

24 CHAIRMAN GLEIMAN: Is there any recross? Mr.  
25 Hollies?

1 MR. HOLLIES: Yes.

2 RECROSS EXAMINATION

3 BY MR. HOLLIES:

4 Q Mr. Sellick, is it your understanding that bound  
5 printed matter and Parcel Post can be reported on the same  
6 postage statement?

7 MR. McKEEVER: Mr. Chairman, again, I would ask  
8 that if the question relates to now as it is phrased, or Mr.  
9 Hollies means to refer to Fiscal Year 1998?

10 COMMISSIONER LeBLANC: I'm referring to the time  
11 period about which he was just asked.

12 MR. McKEEVER: Thank you, Mr. Chairman; that would  
13 be 1998.

14 THE WITNESS: I believe it can be. We've been  
15 attempting to ascertain that from the detailed information  
16 provided in Library Reference 401, but have not yet been  
17 able to determine the incidences of that for sure.

18 But the form does provide for all three types of  
19 mail.

20 BY MR. HOLLIES:

21 Q Is that still true today?

22 A Well, the new form is for Parcel Post only. The  
23 3605PR, I believe it is, that came into effect as of  
24 January, 1999, but as I mentioned, there have at least been  
25 historical incidences where older forms have been used by

1 mailers, as I recall from reviewing the audit reports.

2 So it's possible that there are older forms  
3 floating around out there still in use that do not limit to  
4 Parcel Post only.

5 MR. HOLLIES: Thank you.

6 CHAIRMAN GLEIMAN: Is there anything else?

7 MR. McKEEVER: We have nothing further, Mr.  
8 Chairman.

9 CHAIRMAN GLEIMAN: That being the case, Mr.  
10 Sellick, that completes your testimony here today. We  
11 appreciate your appearance and your contributions to the  
12 record. We thank you, and you are excused.

13 [Witness Sellick excused.]

14 THE WITNESS: Thank you, Mr. Chairman and  
15 Commissioners.

16 CHAIRMAN GLEIMAN: Mr. McKeever, when you're  
17 ready, you can call your next witness.

18 MR. McKEEVER: Mr. Chairman, United Parcel Service  
19 calls Dr. David Sappington to the stand.

20 CHAIRMAN GLEIMAN: Okay, we'll give the witnesses  
21 a moment so that they can gather their materials.

22 [Pause.]

23 CHAIRMAN GLEIMAN: Mr. Sappington, before you  
24 settle in, could I get you to raise your right hand?  
25 Whereupon,

1                   DAVID E. M. SAPPINGTON,  
2 a witness, was called for examination by counsel for United  
3 Parcel Service and, having been first duly sworn, was  
4 examined and testified as follows:

5                   CHAIRMAN GLEIMAN: Please be seated, and if you  
6 could make sure your mike is on, the switch is on the top.  
7                   You may proceed, counsel.

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

9                   DIRECT EXAMINATION

10                  BY MR. McKEEVER:

11                  Q     Dr. Sappington, I have just handed you a copy of a  
12 document entitled "Direct Testimony of David E. M.  
13 Sappington on behalf of United Parcel Service," and marked  
14 as UPS-T-6.

15                  MR. McKEEVER: Mr. Chairman, I might note for the  
16 record that the copy presented to Dr. Sappington does  
17 incorporate the errata that were served on June 22 and on  
18 June 30 of 2000.

19                  BY MR. McKEEVER:

20                  Q     Dr. Sappington, you are familiar with that  
21 document, I take it, aren't you?

22                  A     Yes, I am.

23                  Q     It represents your direct testimony in this case?

24                  A     That is correct.

25                  CHAIRMAN GLEIMAN: Excuse me for a moment. I

1 don't know whether -- it's on? Okay. Just needed to be  
2 pulled a little closer.

3 BY MR. McKEEVER:

4 Q Do you have any other changes to make to that  
5 testimony from the version that was filed on May 22?

6 A Yes, I do.

7 There is a change on page 29 in Footnote Number  
8 32. The correct reference to the ODIS Report should be  
9 number HSA360P1, instead of HSA369P1, and also that should  
10 be Attachment G rather than Attachment A.

11 MR. McKEEVER: Mr. Chairman, those changes have  
12 been made in the copies I will present to the court  
13 reporter.

14 BY MR. McKEEVER:

15 Q Dr. Sappington, with those changes, if you were to  
16 testify orally here today, would your testimony as set forth  
17 in UPS-T-6?

18 A Yes, it would.

19 MR. McKEEVER: Mr. Chairman, I move that the  
20 document entitled "Direct Testimony of David E. M.  
21 Sappington on behalf of United Parcel Service" and marked as  
22 UPS-T-6 be admitted into evidence and transcribed into the  
23 transcript of today's proceedings.

24 CHAIRMAN GLEIMAN: Is there any objection?

25 Hearing none, if counsel would please provide

1 copies to the court reporter I will direct that the material  
2 be received into evidence and transcribed into the record.

3 [Direct Testimony of David E. M.  
4 Sappington, UPS-T-6, was received  
5 into evidence and transcribed into  
6 the record.]  
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UPS-T-6

BEFORE THE  
POSTAL RATE COMMISSION

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POSTAL RATE AND FEE CHANGES, 2000

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DOCKET NO. R2000-1

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DIRECT TESTIMONY  
OF  
DAVID E. M. SAPPINGTON  
ON BEHALF OF  
UNITED PARCEL SERVICE

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## AUTOBIOGRAPHICAL SKETCH

1

2           My name is David E. M. Sappington. I am the Lanzillotti-McKethan Eminent  
3 Scholar in the Warrington College of Business at the University of Florida. I am also the  
4 Director of the University of Florida's Public Policy Research Center.

5           I earned my B.A. in Economics from Haverford College in 1976, my M.A. in  
6 Economics from Princeton University in 1978, and my Ph.D. in Economics from  
7 Princeton University in 1980. Since that time, I have served on the faculties of the  
8 University of Michigan, the University of Pennsylvania, and the University of Florida. I  
9 have also served as a Visiting Professor with the title of Full Professor at Princeton  
10 University, and as a District Manager at Bell Communications Research.

11           My research examines various aspects of industrial organization, with particular  
12 emphasis on the design of regulatory policy. Several organizations have supported my  
13 research, including the National Science Foundation. My research has culminated in  
14 more than ninety published articles.

15           I presently serve on the editorial boards of five leading economics journals,  
16 including The Rand Journal of Economics, The Journal of Regulatory Economics, and  
17 The Journal of Economics and Management Strategy. I have served on the editorial  
18 boards of other major journals in recent years, including The American Economic  
19 Review. I have also served as an advisor on the design of regulatory policy to many  
20 firms and organizations, including The World Bank, the New York State Public Service  
21 Commission, and The Governor's Office in the State of New Jersey.

1 I have testified before the California Public Utility Commission and the Canadian  
2 Radio-Television and Telecommunications Commission.

3 **I. PURPOSE OF TESTIMONY**

4 The purpose of my testimony is to recommend cost coverages (the ratio of  
5 revenue to attributed cost) and average rate increases for Priority Mail and Parcel Post,  
6 and to explain why the rate increases that I recommend are consistent with the  
7 ratemaking criteria specified in the Postal Reorganization Act.

8 **II. GUIDE TO TESTIMONY**

9 My testimony proceeds as follows. In Section III, I review the nine ratemaking  
10 criteria specified in the Postal Reorganization Act. I focus on the proper implementation  
11 of two of these criteria: the value of service criterion (§ 3622(b)(2)) and the cost criterion  
12 (§ 3622(b)(3)). The cost coverage and rate increase that I recommend for Priority Mail  
13 are described and justified in Section IV. My corresponding recommendations for  
14 Parcel Post are presented and explained in Section V.

15 **III. RATEMAKING PRINCIPLES**

16 **A. The Nine Ratemaking Criteria**

17 Section 3622(b) of the Postal Reorganization Act (hereafter, "the Act") requires  
18 the Postal Rate Commission to consider nine specific factors when formulating its  
19 recommended decision on rates and fees. These factors, hereafter referred to as  
20 criteria, are the following:

1        Criterion 1. Fairness and Equity

2        The first criterion is “the establishment and maintenance of a fair and equitable  
3        schedule” (§ 3662(b)(1)). Fairness and equity require a delicate balancing of the  
4        interests of all mailers and suppliers of delivery services when setting rates and fees.  
5        This balancing is fostered by careful consideration of the policies of the statute and the  
6        other eight criteria specified in the Act.<sup>1</sup>

7        Criterion 2. Value of Service

8        The second criterion is “the value of the mail service actually provided each class  
9        or type of mail service to both the sender and the recipient, including but not limited to  
10       the collection, mode of transportation, and priority of delivery” (§ 3622(b)(2)). Additional  
11       factors that influence the value of a mail service to senders and recipients include its  
12       speed and reliability, the level of priority it is afforded in mail processing and  
13       transportation, its success in avoiding content damage, and the opportunity it affords  
14       users to purchase value-added services such as delivery confirmation.

15       The measurement of the value of mail services is discussed further in Section  
16       III(B), below.

---

1.       Section 101 of the Act states that the basic function of the Postal Service is “to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people.” Section 403(c) prohibits the Postal Service from making any “undue or unreasonable discrimination among users of the mails.”

1           Criterion 3. Cost

2           The third criterion is "the requirement that each class or type of mail service bear  
3 the direct and indirect postal costs attributable to that class or type plus that portion of  
4 all other costs of the Postal Service reasonably assignable to such class or type"  
5 (§ 3622(b)(3)). The Postal Rate Commission (hereafter, "the Commission") has  
6 identified this third criterion as "the most important" of the nine criterion, in part because  
7 it is "the only factor cast by Congress as a requirement."<sup>2</sup> This requirement leads to the  
8 two-step procedure that the Commission uses to develop its rate recommendations.  
9 First, the Commission determines the costs that are attributable to each mail subclass.  
10 In doing so, the Commission also necessarily determines the magnitude of unattributed  
11 costs, which are called institutional costs. Second, the Commission assigns the  
12 institutional costs to mail subclasses in accordance with the eight other criteria specified  
13 in the Postal Reorganization Act.

14           The importance of this two-step procedure and the appropriate calculation of  
15 *attributable costs* are discussed in Section III(C).

16           Criterion 4. The Effect of Rate Increases

17           The fourth criterion is "the effect of rate increases upon the general public,  
18 business mail users, and enterprises in the private sector of the economy engaged in  
19 the delivery of mail matter other than letters" (§ 3622(b)(4)). High rates and large rate

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2.   Postal Rate Commission, Opinion and Recommended Decision, Docket No. R87-1, ¶ 4031.

1 increases can be onerous for individual and business mailers alike, and so should be  
 2 avoided whenever possible. The Senate Report on the Act suggests that Congress  
 3 was particularly concerned with avoiding undue rate increases for individual mailers.<sup>3</sup>

4 Although low rates and significant rate reductions can benefit some mailers, they  
 5 can unfairly disadvantage other mailers who must pay higher rates as a result. Low  
 6 rates and significant rate reductions can also unfairly disadvantage competing suppliers  
 7 of delivery services. Rates that disadvantage competitors unfairly should be avoided.  
 8 They can be avoided through appropriate implementation of all of the criteria specified  
 9 in the Act, and of the cost criterion (§ 3622(b)(3)) in particular. The implementation of  
 10 the cost criterion is discussed in detail in Section III(C).

11 Criterion 5. Available Alternatives

12 The fifth criterion is “the available alternative means of sending and receiving  
 13 letters and other mail matter at reasonable costs” (§ 3622(b)(5)). When mailers can  
 14 obtain comparable services at reasonable cost from suppliers other than the Postal  
 15 Service, high postal rates impose fewer hardships on those mailers. Consequently,  
 16 higher rates for postal services are appropriate in such situations, *ceteris paribus*.

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3. The Senate Report states: “The temptation to resolve the financial problems of the Post Office by charging the lion’s share of all operational costs to first class is strong; that’s where the big money is. The necessity for preventing that imposition upon the only class of mail which the general public uses is one of the reasons why the Postal Rate Commission should be independent of operating management.” S. Rep. No. 912, 91st Cong., 2d Sess. (1970) at 13.

1           Criterion 6. Degree of Mail Preparation

2           The sixth criterion is “the degree of preparation of mail for delivery into the postal  
3           system performed by the mailer and its effect upon reducing costs to the Postal  
4           Service” (§ 3622(b)(6)). It is reasonable to pass on to a mailer some or all of the cost  
5           savings that accrue to the Postal Service because of mail preparation or transportation  
6           activities performed by the mailer. Doing so encourages mailers to undertake the mail  
7           functions that they can perform at lower cost than the Postal Service. An appropriate  
8           portion of the realized cost savings can be passed on in the form of rate discounts or  
9           more modest rate increases.

10           Criterion 7. Simplicity

11           The seventh criterion is the “simplicity of structure for the entire schedule and  
12           simple, identifiable relationships between the rates or fees charged the various classes  
13           of mail for postal services” (§ 3622(b)(7)). Simple rate schedules that render apparent  
14           the underlying rationale for differences among rates help to promote the perceived  
15           equity and fairness of the rate structure.

16           Criterion 8. ECSI Value

17           The eighth criterion is the “educational, cultural, scientific and informational value  
18           to the recipient of mail matter” (§ 3622(b)(8)). Lower rates for mail subclasses which  
19           convey a great deal of material with educational, cultural, scientific, or informational  
20           (“ECSI”) value help to expand the dissemination of this material. Section 101 of the Act  
21           identifies such dissemination as an important function of the Postal Service.

1           Criterion 9. Other Factors

2           The ninth and final criterion is “such other factors as the Commission deems  
3 appropriate” (§ 3622(b)(9)). This criterion empowers the Commission to employ its  
4 considerable expertise to consider important criteria other than the first eight when  
5 developing its rate recommendations.

6           Two of the Act’s nine criteria warrant special emphasis: the value of service  
7 criterion (§ 3622(b)(2)) and the cost criterion (§ 3622(b)(3)). The value of service  
8 criterion merits emphasis because service value is particularly difficult to measure and  
9 because this difficulty may tempt some to afford undue influence to particular imperfect  
10 indicators of service value. The cost criterion merits additional emphasis because it is  
11 the only one of the nine criteria that is stated as a requirement and because it plays a  
12 fundamental role in promoting fair competition and fair treatment of all mailers.

13                   B. Implementing the Value of Service Criterion

14                           1. Intrinsic vs. Economic Value

15           The value that customers derive from a service is typically difficult to quantify and  
16 measure precisely. Section 3622(b)(2) lists some of the factors that merit explicit  
17 attention when attempting to assess the value that a mail service provides to senders  
18 and recipients. These factors, along with other relevant factors like those identified  
19 above in the discussion of the value of service criterion, together are said to influence  
20 the “intrinsic value” of a mail service.



1           It has been suggested in the present rate case and in preceding rate cases that  
 2   both the intrinsic value and what has been called the “economic value” of a mail service  
 3   should be considered in assessing the service’s value to senders and recipients.<sup>4</sup> The  
 4   economic value of a mail service is described as a measure of “the degree to which  
 5   usage of the service declines in response to price increases.”<sup>5</sup> Thus, the economic  
 6   value of a service is simply the own-price elasticity of demand for the service.<sup>6</sup>

7           Any distinction between the “intrinsic” and the “economic” components of value is  
 8   problematic because the two are inextricably linked. The extent to which the usage of a  
 9   service declines as its price increases is influenced by the characteristics of the service,  
 10   including its many “intrinsic” characteristics. Therefore, except for the fact that the  
 11   definition of economic value renders it susceptible to measurement, the rationale for  
 12   distinguishing between intrinsic value and economic value is not apparent.

## 13                               2.       Inappropriate Use of the Own-Price Elasticity

14           Undue reliance on the own-price elasticity of a service as a measure of its value  
 15   can be inappropriate for at least three reasons. First, the own-price elasticity is not an  
 16   accurate measure of value. Second, its use as a measure of value can contradict the  
 17   pricing criteria specified in § 3622(b) of the Act and can afford the Postal Service undue

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4.    See, for example, the testimonies of Postal Service witnesses Mayes (USPS-T-32) in this case and O’Hara (USPS-T-30) in Docket No. R97-1.

5.    Testimony of Postal Service witness Mayes, USPS-T-32 at 5.

6.    The own-price elasticity of demand for a service is defined as the percentage change in the usage of the service that results from a one percent increase in the price of the service, holding constant all other determinants of demand. Jeffrey M. Perloff, Microeconomics, 1999, Addison Wesley Longman, Inc., p. 53.

1 protection from competition. Third, use of the own-price elasticity as a measure of value  
2 is essentially the same as Ramsey pricing.<sup>7</sup> These three conclusions are now  
3 explained in detail.

4 a. Imperfect Measure of Value

5 The first conclusion is that, even when it is estimated accurately, the own-price  
6 elasticity of demand is, at best, a very imperfect measure of the value that senders and  
7 receivers derive from a mail service. It is an imperfect measure of value in part because  
8 demand is influenced by many factors other than price. Therefore, even if the demand  
9 for a service declines substantially as its price increases, customers may value the  
10 service highly. To illustrate this fact, notice that a price increase may force customers  
11 with limited wealth to reduce their usage of a service substantially even though they  
12 cherish the service dearly.

13 b. Inverted Rate Changes and Undue Protection

14 The second conclusion is that the use of the own-price elasticity as a primary  
15 measure of value can have undesirable consequences. The own-price elasticity of  
16 demand for a service can reflect, in part, the availability of alternative means of sending  
17 and receiving mail (§ 3622(b)(5)). The volume of a particular service supplied by the  
18 Postal Service may decline substantially as the rate charged for the service increases if

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7. Ramsey prices are the prices that maximize the combined welfare of the consumers and the producer of a set of services, while ensuring a specified level of profit for the producer. See William J. Baumol and David F. Bradford, "Optimal Departures From Marginal Cost Pricing," 60 American Economic Review 265 (June 1970).

1 mailers can secure comparable services from competing suppliers at reasonable cost.  
2 When mailers have ready access to reasonable alternatives, they can protect  
3 themselves from the adverse consequences of rate increases on services supplied by  
4 the Postal Service. Therefore, they have less need for protection from the Commission  
5 than do mailers who use a monopoly service. Thus, more substantial increases in  
6 Postal Service rates are appropriate when mailers have ready alternatives to the Postal  
7 Service, *ceteris paribus*. This conclusion implies that a higher own-price elasticity may  
8 appropriately be associated with a higher rate increase. In contrast, when own-price  
9 elasticity is interpreted primarily as a measure of "economic value," a higher own-price  
10 elasticity can (inappropriately) be associated with a lower rate increase.

11         Since high own-price elasticities can reflect the presence of effective  
12 competition, a policy that implements lower rates and smaller rate increases in  
13 response to higher own-price elasticities for Postal Service products can serve primarily  
14 to protect the Postal Service from effective competition. Section 3622(b) of the Act  
15 does not explicitly list such protection as one of the specific factors that should be  
16 considered when formulating rate recommendations. Its omission is appropriate. If the  
17 Postal Service cannot successfully market a service with rates that cover attributable  
18 costs and a reasonable share of institutional costs (as determined by the criteria listed  
19 in § 3622(b)), then society may be better served when competitors, not the Postal  
20 Service, are the primary providers of the service in question.

21         In addition, systematic protection of the Postal Service against effective  
22 competition can discourage innovation and entry in the postal industry, and can thereby

1 harm mailers and mail recipients alike. A policy that reduces Postal Service rates as  
 2 competition increases and permits revenues to fall toward incremental cost can also  
 3 encourage the Postal Service to choose an inefficient production technology with  
 4 unnecessarily large institutional costs and relatively low incremental costs for  
 5 competitive services. By doing so, the Postal Service can drive competitors from the  
 6 market if it is permitted to reduce rates toward (artificially low) incremental costs  
 7 whenever effective competition develops. It can even eliminate more efficient  
 8 competitors, i.e., those who could serve customers at lower cost than the Postal  
 9 Service if the Postal Service operated with the technology that minimized its overall  
 10 operating costs. *Unnecessarily large institutional costs can also increase rates unduly*  
 11 *for captive users of monopoly mail services. Such harm to competition and to captive*  
 12 *customers should be avoided, and it can be avoided if rates are not systematically*  
 13 *lowered as own-price elasticities rise.*<sup>8</sup>

14 c. Ramsey Pricing in Disguise

15 The third conclusion is that a process which uses the own-price elasticity of a  
 16 service to measure its value is essentially the same as Ramsey pricing. When high  
 17 own-price elasticities are presumed to indicate low-value services and when lower rates  
 18 are established for such services, the lowest rates will be set for those services that  
 19 exhibit the highest own-price elasticities. This is precisely the prescription of the

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8. The Commission has astutely recognized both the incentive the Postal Service may have to choose an inefficient technology and the undesirable consequences of such a choice. Opinion and Recommended Decision, Docket No. R97-1, ¶ 4047-49.

1 famous inverse-elasticity rule,<sup>9</sup> which is commonly employed to characterize Ramsey  
2 prices. The Commission has "reject[ed] the use of a Ramsey model as a proper  
3 measure of value of service".<sup>10</sup> Consequently, the mechanistic use of own-price  
4 elasticities as proxies for service value should similarly be rejected.

5 In summary, the factors that influence the intrinsic value of a mail service (e.g.,  
6 its priority in processing, transportation, and delivery and its success in avoiding content  
7 damage) merit careful consideration in assessing the value of a mail service.<sup>11</sup> In  
8 contrast, the own-price elasticity of demand for a service does not merit corresponding  
9 consideration in this regard. Such consideration can lead more to the implementation of  
10 Ramsey prices and to unwarranted protection of the Postal Service from competition  
11 than to an accurate assessment of service value.

#### 12 C. Implementing the Cost Criterion

13 As noted above, the cost criterion (criterion 3) requires that rates be set to  
14 generate revenue for each mail subclass that is at least as great as the direct and  
15 indirect costs attributed to the subclass plus a reasonable contribution to unattributed  
16 costs. This requirement is crucial because it helps to ensure that no mail subclass  
17 cross subsidizes another. For the reasons identified below, the requirement thereby

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9. Baumol and Bradford, op. cit., at 270.

10. Opinion and Recommended Decision, Docket No. R87-1, p. 372.

11. Section IV(C) provides a more detailed discussion of these factors in the case of Priority Mail.

1 helps to ensure that the Postal Service treats mailers fairly and does not disadvantage  
2 competitors unfairly.

3 1. Incremental Cost

4 The costs that are properly attributed to a mail subclass are the costs that the  
5 Postal Service incurs because it produces that subclass. These costs can be viewed  
6 alternatively as the cost savings that the Postal Service would realize if it decided to  
7 discontinue its supply of the mail subclass in question, without changing the volumes of  
8 the other subclasses it supplies. These cost savings are commonly referred to as the  
9 incremental cost of producing the mail subclass in question.<sup>12</sup> Incremental costs can  
10 include costs that vary with volume and costs that do not vary with volume. The former  
11 are commonly called volume variable costs, and the latter include what are called  
12 specific fixed costs.

13 If the incremental cost of a service were to exceed the revenues it generated, the  
14 service would be cross subsidized by other services. This is because when customers  
15 of one service pay less than it costs to serve them, consumers of other services are  
16 forced to pay higher rates than they otherwise would in order to make up for this  
17 shortfall in net revenue. Cross subsidies are undesirable because they encourage  
18 excessive consumption of those services for which prices are unduly low, and because  
19 they impose inappropriate burdens on customers of other services.

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12. William J. Baumol, John C. Panzar, and Robert D. Willig, Contestable Markets and the Theory of Industry Structure 1982 Harcourt Brace Jovanovich, Inc., p. 352.

1           Cross subsidies are also undesirable because they can disadvantage  
 2 competitors unfairly. A competitor of the Postal Service may be driven from the  
 3 marketplace even though it is the least-cost supplier of a service if the competing  
 4 service offered by the Postal Service is being cross subsidized. Total industry costs  
 5 rise and consumers are harmed if the least-cost supplier is driven from the marketplace.  
 6 The cost criterion (criterion 3) guards against such unfair and undesirable competition  
 7 by requiring each mail subclass to generate at least enough revenue to cover its  
 8 attributable (incremental) cost of production.<sup>13</sup> To ensure the solvency of the Postal  
 9 Service and to further guard against unfair competition, the cost criterion also requires  
 10 each mail subclass to bear some portion of the Postal Service's institutional costs.<sup>14</sup>  
 11 Institutional costs are the costs that remain after all attributable (incremental) costs  
 12 have been assigned to their relevant mail subclasses.

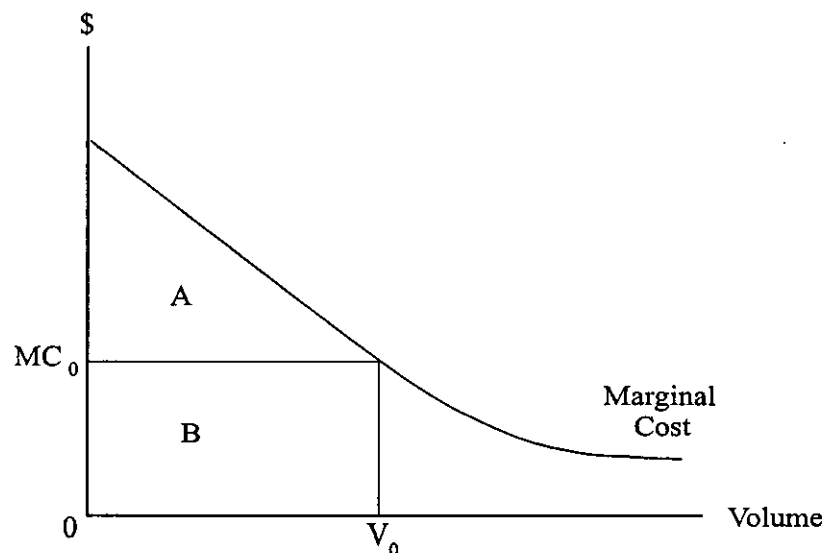
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13. The Commission has emphasized the importance of avoiding cross subsidies. In its R94-1 Decision, the Commission stated that "if there is to be one 'benchmark' or starting point from which all other pricing analysis proceeds, a benchmark that minimizes the risk of cross-subsidy of one class of mail users by another is preferable." Opinion and Recommended Decision, Docket No. R94-1, ¶ 4010.
14. The Postal Service derives significant financial benefits from its status as a public enterprise. For instance, the Postal Service is not required to pay all of the taxes and fees that its competitors must pay. The Postal Service also enjoys privileged access to the United States Treasury. Because of these artificial cost advantages, the Postal Service may be able to drive more efficient producers from the market even if revenues exceed incremental costs on every service that the Postal Service supplies. To limit the likelihood that more efficient producers are excluded from the market as a result of these Postal Service advantages, it is wise to ensure that each service for which the Postal Service faces competition bears a meaningful portion of institutional costs.

## 2. Calculating Incremental Cost

One must know how production costs vary with volume in order to calculate precisely the incremental cost of providing a specified volume of a service. To understand why this is the case, consider Figure 1. The figure depicts a setting in which the extra cost of producing each additional unit of the service (i.e., the service's marginal cost of production) declines with volume. The incremental cost of producing  $V_0$  units of the service in this setting is the sum of the areas labeled A and B in Figure 1, plus any fixed costs that would disappear if the service were not provided.

**FIGURE 1**

Calculating Incremental Cost



Areas A and B together represent the sum of the extra costs incurred from producing all of the additional units of output between 0 and  $V_0$ . If the service were no longer produced, none of these extra costs would be incurred, and any fixed costs that



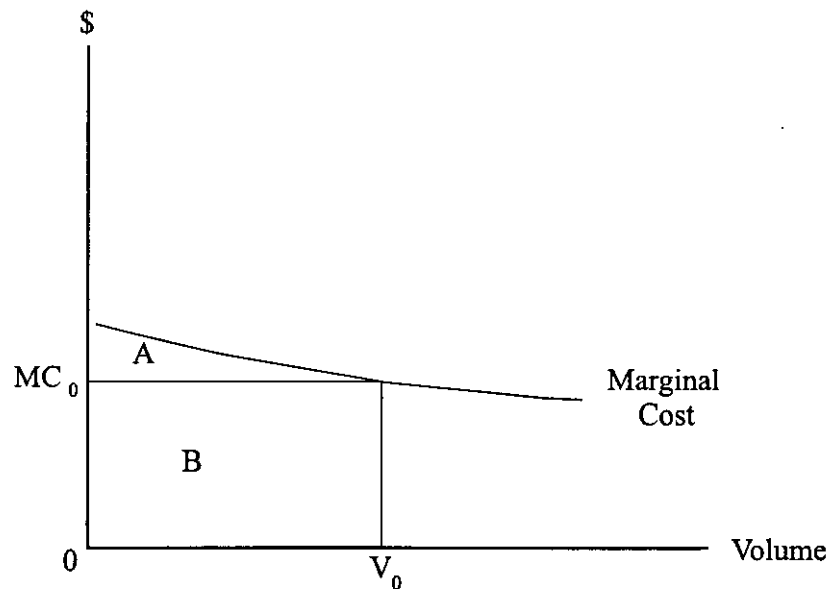
1 disappeared when production of the service ceased would also be avoided. Therefore,  
 2 the incremental cost of producing  $V_0$  units of the service is the sum of these extra costs  
 3 (areas A and B) plus any fixed costs incurred to provide the service.

### 4 3. Approximating Incremental Cost

5 A reasonable approximation of the incremental cost of producing a service is  
 6 available when the marginal cost of producing the service varies little as volume  
 7 changes. A marginal cost that varies little with volume is represented graphically by a  
 8 marginal cost curve that is nearly horizontal, like the one drawn in Figure 2.

FIGURE 2

Approximating Incremental Costs



9 The reasonable approximation of incremental cost that is available when  
 10 marginal cost varies little with volume is simply the cost savings that would be realized

1 from discontinuing a service if the marginal cost of producing each unit of the service  
2 were equal to the marginal cost of producing the last unit of the service. In Figures 1  
3 and 2, this approximation to the incremental cost of producing volume  $V_0$  is the product  
4 of  $V_0$  and the marginal cost of producing  $V_0$  (plus the related fixed costs). The marginal  
5 cost of producing  $V_0$  is labeled  $MC_0$  and the product of  $V_0$  and  $MC_0$  is simply area B in  
6 both Figures. Thus, the approximation of incremental cost omits area A. The omission  
7 is inconsequential if marginal cost does not vary with volume (so that the marginal cost  
8 curve is horizontal). The omission becomes more consequential, but may still provide a  
9 reasonable estimate of incremental cost, if marginal cost varies little with volume (so  
10 that the marginal cost curve is nearly horizontal, as in Figure 2). If marginal cost varies  
11 substantially with volume (as in Figure 1), then an approximation that omits area A may  
12 understate incremental cost substantially.

13 Historically, the Commission has employed such approximations of incremental  
14 cost when formulating its rate recommendations because incremental cost measures  
15 were not available. As noted, these approximations systematically understate  
16 incremental cost when marginal cost declines with volume. Therefore, modest markups  
17 of these under-estimates of incremental cost can permit revenue to fall below  
18 incremental cost, and thereby lead to cross subsidies. To provide stronger safeguards  
19 against cross subsidies, reasonable estimates of incremental cost should be employed  
20 when they are available. However, the Commission has not yet adopted any such  
21 estimates. Therefore, the rate recommendations that follow employ the historic  
22 approximation of incremental cost as the sum of volume variable cost (the product of

1 volume and marginal cost, which corresponds to area B in Figures 1 and 2) and specific  
2 fixed costs. The sum of these costs serves as the attributable cost markup base for  
3 determining a service's appropriate share of institutional costs.

4 Once the Commission is presented with incremental cost estimates that it  
5 believes to reasonably approximate incremental costs as properly defined and  
6 measured, those estimates of incremental cost should be used as the attributable cost  
7 base that is marked up in determining each service's appropriate contribution to  
8 institutional costs.

#### 9 IV. PRIORITY MAIL RATE RECOMMENDATION

##### 10 A. The Recommendation

11 Based upon careful consideration of both the criteria specified in § 3622(b) of the  
12 Act and the special circumstances in this case and in the R97-1 rate case, I recommend  
13 a 40.3% increase in the average rate for Priority Mail. This rate increase represents a  
14 cost coverage of 176% and a markup (the ratio of contribution to attributed cost) of  
15 76%, which provides the same markup index that the Postal Service proposes for First  
16 Class Mail in this case. Under this recommendation, Priority Mail's markup index (the  
17 ratio of its markup to the systemwide markup) is 1.395.

##### 18 B. Basis for the Recommendation

19 Prior to R97-1, Priority Mail had consistently been assigned a cost coverage that  
20 exceeded both the systemwide average cost coverage and the cost coverage assigned  
21 to First Class Mail. A higher cost coverage for Priority Mail is appropriate, given the

1 priority it is afforded in the mail stream, the extra services and service options it  
 2 provides, and the Commission's long-standing emphasis on protecting users of  
 3 monopoly mail services.<sup>15</sup>

4 In R97-1, the Commission recommended a deviation from the consistent policy  
 5 of affording Priority Mail a higher cost coverage than First Class Mail. It did so for three  
 6 main reasons. First, Priority Mail's attributable costs increased dramatically between  
 7 the R94-1 and the R97-1 rate cases. Therefore, applying historic coverages to Priority  
 8 Mail's higher base of attributable costs would have caused Priority Mail's rates to rise  
 9 more rapidly than they had historically.<sup>16</sup> Second, the Commission expressed the  
 10 concern that a large rate increase for Priority Mail might jeopardize its ability to compete  
 11 in the marketplace.<sup>17</sup> Third, the Commission questioned the level of service quality  
 12 delivered by Priority Mail relative to the corresponding level delivered by First Class  
 13 Mail.<sup>18</sup>

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15. See, for example, the Commission's Opinion and Recommended Decision in Docket No. R90-1, ¶ 4021.

16. The Commission stated in R97-1 that its recommendation to reduce Priority Mail's markup index substantially from historic levels was appropriate "especially in light of the magnitude of growth in the estimated costs of providing the service." Opinion and Recommended Decision, Docket No. R97-1, ¶ 5306.

17. The Commission cited NDMS witness Haldi's observation that "Priority Mail's overall market share has continued to decline since R94-1," and suggested that it would be "premature" to conclude that its increased growth rates in 1995 and 1996 "portend a reversal of the long-term trend of diminishing market share." *Ibid.* at ¶ 5307.

18. The Commission stated that "witness Haldi's testimony in this case raises significant concerns regarding the intrinsic quality and value of Priority Mail service. His analysis of delivery performance suggests that Priority Mail often

1           The evidence shows that Priority Mail has continued to experience sustained  
 2 volume and revenue growth since R97-1, and has continued to maintain a lion's share  
 3 of the two- to three-day delivery market. The evidence in its entirety also suggests that  
 4 Priority Mail provides a high level of service quality relative to First Class Mail.  
 5 Consequently, absent another unusually large increase in Priority Mail's attributable  
 6 costs and absent any other unusual developments, a return to historic markup  
 7 relationships would be appropriate. Historically, the markup assigned to Priority Mail  
 8 has exceeded the markup assigned to First Class Mail by a substantial margin.<sup>19</sup>

9           However, Priority Mail's attributable cost per piece has increased substantially  
 10 since R97-1. Consequently, a very large rate increase for Priority Mail would be  
 11 required to restore the historic relationship between the markups assigned to Priority  
 12 Mail and First Class Mail. Some mitigation of this rate increase is appropriate in light of  
 13 its potential impact on Priority Mail users (§ 3622(b)(4)). The mitigation I recommend is  
 14 to assign the same markup to Priority Mail that is assigned to First Class Mail. The rate  
 15 increase proposed by the Postal Service in this case entails a 76% markup for First  
 16 Class Mail. An average rate increase of 40.3% achieves the same 76% markup for  
 17 Priority Mail.

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fails to provide a standard of service superior to, or at times even equal to, that of First-Class Mail." Ibid. at ¶ 5308.

19. In R94-1, the markup assigned to Priority Mail exceeded the markup assigned to First Class Mail by more than 30%. Opinion and Recommended Decision, Docket No. R97-1, Appendix G, Schedule 1.

1           C.   Explanation of the Recommendation

2           A more complete explanation of my rate recommendation for Priority Mail follows  
3   in five steps. First, I review the sustained volume and revenue growth that Priority Mail  
4   has experienced in recent years. I also document the large market share that Priority  
5   Mail continues to enjoy, and note an enhanced feature that Priority Mail has added  
6   recently. Together, these facts suggest that Priority Mail can sustain a significant rate  
7   increase.

8           Second, I review the available evidence regarding Priority Mail's service quality. I  
9   explain why it is difficult to compare the service qualities of Priority Mail and First Class  
10   Mail directly using existing data. I also explain why the evidence, when viewed in its  
11   entirety, indicates that Priority Mail provides a high level of service quality relative to  
12   First Class Mail.

13          Third, I explain why a balanced consideration of the criteria in § 3622(b) of the  
14   Act justifies a higher markup for Priority Mail than for First Class Mail. Fourth, I  
15   document the large increase in Priority Mail's attributable cost per piece since R97-1.  
16   Fifth, I review my recommendation to equate the markups for Priority Mail and First  
17   Class Mail in order to mitigate the large rate increase for Priority Mail that would be  
18   needed to restore the appropriate historic markup relationships.

1 1. Priority Mail's Strong Competitive Position

2 a. Volume, Revenue, and Market Share

3 Any relevant concerns that may have arisen in the R97-1 rate case regarding the  
4 ability of Priority Mail to compete successfully in the marketplace appear to be less  
5 pressing in the present rate case. Tables 1, 2, and 3 indicate that Priority Mail has  
6 experienced steady growth in volume and revenue in recent years, and has maintained  
7 the lion's share of the two- to three-day delivery market.<sup>20</sup>

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20. The data in Tables 1 and 2 are taken from: (1) United States Postal Service Domestic Mail Volume History: 1970-1998, May 1999, USPS-LR-I-117, p. 5; (2) United States Postal Service Domestic Mail Revenue History: 1970-1998, May 1999, USPS-LR-I-117, p. 16; and (3) United States Postal Service Cost and Revenue Analysis: Fiscal Year 1999, USPS-LR-I-275, September 30, 1999, pp. 1, 3. The data in Table 3 are derived from Postal Service witness Robinson's response to interrogatory APMU/USPS-T34-48 (Revised 5/2/2000). The 1999 data in Table 3 reflect performance through the third quarter of CY1999.

TABLE 1  
PRIORITY MAIL VOLUME GROWTH

Fiscal Year	Priority Mail Volume (millions of pieces)	Annual % Change in Volume
1990	518	10.0%
1991	530	2.3%
1992	584	10.2%
1993	664	13.7%
1994	770	16.0%
1995	869	12.9%
1996	937	7.8%
1997	1,068	14.0%
1998	1,174	9.9%
1999*	1,279*	8.9%*

\*Excluding estimated migration to First Class Mail. Priority Mail's reported 1999 volume after migration is 1,189 million. USPS-LR-I-275, p. 1.

TABLE 2  
PRIORITY MAIL REVENUE GROWTH

Fiscal Year	Priority Mail Revenue (millions of dollars)	Annual % Change in Revenue
1990	1,555	9.8%
1991	1,764	13.4%
1992	2,071	17.4%
1993	2,300	11.1%
1994	2,653	15.4%
1995	3,075	15.9%
1996	3,321	8.0%
1997	3,856	16.1%
1998	4,186	8.6%
1999	4,533	8.3%



TABLE 3

## PRIORITY MAIL MARKET SHARES

Calendar Year	Priority Mail Market Share of Two- to Three-Day Market	
	Volume	Revenue
1997	62.7%	45.2%
1998	62.8%	45.3%
1999	61.9%	45.8%

1        Table 1 shows that Priority Mail volume has increased at an average annual rate  
2        of more than 10% between 1990 and 1998. Table 2 shows that the corresponding  
3        average annual increase in Priority Mail revenue exceeds 12%. The migration  
4        mentioned in the footnote to Table 1 stems from the increase (from 11 ounces to 13  
5        ounces) in the weight break between First Class Mail and Priority Mail that was  
6        implemented on January 10, 1999. The Postal Service estimates that this change  
7        caused approximately 90 million pieces of Priority Mail volume to migrate to First Class  
8        Mail.<sup>21</sup>

9        This migration is likely to have reduced the estimate of Priority Mail's 1999  
10       revenue and its market share reported in Tables 2 and 3.<sup>22</sup> Nevertheless, Priority Mail

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21. Response of Postal Service Witness Musgrave to interrogatory UPS/USPS-T34-8(a), Tr. 9/3578.

22. To illustrate the potential impact of the increase in the maximum weight for First Class Mail on Priority Mail's market share, suppose that the increase caused no change in the volumes of competitors in the two- to three-day delivery market. Then the additional 90 million pieces would have increased Priority Mail's share of 1999 volume from the 61.9% reported in Table 3 to 63.6%.

1 continues to enjoy a dominant share of both volume and revenue in the two- to three-  
2 day delivery market.

3 b. Delivery Confirmation and One-Pound Rate

4 Tables 1, 2, and 3 do not reflect fully the availability of Priority Mail's new  
5 Delivery Confirmation Service, since the service was only implemented on March 14,  
6 1999, half-way through FY1999. Delivery Confirmation, which is available at no extra  
7 charge to larger Priority Mail users, enhances the appeal of Priority Mail relative to other  
8 postal services and to competing services.<sup>23</sup> Priority Mail's competitive position will be  
9 further strengthened if the Postal Service's proposal to introduce a new, lower one-  
10 pound rate for Priority Mail is approved. This new rate will enhance the ability of Priority  
11 Mail to deliver relatively low rates to a large portion of its customers, and thereby  
12 sustain solid volume growth and a dominant market share.<sup>24</sup>

13 2. Service Quality

14 The attention that the Commission devoted to service quality in R97-1 was  
15 appropriate. Service quality typically affects the value that senders and recipients

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23. Postal Service witness Robinson estimates "conservatively" that Priority Mail's new Delivery Confirmation Service will increase Priority Mail volume by 1% in 2000 and will increase the growth rate for Priority Mail volume by 1% in 2001. USPS-T-34, p. 20.

24. In FY1999, nearly 39% of Priority Mail volume consisted of pieces weighing less than one pound, even in the absence of a lower one-pound rate. USPS-LR-I-250, PRO\_Z99R.XLS.

1 derive from a mail service, and § 3622(b)(2) of the Act cites the value of mail service as  
2 a relevant factor when formulating rate recommendations.

3 a. Measurement Difficulties

4 Unfortunately, service quality and the value that senders and recipients derive  
5 from a mail service can be difficult to measure accurately. To illustrate this point,  
6 consider Table 4, which reports the success of Priority Mail and First Class Mail in  
7 meeting their service standards in 1999.<sup>25</sup>

TABLE 4

PERCENT OF STANDARDS ACHIEVED IN FY1999

	% of Time Overnight Standard is Achieved	% of Time Two-Day Standard is Achieved
Priority Mail	90.4	79.3
First Class Mail	93.3	86.5

8 Table 4 indicates that Priority Mail does not meet its service standards as  
9 frequently as First Class Mail meets its standards.<sup>26</sup> One might be tempted to conclude

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25. The data in Table 4 reflect PETE and EXFC statistics, and are derived from the Postal Service's responses to interrogatories UPS/USPS-T34-19, Tr. 21/9372, and UPS/USPS-T34-20, Tr. 21/9373. Corresponding statistics based upon ODIS data and Delivery Confirmation data are provided in the Postal Service's responses to interrogatories APMU/USPS-T34-52, DFC/USPS-T34-8, UPS/USPS-T34-18, and UPS/USPS-T34-33, Tr. 7/2736, 21/8875-76, 9371, 9387.

26. This difference may stem in part from the fact that the Priority Mail PMPC dedicated network only became fully operational in July, 1998. The data provided in the Postal Service's response to interrogatory UPS/USPS-T34-26, Tr. 21/9376, reveals that Priority Mail achieved its service standards more frequently on average in FY1999 than it did in FY1997.

1 from this fact that Priority Mail provides a lower level of service quality than does First  
 2 Class Mail. The facts do not support this conclusion, however, in part because Priority  
 3 Mail has a more stringent service standard than First Class Mail, especially in two-day  
 4 delivery service areas.<sup>27</sup> Consequently, Priority Mail may systematically deliver higher  
 5 service quality in the form of more expeditious delivery than First Class Mail even  
 6 though Priority Mail meets its more exacting service standard less frequently.

7 Priority Mail's more stringent service standard takes the form of faster delivery  
 8 times for items traveling between identical origin-destination 3-digit ZIP code pairs.  
 9 Table 5 reports the number of ZIP code pairs with a one-, two-, and three-day standard  
 10 for Priority Mail and for First Class Mail.<sup>28</sup>

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27. PETE data indicate that in 1999, the volume of Priority Mail sent to destinations with a two-day service standard was more than five times the volume of Priority Mail sent to destinations with a one-day service standard. USPS response to interrogatory UPS/USPS-21, Tr. 21/9374. ODIS data place this ratio at approximately 3.5 to 1.0. Response of Postal Service witness Robinson to questions posed during oral examination, Tr. 21/8564.

28. The data in Table 5 are derived from: (1) Postal Service witness Robinson's Response to the Presiding Officer's Information Request No. 6, Question 10, page 2 of 2, Tr. 21/8560; and (2) the response of the United States Postal Service to interrogatories DFC/USPS-53, Tr. 21/8851-56, and UPS/USPS-36 (filed May 8, 2000). The data provided by these sources appear to conflict. The most recent response (UPS/USPS-36) reports that there are 780,514 ZIP code pairs for which Priority Mail has a two-day service standard. An earlier response (DFC/USPS-53, Tr. 21/8851-56) suggests that this number should be 780,757. Table 5 presents from among the reported statistics those that are least favorable to Priority Mail.

TABLE 5  
PRIORITY MAIL AND FIRST CLASS SERVICE STANDARDS

	Number of 3-Digit ZIP Code Pairs With:		
	One-Day Service Standard	Two-Day Service Standard	Three-Day Service Standard
Priority Mail	8,786	780,514	59,562
First Class Mail	8,744	157,081	683,281

1           Table 5 indicates that there are more than 600,000 three-digit ZIP code pairs  
2   between which Priority Mail's service standard is two days whereas First Class Mail's  
3   service standard is more than two days.<sup>29</sup> This fact helps to explain why Priority Mail  
4   may systematically provide faster delivery than First Class Mail, despite the statistics in  
5   Table 4.<sup>30</sup>

6           To illustrate this point more concretely, assume that all instances where Priority  
7   Mail fails to achieve its two-day service standard occur between ZIP code pairs where

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29. In her response to a question posed during oral cross-examination, Postal Service witness Robinson stated that "There are no ZIP Code pairs where Priority Mail has a slower service standard than First-Class Mail." Tr. 7/2857.

30. As the Postal Service states, a comparison of First Class Mail and Priority Mail performance on "two-day committed mail is not meaningful because it would match performance between shorter distance, First-Class Mail network legs with longer distance, Priority Mail legs." Postal Service response to interrogatory UPS/USPS-36 (filed May 8, 2000).

1 Priority Mail has a two-day service standard and First Class Mail has a three-day  
 2 standard. In that case, even if First Class Mail always achieved its (three-day) standard  
 3 exactly while Priority Mail achieved its (two-day) standard only half of the time and  
 4 provided three-day delivery the remainder of the time, Priority Mail would never provide  
 5 slower delivery than First Class Mail. This would be the case even though Priority Mail  
 6 met its more challenging service standard far less often than First Class Mail met its  
 7 standard, which is not the case in practice.<sup>31</sup>

8 Even identical delivery standards between identical ZIP code pairs can present  
 9 greater challenges to Priority Mail than to First Class Mail because of differences in  
 10 their mail mixes. Priority Mail includes pieces that weigh up to 70 pounds, while no First  
 11 Class Mail piece weighs more than thirteen ounces. Furthermore, Priority Mail consists  
 12 primarily of flats and parcels, whereas the majority of First Class Mail is letters.<sup>32</sup>

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31. Higher "failure rates" can be indicative of higher service quality in other important settings also. Consider mortality rates in hospitals, for example. Some highly regarded hospitals experience higher mortality rates than do less highly regarded hospitals. Higher mortality rates can arise at the best hospitals because the most seriously ill patients seek treatment at those hospitals. When they agree to treat the most seriously ill patients, the best hospitals implicitly set more exacting standards for themselves. The higher standards can cause the best hospitals to "fail" more often than do more mediocre hospitals, even though the former unquestionably deliver superior service quality. Lisa I. Iezzoni, "Risk Adjustment and Current Health Policy Initiatives," in Risk Adjustment for Measuring Healthcare Outcomes, Second Edition, 1997, Lisa I. Iezzoni (ed.), Chicago: Health Administration Press.

32. Flats, parcels, and irregular pieces and parcels accounted for more than 99% of Priority Mail volume in PFY1998. Less than 1% of Priority Mail volume was letters. In contrast, letters accounted for more than 88% of First Class Mail volume in PFY1998. Origin-Destination Volume Summary Report, Origin-Destination Information System Report HSA360P1, Attachment G to the Postal Service's Request.

1           Some mail mixes can be more difficult and more time-consuming than others to  
 2 process, transport, and deliver. For example, flats may take more time to deliver than  
 3 letters. In 1999, First Class letters achieved their service commitments 90.2% of the  
 4 time; in contrast, First Class flats achieved their service commitments only 78.5% of the  
 5 time.<sup>33</sup> These statistics suggest that because of differences in mail mixes, even an  
 6 identical delivery standard for an identical ZIP code pair may not pose an identical  
 7 challenge to Priority Mail and to First Class Mail. Consequently, comparisons of  
 8 performance statistics that do not control for mail mix may not permit meaningful  
 9 inferences about relative levels of service quality and customer value.<sup>34</sup>

10           Difficulties in drawing meaningful conclusions about relative service qualities  
 11 from the available data are further compounded by concerns about the accuracy of the  
 12 data. The Priority Mail performance statistics reported in Table 4 reflect Priority-End-to-  
 13 End ("PETE") data. As the name suggests, the PETE system tracks Priority Mail pieces  
 14 from the time they enter the mail stream to the time they are delivered to the  
 15 addressee. In contrast, the Postal Service's Origin/Destination Information System  
 16 ("ODIS") tracks pieces from the time they are received at the originating Post Office to  
 17 the time they arrive at the destination Post Office.<sup>35</sup> The time between entry into the

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33. Response of the United States Postal Service to interrogatory DFC/USPS-70 (filed May 12, 2000).

34. When attention is restricted to flats, Priority Mail's on-time performance in FY1999 (81.2%) exceeds First Class Mail's on-time performance (78.5%), despite Priority Mail's more exacting service standard. Revised Response of United States Postal Service to Interrogatory UPS/USPS-10 (filed May 16, 2000).

35. Tr. 21/8843-48, 8875-76.

1 mail stream and delivery to the addressee cannot be shorter than the time between  
2 receipt at the originating Post Office and arrival at the destination Post Office.  
3 Therefore, any Priority Mail piece that achieves its service standard as measured by the  
4 PETE system should also achieve its service standard when measured by ODIS. Yet,  
5 ODIS often reports Priority Mail to have achieved its service standards less frequently  
6 than does the PETE system.<sup>36</sup> This is counter-intuitive. Apparent anomalies of this sort  
7 raise concerns about the accuracy of the reported service quality statistics.

8 b. Other Direct Measures of Value

9 In light of concerns about the accuracy of available data and difficulties in  
10 interpreting even the most accurate data, excessive focus on a single imperfect  
11 measure of service quality should be avoided. Instead, all available direct measures of  
12 service quality and value should be studied carefully. A thorough consideration of  
13 more indirect potential indicators of service quality and value can also be instructive.

14 Direct measures of service quality and value other than achievement of service  
15 standards include measures of the reliability, convenience, security, and freedom from  
16 content damage that a service delivers, as well as the options it provides to purchase  
17 additional value-added features. Priority Mail fares well on many of these direct  
18 measures of service quality. To illustrate, Priority Mail (like First Class Mail) is sealed  
19 against inspection. It also enjoys the convenience of the collection system for a large

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36. For FY1999, ODIS data report that Priority Mail achieved its one-day service standard 85% of the time and its two-day service standard 74% of the time. APMU/USPS-T34-52, Tr. 7/2736. Both of these percentages are less than the corresponding percentages reported in Table 4, which reflect PETE data.



1 portion (nearly 39% in FY1999) of the pieces it carries, those that weigh less than one  
 2 pound.<sup>37</sup> Pick-up service is available for Priority Mail for an additional fee, whereas  
 3 pick-up service is not available at all for First Class Mail. Priority Mail also provides  
 4 electronic Delivery Confirmation at no extra charge to large users, and other Priority  
 5 Mail customers can purchase manual Delivery Confirmation Service. The Postal  
 6 Service also supplies packaging materials at no charge to Priority Mail customers.

7 c. Operating Procedures

8 The operating procedures of a mail service also serve as indirect indicators of  
 9 service quality and value, as the references to "collection, mode of transportation, and  
 10 priority of delivery" in § 3622(b)(2) of the Act suggest. Priority Mail exhibits at least six  
 11 distinguishing features in this regard.<sup>38</sup>

12 First, Priority Mail has its own dedicated processing and transportation network  
 13 in the Northeast and Florida, which is supplemented by the main mail network.<sup>39</sup>  
 14 Second, Priority Mail is generally cleared before First Class Mail, and is thereby  
 15 afforded priority for transportation resources. Third, there are many origin-destination  
 16 pairs for which Priority Mail travels by air while First Class Mail remains in the surface

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37. USPS-LR-I-250, PR\_OZ99R.XLS. Priority Mail pieces that weigh more than one pound can also be deposited in the collection system if postage is paid by meter imprint. Domestic Mail Manual, Issue 55, § D100(2.3) (January 10, 2000).

38. These six features of Priority Mail operating procedures are described by Postal Service witness Robinson in her response to interrogatory APMU/USPS-T34-45, Tr. 2724-25.

39. Tr. 27/2724-25. Priority Mail is processed at the local Processing and Distribution Center if volume exceeds capacity at, or if mail arrives late at, a Priority Mail Processing Center. DBP/USPS-128, Tr. 7/2751.

1 network. Fourth, Priority Mail is typically assigned to earlier flights than First Class Mail  
2 on the Eagle Network and on commercial airlines. Fifth, Priority Mail is delivered before  
3 First Class Mail if it is not possible to deliver both. Sixth, during the peak year-end  
4 season, Priority Mail is sometimes delivered on Sunday, while First Class Mail is not.

5 d. Customer Behavior

6 Customer behavior is another indirect measure of service value. If customers  
7 repeatedly choose a more expensive mail service when a less expensive service is  
8 available, their choice provides strong evidence that they value the more expensive  
9 service more highly. In 1996, more than 136 million pieces were sent as Priority Mail,  
10 even though these pieces could have been sent more cheaply as First Class Mail.<sup>40</sup> By  
11 1999, the number of such pieces sent by Priority Mail had grown to more than 215  
12 million.<sup>41</sup> These numbers suggest that many customers value Priority Mail more highly  
13 than they do First Class Mail. The fact that the numbers have grown impressively  
14 suggests that customer perceptions are matched by actual customer experience.

15 3. The Criteria in § 3622(b) of the Act

16 To the extent that its extra enhanced features enable Priority Mail to deliver  
17 greater value to its users than First Class Mail delivers to its users, § 3622(b)(2) of the  
18 Act suggests that the markup established for Priority Mail should exceed the markup

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40. This statistic is derived from Postal Service witness Sharkey's response to interrogatory NDMS/USPS-T33-7 in Docket No. R97-1.

41. This statistic counts only Priority Mail volume weighing less than 11 ounces. The number of Priority Mail pieces weighing less than 13 ounces in 1999 exceeds 289 million. USPS-LR-I-250, PR\_OZ99R.XLS.

1 established for First Class Mail. A higher markup for Priority Mail is also supported by  
2 other criteria in the Act.

3 Section 3622(b)(4)'s concern with the effect of rate increases on private  
4 competitors is particularly relevant to Priority Mail, since First Class Mail letters are  
5 largely sheltered from competition by the Postal Service's letter monopoly. The  
6 concern with the effect of rate increases on private competitors justifies a higher  
7 markup for Priority Mail than for First Class Mail, ceteris paribus. A smaller markup for  
8 First Class Mail is also consistent with the Commission's desire to "avoid unfairly  
9 penalizing First-Class Mail" and to have First Class Mail "bear a markup at, or only  
10 slightly above, systemwide average."<sup>42</sup> A smaller markup for First Class Mail also helps  
11 to target rate relief to individual mailers, as opposed to business mailers.<sup>43</sup>

12 Under the Postal Service's letter monopoly, Priority Mail users often have more  
13 alternatives than do First Class Mail users (§ 3622(b)(5)). Numerous private carriers  
14 transport non-letter items weighing up to 70 pounds, just as Priority Mail does.  
15 Competitive alternatives also exist even for Priority Mail letters due to the suspension of  
16 the letter monopoly for expedited shipments. Consequently, Priority Mail users are

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42. Opinion and Recommended Decision, Docket No. R90-1, ¶¶ 4021, 4022.

43. Only 12% of 1998 Priority Mail volume was sent by households, whereas almost 27% of First Class single piece letters were sent by households in 1998; approximately 55% of First Class single piece letters were sent to or from households in 1998, compared to 45% for Priority Mail. Response of Postal Service witness Tolley to interrogatory UPS/USPS-T6-5, Tr. 9/3659-61, and Response of Postal Service witness Musgrave to interrogatory UPS/USPS-T8-1, Tr. 9/3566-67.

1 often better able to mitigate any adverse consequences of rate increases, which  
 2 suggests that a higher markup for Priority Mail than for First Class Mail is appropriate.

3 The Commission has also indicated that rate increases for First Class Letters  
 4 (and for Regular Periodicals, Special Standard Mail, and Bound Printed Matter) merit  
 5 some mitigation because of the ECSI value of their content (§ 3622(b)(8)).<sup>44</sup> This  
 6 consideration is less applicable to Priority Mail in light of its greater "non-letter" content.  
 7 The consideration of ECSI value is one additional reason to establish a markup for  
 8 Priority Mail that exceeds the markup for First Class Mail.

#### 9 4. The Increase in Attributable Costs

10 The Commission reversed a well-established precedent in R97-1 when it  
 11 recommended a lower markup for Priority Mail than for First Class Mail. As noted, the  
 12 Commission's recommendation was based in part on the substantial increase in Priority  
 13 Mail's attributable costs that occurred between R94-1 and R97-1.

14 The corresponding increase in Priority Mail's attributable costs since R97-1,  
 15 while substantial, is less pronounced.<sup>45</sup> As reported in the fourth column of Table 6,  
 16 Priority Mail's attributable costs have increased by 35.9% since R97-1. (The  
 17 corresponding increase in real (inflation-adjusted) terms is 29.5%, as the fifth column in

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44. USPS-T-32, p. 11 (Mayes).

45. The data in Table 6 are taken from: (1) Opinion and Recommended Decision, Docket Nos. R80-1, R84-1, R87-1, R90-1, R94-1, and R97-1, Appendix G, Schedule 1; and (2) UPS-T-5, p. 19, Table 8, and workpaper UPS-Luciani-WP-3-1.1.

1 Table 6 reveals.)<sup>46</sup> This increase is comparable to the corresponding average increase  
 2 between recent rate cases prior to R97-1, and less than half of the corresponding  
 3 increase in R97-1. In this respect, the unusually large increase in Priority Mail's  
 4 attributable costs in R97-1 is not replicated in the present case. Consequently, a  
 5 restoration of the historic markup relationship between Priority Mail and First Class Mail  
 6 might seem to be appropriate.

TABLE 6

## CHANGES IN PRIORITY MAIL ATTRIBUTED COST

Rate Case	Test Year Estimated Volume (000 Pieces)	Test Year Attributed Cost (\$ 000)	% Change in Attributed Cost	% Change in Real Attributed Cost	Average Annual % Change in Attributed Cost per Piece	Average Annual % Change in Real Attributed Cost per Piece
R80-1	237,720	465,774				
R84-1	296,017	462,436	- 0.7	- 17.5	- 5.1	- 8.4
R87-1	394,781	712,925	54.2	42.5	5.2	2.3
R90-1	518,458	1,002,899	40.7	25.1	2.4	- 1.7
R94-1	762,115	1,401,597	39.8	27.3	- 1.2	- 3.4
R97-1	1,058,687	2,419,687	72.6	64.0	8.1	6.1
R2000-1	1,070,173	3,288,724	35.9	29.5	11.5	9.4

46. The inflation adjustment uses the Gross Domestic Product Implicit Price Deflator (1996=100). <http://www.economagic.com/em-cgi/data.exe/fedstl/gdpef>. The test year attributed costs reported in the third column of Table 6 were translated into 1981 dollars by multiplying each entry by the ratio of the Deflator in the first quarter of calendar year 1981 to the Deflator in the first quarter of the calendar year following the rate case (e.g., 1998 for R97-1). The Deflator for the first quarter of 2001 was estimated to be the Deflator for the first quarter of 2000 (105.90) and the percent increase in the Deflator (1.758) between the first quarter of 1999 and the first quarter of 2000.

1           However, as the last two columns in Table 6 indicate, Priority Mail's attributable  
2   cost per piece has increased even more rapidly since R97-1 than it increased between  
3   R94-1 and R97-1.<sup>47</sup> This increase reflects in part the migration of a significant portion of  
4   Priority Mail weighing between 11 and 13 ounces to First Class Mail, due to the  
5   increase in the weight break between First Class Mail and Priority Mail. That migration  
6   has reduced Priority Mail volume. The reduced volume implies that a larger rate  
7   increase is required to generate enough extra revenue to offset any given increase in  
8   attributable costs, *ceteris paribus*.

9                    5. Mitigation of the Rate Increase

A very large rate increase for Priority Mail would be required to restore the historic relationship between the markups assigned to Priority Mail and to First Class Mail, given the relatively large markup that the Postal Service proposes for First Class Mail. Some mitigation of this rate increase is appropriate in light of its potential impact on Priority Mail users (§ 3622(b)(4)). The mitigation I recommend takes the form of implementing the same markup for Priority Mail as for First Class Mail, assuming that the Commission recommends the rate increase for First Class Mail that the Postal

47. Attributed cost per piece is the ratio of attributed cost to volume. The percentage increase in this statistic between two successive rate cases is the product of 100 and the ratio of the difference between the statistics to the statistic in the earlier rate case. The average annual percentage increase between two successive rate cases is simply the total percentage increase divided by the number of years between rate cases. The number is taken to be three in all cases except between R80-1 and R84-1 and between R90-1 and R94-1, where it is taken to be four.

1 Service proposes. If the Commission does so, a 40.3% average rate increase for  
 2 Priority Mail will secure an equal (76%) markup for Priority Mail and First Class Mail.

3 This recommended rate increase is substantial. However, it mainly reflects the  
 4 35.9% increase in Priority Mail's attributable costs since R97-1. Furthermore, the  
 5 recommended rate increase provides a cumulative average rate increase for Priority  
 6 Mail since R94-1 of approximately 48%.<sup>48</sup> This increase is much less than half of the  
 7 corresponding increase (135%) in Priority Mail's attributable costs.

8 Historically, Priority Mail volumes have continued to grow rapidly despite  
 9 substantial rate increases.<sup>49</sup> This sustained growth indicates that Priority Mail users  
 10 have been able to adapt to substantial rate increases (§ 3622(b)(4)) in the past, and so  
 11 are likely to be able to do so in the future. However, if convincing evidence to the  
 12 contrary arises which demonstrates that the recommended 40.3% rate increase would  
 13 unduly affect Priority Mail users, then some further mitigation of the rate increase might  
 14 be appropriate.

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48. The 5.6% average rate increase from R97-1 (R97-1 Opinion and Recommended Decision, Summary, at iii) combined with the recommended 40.3% increase provides a cumulative rate increase of 48.2% (since  $1.056 \times 1.403 = 1.482$ ).

49. Priority Mail rates increased by 19% on February 3, 1991, for example. USPS-T-34, p. 7. Nevertheless, Priority Mail's volume and revenue grew substantially in the succeeding years. See Tables 1 and 2 on page 23, above.

1                   V.       PARCEL POST RATE RECOMMENDATION

2           A.   The Recommendation

3           Based upon careful consideration of the criteria specified in § 3622(b) of the Act  
4   and relevant changes that have occurred since the R97-1 rate case, I recommend a  
5   24.9 percent increase in the average rate for Parcel Post. This rate increase reflects a  
6   cost coverage of 111%, a markup of 11%, and a markup index of 0.202.

7           B.   Basis for the Recommendation

8           The 24.9 percent rate increase that I recommend reflects in large part the  
9   substantial increase in Parcel Post's attributable costs since the R97-1 rate case. It  
10   also reflects the solid volume and revenue growth that Parcel Post has experienced in  
11   recent years, which suggests that Parcel Post can reasonably bear a markup closer to  
12   the systemwide average than it does presently. The 11% markup that I recommend is  
13   also important to reduce the risk that Parcel Post revenue will fall below its attributable  
14   costs in the future, as it has done repeatedly in the past. The recommended markup  
15   also reflects the higher value that its new Delivery Confirmation Service and its new rate  
16   categories enable Parcel Post to deliver to its customers.

17          C.   Explanation of the Recommendation

18          A more complete explanation of my rate recommendation for Parcel Post follows  
19   in five steps. First, I review the substantial increase in Parcel Post's attributable costs  
20   since the R97-1 rate case. Second, I document the solid growth in volume and revenue  
21   that Parcel Post has experienced in recent years. Third, I explain how the low cost



1 coverage that Parcel Post was assigned in the R97-1 rate case may have caused  
 2 Parcel Post revenue to fall below its attributed cost in FY1998, the R97-1 test year.  
 3 Fourth, I note that Parcel Post may no longer be the low-value service that it has  
 4 historically been considered to be, in part because the new rate categories introduced  
 5 in R97-1 have enabled Parcel Post to become an integral component of higher value  
 6 mail services. Fifth, I point out that if the Postal Service's estimates of Parcel Post  
 7 volume are accurate, then earlier Commission concerns that higher Parcel Post rates  
 8 would cause unacceptably low volumes are no longer applicable.

9                                   1.       Increased Attributable Costs

10           Parcel Post's attributable costs have increased substantially since R97-1. Parcel  
 11 Post's estimated attributable costs in the R97-1 test year were \$685.9 million.<sup>50</sup> Parcel  
 12 Post's estimated attributable costs in the current test year are 41% higher, at \$965.5  
 13 million.<sup>51</sup> This substantial increase in Parcel Post's attributable costs since R97-1  
 14 necessitates a substantial increase in rates to ensure that revenues exceed attributable  
 15 costs, as required by § 3622(b)(3) of the Act.

16                                   2.       Solid Volume and Revenue Growth

17           Recent data suggest that Parcel Post can sustain a rate increase designed to  
 18 ensure that its revenues exceed its attributable costs by a more healthy margin than the  
 19 margin adopted in R97-1. In contrast to the years immediately prior to the R97-1 rate

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50. Opinion and Recommend Decision, Docket No. R97-1, Appendix G, Schedule 1.

51. UPS-T-5, p. 19 (Table 8) (Luciani).

- 1 case, Parcel Post volume and revenue have grown substantially in recent years, as
- 2 Tables 7 and 8 show.<sup>52</sup>

TABLE 7

## PARCEL POST VOLUME GROWTH

Fiscal Year	Parcel Post Volume (millions of pieces)	% Change in Parcel Post Volume
1990	128	5.8%
1991	138	7.8%
1992	165	19.6%
1993	187	13.3%
1994	224	19.8%
1995	218	- 2.7%
1996	213	- 2.3%
1997	237	11.3%
1998	267	12.7%
1998 <sup>†</sup>	316 <sup>†</sup>	--
1999 <sup>†</sup>	319 <sup>†</sup>	0.9% <sup>†</sup>

<sup>†</sup> Based on the Postal Service's proposed new methodology.

52. The data in Tables 7 and 8 are taken from: (1) United States Postal Service Domestic Mail Volume History: 1970-1998, May 1999, USPS-LR-I-117, p. 8; (2) United States Postal Service Domestic Mail Revenue History: 1970-1998, May 1999, LR-I-117, p. 8; (3) United States Postal Service Cost and Revenue Analysis: Fiscal Year 1999, September 30, 1999, USPS-LR-I-275, p. 4; and (4) United States Postal Service Cost and Revenue Analysis: FY1998, PRC Version, Revised June 11, 1999, pp. 6, 8. Volume and revenue statistics for FY1998 are reported as measured using both the Postal Service's traditional methodology and its new proposed methodology for measuring Parcel Post volume and revenue.

TABLE 8  
PARCEL POST REVENUE GROWTH

Fiscal Year	Parcel Post Revenue (millions of dollars)	% Change in Parcel Post Revenue
1990	419	7.2%
1991	455	8.6%
1992	560	23.1%
1993	576	2.9%
1994	667	15.8%
1995	703	5.4%
1996	691	- 1.7%
1997	771	11.6%
1998	824	6.9%
1998 <sup>†</sup>	948 <sup>†</sup>	--
1999 <sup>†</sup>	1,021 <sup>†</sup>	7.7% <sup>†</sup>

<sup>†</sup> Based on the Postal Service's proposed new methodology.

1           It is important to note that Parcel Post volume and revenue continued to  
2 increase in 1999 even in the face of the average rate increase of more than 12% that  
3 was implemented on January 10, 1999. In fact, the rate increase contributed to a  
4 nearly 8% increase in Parcel Post revenue in 1999.

5                               3.     1998 Revenue Below Cost

6           The extremely low cost coverage that Parcel Post has had in recent years runs a  
7 high risk of violating the requirement that the revenues derived from each mail subclass  
8 exceed its attributable costs (§ 3622(b)(3) of the Act). Since revenue and cost cannot  
9 be predicted perfectly, actual revenue may fall below actual cost if rates are set to  
10 generate revenues that are expected to exceed costs by only a modest amount.

1           To illustrate this point, note that FY1998 Parcel Post revenue and attributable  
 2 cost were predicted in the R97-1 rate case to be \$740.5 million and \$685.9 million,  
 3 respectively.<sup>53</sup> Realized revenue and attributable cost in 1998 were measured to be  
 4 \$823.6 million and \$840.0 million, respectively, using the Postal Service's historic  
 5 measurement methodology.<sup>54</sup> These observations lead to two important observations.  
 6 First, in practice, revenue and cost forecasts can diverge substantially from actual  
 7 levels of revenue and cost. In FY1998, attributable cost exceeded predicted  
 8 attributable cost by more than 22%. Second, using the historic methodology, Parcel  
 9 Post's measured revenue was below its measured attributable cost in 1998.<sup>55</sup> Revenue  
 10 below attributable cost is inconsistent with § 3622(b)(3) of the Act. The cross subsidy it  
 11 entails is unfair to competitors and to the users of other postal services who must make  
 12 up the shortfall in net revenue.

13           FY1998 is not the only year in which Parcel Post revenue seems to have failed  
 14 to cover its attributable costs. In fact, with only two exceptions, Parcel Post revenues  
 15 have fallen short of attributable costs in every year between FY1989 and FY1997.<sup>56</sup> The  
 16 risk of continuing this history of unfair and illegal cross subsidy can be reduced by

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53. Opinion and Recommend Decision, Docket No. R97-1, Appendix G, Schedule 1.

54. United States Postal Service Cost and Revenue Analysis: Fiscal Year 1998,  
 PRC Version, Revised June 11, 2000, p. 6.

55. Recall also from the discussion in Section III(C), above, that the sum of volume  
 variable cost and specific fixed cost typically understates incremental cost.  
 Therefore, even if measured revenue exceeds measured attributable cost,  
 revenue may still fall below incremental cost.

56. The exceptions are FY1992 and FY1995. United States Postal Service Cost and  
 Revenue Analysis, Fiscal Years 1989-1998.

1 avoiding very low cost coverages like the one adopted for Parcel Post in the R97-1 rate  
 2 case. The 111% cost coverage I recommend for Parcel Post is designed in part to  
 3 reduce the likelihood of violating § 3622(b)(3) of the Act and of disadvantaging  
 4 competitors and other mail users unfairly, without burdening Parcel Post mailers unduly  
 5 (§ 3622(b)(4)).

#### 6 4. Higher-Value Services

7 In part because of the relatively low priority it is afforded in the mail stream,  
 8 Parcel Post has traditionally been viewed as a lower-value service. However, the  
 9 average time for delivery of Parcel Post packages has been less than four days on a  
 10 fairly consistent basis since 1995.<sup>57</sup> Furthermore, the Destination Delivery Unit ("DDU")  
 11 and Destination Sectional Center Facility ("DSCF") discounts introduced in R97-1 have  
 12 enabled Parcel Post to become an integral component of even more expedited parcel  
 13 services. To illustrate, the Airborne@Home service provided by Airborne Express  
 14 delivers parcels to the DDU and obtains next-day delivery by the Postal Service with  
 15 great regularity.<sup>58</sup> This timely, reliable delivery of parcels enables Airborne Express to  
 16 promise three-day delivery from "virtually any business to any residential destination in

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57. Parcel Post's average time to delivery has been less than four days in all Postal Quarters since 1995, with the exception of the First Postal Quarter in 1995, 1997, and 1998, and the Fourth Postal Quarter in 1997. The average days to delivery in these quarters were 4.08, 4.07, 4.12, and 4.56, respectively. ODIS Quarterly Statistics Reports, Table 4, Postal Quarter 1, PFY 1995 through Postal Quarter 4, PFY 1999.

58. Postal Service witness Kingsley reports that the "stated delivery expectation is next day delivery for parcels entered at the DDU," and although delivery times are not tracked, "anecdotal customer feedback" suggests that next day delivery is achieved approximately 97% of the time. UPS/USPS-T10-21, Tr. 5/1912.

1 the U.S."<sup>59</sup> Arrangements of this sort make DDU Parcel Post an integral component of  
 2 a service that provides high value to both the senders and the recipients of parcels.

3 As of March 14, 1999, Parcel Post shippers have the option of purchasing  
 4 Delivery Confirmation for their shipments. This new feature further increases the value  
 5 of service that Parcel Post now delivers to its users. Consequently, the value of service  
 6 criterion (§ 3622(b)(2) of the Act) suggests that the appropriate markup for Parcel Post  
 7 should exceed the markup that the Commission recommended in the R97-1 rate case.

#### 8 5. Revised Volume Forecasts

9 The Postal Service changed its methodology for measuring Parcel Post volume  
 10 and revenue after the R97-1 rate case. The change provides a substantial increase in  
 11 measured Parcel Post volume.<sup>60</sup> UPS witness Sellick (UPS-T-4) documents flaws in  
 12 this new methodology. However, if the new methodology accurately reflects Parcel  
 13 Post volume, the much higher volume it reveals should allay any concerns the  
 14 Commission might have had in R97-1 that a sizeable increase in rates would reduce  
 15 Parcel Post volumes to unacceptably low levels.

16 *To the extent that a concern over low Parcel Post volumes led the Commission*  
 17 *to recommend an extremely modest cost coverage for Parcel Post in R97-1, a more*

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59. Airborne Express web site, <<http://www.airborne.com/factsheet2/currenthtml/19990603928368205.html>>.

60. As noted above, 1998 Parcel Post volume, as measured using the historic methodology, is 266.5 million pieces. As Table 7 indicates, the corresponding volume is nearly 19% higher (316 million pieces) when measured using the new methodology.

1 robust cost coverage is appropriate in the present rate case, since that concern is less  
2 pressing now. Indeed, under the new methodology, 1999 Parcel Post volume achieved  
3 its highest level since 1977. This peak volume represents an increase of more than  
4 163% in the past decade.<sup>61</sup>

5                                   6.     Summary

6             In summary, the changes that have occurred since R97-1 lead to the conclusion  
7 that the markup for Parcel Post should be increased to a level that is closer to the  
8 systemwide average, thereby requiring Parcel Post to shoulder a larger share of the  
9 institutional cost burden that has been shouldered primarily by other mailers in recent  
10 years.

11            The 11% markup that I recommend reflects a balanced consideration of all of the  
12 criteria specified in § 3622(b) of the Act. The recommended markup is only 3  
13 percentage points higher than the markup recommended by the Commission in R97-1,  
14 and is lower than the markups recommended by the Commission in R84-1, R87-1, and  
15 R90-1. A more substantial markup would be appropriate, if not for the large increase in  
16 Parcel Post's attributable costs since R97-1. This substantial increase in costs requires  
17 a substantial increase in rates to limit the risk of cross subsidy.

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61. Parcel Post volume was 121 million pieces in 1989. USPS-LR-I-117, op. cit.,  
p. 4.

1 CHAIRMAN GLEIMAN: Dr. Sappington, have you had an  
2 opportunity to examine the packet of designated written  
3 cross examination that was made available earlier today?

4 THE WITNESS: Yes, I have.

5 CHAIRMAN GLEIMAN: If those questions were asked  
6 of you today, would your answers be the same as those you  
7 previously provided in writing?

8 THE WITNESS: Yes, with just a few minor changes.

9 CHAIRMAN GLEIMAN: And what are those changes,  
10 sir?

11 THE WITNESS: The first one is in my response to  
12 APMU/UPS-T6-18, in part (a) of my response on the second  
13 line the number should be 3,288,724,000 instead of -734,000.

14 The second change would be on USPS/UPS-T6-26, in  
15 line 3, in the second paragraph of my response, the word  
16 "consistent" should actually be "constant".

17 The third change is to PSA/UPS-T6-2 and my  
18 response to part (d) now reads, "An order of magnitude  
19 estimate of Fiscal Year 1999 Parcel Post volume was prepared  
20 by UPS Witness Ralph L. Luciani and is contained in his work  
21 papers at UPS-Luciani-WP3-1.7 or in the electronic version  
22 filed June 22nd, 2000, File UPS-T5-Luciani-WP3-1, Revised  
23 .XLS, Tab 3-1.7 Volume Modifications."

24 MR. MCKEEVER: Mr. Chairman, that last change was  
25 served.



1           It was filed yesterday as a revised response to  
2 that interrogatory.

3           I do have extra copies of that page available if  
4 desired. It consists mainly of just a technical reference  
5 to a place in Witness Luciani's work papers, as Dr.  
6 Sappington indicated.

7           That change and the other two changes mentioned by  
8 Dr. Sappington have been made in the packet of designated  
9 written cross examination.

10          CHAIRMAN GLEIMAN: That being the case, counsel,  
11 if you would please provide the two copies of the designated  
12 written cross examination to the court reporter, I will  
13 direct that the material be received into evidence and  
14 transcribed into the record.

15                               [Designated Written  
16 Cross-Examination of David E. M.  
17 Sappington, UPS-T-6, was received  
18 into evidence and transcribed into  
19 the record.]

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 PARCEL SERVICE  
WITNESS DAVID E. M. SAPPINGTON  
(UPS-T-6)

Party

Interrogatories

Amazon.com, Inc.

AMZ/UPS-T6-1-16

PSA/UPS-T6-1, 5-6, 8, 12

USPS/UPS-T6-1, 6, 9, 14, 18-21, 29, 34-36, 38,  
45, 48

Association of Priority Mail Users, Inc.

APMU/UPS-T6-1-7, 9-13, 15-22

USPS/UPS-T6-3-5, 27-28, 39, 41

Newspaper Association of America

AMZ/UPS-T6-3, 6

APMU/UPS-T6-2, 8

USPS/UPS-T6-2, 4, 7, 9, 11-13, 18, 37, 41, 43,  
45, 47-48, 51

Parcel Shippers Association

PSA/UPS-T6-1-12

United States Postal Service

USPS/UPS-T6-1-52

Respectfully submitted,



Margaret P. Crenshaw  
Secretary

INTERROGATORY RESPONSES OF  
UNITED PARCEL SERVICE  
WITNESS DAVID E. M. SAPPINGTON (T-6)  
DESIGNATED AS WRITTEN CROSS-EXAMINATION

<u>Interrogatory</u>	<u>Designating Parties</u>
AMZ/UPS-T6-1	Amazon
AMZ/UPS-T6-2	Amazon
AMZ/UPS-T6-3	Amazon, NAA
AMZ/UPS-T6-4	Amazon
AMZ/UPS-T6-5	Amazon
AMZ/UPS-T6-6	Amazon, NAA
AMZ/UPS-T6-7	Amazon
AMZ/UPS-T6-8	Amazon
AMZ/UPS-T6-9	Amazon
AMZ/UPS-T6-10	Amazon
AMZ/UPS-T6-11	Amazon
AMZ/UPS-T6-12	Amazon
AMZ/UPS-T6-13	Amazon
AMZ/UPS-T6-14	Amazon
AMZ/UPS-T6-15	Amazon
AMZ/UPS-T6-16	Amazon
APMU/UPS-T6-1	APMU
APMU/UPS-T6-2	APMU, NAA
APMU/UPS-T6-3	APMU
APMU/UPS-T6-4	APMU
APMU/UPS-T6-5	APMU
APMU/UPS-T6-6	APMU
APMU/UPS-T6-7	APMU
APMU/UPS-T6-8	NAA
APMU/UPS-T6-9	APMU
APMU/UPS-T6-10	APMU
APMU/UPS-T6-11	APMU
APMU/UPS-T6-12	APMU
APMU/UPS-T6-13	APMU
APMU/UPS-T6-15	APMU
APMU/UPS-T6-16	APMU
APMU/UPS-T6-17	APMU
APMU/UPS-T6-18	APMU

APMU/UPS-T6-19  
APMU/UPS-T6-20  
APMU/UPS-T6-21  
APMU/UPS-T6-22  
PSA/UPS-T6-1  
PSA/UPS-T6-2  
PSA/UPS-T6-3  
PSA/UPS-T6-4  
PSA/UPS-T6-5  
PSA/UPS-T6-6  
PSA/UPS-T6-7  
PSA/UPS-T6-8  
PSA/UPS-T6-9  
PSA/UPS-T6-10  
PSA/UPS-T6-11  
PSA/UPS-T6-12  
USPS/UPS-T6-1  
USPS/UPS-T6-2  
USPS/UPS-T6-3  
USPS/UPS-T6-4  
USPS/UPS-T6-5  
USPS/UPS-T6-6  
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USPS/UPS-T6-22  
USPS/UPS-T6-23

APMU  
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Amazon, PSA  
PSA  
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Amazon, PSA  
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Amazon, USPS  
Amazon, USPS  
USPS  
USPS

USPS/UPS-T6-24	USPS
USPS/UPS-T6-25	USPS
USPS/UPS-T6-26	USPS
USPS/UPS-T6-27	APMU, USPS
USPS/UPS-T6-28	APMU, USPS
USPS/UPS-T6-29	Amazon, USPS
USPS/UPS-T6-30	USPS
USPS/UPS-T6-31	USPS
USPS/UPS-T6-32	USPS
USPS/UPS-T6-33	USPS
USPS/UPS-T6-34	Amazon, USPS
USPS/UPS-T6-35	Amazon, USPS
USPS/UPS-T6-36	Amazon, USPS
USPS/UPS-T6-37	NAA, USPS
USPS/UPS-T6-38	Amazon, USPS
USPS/UPS-T6-39	APMU, USPS
USPS/UPS-T6-40	USPS
USPS/UPS-T6-41	APMU, NAA, USPS
USPS/UPS-T6-42	USPS
USPS/UPS-T6-43	NAA, USPS
USPS/UPS-T6-44	USPS
USPS/UPS-T6-45	Amazon, NAA, USPS
USPS/UPS-T6-46	USPS
USPS/UPS-T6-47	NAA, USPS
USPS/UPS-T6-48	Amazon, NAA, USPS
USPS/UPS-T6-49	USPS
USPS/UPS-T6-50	USPS
USPS/UPS-T6-51	NAA, USPS
USPS/UPS-T6-52	USPS

ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON TO  
INTERROGATORY AND REQUEST FOR PRODUCTION OF DOCUMENTS  
OF AMAZON.COM, INC.

**AMZ/UPS-T6-1.**

At pages 4-5 of your testimony you state that "[h]igh rates and large rate increases can be onerous for individual and business mailers alike, and so should be avoided whenever possible."

- a. Please define "large rate increases" as you use the term here.
- b. Please define "onerous" as you use the term here.
- c. Please explain the extent to which the term "large rate increases" refers to some absolute percentage or amount, and the extent to which it is relative to, for example, (i) the average percentage rate increase proposed for all classes and subclasses of mail, and (ii) percentage rate increases proposed for individual classes and subclasses of mail.
- d. To the extent that you define a "large rate increase" as relative in the sense described by (i) or (ii) in preceding part (c), please discuss the point at which a rate increase becomes "large" in relation to (i) the percentage rate increases proposed for other individual classes and subclasses of mail, or (ii) the average percentage rate increase proposed for all classes and subclasses of mail; e.g., 1.5 times, 2.0 times, 2.5 times, etc.

**Answer to AMZ/UPS-T6-1.**

(a) What constitutes a "large" rate increase from the perspective of a mailer will generally vary according to the mailer's circumstances. Virtually any rate increases can seem "large" to a household mailer with limited income or to a business mailer with very limited earnings and earnings prospects, for example. Thus, the word "large" is not critical in the sentence you cite. It could well be omitted, so that the sentence would

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read: "High rates and rate increases can be onerous for individual and business mailers alike, and so should be avoided whenever possible."

The difficulty the Commission faces, of course, is that some rates must rise as long as Postal Service costs increase. Thus, in practice, it is highly unlikely that it will ever be possible to avoid rate increases for all mail subclasses.

(b) Please see my response to USPS/UPS-T6-1(a).

(c)-(d) Please see my answer to part (a), above. The term "large" is intended to refer only to the absolute amount of a rate increase for a particular mail subclass. It is conceivable that some mailers might feel particularly burdened if they experience a rate increase that exceeds the rate increases experienced by other mailers. However, I had absolute, not relative, rate increases in mind when I wrote the sentence that you cite.

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**AMZ/UPS-T6-2.**

At page 6, lines 7-9, of your testimony, you state that "[a]n appropriate portion of the realized cost savings can be passed on in the form of rate discounts or more modest rate increases."

- a. Please define or explain the term "appropriate portion" as you use it here.
- b. Please explain "appropriate portion" in terms of departures from a discount equal to 100 percent of the avoided cost.

**Answer to AMZ/UPS-T6-2.**

(a)-(b) Please see my answer to PSA/UPS-T6-12.



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**AMZ/UPS-T6-3.**

At page 9 of your testimony you state that "even if the demand for a service declines substantially as its price increases, customers may value the service highly. To illustrate this fact, notice that a price increase may force customers with limited wealth to reduce their usage of a service substantially even though they cherish the service dearly." For your response to this question, assume that the facts are exactly as those described in your testimony. That is, the product has a high own-price elasticity of demand, and thus the demand declines substantially as its price increases, but it is also determined (from some special sociological, psychological or other type survey, or even some other information source) that customers whose wealth is limited and who cannot afford a large rate increase, nevertheless subjectively cherish the service dearly.

- a. Based on this information, should the Commission increase or decrease the rate over the level they would recommend in the absence of such supplementary subjective information?
- b. Please describe the most important factors, other than price responsiveness, that would be important to consider when measuring value.
- c. Please describe the type(s) of information that you would recommend be gathered about these other factors to augment the estimated own-price elasticity of demand.

**Answer to AMZ/UPS-T6-3.**

(a) There is no simple answer to your question because of the many different considerations in 39 U.S.C. § 3622(b). Because some consumers value the service particularly highly in your example, § 3622(b)(2) would suggest that a higher price would

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be appropriate. In contrast, because a rate increase might be particularly onerous for the customers with limited wealth, § 3622(b)(4) would suggest that some mitigation of the rate increase would be appropriate. The extent to which the wealth-constrained customers have ready access to delivery alternatives (§ 3622(b)(5)) would also warrant consideration, as might fairness and equity concerns (§ 3622(b)(1)). The matter would be further complicated by differences in wealth among customers, since a given rate increase can have very different effects on customers with different levels of wealth.

(b) Please see my answer to USPS/UPS-T6-9(b).

(c) The information required to assess some of the many direct and indirect measures of value of service is apparent. For example, a simple list of the options (e.g., delivery confirmation and pick-up service) associated with a service will allow direct comparisons across services. Such lists could be augmented by statistics regarding the number of customers that purchase each of the available options. Surveys that solicit customer perceptions of service value might also be considered.

For measures such as the speed of a mail service, data regarding actual delivery times for each mail service (as opposed to performance relative to standards that vary across mail services) should be collected and analyzed. The data should be gathered in as much detail as is economically reasonable. For instance, it would be useful to distinguish among different types of mail pieces (e.g., letters, flats, and parcels), and to differentiate among pieces according to their size, weight, origin, destination, and degree of mailer processing. Such detailed information would allow one to determine,

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for example, how rapidly a three-pound package is transported from Washington, D.C.,  
to Seattle, Washington, on average.

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**AMZ/UPS-T6-4.**

At page 10 of your testimony, you state that:

[t]hus, more substantial increases in Postal Service rates are appropriate when mailers have ready alternatives to the Postal Service, *ceteris paribus*.... If the Postal Service cannot successfully market a service with rates that cover costs and a reasonable share of institutional costs (as determined by the criteria listed in §3622 (b)), then society may be better served when competitors, not the Postal Service, are the primary providers of the service in question.

- a. When the availability of ready alternatives gives Parcel Post a high own-price elasticity of demand, is it your opinion that the Commission should set rates sufficiently high so as to diminish volume to the point where it would reduce the total amount of any contribution which Parcel Post might make to institutional cost? Please explain your position fully.
- b. Is it your recommendation that the Commission should help price Parcel Post out of any of the market segments in which it has established a position because it makes an inadequate contribution to institutional costs, as you view it? Please explain fully.

**Answer to AMZ/UPS-T6-4.**

(a) Whether the Commission should set rates at levels that diminish Parcel Post's contribution to institutional costs will depend upon the circumstances of the case. For example, if such rates are required to ensure that Parcel Post revenues exceed its attributable costs, then 39 U.S.C. § 3622(b)(3) requires that these rates be implemented. In contrast, suppose Parcel Post's contribution to institutional costs would

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decline if rates were increased above the level at which they generate revenues that cover attributable costs and a reasonable share of institutional costs based on a balanced consideration of all of the criteria in 39 U.S.C. § 3622(b). In this situation, I would not recommend that the Commission raise Parcel Post rates above this level, and thereby diminish Parcel Post's contribution to institutional costs.

(b) I am not certain what you mean by the phrase "help price Parcel Post out of [a] market segment." However, I would recommend that the Commission follow the requirement of 39 U.S.C. § 3622(b)(3) that Parcel Post rates be set so as to generate revenues that exceed its attributable costs plus a reasonable share of institutional costs.

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**AMZ/UPS-T6-5.**

At page 11 of your testimony, you state that "[a] policy that reduces Postal Service rates as competition increases and permits revenues to fall toward incremental cost can also encourage the Postal Service to choose an inefficient production technology with unnecessarily large institutional costs and relatively low incremental costs for competitive services."

- a. Please provide one or two specific examples of an inefficient production technology with unnecessarily large institutional costs and relatively low incremental costs for competitive services. The examples should be within the context of the Postal Service, unless you are unable to cite any, in which instance the examples would preferably be from either the delivery services or transportation industry.
- b. For each example provided in response to preceding part (a), please explain fully which costs of the technology would be considered institutional, rather than incremental, and why. Please provide citations to all studies, reports, or published literature on which you rely to support your answer.

**Answer to AMZ/UPS-T6-5.**

- (a) Please see my response to USPS/UPS-T6-14.
- (b) In the examples I provide, the costs of the general-purpose machinery and the generalized processing facilities and equipment might all be counted as institutional costs because the machinery, facilities, and equipment are employed to deliver multiple mail services rather than a single mail service.

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**AMZ/UPS-T6-6.**

At page 11 of your testimony, you state that "the Postal Service can drive competitors from the market if it is permitted to reduce rates toward (artificially low) incremental costs whenever effective competition develops."

- a. Do you contend that the Postal Service's estimate of incremental costs for Parcel Post is artificially low? Please explain fully any answer that is not an unqualified negative.
- b. Your testimony mentions that in certain years preceding the filing of a new rate case, the revenues from Parcel Post have failed to cover attributable costs. Please indicate the adverse effects which this situation has had on the prices, revenues, volume, and market share of UPS and other competitors.

**Answer to AMZ/UPS-T6-6.**

(a) I am not an expert on Postal Service costing methodologies. However, I do not believe that Postal Service estimates of incremental cost account for the costs that the Postal Service avoids because of its status as a public enterprise. These avoided costs include the costs of fines, fees, and taxes that competitors must incur but the Postal Service can avoid because of its status as a public enterprise. To the extent that these avoided costs are not reflected in Postal Service estimates of incremental cost, the estimates of incremental cost will be artificially low in the sense that they do not reflect costs that private competitors cannot avoid, no matter how efficiently they operate.

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(b) The losses that competitors incur when Postal Service rates fall below attributable costs are difficult to quantify. A complete quantification would require information regarding: (1) the amount of volume that was served by the Postal Service rather than competitors because Postal Service prices were below attributable cost, and (2) the reduction in earnings that competitors suffered because of this loss of volume. I do not have the data required to perform this quantification.



ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON TO  
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**AMZ/UPS-T6-7.**

At page 16 of your testimony, you state that "[t]herefore, the incremental cost of producing  $V_0$  units of the service is the sum of these extra costs (areas A and B) **plus any fixed costs incurred to provide the service.**" (Emphasis added.) Please explain whether the marginal cost of the first unit includes specific fixed costs required to provide the service.

**Answer to AMZ/UPS-T6-7.**

To avoid double counting, I do not include specific fixed costs as a component of the marginal cost of producing the first unit of a service. Thus, a specific fixed cost is treated as a fixed cost that must be incurred if any production is to occur, and is not counted again when considering the additional cost required to produce the first unit of output.

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**AMZ/UPS-T6-8.**

At page 17 of your testimony, you state that "[h]istorically, the Commission has employed such approximations of incremental cost when formulating its rate recommendations because incremental cost measures were not available.... To provide stronger safeguards against cross subsidies, reasonable estimates of incremental cost should be employed when they are available."

- a. Is it your contention that estimates of incremental costs for Parcel Post were not available in Docket No. R97-1?
- b. Is it your contention that the estimates of incremental costs for Parcel Post that were available in Docket No. R97-1 were not reasonable?
- c. Unless your answers to preceding parts a and b are unqualified negatives, please explain fully the shortcomings of the Postal Service's estimate of incremental costs for Parcel Post in Docket No. R97-1.
- d. In Docket No. R97-1, for each instance where attributable cost of any class or subclass, including but not limited to Parcel Post, was less than incremental cost, explain why you think the Commission erred in not using incremental cost as the basis for its markups. Please explain.
- e. Is it your contention that no reasonable estimate of incremental cost for Parcel Post is available in this docket? Please explain fully any affirmative answer.
- f. In your opinion, what are the major shortcomings of the Postal Service's estimate of incremental cost for any class or subclass, including but not limited to Parcel Post, in this docket? In your answer, please indicate each estimate of incremental cost that, in your opinion, is unreasonably low and provides an inadequate safeguard against cross subsidies.

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- g. For the Postal Service's submission in this docket, provide each instance of which you are aware where the Commission's methodology for determining attributable cost will result in an amount that is less than the Postal Service's estimate of incremental cost and present a danger of cross-subsidy.

**Answer to AMZ/UPS-T6-8.**

- (a) No.
- (b) No. I am neither an econometrician nor an expert on Postal Service costing methodologies. Consequently, I cannot offer a useful assessment of the estimates of incremental cost provided in Docket No. R97-1 or in the present docket.
- (c)-(g) Please see my answer to part (b), above.

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**AMZ/UPS-T6-9.**

Refer to your testimony at page 39, where you state "I recommend a 31.1% increase in the average rate for Parcel Post."

- a. Please state whether your recommendation for a 31.1 percent rate increase is intended to apply equally to every Parcel Post rate schedule, or whether this is an average of various different proposed increases.
- b. If your response is anything other than an equal increase on each rate schedule, please provide the rate increases which you propose for each rate schedule separately, and show how you determine that they result in a 31.1 percent increase in the average rate for Parcel Post.
- c. Please state whether your recommendation for a 31.1 percent rate increase includes the 63 percent markup on DDU-entry pieces as recommended by UPS witness Luciani, UPS-T-5, at page 32, lines 13-14, of his testimony.
- d. If your recommendation is intended to include witness Luciani's 63 percent markup on DDU-entry pieces, please specify the average rate increases which you propose for DBMC and DSCF entry, along with all other rate increases you propose, and show how you determined that combined they represent a 31.1 percent increase in the average rate for Parcel Post.
- e. Did you prepare an explicit rate design for any portion of Parcel Post? If so, please provide.

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**Answer to AMZ/UPS-T6-9.**

(a) As a result of errata filed on June 22, 2000, the 31.1% figure you cite should be 24.9%. The 24.9% increase that I recommend for Parcel Post is an average rate increase for the entire mail subclass. My testimony does not address rate design issues.

(b)-(e) Please see my answer to part (a), above.

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**AMZ/UPS-T6-10.**

Refer to your testimony at page 39, where you state "I recommend a 31.1% increase in the average rate for Parcel Post. This rate increase reflects a cost coverage of 111%...."

- a. Is the 111 percent cost coverage computed on an After Rates basis? If not, please explain the basis on which it was computed.
- b. Please provide the numerator and denominator (i.e., total revenue and total cost) which you used to compute the cost coverage of 111 percent.
- c. Explain fully how you derived your After Rates estimate of total revenue and total cost based on a 31.1 percent average rate increase. Please indicate clearly all Before Rates data which you used as input to the derivation of your After Rates estimate.
- d. What is the After Rates volume associated with the total revenue and total cost used to compute the 111 percent coverage?

**Answer to AMZ/UPS-T6-10.**

- (a) Yes.
- (b) Parcel Post test year after rates revenue is \$1,071.7 million. Parcel Post test year after rates attributable cost is \$965.5 million. These statistics are reported in UPS witness Luciani's workpaper, UPS-Luciani-WP-3-1.1, as corrected in the errata filed on June 22, 2000.
- (c) The derivations of these statistics are explained in witness Luciani's workpaper and on pages 18-21 of witness Luciani's testimony (UPS-T-5).

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(d) Parcel Post test year after rates volume is 265.1 million pieces, as reported in UPS witness Luciani's workpaper, UPS-Luciani-WP-3-1.1, as corrected in the errata filed on June 22, 2000. See also Mr. Luciani's response to USPS/UPS-T5-23.

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**AMZ/UPS-T6-11.**

Refer to your testimony at page 39, where you state "[t]he 31.1 percent rate increase that I recommend reflects in large part the substantial increase in Parcel Post's attributable costs since the R97-1 rate case." Also refer to page 40, lines 10-15 which elaborate on this point.

- a. Would you agree that the total attributable costs of \$685.9 million in the R97-1 test year reflected both the volume in that year as well as the rates charged? Please explain fully any negative response.
- b. Would you agree that the total attributable costs of \$898.7 million in the current test year reflect both the volume in that year as well as the rates charged? Please explain fully any negative response.
- c. Would you agree that the increase in total attributable costs between the R97-1 test year and the current test year reflect changes in both the volume of Parcel Post and changes in the rates charged? Please explain fully any negative response.
- d. Before determining that the increase in total attributable costs was the most relevant cost measure to use to support your recommended average rate increase, did you examine the change in unit attributable cost for Parcel Post, which isolates cost changes from volume changes? If you did not, please explain why you did not consider it pertinent. If you did, please provide all data which you examined, and indicate the change(s) in unit attributable cost shown or derived from those data.
- e. Please explain fully why the magnitude of changes in total attributable costs, which at least in part reflect changes in volume, is more relevant to supporting the magnitude of a proposed change in the rates for Parcel



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Post than the magnitude of change in unit attributable cost. Please provide all studies, reports, or economic literature upon which you rely to support your position that the magnitude of changes in total attributable costs should be used as the basis for the magnitude of changes in rates.

•  
**Answer to AMZ/UPS-T6-11.**

(a) Yes.

(b) Yes, except that the correct number for Parcel Post's attributable cost in the current test year is \$965.5 million, as indicated in the errata filed on June 22, 2000.

(c) Yes.

(d) It is not my testimony that the increase in total attributable costs is necessarily the "most relevant cost measure" to employ when formulating rate recommendations. As I explain in my answer to APMU/UPS-T6-19, other measures of cost increases, such as the increase in unit attributable costs, can also provide useful information.

By comparing unit attributable costs from one test year to the next, one can control partially for changes in total cost that are due to changes in volume. The control is not perfect, however, since unit costs typically vary with the level of output. Therefore, even though costs are expressed on a per unit of volume basis, the predicted level of unit cost is typically influenced by predicted volume, which, in turn, is influenced by recommended rates.

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I examined changes in Parcel Post's unit attributable costs when formulating my rate recommendation. Parcel Post's unit attributable cost in the R97-1 test year was \$3.18 (= \$685.9 million/215.8 million). Opinion and Recommended Decision, Docket No. R97-1, Appendix G, Schedule 1. Parcel Post's unit attributable cost in the current test year is \$3.64 (= \$965.5 million/265.1 million). (The sources for these numbers are provided in my response to AMZ/UPS-T6-10.) The increase of \$.46 per piece constitutes a 14.5% increase in Parcel Post's attributable cost per piece since R97-1.

(e) Please see my answer to part (d), above.

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**AMZ/UPS-T6-12.**

Refer to your testimony at page 39, where you state "[t]he recommended markup also reflects the higher value that its new Delivery Confirmation Service and its new rate categories enable Parcel Post to deliver to its customers." Also, on page 45, where you state that "[a]s of March 14, 1999, Parcel Post shippers have the option of purchasing Delivery Confirmation Service for their shipments. This new feature further increases the value of service that Parcel Post now delivers to its users."

- a. Is it your understanding that the attributable costs associated with providing delivery confirmation for Parcel Post are included in the attributable costs of Parcel Post? Please explain any affirmative answer.
- b. For those Parcel Post shippers who elect not to use Delivery Confirmation Service, please explain fully all "further increases in the value of service" which they derive from the optional availability of this service.
- c. Please provide a detailed justification and explanation as to why the value of an optional special service, such as and including Delivery Confirmation, should be used as a reason for increasing the Parcel Post rates paid by all customers, including those who do not use the service, rather than incorporated into the price charged for the separate special service itself. Please provide full citations to all economic teachings upon which you rely to support your recommendation that the value of an optional service should be reflected in the base rate, rather than the price of the option itself.
- d. Before determining that the recommended markup should reflect the higher value provided by the new Delivery Confirmation Service, did you examine the proposed rate, the estimated revenue and the cost of

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providing Delivery Confirmation to Parcel Post shippers? If not, please explain why you did not consider such information pertinent. If so, please indicate what information you examined, and explain why, based upon your analysis, you determined that Parcel Post shippers who do not use the service should nevertheless be required to pay for it as part of the markup on Parcel Post.

**Answer to AMZ/UPS-T6-12.**

(a) No.

(b) Options typically provide value even if they are not exercised. The classic illustration of this fact involves fire fighting services. Most of us value and pay for the option of being able to call upon our local fire fighters should our house ever catch on fire. Hopefully, though, none of us will ever have to exercise this option. Although Parcel Post mailers may not value the option to purchase Delivery Confirmation as highly as they value the option to call upon their local fire fighters, they seem likely to place a strictly positive value on the Delivery Confirmation option nevertheless.

(c) My testimony does not address rate design issues. It should be noted, however, that including in the base price of a service an allowance to reflect the value of having an option available can serve a useful purpose. In particular, it can provide a means of charging individuals for the value they derive from having the option to purchase the additional service (as opposed to the value they derive from actually consuming the additional service).

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Among the many references on the value of options is Avinash K. Dixit and Robert S. Pindyck, Investment Under Uncertainty, Princeton University Press, 1994.

(d) Since my testimony does not address rate design issues, I did not analyze the individual revenues and costs of providing Delivery Confirmation to Parcel Post shippers. My analysis took as given the various features of each of the services offered by the Postal Service.

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**AMZ/UPS-T6-13.**

At pages 40-41 of your testimony, you state that "[i]n 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...." [footnote omitted.]

- a. Please define "substantially" as you use it here, and explain whether you consider the term to be an absolute or relative measure.
- b. For the years shown in your Tables 7 and 8 (*i.e.*, 1990-1999), please provide all data at your disposal which show size and growth of the total non-expedited parcel market in terms of (i) pieces and/or (ii) revenue.
- c. If you do not have estimates for size of the total market, please provide such data for UPS and any other firm(s) as you have available. If you do not have data for all years, please provide data for those years which you have available.

**Answer to AMZ/UPS-T6-13.**

(a) As used in the sentence you cite, the word "substantially" means "considerably," as in "of ample or considerable amount." Webster's Encyclopedic Unabridged Dictionary of the English Language, Portland House, 1989, p. 1418. At least in this context, I consider the term "substantially" or "considerably" to be an absolute measure.

(b)-(c) The only data that I have concerning the size and growth of the total non-expedited parcel market in recent years is the data provided by Postal Service witness Tolley. In his testimony at page 158, witness Tolley reports that between 1992 and 1998, "Total ground parcel package shipments increased from just under 3 billion to

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3.2 billion pieces." He also reports that UPS's share of the market declined and that the combined market shares of the Postal Service and RPS increased. USPS-T-6, p. 158. In his response to PSA/USPS-T6-1 (Tr. 9/3651), witness Tolley reports 4.138 billion total ground parcel shipments in 1998, and allocates this total to UPS (2.437 billion), the Postal Service (1.902 billion), FedEx/RPS (349 million), and "others" (121 million).

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**AMZ/UPS-T6-14.**

Refer to footnote 55, at page 43 of your testimony, which states that "the sum of volume variable cost and specific fixed cost typically understates incremental cost. Therefore, even if measured revenue exceeds measured attributable cost, revenue may still fall below incremental cost."

- a. For Parcel Post, please identify all costs that should be included in the incremental costs of Parcel Post, but which are not included in either the volume variable or the specific fixed costs of Parcel Post.
- b. Please provide the estimated the [sic.] dollar amount of all costs identified in your response to preceding part (a), and indicate the percentage which these omitted costs represent of measured attributable costs for test year.

**Answer to AMZ/UPS-T6-14.**

As explained on pages 12-18 of my testimony, volume variable cost is presently approximated by the product of volume and the marginal cost of producing the last unit of output (corresponding to area B in Figures 1 and 2 on pages 15 and 16 of my testimony). Ignoring specific fixed costs, this approximation understates incremental cost if the marginal cost of production declines as output expands. (The extent of the understatement is shown as area A in Figures 1 and 2 in my testimony.)

I am neither an econometrician nor an expert on Postal Service costing methodologies. Therefore, I cannot offer any estimates of the extent to which the sum of Parcel Post's volume variable and specific fixed costs understates Parcel Post's incremental cost.



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**AMZ/UPS-T6-15.**

Refer to your testimony at page 44, where you state that "the average time for delivery of Parcel Post packages has been less than four days on a fairly consistent basis since 1995...." [footnote omitted citing ODIS Quarterly Statistics Reports.]

- a. Are you asserting that the average time for delivery of Parcel Post packages was better in 1997 and 1998 than it was in 1995 and 1996? If so, please provide all studies, reports and data upon which you rely to support your position.
- b. If the Postal Service requires between 3 and 4 days to effect delivery of a parcel from the SCF to the point where it is ready to be delivered by a carrier (*i.e.*, the point where ODIS data are collected), would you consider such delivery to represent a "high value" service. If so, please explain why, and compare it to the service level provided by UPS for its ground products.

**Answer to AMZ/UPS-T6-15.**

(a) No. The statement that you cite simply describes Parcel Post average time to delivery since 1995. The statement does not compare average time to delivery in 1997 and 1998 with average time to delivery in 1995 and 1996.

(b) My understanding is that ODIS "measures service performance from the origin office to the delivery office . . . ." Tr. 21/8875. The Postal Service and its competitors offer services that generally provide faster delivery of parcels than Parcel Post provides. Therefore, I would not judge Parcel Post to offer the highest value of

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service, based on speed of delivery. I do not have data on average time to delivery for  
UPS ground products, and therefore I cannot provide the comparison you request.

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**AMZ/UPS-T6-16.**

At page 44 of your testimony, lines 10-13, you state that "the Destination Delivery Unit ("DDU") and Destination Sectional Center Facility ("DSCF") discounts introduced in R97-1 have enabled Parcel Post to become an integral component of even more expedited parcel services."

- a. Is it your testimony that when parcels are entered at the DSCF or the DDU, the Postal Service handles those parcels more expeditiously and more reliably than other parcels that arrive at DSCFs and DDUs which were entered further upstream? If you answer affirmatively, please provide all data, studies, reports, or other evidence upon which you rely to support your answer.
- b. As distinguished from efforts made (and costs incurred) by others, such as Airborne Express, please explain everything of which you are aware that the Postal Service has done to make its own handling of parcels "more expedited" since Docket No. R97-1.
- c. Please explain why, in your opinion, efforts by other firms such as Airborne Express to expedite their handling of parcels to DSCFs and DDUs should result in a higher markup being applied to the rates paid by Parcel Post shippers who do not use such services. In particular, please explain how Parcel Post shippers who do not use such services receive higher value services from Airborne (or any similar intermediary who utilizes DSCF and DDU entry).

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**Answer to AMZ/UPS-T6-16.**

(a) No.

(b) Other than the Postal Service's introduction of dropshipment discounts, which facilitate access to its downstream facilities, I have no information about efforts the Postal Service may have undertaken to expedite its handling of parcels since R97-1. The statement you cite is true even if no such efforts have been undertaken and even if Parcel Post delivery times from the DDU and DSCF have not changed since R97-1. What has changed is the improved ability of other delivery companies to combine their services with Parcel Post delivery services from the DDU and DSCF. These combined operations are what constitute the "more expedited parcel services" mentioned in the sentence that you cite.

(c) The efforts in question are not only by "other firms such as Airborne Express," but also by the Postal Service in the form of providing discounts for dropshipments and facilitating access to its downstream facilities. I note also that the Airborne@Home program appears to be a coordinated service offering between the Postal Service and Airborne. In any event, the issue you raise would seem to be a rate design issue. As suggested by UPS witness Luciani's testimony (see UPS-T-5 at 32-33), the markup that I recommend for Parcel Post as a whole need not be applied uniformly across all Parcel Post rate elements. However, my testimony does not address rate design issues.

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APMU/UPS-T6-1.

At page 5, line 7, you state that "[r]ates that disadvantage competitors unfairly should be avoided."

- a. Please define the term "unfairly" as you use it here.
- b. Please assume that the Commission has full information concerning rates charged by competitors and explain how the Commission should determine whether Postal Service rates (i) disadvantage competitors, and (ii) disadvantage competitors **unfairly**; *i.e.*, please explain how the Commission should determine when Postal Service rates present competitors with an unfair disadvantage. In your explanation, please define the role, if any, which you assign to factors other than incremental cost in determining whether Postal Service rates are unfair and cite all studies, reports or references to the literature on which you rely to support your response.
- c. Please assume that the only information which the Commission has concerning rates charged by competitors is their published rates for single pieces, but the Commission has ample reason to believe that the majority of business lodged with competitors is at rates discounted from their published rates, including reduced effective rates after rebates. However, the Commission has no further information about the extent or depth of discounting because such information is treated as proprietary and

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confidential by shippers and their customers alike, pursuant to shipper-enforced contracts. Under these circumstances, please explain how the Commission should determine whether Postal Service rates disadvantage competitors unfairly.

- d. Do you believe that the assumption in the hypothetical question in part (c) is accurate? That is, is the majority of business lodged with competitors at or below published rates?

**Answer to APMU/UPS-T6-1.**

- (a) Please see my answer to USPS/UPS-T6-6(b).

(b) Any Postal Service rates that induce mailers to purchase Postal Service products rather than the products of competitors serve to disadvantage competitors. However, such rates may be entirely consistent with 39 U.S.C. § 3622(b). In contrast, rates for Postal Service products that fail to generate revenues in excess of the sum of attributable costs and a reasonable share of institutional costs (as determined by the Commission) disadvantage competitors unfairly, in that such rates are not consistent with 39 U.S.C. § 3622(b).

(c) Under these circumstances, the Commission would continue to assess Postal Service costs and revenues to the best of its ability, and continue to recommend rates that are expected to generate sufficient revenue to cover attributable costs and a reasonable share of institutional costs, and that are otherwise consistent with 39 U.S.C. § 3622(b).

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(d) I do not have the data that would allow me to determine the portion of competitors' transactions that occur at discounted rates.

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**APMU/UPS-T6-2.**

Your testimony at page 5, lines 13-15, states that “[w]hen mailers can obtain comparable services at reasonable cost from suppliers other than the Postal Service, high postal rates impose fewer hardships on those mailers.”

- a. Please define the term “reasonable cost” as you use it here.
- b. Please define the term “mailers” as you use it here, and explain whether the reference is to individual mailers, such as the general public who mail single packages, or to mailers who ship regularly and with volumes sufficiently large to qualify for discounted, negotiated rates.
- c. Assuming that the term “reasonable cost from suppliers” means the rates which suppliers charge mailers, please explain whether your reference is to published single piece rates, or to discounted volume rates.
- d. In terms of the rates charged by the Postal Service prior to any general change in rates (*i.e.*, the currently prevailing rates), please explain:
  - (i) whether “reasonable cost” from other suppliers means that the rates available from other suppliers should be lower than, equal to, or higher than those available from the Postal Service;
  - (ii) what information the Commission should use to determine whether comparable services are available at reasonable cost from other suppliers; and



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- (iii) what information other suppliers should provide to the Commission to show that they provide mailers with comparable services at reasonable cost.
- e. What information should the Commission use when attempting to determine whether mailers can obtain comparable service at reasonable cost from suppliers other than the Postal Service? Please explain specifically whether and why the Commission should focus on published rates, or attempt to obtain information on unpublished, negotiated rates offered to all major shippers.

**Answer to APMU/UPS-T6-2.**

- (a) The term "at reasonable cost" in this context means "via making similar expenditures."
- (b) "Mailers" are users of mail services. Mailers include individuals who send single packages infrequently as well as companies that frequently ship large volumes of packages.
- (c) The reference is to the rates that the mailers actually pay.
- (d) (i) Comparable services may be available at reasonable cost whether the prices charged by competitors are above, below, or equal to Postal Service prices. What matters most is whether price differences are small relative to differences in service value. If mailers judge the products offered by the Postal Service and a competitor to be virtually identical, for example, then the competing product would be a

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comparable service available at reasonable cost if the price of the competitor's product were below the price charged by the Postal Service by a small amount, or if it exceeded the Postal Service's price by a small amount.

(ii) In order to determine whether comparable services are available at reasonable cost from suppliers other than the Postal Service, the Commission can examine all available information about service features, performance, prices, and price elasticities of demand. The Commission can also rely upon expert testimony regarding whether markets in which the Postal Service operates are "competitive." In competitive markets, comparable services are available at similar cost from different suppliers.

(iii) In most cases, I suspect that the expert testimony provided by Postal Service witnesses will enable the Commission to obtain a good sense of whether mailers have access to comparable services at reasonable cost. To illustrate, the Postal Service routinely provides estimates of own-price elasticities of demand. Also, in the present proceedings, witness Bernstein reports that "both Federal Express and UPS operate in competitive markets with free entry" (USPS-T-41, pp. 45-46). And in his analysis of Priority Mail, witness Musgrave states that "the expedited delivery market continues to be highly competitive" (USPS-T-8, p. 23). If competing suppliers disagree with the assessments offered by Postal Service witnesses, they can supply any evidence they may have to support their points of view. Please also see my answer to part (e), below.

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(e) Please see my answer to part (d), above. Also, I believe that the Commission should (and, I am sure, does) consider all price information that witnesses provide.

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**APMU/UPS-T6-3.**

At page 10 of your testimony, you state:

Thus, more substantial increases in Postal Service rates are appropriate when mailers have ready alternatives to the Postal Service, *ceteris paribus*.... If the Postal Service cannot successfully market a service with rates that cover costs and a reasonable share of institutional costs (as determined by the criteria listed in §3622 (b)), then society may be better served when competitors, not the Postal Service, are the primary providers of the service in question.

- a. When the availability of ready alternatives gives Priority Mail a high own-price elasticity of demand, is it your opinion that the Commission should set rates sufficiently high so as to deliberately reduce the total contribution which Priority Mail makes to institutional cost? Please explain your position fully.
- b. Suppose the Commission deliberately increases rates to the point where the total contribution to institutional costs from Priority Mail is knowingly and deliberately reduced below what it would otherwise be. What would be the impact of such a rate increase on the monopoly classes of mail?
- c. Is it your recommendation that the Commission should help price Parcel Post or Priority Mail out of its established the [sic] market? Please explain fully.

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**Answer to APMU/UPS-T6-3.**

(a) No. Please see my answer to USPS/UPS-T6-45.

(b) If Priority Mail's contribution to institutional costs were to decline, the combined contribution of all other mail services would have to increase, *ceteris paribus*. The particular impact on the monopoly classes of mail would depend upon what share of the increased contribution the Commission recommends that they bear, after careful consideration of the criteria specified in 39 U.S.C. § 3622(b).

(c) I am not certain what you mean by the phrase "help price Parcel Post or Priority Mail out of its established market." My recommendation is that the Commission follow the requirement of 39 U.S.C. § 3622(b)(3) that rates be set to generate revenues that exceed attributable costs plus a reasonable share of institutional costs for both Parcel Post and Priority Mail.

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**APMU/UPS-T6-4.**

At page 17 of your testimony, you state that "[h]istorically, the Commission has employed such approximations of incremental cost when formulating its rate recommendations because incremental cost measures were not available.... To provide stronger safeguards against cross subsidies, reasonable estimates of incremental cost should be employed when they are available."

- a. Is it your contention that estimates of incremental costs for Priority Mail were not available in Docket No. R97-1?
- b. Is it your contention that the estimates of incremental costs for Priority Mail that were available in Docket No. R97-1 were not reasonable?
- c. Unless your answers to preceding parts a and b are unqualified negatives, please explain fully the shortcomings of the Postal Service's estimate of incremental costs for Priority Mail in Docket No. R97-1. Please provide citations to any testimony in Docket No. R97-1 that supports your position.
- d. Is it your contention that no reasonable estimate of incremental cost for Priority Mail is available in this docket? Please explain fully any affirmative answer.

**Answer to APMU/UPS-T6-4.**

- (a) No.

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(b) No. Since I am neither an econometrician nor an expert on Postal Service costing methodologies, I cannot offer a useful assessment of the estimates of incremental cost provided in R97-1.

(c) Please see my answer to part (b), above. Also see the Commission's explanation for why, in its R97-1 Opinion and Recommended Decision, the Commission "makes no use of witness Takis' estimates of incremental cost and relies instead on attributable costs, as it has in past proceedings" (Docket No. R97-1, ¶¶ 4053-4056).

(d) Please see my answer to part (b), above.

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**APMU/UPS-T6-5.**

At page 18 of your testimony, you state that "I recommend a 40.3 percent increase in the average rate for Priority Mail. This rate increase represents a cost coverage of 176% and a markup (the ratio of contribution to attributed cost) of 76%...."

- a. Please provide the numerator and denominator (*i.e.*, the total revenue and the attributed cost) which you used to determine that your proposed rate increase results in a cost coverage of 176 percent.
- b. Please provide the numerator and denominator (*i.e.*, the contribution and the attributed cost) which you used to determine that your proposed rate increase results in a markup of 76 percent.
- c. Please provide a full explanation showing derivation of the numerator and denominator in each case.

**Answer to APMU/UPS-T6-5.**

(a)-(b) The numerator is test year after rates Priority Mail revenue, or \$5,787.8 million; the denominator is test year after rates Priority Mail attributable cost, or \$3,288.7 million.

(c) These numbers are taken from UPS witness Luciani's workpaper UPS-Luciani-WP-3-1.1. The derivation of these numbers is explained in witness Luciani's workpaper and in his testimony (UPS-T-5).



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**APMU/UPS-T6-6.**

Your testimony at page 19 reviews the Commission's decision concerning coverage in Docket No. R97-1, and cites the Commission as noting that "Priority Mail's attributable costs increased dramatically between the R94-1 and the R97-1 rate cases. Therefore, applying historic coverages to Priority Mail's higher base of attributable costs would have caused Priority Mail's rates to rise more rapidly than they had historically." [footnote citing the *Op. & Rec. Dec.* omitted.] In your opinion, was this part of the Commission's rationale in Docket No. R97-1 either wrong or misguided? Explain fully any affirmative answer.

**Answer to APMU/UPS-T6-6.**

Since I did not participate in Docket No. R97-1, I am not in a position to second-guess the Commission. However, I agree that it can be appropriate to mitigate some portion of substantial cost increases, particularly if those cost increases are thought to represent temporary deviations from historic and future cost growth rates.

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**APMU/UPS-T6-7.**

At page 19 of your testimony, you cite the Commission's decision concerning coverage in Docket No. R97-1 as noting that "the Commission expressed the concern that a large rate increase for Priority Mail might jeopardize its ability to compete in the marketplace." (Footnote citing the *Op. & Rec. Dec.* omitted.) In your opinion, was this part of the Commission's rationale in Docket No. R97-1 either wrong or misguided? Please explain fully any affirmative answer.

**Answer to APMU/UPS-T6-7.**

Since I did not participate in Docket No. R97-1, I am not in a position to second-guess the Commission. However, as I explain in my response to USPS/UPS-T6-45, I agree that it is reasonable for the Commission to consider the contribution that competitive services are likely to make to institutional costs in the course of considering all of the criteria in 39 U.S.C. § 3622(b).

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**APMU/UPS-T6-8.**

At page 20 of your testimony, you state that "[t]he evidence in its entirety also suggests that Priority Mail provides a high level of service quality relative to First Class Mail."

- a. Please define precisely the time period to which this statement refers.
- b. Please explain fully what you mean by "the evidence in its entirety."
- c. If any of the evidence which you cite is in any way conflicting, please explain fully how much weight you give to each datum.
- d. Is it your contention that the service quality of Priority Mail has been equal to or better than First-Class Mail? Unless your answer is an unqualified negative, please provide all data, studies, reports, or other evidence on which you rely to support such contention.
- e. If the service quality of Priority Mail is inferior to that of First-Class Mail despite its greater cost, please explain why the markups should be equal.

**Answer to APMU/UPS-T6-8.**

(a) The statement refers to the time period since R97-1, in particular, FY1998 and FY1999.

(b) The evidence in its entirety refers to all of the evidence that I discuss in my testimony on pages 25-33. This evidence includes the facts that: (1) customers choose persistently to send items via Priority Mail when they could do so at lower cost via First Class Mail; (2) Priority Mail's service standard is at least as fast as First Class Mail's

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service standard for every ZIP code pair, and there are more than 600,000 three-digit ZIP code pairs for which Priority Mail's service standard is two days whereas First Class Mail's standard is more than two days; (3) Priority Mail offers valuable options (like delivery confirmation and pick-up services) to its customers that First Class Mail does not; (4) Priority Mail achieved its service standard for flats more frequently in FY 1999 than did First Class Mail; (5) the Postal Service provides packaging materials at no charge to Priority Mail users, but not to First Class Mail users; (6) Priority Mail is afforded priority over First Class Mail in assigning transportation and delivery resources; (7) Priority Mail is sometimes delivered on Sundays during the peak year-end season, while First Class Mail is not; and (8) Priority Mail has its own dedicated processing and transportation network in the Northeast and Florida, which is supplemented by the main mail network.

(c)-(d) I have not assigned numerical weights to each of the many dimensions of service quality in order to derive a single, comprehensive measure of aggregate service quality. However, I have seen no convincing evidence that First Class Mail provides a higher level of service quality on any dimension.

The statistic that would seem to suggest most strongly that First Class Mail may provide higher service quality than Priority Mail on some dimension is the fact that First Class Mail meets its overnight standard more frequently than Priority Mail, even though the two mail services have an overnight standard between roughly the same number of ZIP code pairs. However, it is important to recall that Priority Mail and First Class Mail have different mail mixes. Priority Mail consists primarily of flats, parcels, and irregular

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pieces and parcels while First Class Mail consists largely of letters. Letters are generally lighter and less bulky than flats, parcels, and irregular pieces, and so may be transported and delivered more easily. If First Class Mail had to transport the same items that Priority Mail does, First Class Mail might well achieve its service standard less frequently. Indeed, when differences in mail mix are taken into account by focusing only on flats, Priority Mail achieved its service standard more frequently than did First Class Mail in FY1999, even though Priority Mail's service standard is never slower and is often faster than First Class Mail's service standard. See footnote 34 in my testimony on page 30.

In summary, even if Priority Mail achieves its more challenging overnight standard less often than First Class Mail achieves its less challenging overnight standard, Priority Mail is not necessarily providing lower service quality.

(e) As explained in my answer to parts (c) and (d), above, I have seen no convincing evidence that Priority Mail provides inferior service quality relative to First Class Mail. Indeed, there is considerable evidence to suggest that Priority Mail provides superior service quality relative to First Class Mail on multiple dimensions. These observations, along with a balanced consideration of all of the criteria in 39 U.S.C. § 3622(b) (as discussed on pages 33-35 of my testimony), suggest that the markup for Priority Mail should be at least as high as the markup for First Class Mail in this case.

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**APMU/UPS-T6-9.**

Please refer to your testimony at page 20, lines 5-7, and your Table 6 on page 36.

- a. Please confirm that in Table 6 the average annual change in attributed costs per piece in the row indicated "R97-1" was 8.1 percent. Please explain fully if you do not confirm.
- b. Please confirm that the average annual percentage change in attributed cost per piece in the row indicated "R97-1" was higher than during any of the preceding periods shown in Table 6. Please explain fully if you do not confirm.
- c. Confirm that in Table 6 the average annual change in attributed costs per piece in the row R2000-1 was 11.5 percent. Please explain fully if you do not confirm.
- d. Please confirm that the percentage change in Docket No. R2000-1 is higher than any of preceding periods shown in Table 6, including Docket No. R97-1. Please explain fully if you do not confirm.
- e. Is it your opinion that another unusually large increase in Priority Mail's attributable cost per piece is present in this case? Please explain fully any negative answer.

**Answer to APMU/UPS-T6-9.**

(a)-(d) Confirmed.

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(e) The increase in Priority Mail's attributable cost per piece in the present case is unusually large relative to the corresponding increases in R84-1 through R94-1. The present increase is also larger than the increase in R97-1.

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**APMU/UPS-T6-10.**

At page 38 of your testimony, you recommend a 40.3 percent average rate increase for Priority Mail .

- a. Did any UPS witness, or anyone working under your supervision at any time, either during or after the preparation of this testimony, project what the effect of your proposed rate increase would be on the volume of Priority Mail during Test Year?
- b. If your answer to part (a) is negative, please explain fully why you did not consider such a projection to be necessary.
- c. If you (or anyone else) developed one or more volume forecasts while preparing your testimony, please provide the results of each such forecast and explain fully how it was derived.
- d. Did any UPS witness, or anyone working under your supervision at any time, either during or after the preparation of this testimony, project what the effect of your proposed rate increase would be on the revenues of Priority Mail during Test Year?
- e. If your answer to part (a) is negative, please explain fully why you did not consider such a projection to be necessary.
- f. If you (or anyone else) developed one or more revenue forecasts while preparing your testimony, please provide the results of each such forecast and explain fully how it was derived.



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- g. Did any UPS witness, or anyone working under your supervision at any time, either during or after the preparation of this testimony, project what the effect of your proposed rate increase would be on the contribution to institutional cost of Priority Mail during Test Year?
- h. If your answer to part (a) is negative, please explain fully why you did not consider such a projection to be necessary.
- i. If you (or anyone else) developed one or more contribution to institutional cost forecasts while preparing your testimony, please provide the results of each and explain fully how it was derived.

**Answer to APMU/UPS-T6-10.**

(a)-(i) The projected effects of the 40.3% rate increase that I recommend for Priority Mail are summarized in the following table. The numbers in the table are drawn from Table 6 on page 18 of witness Luciani's testimony (UPS-T-5) and from witness Luciani's workpaper, UPS-Luciani-WP-3-1.1, as revised on June 22, 2000. The derivations of the statistics reported in the table are explained in witness Luciani's workpaper and in his testimony.

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**Projections for Priority Mail Under UPS Recommendations**

	Volume (million pieces)	Revenue (\$ million)	Attributable Cost (\$ million)	Contribution (\$ million)
Base Year	1,174.4	4,187.4	2,911.6	1,275.8
Test Year Before Rates	1,356.7	5,229.8	3,892.1	1,337.7
Test Year After Rates	1,070.2	5,787.8	3,288.7	2,499.1

Note that Priority Mail's contribution to institutional costs increases by approximately \$345 million under my proposed rate increase as opposed to under the Postal Service's proposal. See my response to APMU/UPS-T6-11.

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**APMU/UPS-T6-11.**

Do you contend that your recommended 40.3 percent increase in rates for Priority Mail will increase the total contribution to institutional cost from Priority Mail above the amount projected by the Postal Service? If so, please indicate the amount and explain fully how the result was derived.

**Answer to APMU/UPS-T6-11.**

Yes. The Postal Service projects a contribution of \$2,153.3 million (see UPS-T-5 at 19, Table 7), whereas the rate increase that I recommend is projected to provide a Priority Mail contribution of \$2,499.1 million (see my response to APMU/UPS-T6-10), or approximately \$345 million above the level generated by the Postal Service's proposed 15% rate increase for Priority Mail.

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**APMU/UPS-T6-12.**

At page 25 of your testimony, you state that "Priority Mail's competitive position will be further strengthened if the Postal Service's proposal to introduce a new, lower one-pound rate for Priority Mail is approved. This new rate will enhance the ability of Priority Mail to deliver relatively low rates to a large portion of its customers, and thereby sustain solid volume growth and a dominant market share."

- a. Are you recommending that the proposal to introduce a new one-pound rate be approved?
- b. Confirm that the proposed one-pound rate is not lower than the existing rate for a package weighing up to two pounds, and in fact is over 7 percent more than the existing rate for a 2-pound piece. Please explain any non-confirmation.
- c. Please define the term "relatively low rates" as you use it here, and explain whether you consider the proposed \$3.45 rate to be relatively low in relation to (i) the FedEx rate for government agencies, or (ii) UPS negotiated rates for one-pound packages receiving second-day delivery.

**Answer to APMU/UPS-T6-12.**

- (a) My testimony does not offer any recommendations with regard to rate design issues.

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(b) Confirmed. The present rate for a Priority Mail package weighing up to two pounds is \$3.20. The Postal Service proposes a rate of \$3.45 for a one-pound Priority Mail package, which is approximately 7.8% higher than \$3.20.

(c) The term "relatively low rates" in the sentence you cite was intended to compare the proposed one-pound rate for Priority Mail with proposed Priority Mail rates for pieces that weigh more than one pound. The proposed one-pound rate (\$3.45) for Priority Mail is more than 10% below the proposed two-pound rate (\$3.85) for Priority Mail, for example.

The proposed one-pound rate for Priority Mail (\$3.45) is less than the current one-pound rate that Federal Express charges to the U.S. Government for two-day service (\$3.57). APMU witness Haldi (UPS/APMU-T1-9) reports that this FedEx rate applies through August 15, 2001. APMU/UPS-T-1 at 37. I do not have any information regarding UPS's negotiated rates for one-pound packages receiving second-day delivery. The current UPS 2nd Day Air published rate for a one-pound package is \$6.40, or twice the Postal Service's present rate. See Library Reference UPS-LR-4.

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**APMU/UPS-T6-13.**

Please refer to Tables 4 and 5 at pages 26 and 28, respectively, of your testimony.

- a. Would you agree that the number of 3-digit ZIP Code pairs with a One-Day Service Standard is approximately equal, and differs by less than 1 percent?
- b. Please confirm that despite all the asserted priority given to Priority Mail in handling and dispatch, according to the data in your Table 4 it did not achieve its overnight standard as often as First-Class Mail.
- c. What is the volume, or share, of First-Class Mail that has an overnight delivery standard?
- d. What is the volume, or share, of Priority Mail that has an overnight delivery standard?

**Answer to APMU/UPS-T6-13.**

- (a) Yes.
- (b) Confirmed. Notice, however, that Priority Mail carries a larger proportion of bulkier, heavier pieces than does First Class Mail. Also notice that, as explained in my answer to APMU/UPS-T6-8(c)-(d), above, Priority Mail achieves its more stringent service standards more frequently than First Class Mail achieves its less stringent standards in delivering flats.

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(c) ODIS data report the volume of First Class Mail with a one-day service standard in FY1999 to be approximately 32.7 billion pieces, or roughly 43.5% of total First Class Mail volume. Tr. 21/8564.

(d) ODIS data report the volume of Priority Mail with a one-day service standard to be approximately 190 million pieces, or roughly 21.5% of total Priority Mail volume. Tr. 21/8564.

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**APMU/UPS-T6-15.**

At page 31 of your testimony, you state that "ODIS often reports Priority Mail to have achieved its service standards less frequently than does the PETE system.

[footnote omitted] This is counter-intuitive."

- a. What is your understanding of the extent to which the PETE system replicates, covers, or is representative of the entire flow of Priority Mail?
- b. What is your understanding of the extent to which the ODIS system replicates, covers, or is representative of the entire flow of Priority Mail?
- c. Is it your assertion that PETE and ODIS are identical, or nearly identical, sampling systems? Please explain your understanding of the two.
- d. Why do you say the results are "counter-intuitive?"

**Answer to APMU/UPS-T6-15.**

(a) My understanding is that the PETE system attempts to replicate the flow of approximately "70% of the nation's destinating, identified Priority Mail volume."

PETE: Priority End-to-End Measurement System, Attachment to DFC/USPS-49, page 1 of 5, Tr. 21/8844. The EXFC and PETE Statement of Work for Transit-Time Measurement (June 23, 1997) states that "The sample frame consists of the largest-volume three-digit ZIP code origins within the 85 Performance Clusters and the largest volume three-digit ZIP code destinations within the 85 Performance Clusters." USPS-LR-I-326, p. 27.



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(b) My understanding is that the ODIS system is intended to replicate the entire flow of Priority Mail volume.

(c) No. There are important differences between the PETE and the ODIS systems. Aside from the differences identified in my answers to parts (a) and (b), above, the two systems employ different time frameworks. The PETE system tracks Priority Mail pieces from the time they enter the mail stream to the time they are delivered to the addressee. Tr. 21/8844. The ODIS system measures performance from the time pieces are received at the origin office to the time they arrive at the delivery office. Tr. 21/8875. There may be other differences of which I am not aware.

(d) As I explain in my testimony on pages 30-31, the time between initial deposit into the mail stream and delivery to the door of the addressee cannot be less than the time between receipt at the origin post office and arrival at the destination office, due to the extra time required to deliver to the door of the addressee. Therefore, since the PETE and ODIS systems employ the same service standards but ODIS measures only part of the delivery cycle, it would be natural to expect Priority Mail to meet its service standards less frequently when performance is measured using the PETE system than when it is measured using the ODIS system, *ceteris paribus*. In fact, though, Priority Mail has met its service standards more frequently in recent years when performance is measured using the PETE system than when it is measured using the ODIS system. This difference between the expected and the realized outcome is what I describe as "counter-intuitive."

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**APMU/UPS-T6-16.**

At page 31 of your testimony, you state that "[d]irect measures of service quality and value other than achievement of service standards include measures of the reliability...."

- a. Please define the term "reliability" as you use it here.
- b. Please explain what measure, or measures, you would use to ascertain the reliability of an expedited delivery service such as Priority Mail.
- c. Please provide all studies, reports, or other information which you rely to show that Priority Mail is a reliable service, and fares well on this direct measure of service quality.

**Answer to APMU/UPS-T6-16.**

(a)-(b) As it is used on page 31, line 15, of my testimony, the term "reliability" of a mail service refers to the variation in delivery time between a given origin and a given destination. Formally, reliability might be measured as the inverse of the variance in delivery times.<sup>1</sup> A more reliable service, then, would be one that exhibits a lower variance in delivery times.

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1. The variance of a random variable is the expectation of the square of the difference between the realization of the variable and its mean. See Robert V. Hogg and Allen T. Craig, Introduction to Mathematical Statistics, Fourth Edition, New York: MacMillan Publishing Co., Inc., 1978, pp. 48-49.

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Customers might value a small variance in delivery times because of the greater certainty it provides as to when a piece of mail is likely to arrive at its destination. Such greater certainty can be valuable for planning purposes.

Of course, reliability is just one of many possible dimensions of service quality. Mailers typically care about the average speed of delivery, for example, as well as the variance in delivery times.

(c) I am not aware of any data that is available which would allow an assessment of the reliability of Priority Mail, as defined above.

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**APMU/UPS-T6-17.**

At page 35, lines 5-6, of your testimony, you state that "[t]his consideration [ECSI value] is less applicable to Priority Mail in light of its greater "non-letter" content.

- a. Please define the term "non-letter content" as you use it here, and state whether you include or exclude documents from non-letter content.
- b. Please provide all studies, reports, documents and information on which you rely for your assertion that Priority Mail has greater "non-letter" content.

**Answer to APMU/UPS-T6-17.**

(a) As the term is employed on page 35, lines 5-6, of my testimony, "non-letter content" refers to parcels and irregular pieces and parcels (IPPS). Parcels and IPPS seem unlikely to include documents to any great degree.

(b) See the Origin-Destination Volume Summary Report (HSA360P1) included as part of Attachment G to the Postal Service's Request.

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**APMU/UPS-T6-18.**

At page 38, line 4, of your testimony, you state that the "recommended rate increase ... mainly reflects the 35% increase in Priority Mail's attributable costs since R97-1."

- a. Please confirm that the numerator and denominator used to derive the 35.9 percent increase in the above-quoted statement were, respectively, the difference between total attributed cost in Docket Nos. R2000-1 and R97-1 (*i.e.*, \$3,288,209,000-\$2,419,687,000) and total attributable cost in R97-1 (*i.e.*, \$2,419,687,000). If you do not confirm, please explain how the 35.9 percent increase was derived.
- b. What is the economic rationale for having percentage changes in rates track percentage changes in total cost? Please provide references to the economic literature that support and justify your rationale for this comparison.
- c. Please explain why rate increases should track changes in total cost rather than changes in unit cost and provide references to the economic literature that support and justify your rationale.

**Answer to APMU/UPS-T6-18.**

- (a) Confirmed, except that Priority Mail's total attributable cost in Docket No. R2000-1 should be \$3,288,<sup>2</sup>~~7~~4,000, as indicated in the errata filed on June 22, 2000.

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(b) Percentage changes in rates need not "track" percentage changes in total costs. The 40.3% rate increase that I recommend for Priority Mail is not designed to "track" the 35.9% increase in Priority Mail's attributable costs since R97-1. As I explain in my testimony on pages 18 and 37-38, the rate increase that I recommend for Priority Mail is designed to equate Priority Mail's markup index with the markup index for First Class Mail under the Postal Service's proposal. A substantial rate increase for Priority Mail is required to achieve this equalization, in large part because Priority Mail's attributable costs have increased by 35.9% since R97-1. UPS-T-6 at 35-36. But the recommended rate increase is not designed to "track" this increase in attributable costs; otherwise, I would have proposed a 35.9% increase.

(c) Please see my answer to part (b), above.

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**APMU/UPS-T6-19.**

At page 28, line 7, of your testimony, you refer to a 135 percent increase in Priority Mail's attributable costs since Docket No. R94-1.

- a. Please indicate the numerator and denominator used to compute the 135 percent referred to in your testimony.
- b. What is the economic rationale for comparing the cumulative percentage change in total attributable cost with the percentage change in rates, rather than with change in unit attributable cost?
- c. Please provide references to the economic literature which support and justify the appropriateness of your comparison.

**Answer to APMU/UPS-T6-19.**

(a) The numerator is the difference between Priority Mail's attributable costs in R2000-1 and in R94-1 ( $\$3,288,724 - \$1,401,597 = \$1,887,127$ ). See UPS-T-6 at 36, Table 6 (as revised 6/22/00). The denominator is Priority Mail's attributable cost in R94-1 ( $\$1,401,597$ ). All numbers are in thousands.

(b)-(c) There is no particular economic rationale for comparing changes in rates to changes in costs. The comparison that you suggest is also informative, which is why I included the last two columns in Table 6 on page 36 in my testimony.

The data in Table 6 is readily employed to compare recommended changes in rates with changes in unit attributable costs. Priority Mail's attributed cost per piece in R94-1 was  $\$1.84 (= \$1,401,597 / 762,115)$ . Its attributed cost per piece in R2000-1 is

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\$3.07 ( $= \$3,288,724 / 1,070,173$ ). The difference in these numbers, \$1.23, constitutes a 67% increase in Priority Mail's attributable cost per piece since R94-1.

As noted on page 38, lines 5-6, of my testimony, the rate increase that I recommend for Priority Mail provides a cumulative rate increase of 48%. Thus, the recommended cumulative increase in the price (per piece) for Priority Mail is approximately 72% of the corresponding cumulative increase in Priority Mail's attributed cost per piece.



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**APMU/UPS-T6-20.**

At page 35, your testimony states that "the Commission's recommendation was based in part on the substantial increase in Priority Mail's attributable costs that occurred between R94-1 and R97-1." Are you stating that the Commission's recommendation was based on (i) the increase in total attributable costs or (ii) the increase in *unit* attributable cost? Please provide a citation to the Commission's *Opinion and Recommended Decision* in Docket No. R97-1 that supports and clarifies your answer.

**Answer to APMU/UPS-T6-20.**

Although I cannot say with certainty, I suspect that the Commission based its recommendation in part on both the substantial increase in Priority Mail's total attributable costs (72.6%) and the related substantial increase in its unit attributable cost (24.3%) between R94-1 and R97-1. See UPS-T-6 at 36, Table 6 (as revised 6/22/00).

As I explain in footnote 16 on page 19 of my testimony, the Commission cited the "magnitude of growth in the estimated costs of providing the service" in explaining its recommended rate increase for Priority Mail. *Opinion and Recommended Decision*, Docket No. R97-1, ¶ 5306. Although the Commission did not distinguish between total costs and unit costs in this passage, it may well have had both cost measures in mind.

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**APMU/UPS-T6-21.**

At page 35 you state that "[t]he corresponding increase in Priority Mail's attributable costs since R97-1, while substantial, is less pronounced." Is it your opinion that an average annual increase of 11.5 percent in unit attributable cost between Docket Nos. R97-1 and R2000-1 is less pronounced than an average annual increase of 8.1 percent in unit attributable cost between Docket Nos. R94-1 and R97-1? Please explain fully any negative response.

**Answer to APMU/UPS-T6-21.**

No. An average annual increase of 11.5% represents a larger percentage increase than an average annual increase of 8.1%. The 11.5% annual increase also represents a larger nominal increase in the present context, since unit attributable costs were higher in R97-1 than in R94-1.

The point you raise here appears to be precisely the point that I emphasize on pages 36 and 37 of my testimony: changes in total costs do not necessarily track changes in unit costs. In particular, although Priority Mail's total attributable costs increased less rapidly between R97-1 and R2000-1 than they increased between R94-1 and R97-1, Priority Mail's unit costs increased more rapidly in the more recent period.

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**APMU/UPS-T6-22.**

In your opinion, when a subclass has suffered a sharp increase in unit attributable cost, and the Commission is setting rates for that subclass, should the Commission attempt to mitigate or compound the effect of the increase in unit cost? Please explain fully, and provide all references, reports, studies, and other documents on which you rely to support your position.

**Answer to APMU/UPS-T6-22.**

This question cannot be answered in the abstract. The Commission must consider many factors and all of the criteria in 39 U.S.C. § 3622(b) when it formulates its rate recommendation. The Commission often attempts to mitigate the impact of sharp cost increases, at least in part in consideration of the impact of rate increases on mailers (§ 3622(b)(4)). But other considerations, such as the requirement that each mail subclass bear its attributable costs and a reasonable share of institutional costs (§ 3622(b)(3)) and fairness and equity concerns (§ 3622(b)(1)) may necessitate a sharp rate increase. The extent to which the Commission attempts to mitigate a sharp cost increase may also depend upon whether it has provided similar mitigation in the recent past. Ongoing pronounced cost increases cannot be mitigated forever without effecting a significant restructuring of historic markup relationships.

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**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.

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**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.

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(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) An order-of-magnitude estimate of FY1999 Parcel Post volume was prepared by UPS witness Ralph L. Luciani and is contained in his workpapers at UPS-Luciani-WP-3-1.7, or in the electronic version filed June 22, 2000, file "UPS-T-5-Luciani WP-3-1 Revised.xls," tab "3-1.7 Volume Modifications."

(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.

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**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

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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.



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**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.

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**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.

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**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.

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**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.

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(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.

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**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

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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

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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).



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**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

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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.

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**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.

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**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

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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).

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**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.

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**USPS/UPS-T6-1** Refer to your testimony on pages 4 - 5 where you state: "High rates and large rates increases can be onerous for individual and business mailers alike, and so should be avoided whenever possible."

- a. At what level does a rate increase become "onerous"? In your answer, please explain fully what you meant by "onerous" in the quoted passage of your testimony, and what you mean by "onerous" in the general context of the postal rate proposals currently being reviewed by the Commission.
- b. Please describe fully the conditions under which you believe it is possible to avoid high postal rates and large postal rate increases.
- c. Please describe fully the conditions under which you believe it is not possible to avoid high postal rates and large postal rate increases.

**RESPONSE TO USPS/UPS-T6-1:**

(a) The definition of onerous is "burdensome, oppressive, or troublesome; causing hardship." *Webster's Encyclopedic Unabridged Dictionary of the English Language*, Portland House, 1989. This is the meaning of the term "onerous" as it is employed on page 5 of my testimony and as it pertains to the rate proposals currently being reviewed by the Commission.

Virtually all rate increases are "onerous" to some degree from the standpoint of mailers. That is why it is generally important to insist on credible demonstrations of harm by mailers, rather than unsubstantiated assertions, before reducing an otherwise appropriate rate increase. The extent of the hardship that a rate increase causes

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should be weighed, and that typically varies with the circumstances of individual mailers, including their income, the value they derive from the Postal Service product in question, and the terms on which they can secure alternative delivery services. In taking into account whether to moderate an assertedly onerous increase, it should be remembered that when one rate increase is moderated, another rate increase must be augmented.

(b)-(c) High rates and large rate increases for Postal Service products can be avoided when the Postal Service's costs and cost increases are low. High rates and large rate increases are difficult to avoid when the Postal Service's costs and cost increases are high.



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**USPS/UPS-T6-2.** Refer to your testimony on page 5 where you state: "Rates that disadvantage competitors unfairly should be avoided." Do you believe that rates giving an advantage to the Postal Service's competitors ever should be encouraged? If so, under what conditions?

**RESPONSE TO USPS/UPS-T-6-2:**

Rates should be set in accordance with the nine criteria specified in § 3622(b) of the Postal Reorganization Act. While these criteria do not include "giving an advantage to the Postal Service's competitors," they do guard against imposing an unfair disadvantage on competitors in a number of ways.

First, § 3622(b)(3) requires that each Postal Service mail subclass generate sufficient revenue to cover its attributable costs plus a reasonable share of institutional costs. If the revenues derived from a service fall below its incremental (attributable) cost, the service will be cross-subsidized by other services. Such cross-subsidization is unfair to customers of other services who must make up the shortfall in net revenue. It is also unfair to firms who supply a service in competition with the cross-subsidized Postal Service product.

Second, § 3622(b)(4) states that the effect of rate increases on "enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters" should be considered. Such consideration is appropriate in light of the many advantages that the Postal Service enjoys because of its status as a public enterprise. Some of these advantages are listed in footnote 14 on page 14 of my testimony. As

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explained there, these artificial advantages may allow the Postal Service "to drive more efficient producers from the market." To guard against this undesirable outcome, "it is wise to ensure that each service for which the Postal Service faces competition bears a meaningful portion of institutional costs."

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**USPS/UPS-T6-3.** Refer to your testimony on page 5 where you state: "When mailers can obtain comparable services at reasonable cost from suppliers other than the Postal Service, high postal rates impose few hardships on those mailers."

a. Please provide all rate tables (including published and discounted rate tables for UPS services) that demonstrate that "mailers can obtain comparable services" to Priority Mail "at a reasonable cost from suppliers other than the Postal Service."

b. Are the services provided by the United Parcel Service (UPS) comparable in all respects to the services provided by the Postal Service, including Priority Mail? If not, please explain fully.

c. Are Postal Service price levels considered in setting UPS's published rates? If so, please explain how and to what extent.

d. Does UPS compete for some customers with the Postal Service?

e. Does UPS consider the Postal Service's prices in determining what price to offer any of its customers?

f. Please confirm that if UPS considers the Postal Service's prices in determining what price to offer some customers, a 40.3% average rate increase for Priority Mail could allow UPS greater latitude to increase the prices it charges these customers. If you do not confirm, please explain fully.

g. Please confirm that a 40.3% average rate increase for Priority Mail would, all other things equal, improve the competitive position of UPS with respect to the Postal Service. If you do not confirm, please explain fully.

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**RESPONSE TO USPS/UPS T6-3:**

(a) UPS-LR-4 contains UPS's published rates for all of its services, including a number of services that compete with Priority Mail. I do not have any other rate schedules.

(b) The two-day and three-day delivery services offered by United Parcel Service are not identical to Priority Mail. For example, Priority Mail includes Saturday delivery in its base price, while the UPS services do not. Priority Mail may also be delivered at no extra charge on Sunday during peak delivery seasons; UPS's services do not provide Sunday delivery. The UPS products include automatic coverage for loss up to \$100, an on-time guarantee, and track and trace in their base prices, while Priority Mail does not.

(c) I do not know what factors UPS considers when it establishes its published rates.

(d) Yes.

(e) Please see my answer to part (c), above.

(f) Confirmed that a Priority Mail average rate increase of 40.3% would increase Priority Mail rates relative to UPS's current rates.

(g) Confirmed.

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**USPS/UPS-T6-4.** Refer to your testimony on pages 18 - 19 where you state that a higher cost coverage for Priority Mail (as compared to the systemwide cost coverage or the First-Class Mail cost coverage) is appropriate, in part, given "...the Commission's long-standing emphasis on protecting users of monopoly mail services" (footnote omitted).

- a. Is it your understanding that a portion of Priority Mail volume is subject to the Postal Service's statutory monopoly? Please explain fully.
- b. If so, how are these Priority Mail customers "protected" by a higher cost coverage? Please explain fully.

**RESPONSE TO USPS/UPS-T6-4:**

(a) Yes. Postal Service witness Mayes cites an estimate (by an unidentified source) that in 1998, "approximately one-fourth of Priority Mail volume was protected by the Private Express Statutes." Response to APMU/USPS-T32-4(b), Tr. 11/4220. In contrast, virtually all of First Class Mail is protected by the Private Express Statutes. ODIS reports that in FY1998, less than 1% of First Class Mail consisted of packages. See USPS-LR-I-170.

(b) As noted in your question, I cite on pages 18-19 of my testimony "the Commission's long-standing emphasis on protecting users of monopoly services." As the accompanying footnote 15 indicates, this emphasis is on protecting users of First Class Mail, where letter mail users are much more numerous and represent a greater proportion of users compared to Priority Mail. In the passage cited in the footnote, the

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Commission states that "care must be taken to avoid unfairly penalizing First-Class Mail, which is the basic means of written personal and business communication in this country, yet is subject to a statutory monopoly."

The Senate Report on the Postal Reorganization Act reflects a similar concern with protecting the users of First Class Mail. As indicated in footnote 3 of my testimony on page 5, the Senate Report states: "The temptation to resolve the financial problems of the Post Office by charging the lion's share of all operational costs to first class is strong; that's where the big money is. The necessity for preventing that imposition upon the only class of mail which the general public uses is one of the reasons why the Postal Rate Commission should be independent of operating management." S. Rep. No. 912, 91st Cong., 2d Sess. (1970) at 13.

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**USPS/UPS-T6-5.** Regarding the proposals explicit or implicit in your testimony:

- a. Confirm that you are proposing a 40.3% average rate increase for Priority Mail. If not confirmed, please explain fully.
- b. Confirm that  $\$3.20 \cdot (1 + 40.3\%) = \$4.49$ . If not confirmed, please explain fully.
- c. Are you proposing that the Postal Rate Commission recommend that the 2-pound Priority Mail rate (currently \$3.20) increase to \$4.49? If not, what rate are you proposing for 2-pound Priority Mail pieces?
- d. Please provide a rate table showing your proposed Priority Mail rates.
- e. Please explain fully all of the rate implications of your testimony. In your response, describe each of the specific rates that you believe the Commission should recommend.

**RESPONSE TO USPS/UPS-T6-5:**

- (a) Confirmed.
- (b) Confirmed.
- (c) No. My testimony does not address rate design issues.
- (d) Please see my answer to part (c), above.
- (e) Please see my answer to part (c), above.

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**USPS/UPS-T6-6.** Please refer to your testimony at page 5, lines 4-7 where you state:

"Although low rates and significant rate reductions can benefit some mailers, they can unfairly disadvantage other mailers who must pay higher rates as a result. Low rates and significant rate reductions can also unfairly disadvantage competing suppliers of delivery services. Rates that disadvantage competitors unfairly should be avoided."

- a. Please define the term "significant" as used in this portion of your testimony, or provide a threshold beyond which a change would be viewed by you to be "significant."
- b. Please define the term "unfairly" as used in this portion of your testimony.
- c. Please clarify the intended meaning of the phrase "disadvantage competitors unfairly."
- d. Please confirm that 39 U.S.C. § 3622(b)(4) refers only to rate "increases" and not to rate reductions.
- e. Is the converse of the statement "low rates and significant rate reductions . . . can unfairly disadvantage other mailers who must pay higher rates as a result" true? When mailers have high rates and significant rate increases, are other mailers "unfairly" benefiting?

**Answer to USPS/UPS-T6-6.**

(a) What constitutes a "significant" rate reduction will vary with the circumstances under which the reduction is implemented. For example, any rate reduction that causes the revenues for a service to fall below its attributable costs is significant. In any event, the word "significant" is not central to the point made in the



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sentences you cite. Those sentences could just as easily read: "Although low rates and rate reductions can benefit some mailers, they can unfairly disadvantage other mailers who must pay higher rates as a result. Low rates and rate reductions can also unfairly disadvantage competing suppliers of delivery services. Rates that disadvantage competitors unfairly should be avoided."

The point of the sentences you cite is that while granting rate reductions to some mailers may at first blush seem attractive, it must be remembered that, given the break-even constraint contained in the statute, lower rates for some mailers necessitate higher rates for other mailers. Likewise, unduly low rates (e.g., rates that generate revenues below attributable costs) may result in more efficient competitors losing business they otherwise would have had.

(b) Mailers are disadvantaged "unfairly" when they must pay higher rates than they would otherwise pay in order to support rates for other mailers that are below attributable costs, or attributable costs plus a meaningful and reasonable amount of institutional costs, taking into account the service levels of the two classes of mail, the degree of mail preparation performed by each set of mailers, and other such considerations as reflected in the criteria of § 3622(b). Similarly, competitors are disadvantaged "unfairly" by prices for Postal Service products that generate revenues below the sum of attributable costs and the institutional costs that are "reasonably assignable" to those products under 39 U.S.C. § 3622(b). Competitors may also be disadvantaged unfairly by rates that are otherwise inconsistent with the ratemaking criteria of 39 U.S.C. § 3622(b). See also my response to (a), above.

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(c) See my answers to parts (a) and (b), above.

(d) Confirmed. Low rates and rate decreases can nevertheless be inconsistent with the requirements of the Postal Reorganization Act. In particular, low rates and rate decreases can cause revenues to fall below the sum of attributable costs and a reasonable share of institutional costs, and thereby violate § 3622(b)(3) of the Postal Reorganization Act.

(e) Not necessarily. If significant rate increases are driven by significant cost increases, for example, other mailers who use services with lower costs do not benefit unfairly from those increases. Similarly, if a significant rate increase reflects the higher value that a service offers, then mailers who choose to use other, less expedited services are not benefited unfairly.

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**USPS/UPS-T6-7.** Please refer to your testimony at page 5, lines 13-16 where you state: "When mailers can obtain comparable services at reasonable cost from suppliers other than the Postal Service, high postal rates impose fewer hardships on those mailers. Consequently, higher rates for postal services are appropriate in such situations, *ceteris paribus*."

- a. Please reconcile these statements with the direction by 39 U.S.C. § 3622(b)(4) to consider the impact of rate increases on mailers.
- b. Please define "comparable services" as used in this portion of your testimony.
- c. Please define "hardships" as used in this portion of your testimony.

**Answer to USPS/UPS-T6-7.**

- (a) The cited statements are entirely consistent with 39 U.S.C. § 3622(b)(4).

Section 3622(b)(4) directs the Commission to consider the impact of rate increases on mailers. The statements cited in your question provide guidance as to when the impacts are likely to be more or less pronounced, *ceteris paribus*. If a mailer can avoid the full impact of a rate increase by securing services from another supplier, then that mailer will not be affected by the high rate increase as adversely as he otherwise would be.

Section 3622(b)(4) also directs the Commission to consider the impact of rate increases on competitors. Higher rates for Postal Service products reduce the likelihood that a public enterprise will drive a more efficient private competitor from the market place, or will divert from the competitor business that would otherwise be

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provided more efficiently by that competitor. Such safeguards are appropriate in light of the many advantages that the Postal Service enjoys because of its status as a public enterprise. As explained in my testimony (on page 14, footnote 14), the advantages enjoyed by the Postal Service include its ability to borrow from the United States Treasury and the fact that it does not have to pay the same taxes and fees that its competitors must pay.

(b) Comparable delivery services are those that customers view as reasonable substitutes for the delivery services provided by the Postal Service.

(c) Hardships include significantly reduced profit for business customers and meaningfully reduced utility (i.e., well-being) for household customers.

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**USPS/UPS-T6-8.** Please confirm that the pricing criteria listed in 39 U.S.C. § 3622(b) are to be used by the Commission in recommending rates and fees that "provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service." 39 U.S.C. § 3621. If you cannot confirm, please explain.

**Answer to USPS/UPS-T6-8.**

Confirmed.

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**USPS/UPS-T6-9.** Please refer to your testimony at page 8 where you state that "except for the fact that the definition of economic value renders it susceptible to measurement, the rationale for distinguishing between intrinsic value and economic value is not apparent."

- a. Is it your opinion that 39 U.S.C. § 3622 (b)(2) refers only to the value of the mail service *relative to the services provided to other mail categories*, or does the customer's perception of the value of a mail service also depend on the nature of services provided by non-postal delivery firms? Please explain.
- b. If the customer's perception of the value of a mail service depends, in part or in whole, on the service provided *relative to the services provided by other firms*, please explain how this should be measured or identified.

**Answer to USPS/UPS-T6-9.**

(a) A focus of § 3622(b)(2), and of the ratemaking provisions of the Postal Reorganization Act as a whole, is on achieving equity *among mailers*. For example, § 3622(b)(2) refers to "the value of the mail service actually provided *each class or type of mail service*" (emphasis added). Section 3622(b)(1) refers to the "maintenance of a fair and equitable schedule" of rates. Section 403(c) prohibits undue discrimination among mailers in setting rates. These provisions suggest that value relative to the services provided other mail categories is a primary consideration. That being said, all available direct and indirect measures of service performance and value merit

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consideration, including the nature of the services provided by other suppliers. That is reflected, for example, in § 3622(b)(5).

(b) The value that customers derive from a service is difficult to measure, whether value is determined on an absolute basis or relative to the value derived from other services. This difficulty has led one observer to conclude that "the 'value of service' principle, as a basis for ratemaking, provides at best a vague and indeterminate formula, rather easily construed as justifying any system of rates found expedient by the carrier." Leo I. Sharfman, The Interstate Commerce Commission, New York: The Commonwealth Fund, 1936, Vol. IIIB, pp. 321-322, quoted in James C. Bonbright, Albert L. Daniels, and David R. Kamerschen, Principles of Public Utility Rates, Second Edition, Arlington, Virginia: Public Utilities Reports, Inc., 1988 ("Bonbright, et al."), pages 129-130.

The value of a service is difficult to assess and measure for a variety of reasons. For instance, the same service can provide very different levels of value to different customers, because customers typically differ in their preferences, needs, and resources. Furthermore, the best metric for assessing value is not always apparent. Value may also be influenced by many different features of a service; the manner in which each feature affects value can be difficult to assess, and typically varies across customers. In addition, a directive to base rates on service value can introduce a circularity into the ratemaking process. This circularity is unavoidable if the measures employed to assess value (e.g., own-price elasticities of demand) are influenced by the established rates. See Bonbright, et al., Chapter 6.

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Despite the difficulties it entails, value of service should be considered when recommending postal rates, as § 3622(b)(2) of the Postal Reorganization Act directs. However, in assessing the value of a mail service, it is important to recognize the difficulty of the task, and to avoid the temptation to summarize all relevant dimensions of value with a single statistic, such as the own-price elasticity of demand. Instead, all of the many available direct and indirect measures of service quality should be considered. Relevant measures include the speed of the mail service, the level of priority it is afforded in mail processing, transportation, and delivery, its success in avoiding content damage, and the opportunity it affords users to purchase value-added services, such as delivery confirmation.



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**USPS/UPS-T6-10.** Please refer to page 8, line 14 of your testimony and provide a definition of the term "undue reliance."

**Answer to USPS/UPS-T6-10.**

A statistic is afforded undue reliance in a decision-making process when the decision is based primarily on the single statistic, while other relevant factors are afforded little or no attention.

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**USPS/UPS-T6-11.** Please refer to your testimony at page 8, lines 16-17 where you state that the use of the own-price elasticity "as a measure of value can contradict the pricing criteria specified in section 3622(b) of the Act."

- a. Please explain this statement.
- b. In your opinion, do any of the criteria specified in the Act contradict other criteria specified in the Act? If so, please provide examples.

**Answer to USPS/UPS-T6-11.**

(a) Section 3622(b)(5) of the Postal Reorganization Act directs the consideration of "the available alternative means of sending and receiving letters and other mail matter at reasonable costs." When mailers can obtain comparable services at reasonable cost from suppliers other than the Postal Service, the mailers will find Postal Service rate increases to be less burdensome. Consequently, higher rates for Postal Service products are appropriate in such situations, *ceteris paribus*.

When mailers can obtain comparable services from other suppliers at reasonable cost, competing Postal Service products will tend to have high own-price elasticities. Consequently, if high own-price elasticities are taken to indicate low service value and so are systematically associated with low rates, then lower rates – not higher rates – will be established in settings where mailers can obtain comparable services at reasonable cost from other suppliers. This inverse relationship between Postal Service rates and the availability of alternative means of sending and receiving mail stands in direct contrast to the relationship implied by 39 U.S.C. § 3622(b)(5). In this sense,

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using the own-price elasticity as a proxy for service value can contradict the directives of 39 U.S.C. § 3622(b)(5).

(b) I am not aware of instances where one criterion in § 3622(b) of the Postal Reorganization Act contradicts other criteria in the Act. That is not to say, though, that the criteria always produce identical implications for rate setting. They do not. For instance, the cost criterion, § 3622(b)(3), may require a substantial increase in rates even though mailers may find the requisite rate increase to be onerous, § 3622(b)(4).

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**USPS/UPS-T6-12.** Please refer to your testimony at page 9 where you claim that the own-price elasticity of demand is a "very imperfect measure of the value that senders and receivers derive from a mail service." Given that conclusion, please provide an alternative means by which the Commission may measure value of service in order to comply with 39 U.S.C. § 3622(b)(2).

**Answer to USPS/UPS-T6-12.**

As explained on pages 31-33 of my testimony and in my response to USPS/UPS-T6-9, there are many direct and indirect measures of service value, and all of these measures should be considered when assessing the value that mailers and recipients derive from a mail service.

Direct measures of service value include the speed of delivery and the convenience, security, and freedom from content damage that a service delivers. Other relevant direct measures of service value include features (e.g., Saturday delivery, insurance, pick-up, and delivery confirmation) that are provided automatically or that can be purchased on an optional basis. Indirect measures of service value can also provide useful information about service value, particularly when direct measures are difficult to assess accurately or to compare. Relevant indirect measures of the value that a service provides include the "mode of transportation, and priority of delivery" that the service provides. See 39 U.S.C. § 3622(b)(2).

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**USPS/UPS-T6-13.** Please refer to your testimony at page 10 where you state that "since high own-price elasticities can reflect the presence of effective competition, a policy that implements lower rates and smaller rate increases in response to higher own-price elasticities for Postal Service products can serve primarily to protect the Postal Service from effective competition."

a. Please define the term "effective competition" as used in this portion of your testimony.

b. Please confirm that the pricing criteria in 39 U.S.C. § 3622(b)(4) and (b)(5), when balanced with criterion (b)(2), are designed to shield against the situation you have described. If you cannot confirm, please explain fully.

**Answer to USPS/UPS-T6-13.**

(a) Effective competition for Postal Service products is present when a substantial proportion of Postal Service customers view the services offered by competing delivery firms as reasonable substitutes for Postal Service products, given the prevailing prices.

(b) In my opinion, a number of the criteria in 39 U.S.C. § 3622(b) are designed to guard against undue protection of the Postal Service from competition. The cost criterion (§3622(b)(3)) is essential in this regard, in that it requires each Postal Service product to bear its attributable costs "plus that portion of all other costs of the Postal Service reasonably assignable" to the product. The criterion related to the effect of rate increases (§3622(b)(4)) is also important in this regard, in that it directs

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consideration of "the effect of rate increases upon . . . enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters." The available alternatives criterion (§3622(b)(5)) is likewise important in this regard, in that it suggests that larger rate increases are more acceptable for services for which Postal Service customers have viable alternatives, *ceteris paribus*. I do not see any criterion in § 3622(b) that is inconsistent with these provisions.

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**USPS/UPS-T6-14.** Please refer to your testimony at page 11, lines 3-4. Define what you mean by "an inefficient production technology with unnecessarily large institutional costs and relatively low incremental costs for competitive services."

**Answer to USPS/UPS-T6-14.**

An "inefficient production technology with unnecessarily large institutional costs and relatively low incremental costs for competitive services" is a technology in which institutional costs exceed, and incremental costs for competitive services are below, the corresponding costs incurred when the cost-minimizing technology is employed. The term "cost-minimizing technology" is defined in my answer to USPS/UPS-T6-15(b). An example of an inefficient production technology is one that employs general-purpose machinery that can sort both letters and flats, even though separate machines for sorting letters and flats would be equally effective but less costly. Another example might be the use of a few large processing facilities and generalized equipment, even though operating costs would be lower and performance would not be reduced if a greater number of smaller, more specialized facilities or equipment were employed.

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**USPS/UPS-T6-15.** Please refer to your testimony at page 11 where you refer to  
“(artificially low) incremental costs.”

- a. Is it your testimony that the Postal Service should engage in production practices that would drive up the costs of its competitive products? Please explain fully.
- b. Please define “the technology that minimized its overall operating costs” and provide any and all evidence that the Postal Service does not now utilize such technology.

**Answer to USPS/UPS-T6-15.**

(a) No. The Postal Service should minimize its costs of delivering all of the services that it provides.

(b) A firm's technology is the means by which it transforms inputs (e.g., facilities, equipment, and labor) into outputs (e.g., various mail services). The cost-minimizing technology for a firm (i.e., the technology that minimizes its overall operating costs) is the technology that, among all feasible technologies, enables the firm to produce its outputs at minimum expense, i.e., while incurring the smallest possible total input costs.

I am not aware of any studies that examine whether the Postal Service employs the cost-minimizing technology.



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**USPS/UPS-T6-16.** Please define and/or quantify "unnecessarily large institutional costs" as referred to at line 10 of page 11 of your testimony.

**Answer to USPS/UPS-T6-16.**

Unnecessarily large institutional costs are any institutional costs in excess of those incurred when operating with the least-cost technology.

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**USPS/UPS-T6-17.** Please confirm that "unnecessarily large institutional costs can also increase rates unduly for captive users of monopoly mail services" only if the pricing criteria are applied "inappropriately" such that this burden is shifted to these captive customers. If you cannot confirm, please explain fully.

**Answer to USPS/UPS-T6-17.**

Not confirmed. Monopoly and non-monopoly services both bear portions of institutional costs when the pricing criteria are applied appropriately. Therefore, if institutional costs exceed cost-minimizing levels, captive users of monopoly services will bear a portion of those excess institutional costs in the form of higher rates.

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**USPS/UPS-T6-18.** Please refer to your testimony at page 11, lines 11-12, where you state that "such harm to competition and to captive customers should be avoided, and it can be avoided if rates are not systematically lowered as own-price elasticities rise."

[footnote deleted]

Is it your testimony that rates have been "systematically lowered as own-price elasticities rise?" If so, please provide supporting evidence. If not, please confirm that this statement is simply a warning and is not meant to reflect on proposals put forth in this docket. If you do not confirm, please explain.

**Response to USPS/UPS-T6-18.**

No. My observation regarding the dangers of lowering rates systematically as own-price elasticities rise is best characterized as a general warning. However, the observation is motivated by my concern about the prominent role that the Postal Service appears to have afforded the own-price elasticity as a measure of value of service in this proceeding. Postal Service witness Mayes states that "Another way to look at value of service is by considering the degree to which usage of the service declines in response to price increases, indicative of what has been referred to as the economic value of service. . . . The lower (in absolute value) the own-price elasticity, the higher the value of service" (USPS-T-32, p. 5). Ms. Mayes identifies other indicators of service value. Therefore, she does not extend her systematic association of the own-price elasticity with the "economic value of service" to value of service more broadly defined. However, identification of the own-price elasticity as the "economic value of service"

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seems to suggest that the own-price elasticity is a reliable and common measure of value of service. As I explain in my testimony on page 9, there is no necessary relationship between own-price elasticity and value of service. Furthermore, to my knowledge, the term "economic value of service" as it is defined by Ms. Mayes is not employed in the economic literature.

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**USPS/UPS-T6-19.** Please refer to your testimony at page 11, lines 17-18, where you state:

"When high own-price elasticities are presumed to indicate low-value services and when lower rates are established for such services, the lowest rates will be set for those services that exhibit the highest own-price elasticities."

- a. Is it your opinion that the rates proposed in this docket represent Ramsey prices? If so, please provide the basis for this opinion. If not, please confirm that this statement in your testimony is meant only as a warning and is not meant to reflect on proposals put forth in this docket.
- b. Is it your understanding that the rates proposed in this docket relied solely on a mapping of low rates to high-elasticity products? If so, please provide the basis for this belief. If not, please confirm that this statement reflects only a hypothetical situation and represents a warning, and is not meant to reflect on proposals put forth in this docket.
- c. Is it your understanding that the rate levels proposed in this docket were dependent solely on value of service considerations as measured by own-price elasticities, and that no other pricing criterion influenced the proposed rate levels? If so, please provide supporting evidence for this belief. If not, please confirm that this statement does not apply to the rates proposed in this docket.

**Response to USPS/UPS-T6-19.**

(a)-(c) No. Please see my response to USPS/UPS-T6-18.

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**USPS/UPS-T6-20.** Please refer to your testimony at page 12, lines 3-4 where you state that "the mechanistic use of own-price elasticities as proxies for service value should be similarly rejected."

- a. What alternate measure of service value should be used?
- b. Please confirm that the "mechanistic use of own-price elasticities for service value" was not proposed in this docket.

**Response to USPS/UPS-T6-20.**

- (a) Alternative indicators of service value include those described in my testimony on pages 31-33 and in my response to interrogatory USPS/UPS-T6-9(b).
- (b) Confirmed. Please see my response to USPS/UPS-T6-18.

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**USPS/UPS-T6-21.** Please refer to your testimony at pages 17-18 where you state that "the Commission has not yet adopted any such estimates [of incremental cost]" and "[o]nce the Commission is presented with incremental cost estimates..." Have you read the testimonies of Postal Service witnesses Bradley and Kay in this docket? If not, please state why you did not. If so, please confirm that they provide the Commission with incremental cost estimates.

**Response to USPS/UPS-T6-21.**

I have read the testimonies of Postal Service witnesses Bradley and Kay. Confirmed that they provide the Commission with incremental cost estimates.

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**USPS/UPS-T6-22.** Please refer to your testimony at page 19, lines 2-3 and explain how your recommendation of a higher cost coverage is consistent with "the Commission's long-standing emphasis on protecting users of monopoly mail services." [footnote omitted]

**Response to USPS/UPS-T6-22.**

As I explain in my response to USPS/UPS-T6-4(b), my testimony at page 19, lines 2-3, refers to the Commission's emphasis on protecting users of First Class Mail, the class of mail with the greatest number and proportion of letter monopoly mail users and the "only class of mail which the general public uses." S. Rep. No. 912, 91st Cong., 2d Sess. (1970) at 13. By setting a higher cost coverage for Priority Mail than for First Class Mail, the Commission can employ the extra contribution generated by Priority Mail to limit the rate increases it might otherwise be compelled to impose on First Class Mail users.



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**USPS/UPS-T6-23.** Please refer to your testimony at pages 18-19, section IV.B. Please provide the percentage rate increases for Priority Mail for the rate cases "prior to R97-1" to which you refer.

**Response to USPS/UPS-T6-23.**

The average rate increases for Priority Mail that were implemented as a result of rate cases R84-1, R87-1, R90-1, R94-1, and R97-1 were 0%, 0%, 19%, 4.8%, and 5.6%, respectively. See Table 2 in USPS-T-34, p. 7.

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**USPS/UPS-T6-24.** Please refer to your testimony at page 18 where you state that the rate increase you have proposed "represents a cost coverage of 176% and a markup...of 76%, which is the same markup that the Postal Service proposes for First Class Mail in this case." Please provide the basis for your representation that the Postal Service is proposing a markup of 76% for First-Class Mail in this case.

**Response to USPS/UPS-T6-24.**

Using its costing procedures, the Postal Service's proposed markup for First Class Mail is 95.3%, and the corresponding markup index for First Class Mail is 1.395. My recommendation is to implement for Priority Mail the same markup index (and thus the same markup) that is implemented for First Class Mail. Taking 1.395 as the relevant markup index and using the Commission's costing procedures, a 76% markup for Priority Mail and First Class Mail ensures that they each have a markup index of 1.395. That is because the systemwide markup is 54.5% under the Postal Service's proposed rates, using the Commission's costing procedures (and because  $76/54.5 = 1.395$ ). See UPS-Luciani-WP-3-1.6.

Perhaps my testimony would have been more clear on this point had I stated in the sentence you cite that my recommended rate increase represents "a markup . . . of 76%, which provides the same markup index that the Postal Service proposes for First Class Mail in this case" (changes underlined). Thus, an errata to my testimony will be issued to clarify my recommendation that Priority Mail have the same markup index that the Postal Service is proposing for First Class Mail, and that a 76% markup for both

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Priority Mail and First Class Mail will ensure that they achieve a markup index of 1.395. As indicated, the errata will change the phrase "is the same markup" on page 18 at line 15 with the phrase "provides the same markup index." The explanation provided above is also intended to clarify similar statements in my testimony on page 20, lines 14-17, and on page 37, line 14, through page 38, line 2.

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**USPS/UPS-T6-25.** Please refer to your testimony at page 34, lines 3-11, where you describe the application of § 3622(b)(4) to First-Class Mail. Please provide the quantitative impact of the application of criterion 4 on the markup for First-Class Mail.

**Response to USPS/UPS-T6-25.**

I have not assigned a precise numerical representation to each of the criteria in 39 U.S.C. § 3622(b) for all mail subclasses. Thus, I cannot provide the quantitative impact you request. Qualitatively, though, 39 U.S.C. § 3622(b)(4)'s concern with the effect of rate increases on the general public and on competitors suggests that a higher markup is appropriate for Priority Mail than for First Class Mail, ceteris paribus, because of the Postal Service's letter monopoly. Please see my response to USPS/UPS-T6-4.

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**USPS/UPS-T6-26.** Please refer to your testimony at page 37, lines 5-8, where you state: "That migration [of Priority to First-Class Mail] has reduced Priority mail volume. The reduced volume implies that a larger rate increase is required to generate enough extra revenue to offset any given increase in attributable costs, ceteris paribus." Please confirm that this is only true for non-volume variable costs. If you do not confirm, please explain.

**Response to USPS/UPS-T6-26.**

Not confirmed. Reduced volume will certainly imply that a larger rate increase is required to generate enough extra revenue to offset any given increase in costs that are not volume variable, as you indicate. Reduced volume may also require a larger rate increase to generate enough extra revenue to offset an increase in volume variable costs.

To see why, consider the simple case where all costs are volume variable. Also suppose that there are initially no economies or diseconomies of scale, so that unit volume variable costs remain <sup>constant</sup> ~~consistent~~ with volume. In this case, the same rate -- a rate equal to the unit volume variable cost -- will generate the revenues required to cover costs, regardless of the level of volume. Now suppose that unit volume variable costs increase at all volumes, and that they increase more for low volumes than for high volumes. The result is that unit volume variable costs will now decrease as volume increases. In other words, scale economies will now be present. In the presence of scale economies, unit (i.e., average) costs of production increase as volume declines.

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Consequently, a reduction in volume will necessitate a higher rate in order to offset the higher unit costs that result from the lower volume.

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**USPS/UPS-T6-27.** Please confirm that you are recommending that the rate increase for Priority Mail exceed the increase in costs since Docket No. R97-1.

**Response to USPS/UPS-T6-27.**

Confirmed. As explained on page 38 of my testimony, though, the rate increase that I recommend constitutes a 48% cumulative rate increase since R94-1, which is far less than the 134% increase in Priority Mail's attributable costs since R94-1.

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**USPS/UPS-T6-28.** Please refer to your testimony at page 38, lines 11-14, where you state: "if convincing evidence to the contrary arises which demonstrates that the recommended 40.3% rate increase would unduly affect Priority Mail users, then some further mitigation of the rate increase might be appropriate."

- a. Please provide your estimated TYAR volume for Priority Mail, given your recommended rate increase.
- b. Please define "unduly affect" as used in this section of your testimony.
- c. Please confirm that the long-run own-price elasticity for Priority Mail as presented by Dr. Musgrave in this docket is  $-0.819$ . If you do not confirm, please provide the correct figure.
- d. What percent decline in Priority Mail volume would you consider to represent a result indicating the rate increase "unduly affected" Priority Mail?
- e. What would represent to you "convincing evidence" that the rate increase you propose would "unduly affect" Priority Mail?
- f. What should be the goals of such "further mitigation"?

**Response to USPS/UPS-T6-28.**

- (a) 1,070,173,000 pieces, as reported in Table 6 on page 36 of my testimony as revised on June 22, 2000.
- (b) As I use the term on page 38 of my testimony, "unduly affect" means to impose severe economic hardship on Priority Mail users.
- (c) Confirmed.



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(d)-(e) There is a difference between an effect on Priority Mail users, and an effect on Priority Mail. In any event, I do not have a threshold percent volume decline in mind. A volume decline is not the only relevant measure of whether Priority Mail users would be unduly affected by the recommended rate increase. Credible evidence that Priority Mail users do not have ready access to alternative suppliers and so would suffer severe economic hardship if the recommended rate increase were implemented would also be relevant to consider. Careful econometric work which demonstrated that the recommended rate increase would cause Priority Mail's contribution to institutional costs to decline rather than to increase would also provide convincing evidence that Priority Mail, its users, and other mail users would be unduly affected by the recommended rate increase.

(f) The primary goal of further mitigation should be to prevent erosion of the contribution to institutional costs that Priority Mail provides.

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**USPS/UPS-T6-29.** Please confirm that the rate levels you have proposed for Parcel Post and Priority Mail have been proposed outside of the context of a set of rate levels designed to achieve financial breakeven in the test year. If you cannot confirm, please provide a complete set of cost coverage proposals designed to achieve financial breakeven.

**Response to USPS/UPS-T6-29.**

Confirmed.

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**USPS/UPS-T6-30.** Please refer to your testimony at page 42, line 6, where you refer to “the extremely low cost coverage that Parcel Post has had in recent years.” To which years are you referring? Please provide the cost coverages for each of those years to which you refer, and indicate whether such measurement of the cost coverage was before or after the revision of the RPW data for additional Parcel Post volume and revenue.

**Response to USPS/UPS-T6-30.**

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 Post in R94-1 and R97-1, rather than to the actual cost coverages realized in the ensuing years. 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. See Opinion and Recommended Decision, Docket No. R97-1, Appendix G, Schedule 3.

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**USPS/UPS-T6-31.** Please refer to your testimony at page 43, lines 6-7, where you state: "in practice, revenue and cost forecasts can diverge substantially from actual levels of revenue and cost." Please confirm that such divergences may be in either direction. If you cannot confirm, please explain fully.

**Response to USPS/UPS-T6-31.**

Confirmed. Actual levels of revenue and cost can either exceed or fall short of forecast levels. However, even if over-estimates and under-estimates occur symmetrically, their ramifications can be asymmetric. In particular, when actual revenues from a service fall short of forecast revenues and when the actual costs of the service exceed forecast costs, the service may fail to bear its attributable costs, contrary to the requirement specified in 39 U.S.C. § 3622(b)(3). Cost coverages that are substantially above 100% based upon forecast revenues and costs can help to avoid such outcomes.

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**USPS/UPS-T6-32.** Please refer to your testimony at page 43, lines 9-10, where you state: "revenue below attributable cost is inconsistent with § 3622(b)(3) of the Act." Is it your interpretation of the Act that criterion 3 refers to each and every year, or to the estimates upon which the Postal Rate Commission recommends test year rates and fees?

**Response to USPS/UPS-T6-32.**

I believe that the intent of the Postal Reorganization Act is to preclude situations in which the revenues derived from a mail subclass fall below the sum of its attributable costs and a reasonable share of institutional costs on an annual basis. In my opinion, the intent of the Act would not necessarily be violated if the realized cost coverage for a mail subclass fell minimally below 100%, but did so very infrequently (e.g., once in a ten year period).

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**USPS/UPS-T6-33.** Please refer to your testimony at page 43, lines 14-15, where you state: "with only two exceptions, Parcel Post revenues have fallen short of attributable costs in every year between FY1989 and FY1997." If the additional volume of Parcel Post indicated by the revised RPW data is incorporated for each of those years, for how many of those years to which you refer is Parcel Post revenue below attributable cost?

**Response to USPS/UPS-T6-33.**

I am not aware of any revised Parcel Post RPW data for years prior to FY 1998, so I am not in a position to answer this question.

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**USPS/UPS-T6-34.** Should the Commission fail to adopt the cost revisions suggested by witness Luciani, is it still your position that the appropriate cost coverage for Parcel Post be 111%, lower than the cost coverage proposed by the Postal Service in this docket?

**Response to USPS/UPS-T6-34.**

No. If the Commission fails to adopt the cost revisions recommended by UPS witness Luciani, the 111% cost coverage that I recommend in my testimony should be increased. As I indicate on page 46 of my testimony, "A more substantial markup [for Parcel Post] would be appropriate, if not for the large increase in Parcel Post's attributable costs since R97-1." The exact magnitude of the appropriate increase in the cost coverage for Parcel Post would depend upon the Commission's assessment of the increase in Parcel Post's attributable costs since R97-1.

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**USPS/UPS-T6-35.** Please confirm that the Postal Service's proposed cost coverage of 114% for Parcel Post would also "reduce the likelihood of violating § 3622(b)(3) of the Act and of disadvantaging competitors and other mail users unfairly, without burdening Parcel Post mailers unduly (§ 3622(b)(4))." [UPS-T-6 at page 44]

**Response to USPS/UPS-T6-35.**

Confirmed.



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**USPS/UPS-T6-36.** Please confirm that the average delivery time of "less than four days" for Parcel Post is due in part, or in large part, to mailer participation in dropship workshare programs in which mailers provide some portion of transportation prior to entering the packages as Parcel Post. If you cannot confirm, please explain fully.

**Response to USPS/UPS-T6-36.**

I do not have the information that is required to confirm or not confirm this statement, although it seems reasonable.

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**USPS/UPS-T6-37.** In your opinion, does criterion 4 encompass cumulative rate increases, i.e., rate increases from previous and recent cases in addition to the proposed rate increase from the current docket? Please explain.

**Response to USPS/UPS-T6-37.**

Criterion 4 (39 U.S.C. § 3622(b)(4)) directs the consideration of the effects of proposed rate increases on mailers and private suppliers of delivery services. To the extent that previous rate increases influence the likely effects of proposed rate increases, the previous rate increases merit consideration.

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**USPS/UPS-T6-38.** Please confirm that the long-run own-price elasticity for Parcel Post as presented by Dr. Tolley in this docket is  $-1.23$ , the second highest own-price elasticity presented in this case. If you cannot confirm, please provide the correct figure.

**Response to USPS/UPS-T6-38.**

Confirmed.

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**USPS/UPS-T6-39.** Refer to Table 6 of your testimony at page 36. Please provide appropriate citations and all calculations and data inputs used to calculate "Average Annual % Change in Real Attributed Cost per Piece."

**Response to USPS/UPS-T6-39.**

The calculations and data inputs required to derive the "Average Annual % Change in Real Attributed Cost Per Piece" are presented below. All relevant citations and explanations of the calculations are provided in footnotes 45, 46, and 47 of my testimony, on pages 35-37.

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Calculation of the Average Annual % Change in

Priority Mail's Real Attributed Cost per Piece

Rate Case	Test Year Estimated Volume (000 Pieces)	Test Year Attributed Cost (\$ 000)	GDP Implicit Price Deflator Conversion Factor*	Real Test Year Attributed Cost (1981 \$ 000)**	Real Test Year Attributed Cost per Piece	Average Annual % Change in Real Attributed Cost per Piece
R80-1	237,720	465,774	1.000	465,774	1.96	
R84-1	296,017	462,436	0.831	384,284	1.30	- 8.4
R87-1	394,781	712,925	0.768	547,526	1.39	2.3
R90-1	518,458	1,002,899	0.683	684,980	1.32	- 1.7
R94-1	762,115	1,401,597	0.622	871,793	1.14	- 3.4
R97-1	1,058,687	2,419,687	0.591	1,430,035	1.35	6.1
R2000-1	1,070,173	3,288,724	0.563	1,851,552	1.73	9.4

- The conversion factor is the ratio of the GDP Implicit Price Deflator in the first quarter of calendar year 1981 to the Deflator in the first quarter of the calendar year following the year of the rate case (e.g., 1998 for R97-1). The Deflators for 1981, 1985, 1988, 1991, 1995, 1998, and 2001 are 60.66, 73.00, 78.98, 88.76, 97.45, 102.62, and 107.76, respectively.
- \*\* Real test year attributed cost is the product of test year attributed cost and the relevant conversion factor.

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**USPS/UPS-T6-40.** Refer to Docket No. R97-1, PRC Lib Ref - 12 at page 22.

- a. Confirm that the Postal Rate Commission's estimated Priority Mail volume in the Test Year After Rates are reduced by 107,352 (000) pieces as a result of the recommended classification change increasing the maximum weight for First-Class Mail from 11 ounces to 13 ounces. If not confirmed, please explain fully.
- b. Confirm that the Postal Rate Commission's estimated Priority Mail costs in the Test Year After Rates are reduced by \$190,238.7 (000) as a result of the recommended classification change increasing the maximum weight for First-Class Mail from 11 ounces to 13 ounces. If not confirmed, please explain fully.
- c. Confirm that the Postal Rate Commission's estimated Priority Mail revenues in the Test Year After Rates are reduced by \$353,526.4 (000) as a result of the recommended classification change increasing the maximum weight for First-Class Mail from 11 ounces to 13 ounces. If not confirmed, please explain fully.
- d. Do you agree that the change in Priority Mail cost per piece in your Table 6 from the Docket No. R94-1 test year to the Docket No. R97-1 test year, in part, reflects the PRC Docket No. R97-1 recommended change in the maximum weight for First-Class Mail from 11 ounces to 13 ounces? If not please explain fully.

**Response to USPS/UPS-T6-40.**

- (a) - (c) Confirmed.
- (d) Yes.

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**USPS/UPS-T6-41.** Please refer to page 9 of your testimony, where you assert that own-price elasticity of demand is "an imperfect measure of value in part because demand is influenced by many factors other than price." Please confirm that the estimates of own-price elasticity of demand utilized in postal ratemaking are derived from statistical procedures which are explicitly designed to take account of and control for the factors other than price which influence changes in demand. If you cannot confirm, please explain fully.

**Response to USPS/UPS-T6-41.**

Although I have not thoroughly studied the procedures the Postal Service uses to measure own-price elasticity, they appear to be designed with the intent to control for factors other than price which influence changes in demand. However, the fact that determinants of demand other than own price are held constant when estimating an own-price elasticity does not imply that own-price elasticities measure value perfectly. As I explain on page 9 of my testimony, even if volume declines substantially when the price of a service is increased, customers may value the service highly. The reduction in volume may arise because the price increase forces customers with limited economic resources to reduce their use of the service, even though they cherish the service dearly.

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**USPS/UPS-T6-42.** Please refer to the following passage from page 9 of your testimony:

Therefore, even if the demand for a service declines substantially as its price increases, customers may value the service highly. To illustrate this fact, notice that a price increase may force customers with limited wealth to reduce their usage of a service substantially even though they cherish the service dearly.

- a. Please confirm that if customers are faced with comparable price increases in all of the postal services they use, the services of which they reduce their usage most substantially are the ones that they cherish least dearly. If you do not confirm, please explain fully.
- b. Please confirm that to whatever extent demand for a service declines as its price increases, customers who are no longer purchasing the service value the services or products they consume instead more than they value the service that they have chosen to forgo. If you do not confirm, please explain fully.
- c. When you used the term "may" in the first of the above quoted sentences, did you more nearly mean to imply that customers "are likely to" value the service highly, or that customers "conceivably might" value the service highly? Please explain.
- d. If "the demand for a service declines substantially as its price increases," the reported own-price elasticity for that service will be relatively high. Of the postal services with relatively high own-price elasticities (see USPS-T-41 at page 11 for the own-price elasticity for each subclass), which do you believe have such relatively high price elasticities because "customers with limited wealth" have been forced to reduce



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their usage substantially "even though they cherish the service dearly." Please explain the basis for your answer fully.

**Response to USPS/UPS-T6-42.**

(a) Not confirmed. Mailers do not necessarily reduce their usage of the services that they value least highly as the prices charged for postal services rise. To illustrate this fact, consider the following example.

Suppose that a mailer has one indivisible item to send, and that she has \$10 to spend on postal services. The mailer places a monetary value of \$100 on service A and a monetary value of \$50 on service B. (The higher monetary value that she places on service A may arise because service A provides faster delivery, for example.) Initially, the price of service A is \$10 and the price of service B is \$5. At these prices, the mailer sends her item via service A, and derives a net monetary value of \$90 from doing so (as opposed to the net monetary value of \$45 she would have derived from sending the item via service B).

Now suppose that the price of each service rises by 20%, so that service A now costs \$12 and service B now costs \$6. The mailer can no longer afford the service she values most highly, service A. Consequently, she decreases (to zero) her use of the most preferred service (A) and increases her use of the less-preferred service (B).

This simple example helps to illustrate and explain the more general fact that mailers do not necessarily reduce their usage of the services that they value least highly as the prices charged for postal services rise.

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(b) Not confirmed. The example presented in part (a), above, illustrates the more general fact that when rate increases induce customers to switch services, they do not necessarily value the service they consume more than the service they chose to forego. In the example, the mailer places a higher monetary valuation (\$100) and a higher net monetary valuation ( $\$88 = \$100 - \$12$ ) on service A than on service B. However, the combination of rate increases and financial constraints compel the mailer to purchase service B.

(c) The word "might" could reasonably be substituted for the word "may" in the sentence you cite. The word is not intended to suggest any empirical estimate (in contrast to the phrase "are likely to" that you suggest).

(d) I do not have the data that would allow one to identify the determinants of measured own-price elasticities. However, the testimonies of witnesses Smith (AISOP-T-1) and Horton (CRPA-T-2) suggest that financial considerations can force mailers to curtail their use of mail services that they value highly.

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**USPS/UPS-T6-43.** Is it your testimony as an economist that an adequate evaluation of the value of a service can exclude all consideration of the presence or absence of effective competition for that service? If not, please explain the exact relationship that exists between value of service and the presence or absence of effective competition.

**Response to USPS/UPS-T6-43.**

I assume that you are asking whether it is possible to fully assess "the value of the mail service actually provided each class or type of mail service" as directed by 39 U.S.C. § 3622(b)(2) without considering the presence or absence of competitive alternatives.

There are at least two plausible interpretations of the term "value of service": gross value of service and net or incremental value of service. The gross value derived from a service is the value the service provides in isolation, independent of the value provided by other services. The net or incremental value of service is the additional value that a service provides above and beyond the value provided by the next-best alternative.

To illustrate the distinction between gross value of service and incremental value of service, suppose there are only two mail services, labeled A and B. Suppose further that the value of a service can be measured accurately by willingness to pay for the service. In addition, suppose an individual would be willing to pay \$10 for mail service A if that service were the only means of sending mail. Also suppose the individual would be willing to pay \$8 for mail service B if it were the only mail service available. In this

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simple setting, the individual assigns a gross value of \$10 to service A and a gross value of \$8 to service B. Each of these (gross) valuations is derived without considering the value of alternatives. In contrast, the individual in this setting assigns an incremental value of \$2 ( $= \$10 - \$8$ ) to service A, and an incremental value of  $-\$2$  ( $= \$8 - \$10$ ) to service B. Each of these (incremental) valuations is derived by considering the value of a service relative to the value of the alternative service.

Problems can arise if one relies exclusively on either the gross or the incremental measures of service value to set prices for postal services in order to reflect value of service. Exclusive use of the gross value of service can promote a pricing structure that allows competitors with higher costs than the Postal Service to serve customers by setting prices below the relatively high prices that are established for services with a high gross value of service. When customers are served by competitors rather than the Postal Service, the Postal Service loses some potential contribution to institutional costs, and so rates for users of monopoly postal services may have to be increased.

Exclusive use of the incremental value of service, in contrast, can protect the Postal Service unduly from competition and thereby discourage innovation and entry in the postal industry. When competitors improve their products, the incremental value of products offered by the Postal Service declines, *ceteris paribus*. Therefore, if Postal Service prices are allowed to decline toward incremental cost as competitors improve their services, three undesirable effects can arise. First, competitors may be discouraged from improving their services. Second, the Postal Service may be encouraged to choose an inefficient production technology that secures low incremental

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costs on competitive services at the expense of incurring higher institutional costs (as explained on page 11 of my testimony). Third, more efficient competitors may be driven from the market or may produce less than they otherwise would, thereby increasing industry costs and reducing customer welfare.

More efficient competitors may be driven from the industry or otherwise harmed even when Postal Service rates exceed measured attributable costs and even when the Postal Service has not adopted a production technology with inefficiently low incremental costs of providing competitive services and inefficiently high institutional costs. There are at least two reasons for this conclusion. First, as explained on pages 15-17 of my testimony, attributable costs, as measured in these proceedings, systematically understate incremental costs whenever unit volume variable cost (i.e., marginal cost) declines as output expands. Therefore, even if the price of a Postal Service product exceeds its per unit attributable cost, the price may still be below the relevant per unit incremental cost. Such a price can make it unprofitable for a more efficient competitor to operate, because even though the competitor's incremental cost may be less than the Postal Service's incremental cost, the competitor's incremental cost may exceed the Postal Service's attributable cost, and thus the price set for the Postal Service's product.

Second, as explained in footnote 14 of my testimony on page 14, the Postal Service enjoys many artificial advantages over its competitors because of its status as a public enterprise. The Postal Service is exempt from many of the taxes, fees, and regulations that its competitors face. The Postal Service also enjoys privileged access

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to the United States Treasury and is not compelled to deliver dividends and capital gains to shareholders. Consequently, the Postal Service may face lower incremental costs than its competitors not because it is a more efficient producer, but because it is not required to incur and record the costs that its competitors must.

In summary, there are potential drawbacks to focusing exclusively on either the gross or the incremental value of service when attempting to assess "the value of the mail service actually provided each class or type of mail service" as directed by 39 U.S.C. § 3622(b)(2). Consequently, it is advisable to consider both the gross and the incremental value of service.

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**USPS/UPS-T6-44.** Is it your testimony as an economist that an adequate evaluation of the value of a service can exclude all consideration of the responsiveness of the demand for the service to changes in the price of the service, whether measured by own-price elasticity of demand or in some other fashion? If not, please explain the exact relationship that exists between value of service and the responsiveness of the demand for the service to changes in its price.

**Response to USPS/UPS-T6-44.**

Use of the term "exact relationship" suggests that there is a systematic, general relationship between value of service and own-price elasticity of demand. That is not the case. A higher own-price elasticity can be associated with either a higher or a lower value of service. The example presented in my response to USPS/UPS-T6-42 can help to explain why this is the case. In that example, use of the most highly-valued service declines sharply as its price increases. Therefore, a high (gross) value of service is associated with a high own-price elasticity in that example. More generally, consumers may judge a service to provide little (gross or incremental) value, and so may reduce their use of the service substantially as its price increases. In such cases, low value of service is associated with a high own-price elasticity.

Using the own-price elasticity as a measure of value of service in order to fulfill the directive of 39 U.S.C. § 3622(b)(2) introduces a further complication (in addition to the complications identified in my response to USPS/UPS-T6-43). The further complication is a circularity in the rate-setting process. 39 U.S.C. § 3622(b)(2) directs

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that value of service be considered when formulating a rate recommendation. In general, the own-price elasticity of demand for a service varies as the price of the service varies. Therefore, if the own-price elasticity is used to measure the value of a service, the price that is ultimately set for the service will influence its measured "value" (i.e., the own-price elasticity of demand). Consequently, when own-price elasticity is employed as a proxy for value of service, the price that is established for a service can (at least in part) determine its value, rather than (or in addition to) having the value of service determine the appropriate price, as 39 U.S.C. § 3622(b)(2) directs. At a minimum, this circularity complicates the rate design exercise.

Despite the many difficulties that it introduces, the own-price elasticity may provide some information about service value, and so should not be ignored when attempting to assess value of service in accordance with the directives of 39 U.S.C. § 3622(b)(2). However, if the own-price elasticity is used for this purpose, it should be considered as only one of many potential indicators of service value. Furthermore, the drawbacks and complications inherent in the use of the own-price elasticity as an imperfect indicator of service value should be explicitly recognized, and always kept in mind.



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**USPS/UPS-T6-45.** Please refer to page 10 of your testimony, where you caution against protecting the Postal Service from "effective competition."

(a) Do you believe that the Commission should be concerned about protecting the Postal Service from ineffective competition, where ineffective competition is defined as a situation in which the Postal Service is the low-cost provider of service, but imposition of a share of institutional costs above a certain level may allow higher-cost providers to undersell the Postal Service and deprive the Postal Service's remaining customers of the contribution to institutional costs that could otherwise be obtained and used to lower their rates? Please explain fully.

(b) Do you believe that the Commission, in determining what share of institutional costs is reasonable for any particular service, should attempt to take into consideration the possibility that imposition of a share of institutional costs above a certain level may facilitate ineffective competition, as defined in subpart (a)? Please explain fully.

(c) Do you believe that concerns about ineffective competition as defined above could appropriately cause the Commission to decide that a lower share of institutional costs for a particular subclass is reasonable under the criteria of the Act than might otherwise be the case in the absence of such concerns? Please explain fully.

**Response to USPS/UPS-T6-45.**

(a) This question is difficult to answer because the term "low-cost provider" is not defined. In the present context, it matters whether the Postal Service has lower costs than competitors because of the artificial advantages it enjoys due to its status as

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a public enterprise. (Please see footnote 14 on page 14 of my testimony.) If, after eliminating the Postal Service's artificial advantages, it has lower costs than its competitors, then, as indicated in my answer to USPS/UPS-T6-43, the Commission should (and, I am sure, does) consider the possible loss of contribution that may occur when Postal Service rates are increased.

Note, however, that higher rates do not necessarily translate into lower contribution. Higher rates can increase revenues and reduce costs, and thereby increase contribution.

(b) As explained in my answer to part (a), I believe that the Commission should be (and, I am sure, is) concerned about securing contribution from competitive services in order to keep First Class Mail rates low. If the best available evidence suggests that a proposed rate increase for a competitive product offered by the Postal Service would reduce the contribution secured from that product, then I would advise the Commission to weigh this drawback of the rate increase against the potential countervailing benefits it identifies as it considers all of the criteria specified in 39 U.S.C. § 3622(b).

(c) Please see my answer to part (b), above.

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**USPS/UPS-T6-46.** Please refer to the following passage from pages 9-10 of your testimony:

The volume of a particular service supplied by the Postal Service may decline substantially as the rate charged for the service increases if mailers can secure comparable services from competing suppliers at reasonable cost. When mailers have ready access to reasonable alternatives, they can protect themselves from the adverse consequences of rate increases on services supplied by the Postal Service. Therefore, they have less need of protection from the Commission than do mailers who use a monopoly service.

- a. Please confirm that when alternatives exist, mailers who choose the Postal Service value its service at its current rate more than they value the service offered by the alternative at the rate charged by the alternative. If you do not confirm, please explain fully.
- b. Please confirm that when postal rates increase and some mailers in response switch to an alternative service provider, they would be harmed in the sense that they would now be purchasing a service that they value less than the mail service they were purchasing previously. If you do not confirm, please explain fully.
- c. Please confirm that if the Postal Service's volume of a competitive product were to decline substantially in response to a price increase, this suggests that there may be many mailers suffering the harm described in subpart b. If you do not confirm, please explain fully.

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- d. Please confirm that minimizing to the extent possible the potential harm (as identified in subparts b. and c.) of rate increases on mailers with alternatives is worthy of the Commission's efforts in the exact same sense that minimizing to the extent possible the potential harm of rate increases on "monopoly service" mailers is worthy of the Commission's efforts. If you do not confirm, please explain fully.
- e. Please confirm that harm to "monopoly service" mailers of a rate increase may be relatively modest if many of such mailers value the service by a substantial amount more than they are currently paying for it (perhaps as a result of the rate restraint resulting from prior ratemaking proceedings). If you do not confirm, please explain fully.

**Response to USPS/UPS-T6-46.**

(a) Confirmed that when a mailer who can afford both products chooses a Postal Service product rather than a product offered by a competitor, the mailer has revealed a preference for the Postal Service product.

(b) Confirmed that when postal rates increase, even mailers that switch to alternative service providers will generally be worse off than they were before the rate increase. It is possible, though, that as a result of the switch to a new provider, a mailer may purchase a product that provides a higher gross value of service. (Please see my response to USPS/UPS-T6-43). The mailer may do so because the postal rate increase causes the alternative service with the higher gross value to become relatively less expensive. Also notice that mailers who switch to an alternative service, unlike

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mailers who do not switch, do not necessarily bear the full impact of the rate increase.

To illustrate the point, consider the following example.

Suppose there are two mailers, labeled 1 and 2, two Postal Service products, labeled A and B, and one service offered by a competitor, labeled C. Product A is a monopoly service. Products B and C are competing services. The mailers require only the use of one service, one time. Each mailer places a monetary value of \$2.00 on use of the monopoly service, A. Mailer 1 places a monetary value of \$3.00 on the use of each of services B and C. Mailer 2 places a monetary value of \$4.25 on use of Postal Service product B and \$4.20 on the use of the competitor's product, C. Initially, the price of service A is \$1.00 and the prices of services B and C are each \$3.00.

Given these prices and monetary valuations, mailer 1 will use the monopoly service A, since her net return from doing so is \$1.00 ( $= \$2.00 - \$1.00$ ), which exceeds her net return ( $= \$3.00 - \$3.00 = \$0.00$ ) from using either service B or service C. Mailer 2 will use Postal Service product B, since his net return from doing so is \$1.25, which exceeds his net return from purchasing service C ( $\$4.20 - \$3.00 = \$1.20$ ) or from purchasing service A ( $\$2.00 - \$1.00 = \$1.00$ ).

Now suppose that the price of services A and B each increase by 10% and the price of service C does not change. Thus, service A now costs \$1.10, service B costs \$3.30, and service C costs \$3.00. Mailer 1 will continue to purchase the monopoly service, although her net return from doing so falls from \$1.00 to \$.90. Thus, the net return of the user of the monopoly service falls by the full amount of the rate increase. Mailer 2 will now purchase the competing product, C, and derive a net return of \$1.20 ( $=$

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\$4.20 - \$3.00) from doing so. Mailer 2's return is reduced because of the rate increase, but the reduction is smaller than the amount of the rate increase. Indeed, the reduction in Mailer 2's net return is only \$0.05, which is less than the reduction in Mailer 1's net return, despite a larger nominal rate increase on Postal Service product B than on Postal Service product A.

This example illustrates the more general common sense point that customers of competitive Postal Service products may be better able than captive monopoly customers to protect themselves against the adverse impact of rate increases on Postal Service products.

(c) Confirmed that a substantial decline in volume of a competitive Postal Service product could suggest that many mailers are suffering some harm. However, as illustrated in my answer to part (b), above, the harm suffered by each mailer with competitive alternatives can be small relative to the magnitude of the rate increase.

(d) I do not know how to interpret your phrase "in the exact same sense." However, confirmed that the Commission should be (and, I am sure, is) concerned with the welfare of all mailers. Also, note that the Postal Reorganization Act exhibits special concern for mailers who use monopoly services as opposed to mailers with alternatives, indicating that those mailers should receive special consideration.

(e) This question suggests a ratemaking philosophy of charging "whatever the traffic will bear," which is not consistent with 39 U.S.C. § 3622(b). In any event, I cannot confirm your assertion, in part because the terms "harm" and "relatively modest" are not defined. Furthermore, the nature of the rate increase you consider is not specified. It is

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certainly the case that the harm from a rate increase can be "relatively modest" if the rate increase is "relatively modest." But I assume this conclusion was not the intent of your question.

The extent of the harm that a rate increase imposes on mailers who use a monopoly service is not necessarily low merely because the mailers value the monopoly service highly. These mailers, like all mailers that do not alter their usage of the mail service in response to the rate increase, bear the full impact of the rate increase.

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**USPS/UPS-T6-47.** Please refer to the following passage from pages 9-10 of your testimony:

The volume of a particular service supplied by the Postal Service may decline substantially as the rate charged for the service increases if mailers can secure comparable services from competing suppliers at reasonable cost. When mailers have ready access to reasonable alternatives, they can protect themselves from the adverse consequences of rate increases on services supplied by the Postal Service. Therefore, they have less need of protection from the Commission than do mailers who use a monopoly service.

- a. Please confirm that if postal rate increases for a competitive product drive customers to competitors to such an extent that the contribution from the product (total revenue minus total cost) declines, mailers of that product may be able to "protect themselves" by leaving the postal system, but mailers who use services for which no alternative is available do not have that option and are left paying increased rates to cover the lost contribution. If you do not confirm, please explain fully.
- b. Please confirm that under the hypothetical scenario described in subpart a., previous mailers of the competitive product who leave the postal system are worse off because they are paying more and/or no longer getting their first choice in service, mailers of the competitive product who stay with the product are worse off because they are paying higher rates and/or mailing fewer units, mailers of all other mail products are worse off because they must pay higher rates to recover the lost contribution, and the only ones better off are the competitors. If you do not confirm, please explain fully.



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c. Please confirm that the approach you are advocating to pricing offers the Commission no ability to protect against the risk of raising prices for competitive products to an extent that causes the situation described in subparts a. and b. If you do not confirm, please explain fully.

**Response to USPS/UPS-T6-47.**

(a) Confirmed that the situation you describe is a possibility, although certainly not an inevitable outcome. The rate increases needed to restore the contribution that is lost from one competitive service could, in principle, be implemented on other competitive services. The rate increases need not be imposed entirely on captive customers.

(b) Not confirmed. There are many parties that can benefit when increased rates induce Postal Service customers to switch to alternative suppliers. Society as a whole can benefit if competing suppliers operate more efficiently than does the Postal Service. When service is provided by the most efficient (i.e., least-cost) supplier, fewer resources are consumed in producing the nation's outputs. Consequently, more resources are available for other productive uses.

The country's citizens also benefit when increased demand for competitors' services causes their earnings to rise. In contrast to the Postal Service, private enterprises pay corporate profit taxes. Consequently, higher earnings for private competitors lead to increased tax revenues, which enable the government to deliver a variety of benefits to many citizens. The prospect of enhanced earnings can also

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stimulate greater innovation in the delivery industry, which can further benefit consumers.

The threat of losing valued customers to competitors can also motivate the Postal Service to reduce its operating costs. Lower operating costs, in turn, can lead to lower rates for all Postal Service customers, including those with limited access to competitive alternatives.

(c) Not confirmed. As I explain in detail in my answer to USPS/UPS-T-6-43, the Commission should be (and, I am sure, is) concerned with securing contribution from competitive Postal Service products in order to limit the rate increases imposed on First Class Mail users.

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**USPS/UPS-T6-48.**

- a. In your view, should the Commission try to protect competitors, or protect competition? Please explain fully.
- b. Please confirm that, in general, competition is protected when prices are set so that the low-cost service provider is able to charge the lowest prices. If you do not confirm, please explain fully.
- c. In recommending rates, do you think that the Commission should take into account the fact that the Postal Service has a universal service obligation and charges uniform prices established in protracted ratemaking proceedings, while its competitors can pick which portions of a market they wish to serve, may change their published prices virtually unilaterally and immediately, and may negotiate different rates for different customers? If so, how should these factors be taken into account? If not, why not?

**Response to USPS/UPS-T6-48.**

(a) In my view, the Commission should follow the directives of the Postal Reorganization Act in formulating its rate recommendations. These directives include specific requirements that help to protect competition (as opposed to particular competitors). In particular, § 3622(b)(3) of the Act requires 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." As I explain in my testimony on pages 12-18, this requirement

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helps to ensure that the Postal Service does not hinder competition by disadvantaging actual or potential competitors unfairly.

(b) I cannot confirm this assertion without precise definitions of the terms "in general," "protected," and "low-cost service provider." As I explain in my answer to USPS/UPS-T6-45, any attempt to manage or protect competition between the Postal Service and alternative providers of delivery services is complicated by the Postal Service's monopoly on letter mail, its status as a public enterprise, and the associated advantages it enjoys over its competitors. Even when the Postal Service enjoys lower accounting costs than its competitors, the full costs caused by Postal Service operations may exceed the corresponding costs of competitors.

For example, I am advised that the Postal Service does not pay property taxes on the buildings and equipment it owns, nor does it pay license and registration fees for its motor vehicles. The Postal Service is also able to borrow funds from the United States Treasury at favorable rates. Because of these advantages, the Postal Service may have lower accounting costs than its competitors, even though its operating costs would exceed the costs of its competitors if it faced the same constraints that they face. Under such circumstances, the enterprise with the lowest accounting costs is not the most efficient producer. Consequently, a policy designed to ensure that the firm with the lowest accounting costs is able to charge the lowest prices is not always in the best interests of society.

(c) Like the advantages the Postal Service enjoys, any disadvantages it faces merit consideration when setting rates. Some of the potential disadvantages you cite

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are likely reflected in the own-price elasticities of demand for Postal Service products. Therefore, to the extent that smaller rate increases are established for services with higher own-price elasticities, *ceteris paribus*, the potential disadvantages you cite would seem to be taken into account.

Notice also that although the Postal Service's universal service obligation increases its total operating costs, it may lower its incremental cost of providing competitive services. Because it has a ubiquitous network for delivering letters, the Postal Service can deliver non-letter mail at relatively low incremental cost. The Postal Service's ability to share the institutional costs of a ubiquitous delivery network between competitive services and monopoly services provides the Postal Service with another advantage over its competitors.

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**USPS/UPS-T6-49.**

- a. Please confirm that a postal service with a relatively high own price elasticity could experience sustained volume and revenue growth over a period of years. If you do not confirm, please explain fully.
- b. Please confirm that a postal service with a relatively low own price elasticity could experience sustained volume and revenue growth over a period of years. If you do not confirm, please explain fully.
- c. Please confirm that a postal service with a relatively high own price elasticity could maintain a large market share. If you do not confirm, please explain fully.
- d. Please confirm that a postal service with a relatively low own price elasticity could maintain a large market share. If you do not confirm, please explain fully.
- e. Please confirm that a postal service with a relatively high own price elasticity could offer enhanced service features. If you do not confirm, please explain fully.
- f. Please confirm that a postal service with a relatively low own price elasticity could offer enhanced service features. If you do not confirm, please explain fully.
- g. Please confirm that the only indicator designed to suggest whether a postal service can sustain a significant rate increase is the price elasticity of demand. If you do not confirm, please explain fully.

**Response to USPS/UPS-T6-49.**

(a)-(f) Confirmed.

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(g) Not confirmed. The own-price elasticity of demand measures the rate at which the volume of a service declines as its price increases, holding all other relevant factors constant. In order to determine whether a Postal Service product can "sustain a significant rate increase," one should consider all of these other factors. For instance, one should consider how rapidly market demand for relevant delivery services is increasing, and whether the Postal Service product will include new features (e.g., Delivery Confirmation) in the future. Only by considering all relevant factors, and not simply the own-price elasticity in isolation, can one assess whether a Postal Service product is likely to be able to sustain a significant rate increase.

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**USPS/UPS-T6-50.** Please refer to the section of your testimony, "Ramsey Pricing in Disguise," at pages 11-12.

a. Please confirm that full-blown application of Ramsey pricing would result in markups and cost coverages based exclusively on the results of the Ramsey model, and no other factors would be considered. If you do not confirm, please explain fully.

b. Is it your testimony that the full-blown Ramsey pricing process described in subpart a. would be essentially the same as a pricing process in which own price elasticities are considered indicative of value of service as part of the application of criterion 2, and criterion 2 is judgmentally balanced in conjunction with all of the other criteria of the Act in order to determine appropriate markups and cost coverages? Please explain fully.

c. With respect to the Ramsey pricing testimony of Postal Service witness Bernstein, please confirm the following, or explain fully:

(i) Because of various additional constraints that he imposes, the markups presented by witness Bernstein are "Ramsey-based" rather than "pure Ramsey" (see USPS-T-41 at page 7, line 22, through page 8, line 2).

(ii) The Postal Service has not proposed that the Commission recommend rates to meet the markups and cost coverages underlying Mr. Bernstein's "Ramsey-based" prices.

(iii) The markups and cost coverages actually proposed by Postal Service witness Mayes (USPS-T-32) vary significantly even from the "Ramsey-based" cost coverages and markups presented by Mr. Bernstein.



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**Response to USPS/UPS-T6-50.**

(a) I do not understand this question, since the term "full-blown application of Ramsey pricing" is not defined. If, by this term, you mean setting "markups and cost coverages based exclusively on the results of the Ramsey model, and no other factors would be considered," then the assertion is tautological.

(b) No, assuming that "full-blown Ramsey pricing" is as defined in my answer to part (a) of this interrogatory. Explicit consideration of factors such as fairness, equity, simplicity, and the educational, cultural, scientific, and informational value of mail should lead to prices that differ from Ramsey prices.

(c)(i) Confirmed.

(ii) Confirmed.

(iii) Confirmed that the markups and cost coverages proposed by witness Mayes differ from the markups and cost coverages presented by witness Bernstein.

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**USPS/UPS-T6-51.** Please refer to page 10 of your testimony, where you refer to mailers that "can secure comparable services from competing suppliers at reasonable costs."

- a. Would you agree that the importance of services being "comparable" is that they are capable of meeting the same needs of the mailer, rather than that they closely mimic the same physical processes? Please explain your answer fully.
- b. Setting aside for this specific question issues of "reasonable costs," would you agree that almost all, if not all, mailers can obtain "comparable" services of some sort? Please explain any answer other than an unqualified affirmative, and provide specific examples.
- c. What standards would you apply to distinguish between mailers for whom comparable services are available at reasonable costs, versus mailers for whom comparable services are available, but only at unreasonable costs? Please explain fully.
- d. Would you agree that within any subclass of mail, different mailers are likely to vary substantially in their access to comparable services at reasonable costs? Please explain any answer other than an unqualified affirmative, and provide specific examples.
- e. In your mind, is there an unambiguous line between a set of subclasses of mail for which reasonable alternatives are readily available, and a set of subclasses for which they are not? Please explain your answer fully.

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- f. Please identify exactly which subclasses of mail are those for which you believe substantial increases in postal rates are appropriate because mailers have ready alternatives.
- g. Are all subclasses other than those you have identified in response to subpart f. equally entitled to protection from the Commission as "monopoly services"? Please explain any answer other than an unqualified affirmative, and provide specific examples.

**Response to USPS/UPS-T6-51.**

- (a) Yes.
- (b) No. For example, other delivery providers of advertising do not have access to the mailbox.
- (c) To distinguish mailers for whom comparable services are available at reasonable costs from other mailers, one would need to consider the needs and resources of the mailers as well as the features, performance, and rates of the available delivery services as well as any restraints on the alternative delivery providers. If the essential features and performance of available services are similar, and if the prices of available services are also similar, then mailers will have access to comparable services at reasonable costs. In contrast, if: (1) essential service features and performance are comparable or if mailers do not value highly the differences in service features, and (2) the prices of the available services are very different, then mailers who use the low-priced service will not have access to comparable services at reasonable cost.

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Consider, for example, individuals who send letters and for whom expedited delivery is not important. Because of the Postal Service's letter monopoly, these individuals can only secure alternative delivery of their letters by paying rates well above First Class Mail rates in order to secure expedited delivery, which they do not value highly. Such First Class Mail users are mailers who are unable to secure comparable services at reasonable costs.

(d) I have not studied mailer access to alternative delivery services in all mail subclasses, and so I do not have the data required to confirm or dispute your assertion. I suspect, however, that there is typically some variation in the ability of mailers within a subclass of mail to access comparable alternatives at reasonable cost.

(e) As my answer to part (c) of this interrogatory suggests, many senders of First Class letters and cards do not have access at reasonable cost to delivery services other than that provided by the Postal Service.

(f) I believe that the substantial rate increases I recommend for Priority Mail and Parcel Post are appropriate in part because mailers have available alternatives (39 U.S.C. § 3622(b)(5)). However, the rate increases I recommend reflect a balanced consideration of all of the criteria specified in 39 U.S.C. § 3622(b), and are driven largely by substantial increases in attributable costs.

(g) No. I have only studied the Priority Mail and Parcel Post subclasses in detail, but I know that there are other subclasses (such as Periodicals or library rate mail) that are not subject to the Postal Service's letter mail monopoly. The "monopoly services" that I refer to in my testimony are the letter services over which the Postal

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Service has a statutory monopoly. I cannot offer useful guidance regarding any de facto monopoly power that the Postal Service may have in other mail subclasses. In general, the "protection" that the Commission affords any mail subclass should be based on a balanced consideration of all the factors cited in 39 U.S.C. § 3622(b).

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**USPS/UPS-T6-52.** Please refer to the following passage from page 10 of your testimony:

When mailers have ready access to reasonable alternatives, they can protect themselves from the adverse consequences of rate increases on services supplied by the Postal Service.

- a. Please confirm that the ability of mailers with ready access to reasonable alternatives to "protect themselves" from postal rate increases may be substantially limited if competitors offering the "reasonable alternatives" use postal rates as an umbrella to their own rate offerings and can respond to postal rate increases with a comparable rate increase of their own. If you do not confirm, please explain fully.
- b. Of the subclasses for which you believe mailers have ready access to reasonable alternatives, for which should the Commission not be concerned about the inability of mailers to protect themselves from postal rate increases because of the ability of competitors to respond with their own rate increases. Please explain exactly what it is about the structure of the market which supports your conclusion for each subclass.

**Response to USPS/UPS-T6-52.**

(a) Not confirmed. It is true that the rates and service features of competitors affect the ability of Postal Service customers to protect themselves from rate increases. However, what is important from the perspective of these customers is not how competitors "can respond to postal rate increases" (emphasis added), as you suggest,

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but how competitors do respond to postal rate increases. Vigorous competition among firms other than the Postal Service can limit the ability and incentive of these firms to raise rates whether Postal Service rates increase or remain unchanged.

(b) It is always appropriate for the Commission to consider evidence that rate increases by competitors limit the ability of Postal Service customers to protect themselves from postal rate increases. The Postal Service provides some useful testimony in this regard. Witness Bernstein states that "both Federal Express and UPS operate in competitive markets with free entry," and that "private firms operating in competitive markets with free entry can be expected to be pricing at marginal cost" (USPS-T-41, pp. 45-46). Witness Musgrave points out in his analysis of Priority Mail that "the expedited delivery market continues to be highly competitive" (USPS-T-8, p. 23). And witness Tolley notes that United Parcel Service's share of the ground parcel market declined from 86.2 to 75.5 percent between 1992 and 1998, while RPS and the Postal Service more than doubled their combined share of this market (USPS-T-6, p. 158).

1 CHAIRMAN GLEIMAN: Is there additional written  
2 cross examination for this witness? Mr. May?

3 MR. MAY: Yes, Mr. Chairman.

4 CROSS EXAMINATION

5 MR. MAY: Yesterday UPS filed responses to  
6 follow-up interrogatories of Parcel Shippers and we request  
7 that the following responses be designated: Parcel Shippers  
8 Association Interrogatories to UPS Witness Sappington T6,  
9 Answers 13, 14, 16A, 17A, and 17C, 18, 19, and 20.

10 I have two copies of those responses and I will  
11 show them to the witness.

12 CHAIRMAN GLEIMAN: Dr. Sappington, if those  
13 questions were asked of you today, would your answers be the  
14 same as those you provided just yesterday in writing?

15 THE WITNESS: Yes, they would.

16 CHAIRMAN GLEIMAN: That being the case, Mr. May,  
17 if I could get your assistance, if you would provide two  
18 copies of that material to the court reporter I will direct  
19 that the material be received into evidence and transcribed  
20 into the record.

21 [Additional Designated Written  
22 Cross-Examination of David E.M.  
23 Sappington, PSA/UPS-T6-13,  
24 PSA/UPS-T6-14, PSA/UPS-T6-16A,  
25 PSA/UPS-T6-17A, PSA/UPS-T6-17C,



1 PSA/UPS-T6-18, PSA/UPS-T6-19, and  
2 PSA/UPS-T6-20 and Witness  
3 Sappington's Responses, were  
4 received into evidence and  
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**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.

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

**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.

**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.

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

**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.

(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.

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

**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.

(c) Confirmed.

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

**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.

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

**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

ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON  
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coverages will almost inevitably lead to volume, revenue, and earnings losses for those competitors.

1 CHAIRMAN GLEIMAN: Is there any other additional  
2 written cross examination? Mr. Koetting?

3 MR. KOETTING: Yes, Mr. Chairman.

4 CROSS EXAMINATION

5 BY MR. KOETTING:

6 Q Dr. Sappington, I am Eric Koetting on behalf of  
7 the Postal Service.

8 I am handing you a copy of responses filed  
9 yesterday to USPS/UPS-T-6, Numbers 53, 54, and 55.

10 Are you familiar with those responses?

11 A Yes, I am.

12 Q If I were to ask you those questions today would  
13 your answers be the same?

14 A Yes, they would.

15 MR. KOETTING: Mr. Chairman, I will hand two  
16 copies to the reporter and ask that they be transcribed and  
17 entered as further written cross examination of the Postal  
18 Service.

19 CHAIRMAN GLEIMAN: It is so ordered.

20 [Additional Designated Written  
21 Cross-Examination of David E.M.  
22 Sappington, USPS/UPS-T6-53,  
23 USPS/UPS-T6-54, and USPS/UPS-T6-55,  
24 and Witness Sappington's Responses,  
25 were received into evidence and

transcribed into the record.]

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ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON  
TO INTERROGATORY OF THE UNITED STATES POSTAL SERVICE

**USPS/UPS-T6-53.** Please refer to your response to USPS/UPS-T6-42, part b., in which, based on a hypothetical that you present in your response to part a. of the same question, you decline to confirm that customers who are no longer purchasing a service (after a price increase) value the service or products that they consume instead more than they value the service that they have chosen to forgo.

a. Please confirm that when funds are received, they are available to be spent (with rare exceptions such as food stamps) however a person chooses, and are not limited *a priori* to be spent on particular categories of expenditures such as transportation, housing, or postage. If you do not confirm, please explain fully.

b. Please confirm that when the mailer in your hypothetical is postulated to have only \$10 to spend on postal services, it is because she has chosen to allocate her remaining funds to other uses based on her assessment of what those other uses are worth to her. If you do not confirm, please explain fully.

c. Please confirm that given a choice of spending \$10 for one postal service that meets her needs (Service A), or spending \$5 for a different postal service (Service B) that apparently also meets her needs, but to a more limited extent, **plus \$5 for whatever else she wants to buy**, she would only choose to spend the \$10 for Service A if the value to her of the Service A were more than the value to her of Service B, **plus** the value of whatever goods or services she can obtain with the remaining \$5. If you do not confirm, please explain fully.

d. Please confirm that given a choice of spending \$12 for one postal service that she was purchasing previously (Service A), or spending \$6 for a different postal service

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(Service B) **plus \$6 for whatever else she wants to buy**, she would only choose not to spend the \$12 for the original postal service if the value to her of the Service A were less than the value to her of Service B, **plus** the value of whatever goods or services she can obtain with the remaining \$6. If you do not confirm, please explain fully.

e. Given that the gross value of Services A and B remain constant regardless of the price, please confirm that the rationality of your hypothetical is contingent upon this particular mailer placing a disproportionate value on the alternative application of the sixth dollar of the \$6 difference between the new prices of Services A and B (relative to the value of the alternative application of the previous \$5 difference between the old prices of Services A and B). If you do not confirm, please explain fully.

f. Please confirm that any attempt to generalize your hypothetical, to explain why a subclass with a high own price elasticity is nevertheless one which customers value highly, would be dependent upon customers in general (or at least a substantial portion of them) placing the same disproportionate value on the alternative application of the new rate differential as does the particular individual mailer you have posited in your hypothetical. If you do not confirm, please explain fully.

**Response to USPS/UPS-T6-53:**

(a) Confirmed that individuals typically have discretion in how they allocate personal income that is not required to meet basic, essential needs. However, the same is not always true of departments or divisions in a business unit. Corporations often assign annual budgets to departments that limit spending on each of many

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different resources, such as travel, equipment, and mailing services. The head of the department or the person in charge of postal matters for the department in this setting might face the type of fixed budget for postal services that I describe in my response to USPS/UPS-T6-42.

(b) Confirmed that when a mailer has discretion to allocate funds across different uses, she will consider the value she derives from all such uses when deciding how to spend the funds. Notice, however, that in the setting described in my response to part (a), above, the person in charge of postal matters in the department of the corporation places little or no value on non-postal services, because she is not permitted to spend on other services funds that are designated for postal services.

(c) Confirmed, for the case of the individual (household) mailer that you have in mind. Note, however, that in the setting described in my response to part (a), above, the person in charge of postal matters in the department of the corporation does not have the opportunity to spend any unused portion of the budget for postal services on "whatever else she wants to buy."

(d) Confirmed, although please see the qualification discussed in my response to part (c), above.

(e) Although I am not certain of the exact meaning of the phrase "placing a disproportionate value on the alternative application of the sixth dollar of the \$6 difference between the new prices of Services A and B," I believe I can confirm that the spirit of your statement is correct. The essence of the example that I describe in my response to USPS/UPS-T6-42 is the following: The mailer finds it particularly onerous



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to increase her overall expenditures on postal services above some level. Such hardship can arise because the mailer truly has a fixed budget, for example (as in the setting described in my response to part (a), above). Alternatively, the hardship can arise because additional expenditures on postal services necessitate a reduction in expenditures on other highly valued commodities, such as essentials like food, clothing, and shelter. By switching to a less expensive (and less highly valued) postal service, the mailer secures additional funds that can be employed to purchase other essentials.

(f) Confirmed that the simple logic explained in my answer to part (e), above, would likely continue to underlie any generalization of the example described in my response to USPS/UPS-T6-42.

ANSWER OF UNITED PARCEL SERVICE WITNESS SAPPINGTON  
TO INTERROGATORY OF THE UNITED STATES POSTAL SERVICE

**USPS/UPS-T6-54.** Please refer to the hypothetical presented in your response to USPS/UPS-T6-42, part a.

a. Please confirm that, in your hypothetical, the price of Services A and B both increase by 20 percent, the volume of Service A decreases, and the volume of Service B increases. If you do not confirm, please explain fully.

b. Please confirm that a necessary implication of your hypothetical is that, for this mailer, the cross-price elasticity of demand for Service B with respect to the price of Service A must exceed the own-price elasticity of demand for Service B. If you do not confirm, please explain fully.

**Response to USPS/UPS-T6-54.**

(a) Confirmed.

(b) Confirmed. Since the consumption of Service B increases while the consumption of Service A decreases when the price of Service A increases, the cross-price elasticity of demand for Service B with respect to the price of Service A is positive while the own-price elasticity of demand for Service A is negative. Therefore, the cross-price elasticity exceeds the own-price elasticity, as is always the case when the products in question are substitutes.

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TO INTERROGATORY OF THE UNITED STATES POSTAL SERVICE

**USPS/UPS-T6-55.** Please refer to the hypothetical presented in your response to USPS/UPS-T6-42, part a.

a. Please confirm that the context of the original question was to probe a portion of page 9 of your testimony in which you state that "a price increase may force customers with limited wealth to reduce their usage of a service substantially even though they cherish the service dearly."

b. Please confirm that, in your hypothetical, the mailer has the option of using a premium postal service for \$10, or a slower service for \$5. If you do not confirm, please explain fully.

c. Please confirm that, in reality, when less expensive options are available, persons with "limited wealth" are unlikely to use a premium postal service, and are therefore unlikely to be in a position to "cherish [such a] service dearly." If you do not confirm, please explain fully.

**Response to USPS/UPS-T6-55.**

(a) Confirmed.

(b) Confirmed.

(c) I can neither confirm nor refute your assertion, since I have not conducted a study of the spending habits of individuals with limited wealth.

1 CHAIRMAN GLEIMAN: Anyone else?

2 If not, that brings us to oral cross examination.

3 Four parties have requested oral cross examination  
4 of this witness: Amazon.com, Inc.; The Association of  
5 Priority Mail Users, Inc.; The Parcel Shippers Association;  
6 and the United States Postal Service.

7 Is there any other party that wishes to cross  
8 examine this witness?

9 If not, then Mr. Olson, you may begin.

10 CROSS EXAMINATION

11 BY MR. OLSON:

12 Q Dr. Sappington, my name is William Olson. I will  
13 be examining you for Amazon.com at the outset.

14 Let me ask you to turn to page 40 of your  
15 testimony.

16 A I have that.

17 Q Do you see at the end of line 10 you begin a  
18 sentence that says, "Parcel Post estimated attributable  
19 costs in the R97-1 test year were \$685.9 million."

20 Do you see that?

21 A Yes, I do.

22 Q And the footnote at the end of that sentence cites  
23 to the opinion and recommended decision of the Commission in  
24 Docket R97-1, correct?

25 A That is correct.

1 Q Do you recall offhand what the test year was in  
2 R97-1?

3 A I believe I have that. I'll check. Just a  
4 moment, please.

5 [Pause.]

6 THE WITNESS: Yes, it was Fiscal Year 1998.

7 BY MR. OLSON:

8 Q And Fiscal Year 1998 ended September 30, 1998, is  
9 that correct?

10 A I believe that is correct, yes.

11 Q And actual data on the attributable costs for  
12 Fiscal '98 have been available since the CRA was published  
13 some time in '99, correct?

14 A I believe so, yes.

15 Q And that was before your testimony was filed in  
16 May of this year?

17 A That sounds correct.

18 Q If you were doing an economic study and for some  
19 particular variable you had the choice of using an old,  
20 stale estimate or actual data, as an economist which choice  
21 would you consider preferable?

22 A I am not sure what you mean by "old, stale data".

23 Q Was the number 685.9 million an actual number or  
24 was that an estimate for Fiscal '98?

25 A I believe that was the estimate entered in R97-1.

1 Q Not the actual data for Fiscal '98, correct?

2 A That is correct.

3 Q Would you consider the actual data to be  
4 preferable to an estimate?

5 MR. MCKEEVER: Mr. Chairman, may I ask for what  
6 purpose?

7 BY MR. OLSON:

8 Q For the purpose of making the statement the  
9 witness made in his testimony. He is making a comparison  
10 here.

11 Let me put it this way. Again, if you were  
12 doing -- let me ask you generally -- if you were doing an  
13 economic study and for a particular variable you have the  
14 choice of using an estimate versus using actual data, as an  
15 economist which choice would you consider preferable.

16 A It would depend very much on the context and the  
17 purpose for which it was being used.

18 In the present purpose, for example, we are  
19 looking at estimates for the current test year and so it  
20 seems to me to be appropriate to compare the current  
21 estimate to a previous estimate.

22 Q So you wanted to compare estimates to estimates  
23 even though you knew the first estimate had been proven to  
24 be significantly at variance from actual Fiscal '98  
25 experience, correct?

1           A     That is the number I presented, but it wasn't as  
2 if I looked at the two numbers and said, well, this one  
3 doesn't serve my purpose and therefore I am using this one.

4           This was just one indication of the fact that  
5 Parcel Post attributable costs have increased from the past  
6 test year to the current test year.

7           Q     Well, it is an indication, is it not, that they  
8 have increased by the amount you say from the Commission's  
9 estimate of what they would be, but not an indication as to  
10 whether they have increased by the amount you said from what  
11 actually occurred.

12          A     That is correct.

13          Q     Okay, and in fact you had those numbers available  
14 to you.

15                I think at page 43 you include those numbers in  
16 your testimony, which you use for another purpose having to  
17 do with how predictions and actual numbers can vary  
18 significantly, correct?

19          A     That is correct, yes.

20          Q     Referring to lines 3 through 5, right?

21          A     Yes.

22          Q     And there you indicated that the actual number was  
23 840.0 million for attributable costs, is that correct?

24          A     That is correct.

25          Q     Now if you had used that actual Fiscal '98

1 attributable cost number of 840 million instead of the  
2 Postal Rate Commission's estimate, and I am going to ask you  
3 to look -- do you have your original testimony before you,  
4 made the errata that counsel just walked you through?

5 Your original page 40?

6 A No, I don't think I have that with me.

7 Q Okay. The two changes that made, as I understand  
8 it, were the number 41 percent in your current version used  
9 to be 31 percent, and further in that line 12, instead of  
10 965.5 million, the old number, if you could write this down,  
11 was 898.7 million. Would you -- does that sound familiar,  
12 or would you --

13 MR. McKEEVER: Mr. Chairman, I can confirm that  
14 those were the changes that were in fact made.

15 BY MR. OLSON:

16 Q Does that sound familiar then?

17 A Yes.

18 MR. OLSON: Okay.

19 MR. McKEEVER: The only change I would make is in  
20 the line number, it was line 11, not line 12.

21 BY MR. OLSON:

22 Q If you had used the actual fiscal year '98  
23 attributable costs of 840 million instead of the  
24 Commission's estimate, and you used your original estimate  
25 of 898.7 million for attributable cost in the current test



1 year, how much would you have shown as Parcel Post increase  
2 in attributable cost since R97-1?

3 MR. McKEEVER: Mr. Chairman, -- I apologize.

4 BY MR. OLSON:

5 Q Can you do the math on that, or is that -- or can  
6 I suggest an answer for you?

7 A Sure.

8 MR. McKEEVER: Mr. Chairman, I would like for it  
9 to be repeated. I thought I heard Mr. Olson say the  
10 Commission's estimate, but I may have misheard him. And  
11 obviously --

12 MR. OLSON: Yes, I said the Commission's estimate.

13 MR. McKEEVER: I don't know that the Commission  
14 has an estimate in this case for the test year in this case,  
15 unless I misheard the question and mixed it up.

16 CHAIRMAN GLEIMAN: Mr. Olson, why don't you please  
17 repeat the question.

18 MR. OLSON: Sure.

19 CHAIRMAN GLEIMAN: And that way perhaps we can all  
20 listen a little bit more carefully.

21 MR. OLSON: Sure. I don't want Mr. McKeever to  
22 get those backwards.

23 BY MR. OLSON:

24 Q Let me go ahead and say, if you had used the  
25 actual fiscal '98 attributable cost of \$840 million, instead

1 of the Postal Rate Commission's estimate of attributable  
2 cost for fiscal '98, and you used your original estimate of  
3 \$898.7 million for attributable cost in the current test  
4 year, not the Commission's estimate, Mr. McKeever, but your  
5 original estimate in your testimony of \$898.7 million for  
6 attributable cost in the current test year, what would that  
7 have shown for the increase in Parcel Post attributable cost  
8 since R97-1 to have been?

9 A I always tell my students when I teach to watch me  
10 very carefully when I try to add and subtract because I tend  
11 to make lots of mistakes in doing that, but I will try it  
12 here, and I believe the number is 58.7 million.

13 Q Well, it was the percentage, I am trying to get  
14 you to come up with a percentage that was comparable to what  
15 you used before. Let me suggest that the increase from 840  
16 to 898.7 million, according to my calculation, which is  
17 subject to check by everybody, is 7 percent. Does that  
18 sound about right?

19 A That does sound about right.

20 Q Okay. And if you had calculated an increase of  
21 only 7 percent in Parcel Post total attributable cost using  
22 those actual data for the base year, then, going back to  
23 your testimony here, lines 13 to 15, would it have been more  
24 accurate to say -- what you said there was this substantial  
25 increase in Parcel Post attributable cost necessitates a

1 substantial increase, correct?

2 A That is correct.

3 Q Okay. Would it have been more accurate then to  
4 have said this increase in Parcel Post attributable cost  
5 necessitates a commensurate increase in rates?

6 A No, not necessarily.

7 Q Why not?

8 A Because my recommendation does not track any  
9 particular measure of cost. The way my recommendation was  
10 formulated was looking at all of the relevant information  
11 and arriving at the decision that a 111 percent cost  
12 coverage was appropriate. And then given that cost  
13 coverage, we would need to figure out the rate increase  
14 required to achieve that cost coverage. And it is at that  
15 point that the nature of the actual cost becomes important  
16 or the estimated cost. And the real -- the difference  
17 between test year or actual and the current year is not  
18 terribly consequential at that point, it is more what are  
19 the estimates in the test year, and given those cost  
20 estimates, what is the rate increase need to achieve a 111  
21 percent cost coverage.

22 Q Well, let me go back to your testimony, and I  
23 failed to clarify with you that in line 14, where your  
24 current testimony says "substantial," it used to say  
25 "commensurate," "necessitates a commensurate increase in

1 rates." Do you see how that used to be worded?

2 A Yes, I recall that word.

3 Q Okay. So it used to say, "The substantial  
4 increase in Parcel Post attributable cost since R97-1  
5 necessitates a commensurate increase in rates." And that is  
6 when you thought the increase was 31 percent. And now that  
7 we have discussed that, looking at it another way, it was 7  
8 percent, I would just ask you if that language stands or if  
9 you thought your language was in error at the time?

10 A Well, partly in response to other interrogatories  
11 that you asked, I went back and reread the testimony, and I  
12 did want to make sure it was crystal clear, which is why I  
13 took that word "commensurate" out. And I did want to make  
14 absolutely clear that my rate recommendation is not in any  
15 way tracking any particular measure of cost, be they unit  
16 costs or total costs.

17 As I indicated, my rate recommendation is coming  
18 from the fact that I am recommending a 111 percent cost  
19 coverage and then, given the estimated cost, this is the  
20 rate increase required to achieve that coverage. But,  
21 again, I do want to emphasize, and, again, I thank you for  
22 helping me to clarify this through your interrogatories,  
23 that I am not recommending rates that track any particular  
24 measure of costs or cost change.

25 Q Okay. Just to clarify then, your change in your

1 opinion from when you wrote this testimony, because this  
2 testimony indicates a substantial increase in total  
3 attributable cost between R97 -- since R97-1 necessitated a  
4 commensurate increase. You are saying that is no longer  
5 your position, correct?

6 MR. MCKEEVER: Mr. Chairman, I am going to object  
7 to the characterization. The phrase "substantial," by the  
8 way, the word applies to the increase in rates, not to the  
9 increase in cost in that sentence.

10 MR. OLSON: Excuse me.

11 MR. MCKEEVER: Now, if Mr. Olson is questioning  
12 whether the increase in rates proposed for Parcel Post is  
13 not substantial, then he is, you know, he is free to do  
14 that. And if he would rather say it is commensurate -- but  
15 he did -- the word "substantial" applies to increase in  
16 rates in that sentence, Mr. Chairman, not as he indicated in  
17 cost.

18 MR. OLSON: Mr. Chairman, I believe that to be a  
19 mischaracterization of the testimony by counsel for UPS, and  
20 I would like to ask the witness if he agrees with his  
21 counsel's interpretation.

22 MR. MCKEEVER: Mr. Chairman, I didn't provide any  
23 interpretation, I read the language on page 40, line 14,  
24 which referred to a substantial increase in rates.

25 MR. OLSON: Mr. Chairman, may I read for the

1 record the sentence that counsel has mischaracterized.

2 CHAIRMAN GLEIMAN: Everybody take a deep breath.  
3 You may read it for the record, because you will read it for  
4 the record faster than I will pop it up on my screen and  
5 read it.

6 MR. OLSON: Okay. And let me make this as a  
7 question to Dr. Sappington.

8 BY MR. OLSON:

9 Q Does the sentence not say, in its original form,  
10 this substantial increase in Parcel Post attributable costs  
11 since R97-1 necessitates a commensurate increase in rates?

12 A I believe that is what it said when my testimony  
13 was originally filed.

14 Q Right. That is all I am asking at the moment. We  
15 will get on to what it now says. But counsel's  
16 representation that the words "substantial increase" had to  
17 do with rates is false, is it not

18 A Well, I think what Mr. McKeever was getting at --

19 CHAIRMAN GLEIMAN: Let's -- you know, Mr.  
20 McKeever's reading or interpretation, he raised an  
21 objection. You read the statement. I don't think that any  
22 purpose is served to further characterize how counsel put an  
23 objection.

24 MR. OLSON: I will withdraw that question.

25 CHAIRMAN GLEIMAN: So, if you would withdraw that

1 and move on, I would appreciate it.

2 MR. OLSON: Sure. I will withdraw that question.

3 BY MR. OLSON:

4 Q I can get on to dealing with the change in your  
5 view, and you had indicated that it was some of our  
6 interrogatories that might have helped you either change  
7 your view or clarify the way you expressed your view. So, I  
8 take it the reason -- let me just see if I can summarize  
9 this. The reason that you have no longer wanted to speak in  
10 terms of substantial increases in costs necessitating  
11 commensurate increases in rates, when we talk about total  
12 attributable cost, is that you no longer feel that total  
13 attributable cost increases of this sort would necessarily  
14 justify commensurate increases in rates?

15 A Two points. First, I do want to make clear that a  
16 few times I believe you mentioned my change in opinion or  
17 change in view. There is no change of opinion or change in  
18 view, it is changing the words to clarify what I was trying  
19 to say, because I inferred through your interrogatories that  
20 there may have been some confusion, and if I were the source  
21 of that confusion, I wanted to make sure I had cleared it  
22 up.

23 In answer to your question, the magnitude of cost  
24 changes, be they total costs or unit costs, will ultimately  
25 impact and affect the recommended rate increase. But the

1 manner in which it does so is the manner which I described a  
2 few moments ago, which is that I arrived at the conclusion  
3 that a 111 percent cost coverage was reasonable, and, given  
4 that cost coverage, I then had to check to see what rate  
5 increase was required to achieve that cost coverage, and  
6 because total costs had increased substantially, as had unit  
7 costs, to achieve that 111 percent cost coverage, a rate  
8 increase of 24.9 percent was required.

9 Q Right. Well, let's take a look. This is clearing  
10 up a related point having to do with sometimes you using the  
11 Commission's estimate and sometimes -- sometimes using the  
12 Commission's estimate. Let me ask you to look at your  
13 response to PSA-1.

14 A Okay.

15 Q Do you have that?

16 A Yes, I do.

17 Q Do you see in A that that was the number that was  
18 in the part of your response which is in parentheses, Parcel  
19 Post attributable costs were \$685.9 million in the R97-1  
20 test year.

21 You really don't mean to imply that \$685.9 million  
22 was the figure for actual attributable costs in Fiscal 98,  
23 do you?

24 A That was the number as estimated in R97-1.

25 Q Okay, so if you were to -- would you like to make



1 any revision to your response to the interrogatory? Do you  
2 think it's clear the way it stands?

3 [Pause.]

4 A Well, I believe it is clear, since it references  
5 the source.

6 Q And the source being Witness Luciani's testimony?

7 A Right, and I presume that he also then references  
8 the Commission's decision, Appendix G, Schedule I.

9 Q Okay. Would you look again at page 40 of your  
10 testimony, this time as corrected by your errata of June  
11 22nd, I think it was?

12 It now says Parcel Post estimated attributable  
13 costs in the current year are 41 percent higher at \$965.9  
14 million, correct?

15 A That's correct.

16 Q And the footnote still references -- or their  
17 references, again, Witness Luciani and his T-5 Table 8,  
18 correct?

19 A That is correct.

20 Q Okay, now, is this \$965.5 million figure a UPS  
21 estimate of attributable costs for Parcel Post?

22 A Yes, it is.

23 Q Was it prepared by you?

24 A No, that was prepared by Witness Luciani.

25 Q Okay, so it was prepared by him. Did you make any

1 effort to do your own estimate of test year attributable  
2 costs for Parcel Post?

3 A No, I did not. I relied on Witness Luciani's  
4 estimates.

5 Q Okay.

6 Since that -- and he was the only UPS witness that  
7 came up with such a number, correct?

8 A Yes.

9 Q Okay.

10 So if that \$965.5 million represents the official  
11 UPS estimate for Parcel Post total attributable costs in the  
12 test year in this docket, would it be reasonable to presume  
13 it incorporates all of the UPS recommended adjustments to  
14 attributable costs for Parcel Post?

15 A Yes, I believe it does.

16 Q And, again, looking at the revised page 40, with  
17 the revised numbers, if you were to use the actual figure  
18 for total attributable costs in Fiscal 98 of \$840 million,  
19 instead of the Commission's estimate which you used, or  
20 which you currently use, and you were to show the amount of  
21 the increase between that and the \$965.5 million UPS  
22 estimate of total attributable costs, would you accept,  
23 subject to check, that my calculations indicate that was a  
24 14.9 percent increase?

25 A Subject to check.

1 Q Okay.

2 And if the Commission were to decline to agree or  
3 accept -- agree with or accept some of the UPS proposed  
4 changes in Parcel Post attributable costs, then is it not  
5 true that the increase in total attributable costs over the  
6 actual base year attributable costs in Fiscal 97 would be  
7 less than 14.9 percent?

8 A Yes, I believe so.

9 Q Okay. So, stated another way, the 14.9 percent  
10 increase would be the maximum increase in total attributable  
11 costs for Parcel Post, using the actual data for the test  
12 year in R97?

13 A I don't think you can conclude that it's the  
14 maximum; it would depend upon what the Commission decides  
15 are the correct attributable costs for Parcel Post.

16 Q Well, if it were to -- I should have said under  
17 the UPS proposal, that would be the maximum increase in  
18 total attributable costs for Parcel Post, correct?

19 A I believe that's correct, yes, using the adjusted  
20 numbers that you have suggested.

21 Q Okay.

22 Can you turn to Amazon Number 6 to you?

23 [Pause.]

24 A Okay.

25 Q We asked you a question there about incremental

1 costs, and we're playing off some of the language there of  
2 page 11 of your testimony where you said the Postal Service  
3 can drive competitors from the market if it is permitted to  
4 reduce rates toward artificially low, in parens, incremental  
5 costs, whenever effective competition develops.

6 That was in your testimony, correct?

7 A That is correct.

8 Q And we asked you if you thought that the Postal  
9 Service's estimate of incremental costs was artificially  
10 low, and you gave a response on Section A, correct?

11 A That is correct.

12 Q And can I summarize what you said in Section A by  
13 saying that you thought there were a variety of costs that  
14 the Postal Service did not pay, did not incur, because of  
15 its status as a government agency, fines, fees, taxes?

16 A Yes, that's right.

17 Q Okay.

18 And is it your position that it would be a better  
19 way to calculate incremental costs if the Postal Service  
20 were to include an imputed amount for costs of those natures  
21 -- costs of the type you cite in your response to our  
22 interrogatory?

23 A At this point, at least, I believe that making  
24 imputations of that sort would be difficult, because trying  
25 to get a good estimate of the value of these advantages

1 might be difficult.

2           Therefore, I think probably the more appropriate  
3 way to proceed would be just to keep these advantages in  
4 mind when setting appropriate markups, and realizing that if  
5 you do reduce rates right down towards measured incremental  
6 costs, there is a serious risk of driving more efficient  
7 competitors from the marketplace.

8           Q     In a perfect world, if estimates of the imputed  
9 value of those benefits to the Postal Service because of its  
10 status as a government agency were available, you'd want to  
11 use those in determining incremental costs?

12          A     I'm not an expert in calculating incremental  
13 costs, so I wouldn't want to make a recommendation along  
14 those lines. I think it's just that the most important  
15 thing to recognize is that these artificial advantages are  
16 there and should be kept in mind when setting cost  
17 coverages.

18          Q     Well, if there are these advantages that the  
19 Postal Service has by virtue of being a government agency  
20 that you have identified, have you thought about the  
21 reverse, as to whether the Postal Service has any costs that  
22 it is forced to incur by virtue of the fact that it is a  
23 government agency?

24                Have you ever thought about the additional costs  
25 of things like Veterans hiring preferences, and as to

1     whether that, for example, would be an additional cost the  
2     Postal Service has to incur because it's a government  
3     agency?

4           A     Yes, that sounds reasonable, and as I understand  
5     it, all of the Postal Service's costs are, in fact, covered  
6     as revenues are set to cover costs.

7           Q     Well, what I'm asking is this notion that in  
8     looking at incremental costs, we ought to keep in mind, I  
9     think you said, in setting coverages, that there are certain  
10    benefits that the Postal Service has because it's a  
11    government agency.

12           And I'm flipping this around on you and I'm saying  
13    that if you're going to look at the benefits, shouldn't you  
14    also look at the additional burdens that the Postal Service  
15    operates under because it's a government agency, and keep  
16    those in mind as well?

17           The one example I've given you so far is Veterans  
18    hiring preferences.

19           A     Yes, certainly a balanced approach would take into  
20    account, both the benefits and the costs, but the point I  
21    was trying to make is that I believe that the Postal Service  
22    is already fully compensated for its costs through the  
23    process of matching revenues to costs.

24           Q     Well, the Postal Service is fully compensated for  
25    its costs, but I am not sure that is responsive to the

1 question as to if you are going to look at benefits of being  
2 a Government agency, you should also look at burdens of  
3 being a Government agency, and I think you agreed that you  
4 should have an even-handed approach and look at both, did  
5 you not?

6 A Yes, I did.

7 Q Okay. If the Postal Service has to incur, for  
8 example has to pay compensation rates which might be higher  
9 than those paid in the private sector because it is a  
10 Government agency, or might have to incur the costs of  
11 keeping small post offices open, wouldn't those kinds of  
12 cost incurrences be just as -- I think you used the word  
13 "artificial" as the cost avoidances that you cited in your  
14 response?

15 A I would put them in the same category, yes.

16 Q Do you happen to recall the name of the Postal  
17 Service witness who testified about Parcel Post rate design  
18 in this docket?

19 A I was not here for that testimony but I suspect it  
20 may have been Witness Plunkett.

21 Q Well, prior to preparing your testimony, did you  
22 read Witness Plunkett's testimony?

23 A Yes, I did.

24 Q Let me ask you to look at your response to  
25 Amazon-9, and at the end of your response to 9(a) you said,

1 "My testimony does not address rate design issues."

2 Is that correct?

3 A Yes, it is.

4 Q Did you give Witness Luciani any guidance about  
5 rate design for Parcel Post?

6 A No, I did not.

7 Q Is he the witness that did rate design for Parcel  
8 Post for UPS?

9 A I believe he had a recommendation on a particular  
10 markup for DDU drop ship, yes.

11 Q In your response to the interrogatory -- and this  
12 is your current view, right, that there should be a 24.9  
13 percent increase in Parcel Post across the entire subclass?

14 A That would be the average increase in rates for  
15 Parcel Post that I am recommending, yes.

16 Q So I take it from your testimony you really don't  
17 care how the Commission gets to the 24.9 percent as long as  
18 that is the aggregate Parcel Post increase in rates?

19 A I wouldn't say I don't care but what I would say  
20 is that that is the only guidance I am offering to the  
21 Commission at this point.

22 Q The aggregate level?

23 A The average rate increase for Parcel Post.

24 Q For average, yes. Turn to Interrogatory 5 for a  
25 second.



1 A From Amazon?

2 Q Yes, and in Section (b) -- let me go back to see  
3 where this comes from. At page 11 of your testimony, you  
4 said, "A policy that reduces Postal Service rates as  
5 competition increases and permits revenues to fall toward  
6 incremental cost can also encourage the Postal Service to  
7 choose an inefficient production technology with  
8 unnecessarily large institutional costs and relatively low  
9 incremental costs for competitive services."

10 And then we asked you for some examples of those  
11 and you referred us to another interrogatory response, but  
12 then in (b) we said for each example provided, please  
13 explain which costs would be considered institutional rather  
14 than incremental, correct?

15 A That was the question, yes.

16 Q And there -- let me just read you the sentence in  
17 (b) -- "In the examples I have provided the cost of the  
18 general purpose machinery and the general processing  
19 facilities and equipment might all be counted as  
20 institutional costs because the machinery, facilities and  
21 equipment are employed to deliver multiple mail services  
22 rather than a single mail service."

23 Does that constitute a recommendation to the  
24 Commission as to how it ought to determine institutional  
25 costs?

1 A No, it doesn't.

2 Q What is the -- I am having a hard time  
3 understanding what you meant there, as to why those might be  
4 counted as institutional costs if it is not a recommendation  
5 to the Commission.

6 A Well, I am certainly not making recommendations to  
7 the Commission on how to do costing because I am by no means  
8 a costing expert.

9 The sense of your question, as I interpret it, was  
10 if you have general purpose machinery or operating  
11 facilities or whatever, as opposed to machines or services  
12 that are directly attributable and that they only serve a  
13 particular function for a particular class or subclass of  
14 mail, then again I am not a costing expert, but my  
15 understanding is that when you do use facilities or  
16 equipment for multiple purposes that some of that may become  
17 institutional costs.

18 Q Some of it.

19 A And again the details of how much it would be are  
20 details that a costing expert might know and I certainly do  
21 not.

22 Q Okay. The reason I said some of it was that it  
23 seems at variance with your response there, where you said  
24 in the second line that, "The cost of the general purpose  
25 machinery and the general processing facilities and

1 equipment might all be counted as institutional costs."

2 A Yes, and the word "might" is important there.

3 Q Okay. Should it be some of it or all of it?

4 A If I knew for sure I would have said for sure. I  
5 don't know.

6 Q Well, is it your understanding that the Postal  
7 Service has specialized plants that process only one type of  
8 mail, such as letters and other plants that process mail  
9 such as flats?

10 A I don't believe that to be the case, but I do know  
11 in Priority Mail, for example, there is a dedicated network.

12 Q Right. But just in terms of handling -- I think  
13 in your response to USPS/UPS-T6-14 you talked about letter  
14 and flat machinery, correct?

15 A I will have to turn to that. Could you tell me  
16 what number that was again, please?

17 Q Sure. It's the one you reference there in that  
18 same interrogatory, USPS/UPS-T6-14.

19 A Okay. I have that now.

20 Q And the reference is to the example, so I guess  
21 beginning with the language that starts talking about  
22 examples, you say, "An example of an inefficient production  
23 technology is one that employs general purpose machinery  
24 that can sort both letters and flats even though separate  
25 machines for sorting letters and flats would be equally

1 effective but less costly" and then you have another example  
2 about equipment.

3 I am just trying to see if there is a tie between  
4 these theoretical examples and something that you are urging  
5 the Commission to do in this docket.

6 A No, there's not.

7 Q Well, that saves me a lot of questions then.

8 Well, there still is sort of an implicit  
9 criticism, it seems, of the way things are done, and I am  
10 not sure -- you didn't have a specific example that I could  
11 grab my hand around, so let me ask you now do you have a  
12 specific example of a Postal Service cost that is treated as  
13 an institutional cost when it should be treated as either  
14 attributable or incremental?

15 A Well, again, not being an expert on costing  
16 methodologies, I am not the best person to give you an  
17 example, but one possibility might be advertising, for  
18 example, whereby the advertising is really directed at  
19 selling competitive services and yet it is posed as general  
20 "We Deliver" type Postal Service advertising.

21 Now conceivably that might be an example of a  
22 situation where the costs are really serving one particular  
23 purpose but given the manner in which it is formulated would  
24 appear more as an institutional cost, but again I am not an  
25 expert on how advertising costs are actually treated.

1 Q Okay. Your response to Interrogatory 5 discusses  
2 machinery, facilities and equipment. Can you think of any  
3 examples regarding machinery, facilities, and equipment?

4 A One example there, which is in a sense a  
5 counter-example, is the Priority Mail PMPC network and there  
6 the Postal Service has decided that the most efficient way  
7 to operate is to in fact have a separate delivery system  
8 whereby the costs are clearly attributable to Priority Mail.

9 Q And in fact attributed, correct?

10 A And attributed, as far as I am aware, yes.

11 Q You call that a counter-example?

12 A Yes, in the sense that here the Postal Service has  
13 decided to separate out the activity and make the costs that  
14 serve Priority Mail clearly attributable.

15 An alternative might be if they decided to abandon  
16 this approach, and put all of the Priority Mail processing  
17 back into the general stream and in that case if it is the  
18 case, and again I don't know for sure, but if it is the case  
19 that the most efficient way to deliver value to customers is  
20 with a separate dedicated network but the Postal Service  
21 chose to put it back in with the main network, then that  
22 process would be an example of where they have intentionally  
23 chosen an inefficient operating technology.

24 Q Okay. Other than that hypothetical future  
25 scenario, I am trying to get to an understanding of what you

1 wrote at page 11 of your testimony that was cited to you  
2 before, and ask you if you have an example of a Postal  
3 Service cost for machinery, facilities, equipment that is  
4 now treated as an institutional cost when it should be  
5 treated as attributable or incremental?

6 A No, I don't.

7 Q Could you look at your response to Amazon-2? Now,  
8 that actually references your response to PSA/UPS-T6-12,  
9 which I summarized in my notes as not studied passthroughs.  
10 Is that an accurate summary?

11 A That does sound accurate, yes.

12 Q Okay. Then let's go to -- strike that. Are you  
13 familiar with what is described in the economics literature  
14 as efficient component pricing principle?

15 A I have a rudimentary understanding of the concept.

16 Q Insofar as you understand the concept, do you  
17 agree with it?

18 A I am not sure that I could answer that broad a  
19 question. I would need to know the context that you are  
20 talking about.

21 Q Well, let me give you a specific. As an  
22 economist, would you agree with the proposition that a  
23 passthrough of 100 percent of avoided costs gives the  
24 private sector a proper incentive to provide the services  
25 which it can produce at a lower cost than the Postal

1 Service's avoided costs?

2 MR. McKEEVER: Mr. Chairman, I am going to object.  
3 It is really beyond the scope of his testimony. He has  
4 testified in response to two interrogatory answers that he  
5 hasn't studied passthroughs. And now Mr. Olson is going on  
6 to conduct cross-examination about what are appropriate  
7 passthroughs.

8 MR. OLSON: Actually, it was about efficient  
9 component pricing principle.

10 CHAIRMAN GLEIMAN: Well, let's see if the witness  
11 can answer the question. He has indicated he has some  
12 general knowledge of efficient component pricing.

13 MR. McKEEVER: May I ask that it be repeated, Mr.  
14 Chairman?

15 CHAIRMAN GLEIMAN: Sure. I appreciate that so I  
16 can follow it.

17 BY MR. OLSON:

18 Q Dr. Sappington, as an economist, would you agree  
19 with the proposition that a passthrough equal to 100 percent  
20 of avoided costs gives the private sector an incentive to  
21 provide the services which it can produce at a lower cost  
22 than the Postal Service's avoided costs?

23 A Again, I have studied the issue in detail, but I  
24 do believe it would provide those incentives, but I do not  
25 believe it would satisfy all the relevant objectives or

1 considerations in setting cost passthroughs. And I can give  
2 you an example to explain what I mean by that.

3 Q Sure.

4 A As you indicated, if you passthrough 100 percent  
5 of the costs, then a competitor will delivery the function  
6 or supply the service if and only if that competitor can do  
7 it more efficiently than the Postal Service.

8 However, that is not the only passthrough that  
9 will induce the same behavior from the competitor. For  
10 example, suppose we have a function that it costs the Postal  
11 Service \$1 to perform and it costs the competitor 50 cents  
12 to perform. A passthrough of much less than the full dollar  
13 avoided by the Postal Service will still get that competitor  
14 to provide the service, in particular, if you only pass  
15 through 60 percent, 60 cents out of the dollar, that will  
16 still get the competitor to provide the service, and, in  
17 addition, save some contribution for institutional costs.  
18 So, 100 percent passthrough is not the only way to ensure  
19 that the most efficient provider in fact provides service.

20 Q So that answer, I take it, requires a study of  
21 what the costs of private sector vendors are, correct?

22 A In the illustration I have given here, I assumed I  
23 did know the costs.

24 Q And if you don't know it, you have to expend  
25 effort to find that out somehow, correct?



1           A     Well, not necessarily -- well, if you wanted to  
2 know those facts, yes, you would have to spend some effort  
3 to figure them out.

4           Q     Otherwise you wouldn't know, particularly at the  
5 margin, as to whether there are additional private sector  
6 vendors that would want to come in whose costs might be more  
7 than 50 cents?

8           A     That's correct. But that is a tradeoff you face  
9 in setting cost passthroughs. Again, I am not an expert on  
10 the issue, but it is certainly a tradeoff you would face.  
11 By not passing through 100 percent, you do save some  
12 contribution for institutional cost, which generally has  
13 value. The potential cost of that is that you may sacrifice  
14 some instance in which a competitor could do it more  
15 efficiently than the Postal Service, and that is a standard  
16 type of tradeoff you face in a variety of pricing issues.

17               For example, we know -- economists will often tell  
18 you that pricing at marginal cost is a good idea, again, to  
19 make sure you have taken account of every single opportunity  
20 where a customer values the product more highly than it  
21 costs to produce. But we know that in practice we generally  
22 do not price at marginal cost because there are other  
23 objectives such as covering fixed costs.

24           Q     But you would agree that a passthrough of 100  
25 percent of avoided costs would give the private sector the

1 proper price signal as to who should perform those services  
2 to have maximum societal utilization or utility, isn't that  
3 correct?

4 A Again, if you had perfect information on what  
5 costs are, so you knew exactly how much to pass through, and  
6 your only objective was to ensure that the least cost  
7 provider performed the service, then 100 percent passthrough  
8 would make some sense, but that does ignore a variety of  
9 other important considerations.

10 Q Okay. Let me see, I have a question about page 41  
11 of your testimony, and there you have a Table 7 that shows  
12 volumes from fiscal '90 to fiscal '99, and how Parcel Post  
13 volume changed per year, correct?

14 A That is correct.

15 Q And in '95 and '96, there was a decline in Parcel  
16 Post volume according to your chart of negative 2.7 percent  
17 and negative 2.3 percent, correct?

18 A Yes.

19 Q Would you characterize those declines as  
20 substantial?

21 A Could you define the word "substantial" for me,  
22 please?

23 Q Meaningful, significant, noteworthy. Bigger than  
24 a breadbox.

25 A They are not insignificant.

1 Q Well, let me ask you to -- let me get at this  
2 another way. Let me ask you to look PSA Number 8.

3 A Yes.

4 Q And (c) is what I am referring to, and there you  
5 correct our interrogatory which talked about the original  
6 estimate of a loss of 81 million parcels, and you said the  
7 correct number is 45.8 parcels, correct?

8 A Yes, I see that.

9 Q So that would be the volume decline that you  
10 project under UPS-recommended pricing in this case, correct?

11 A Yes, that would be the volume decline relative to  
12 the case where you're not implementing any increase for  
13 Parcel Post.

14 Q Okay, and let's compare that page in your table we  
15 just had -- excuse me, the page in your testimony, Table 7  
16 that we just had, which showed a 98 volume of --

17 MR. McKEEVER: Do you have that?

18 THE WITNESS: Page 41, Table 7.

19 BY MR. OLSON:

20 Q Do you have the amount of the volume decline in  
21 98.

22 A In 1998, there was. --

23 Q Not the decline, but the amount of the volume in  
24 98, I'm sorry.

25 A There are two numbers given in my table; one is

1 the BRPW estimate and the other is the DRPW estimate.

2 Q Well, let's just work for a moment with the 267.  
3 What does the 267 represent?

4 A That's the Commission methodology.

5 Q Okay, well, let's use that. Do you know offhand  
6 -- strike that.

7 The 45.8 million parcel reduction would be in the  
8 test year in this case, or would it be 99? Can you compare  
9 that to 98? That's what I'm trying to get at.

10 What is it a reduction from?

11 A It is the reduction resulting from the recommended  
12 rate increase in the test year.

13 Q And we could compare that to Fiscal 98 Commission  
14 methodology volume of 267 million; could we not?

15 A I guess we could.

16 Q And what percentage reduction -- well, would you  
17 accept, subject to check, that that was a 17-percent  
18 reduction in volume for Parcel Post?

19 A Relative to what?

20 Q Relative to 1998 Commission methodology, the  
21 number 267 million in your chart, Table 7, page 41?

22 A Right, I've got that part of it, but you were  
23 talking about a reduction.

24 Q Right, the reduction is the one we just referenced  
25 in your response to PSA-8(c) of 45.8 million parcels.

1           A     Okay, so now we're talking about a reduction  
2 relative to the test year, which is 2001.

3           Q     Well, I'm comparing the 98 level of volume to what  
4 it would be with this reduction, and I'm asking you if that  
5 isn't a 17-percent reduction from 98?

6           A     Okay, so what you're suggesting is that we want to  
7 take 267 and add 45.8 million to that?

8           Q     No, I'm asking if you're suggesting it would come  
9 off that. I'm trying to understand the 45.8 million  
10 parcels; that's what I'm trying to get at.

11           MR. McKEEVER: Mr. Chairman, I think Dr.  
12 Sappington did explain what that was, but he's -- I  
13 certainly have no objection to him doing that again, if that  
14 is the question.

15           THE WITNESS: Why don't we turn to Mr. Luciani's  
16 workpaper if you have that with you.

17           BY MR. OLSON:

18           Q     No, I don't. I had it the other day.

19           A     Why don't we not do that then?

20           [Laughter.]

21           THE WITNESS: Why don't I turn to Mr. Luciani's  
22 workpaper, and I can give you the numbers there.

23           BY MR. OLSON:

24           Q     I'd appreciate it.

25           A     Okay.

1 [Pause.]

2 Okay, from Mr. Luciani's workpaper,  
3 UPS-Luciani-WP-3-1.1 --

4 Q Okay.

5 A -- for Parcel Post, the test year before rates  
6 volume is 310.9 million. The corresponding after rates  
7 volume is 265.1 million, and that difference should be 45.8  
8 million.

9 The comparison it's to is to a hypothetical --

10 Q Right.

11 A -- in the test year where we're not raising  
12 Parcel Post rates, which is clearly inappropriate.

13 Q Would you characterize the test year after rates  
14 volume decrease as being substantial from test year before  
15 rates with UPS-recommended rates?

16 A It's a 14.7 percent reduction. That, I would  
17 consider substantial, yes.

18 Q Okay.

19 A But again, we have to be clear on substantial  
20 relative to what, and it's relative to a hypothetical that,  
21 in my opinion, is not appropriate.

22 Q Okay, let me ask you to look at your response to  
23 Amazon 12(d) where you talk about the firefighting services.  
24 Do you remember that interrogatory?

25 A I do. I'll find it here.

1 [Pause.]

2 Q This is the one that had to do with delivery  
3 confirmation service, and the question was, for those Parcel  
4 Post shippers who elect not to use delivery confirmation  
5 service, please explain fully, all, quote, "further  
6 increases in the value of services," close quote, which they  
7 derive from the optional availability of this service.

8 And you talk about -- your responses says that  
9 options typically provide value, even if they are not  
10 exercised. And then you give this illustration of  
11 firefighting services, correct?

12 A That is correct.

13 Q That, you said, is a classic illustration. I take  
14 it it's not yours, it's been around for years?

15 A I don't recall exactly where, but I think I have  
16 seen it somewhere before, yes.

17 Q Let me ask you a firefighting hypothetical. And  
18 I'm going to read this and hopefully slowly enough so that  
19 everyone can pick up on it, but I want to ask you a simple  
20 question at the end, having to do with the value of an  
21 option that is not exercised, someone who chooses not to buy  
22 the optional service.

23 My question at the end is going to be about  
24 whether it really -- you really receive value if you choose  
25 not to buy the additional service. Do you have that in

1 mind?

2 A Yes.

3 Q Okay. Here's the hypothetical:

4 In a particular suburb, homeowners have the option  
5 of buying firefighting services from the local fire  
6 department. Let's assume there are three houses in a row,  
7 A, B, and C.

8 There are no numbers in this hypothetical, but A,  
9 B, and C.

10 And the owners of A and C buy the option, but the  
11 owner of B does not. The owner of B doesn't think the  
12 option is worth the money, and he decides to take the risk.

13 Now, assume that House B catches fire, and the  
14 fire department comes and it stands by to make sure the  
15 sparks don't spread to houses A or C which bought their  
16 option, but otherwise, stands by and watch house B burn to  
17 the ground because B did not buy the option.

18 Under that hypothetical, please explain the  
19 positive value of the option to the homeowner who elected  
20 not to buy the option.

21 [Pause.]

22 A The option itself could very well have had value  
23 to House B, but the House B decided that the cost of the  
24 option outweighed its value.

25 So the fact that it did not purchase it, doesn't



1 mean it doesn't have value. It just means the value or  
2 expected value to Household B outweighed the cost.

3 Q I think the phrase you used was could have had  
4 value, correct?

5 A Well, the option itself has value, as long as  
6 there is any probability that, in fact, the owner of the  
7 option will exercise it at the current strike price.

8 Q The fellow whose house is burning has a positive  
9 value of having had the option to buy a service he chose not  
10 to buy; that's your testimony?

11 A No, it's not what I said.

12 Q Okay.

13 A I said that at the point in time before his house  
14 burned down, when he had the option to either -- when he had  
15 the choice of either buying the option or not buying the  
16 option, there was most likely positive value there to that  
17 homeowner, but the homeowner decided that the value did not  
18 outweigh the cost of purchasing that option.

19 Q And at the end of the day when he decides not to  
20 exercise the option, at that point, it has no value to him;  
21 isn't that correct?

22 A Well, if he doesn't own it, it has no value to him  
23 because he has no right to use it.

24 Q Okay. Let me finish up with where we started.  
25 This is Amazon 11(d), and it has to do with this issue of

1 total costs and unit costs and how you have clarified any  
2 misunderstanding that has come up about whether unit costs  
3 or total attributable costs are the most relevant cost  
4 measure.

5 Let me just ask a couple of things to make sure  
6 that this is absolutely clear in the record as to what your  
7 view is:

8 As between an increase in total attributable costs  
9 or an increase in unit attributable costs, which of the two  
10 is the more relevant cost measure to use in formulating rate  
11 recommendations?

12 A For my recommendation, both are relevant, and I  
13 don't think I could characterize one as being more relevant  
14 than the other, and, again, the reason being that my  
15 recommendation comes about because I'm recommending a  
16 111-percent cost coverage.

17 And given the cost increase that has occurred, be  
18 that total cost or unit cost or inflation-adjusted unit cost  
19 or cost per year, however else you want to measure it, given  
20 the costs that are here now, a 24.9 rate increase is  
21 required to achieve that 111-percent cost coverage.

22 Q Okay, let's get at it this way: Please take a  
23 look at USPS-1.

24 [Pause.]

25 And in your answer to B and C, you have a section

1 there that says high rates -- the second sentence -- high  
2 rates and large rate increase are difficult to avoid when  
3 the Postal Service's costs and cost increases are high.

4 Are you talking there about unit costs or total  
5 costs?

6 A That sentence I believe is true regardless of  
7 whether you are talking about unit costs or total costs.

8 Q So, high rates and large rate increases are  
9 difficult to avoid when the Postal Service's total  
10 attributable costs and total cost increases are high?

11 A Generally that would be the case, yes.

12 Q When would it not be the case?

13 A If the volume was so extraordinarily large that an  
14 increase in a fixed cost, say, when distributed over that  
15 huge volume would amount to a small increase per piece.

16 Q Okay. Let me give you a very simple hypothetical  
17 to illustrate this and see if you agree with this, and then  
18 I will be done. Let me just ask you to assume that the  
19 Postal Service's unit attributable costs for Parcel Post  
20 declined a very small amount, maybe 2 percent. The unit  
21 attributable costs declined by 2 percent, but volume  
22 increased 12 percent, and as a result of the increase in  
23 volume, total attributable costs increased 10 percent. I am  
24 not sure if that would work out, but you understand the  
25 hypothetical, don't you?

1 A I'm sorry, I am a little bit behind you here.

2 Q Sure.

3 A Unit costs are down 2 percent?

4 Q Right. Volume increase is about 12 percent.

5 A And the third component was?

6 Q And total attributable cost increases 10 percent.

7 What I am trying to get to is a situation where unit costs  
8 are going down, total costs are going up because of volume.  
9 Okay. Would that situation call for a rate increase  
10 commensurate with the increase in total attributable costs?

11 A That would depend upon the particulars of the case  
12 and the appropriate cost coverage in particular.

13 Q So even if unit costs were declining, under the  
14 circumstances you identified, it would call for a rate  
15 increase commensurate with the increase in total  
16 attributable costs?

17 A It is conceivable.

18 Q Everything is conceivable. Is it likely?

19 A I really couldn't say whether it is likely or  
20 unlikely without knowing the particulars of the case you  
21 have in mind.

22 MR. OLSON: Thank you very much, Dr. Sappington.  
23 Thank you, Mr. Chairman.

24 CHAIRMAN GLEIMAN: I take it that you have some  
25 cross-examination for the Priority Mail Users Association?

1 MR. OLSON: Boy, I am glad you are on top of this.

2 CHAIRMAN GLEIMAN: And if you do, we will give you  
3 until 1:30 to find your other hat to put on.

4 MR. OLSON: Okay.

5 CHAIRMAN GLEIMAN: And we will perhaps have a bite  
6 of lunch between now and then. So we will come back at  
7 1:30.

8 [Whereupon, at 12:41 p.m., the hearing was  
9 recessed, to reconvene at 1:30 p.m., this same day.]

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## AFTERNOON SESSION

CHAIRMAN GLEIMAN: Mr. Olson, I see you have changed your hat. You are now wearing the hat of the Association of Priority Mail Users, so if you are ready to proceed with cross examination under that guise, you may do so.

MR. OLSON: If the Commission is ready, I'm ready.

CHAIRMAN GLEIMAN: I am not sure we are ready, so you best go ahead while you have got the chance. Whereupon,

DAVID E. M. SAPPINGTON,  
the witness on the stand at the time of the recess, having been previously duly sworn, was further examined and testified as follows:

## CROSS EXAMINATION

BY MR. OLSON:

Q Dr. Sappington, turning to the Association of Priority Mail Users and their questions, I wonder if you have your interrogatory responses to the APMU set there handy.

I want to begin with the first question.

A Yes, I have that here.

Q Okay. This keys off your testimony at page 5, which deals with Criterion 4, the effect of rate increases. The particular line we cited from your testimony

1 was that rates that disadvantage competitors unfairly should  
2 be avoided, correct?

3 A Yes, correct.

4 Q And that has to do with B(4) on the effect of rate  
5 increases on enterprises in the private sector of the  
6 economy engaged in the delivery of mail matter other than  
7 letters, correct?

8 A Correct.

9 Q In C we asked you to make an assumption. We said,  
10 "Please assume the only information which the Commission has  
11 concerning rates charged by competitors is their published  
12 rates for single pieces but the Commission has ample reason  
13 to believe that the majority of business lodged with  
14 competitors is at rates discounted from their published  
15 rates including reduced effective rates after rebates.  
16 However the Commission has no further information about the  
17 extent or depth of discounting because this information is  
18 treated as proprietary and confidential by shippers and  
19 their customers alike pursuant to shipper enforced  
20 contracts. Under these circumstances, please explain how  
21 the Commission should determine whether Postal Service rates  
22 disadvantage competitors unfairly."

23 And I think your response pretty much said that  
24 the Commission should continue to assess Postal Service  
25 costs and revenues to the best of its ability and recommend

1 rates that cover costs and provide a reasonable share of  
2 institutional costs, correct?

3 A That is correct.

4 Q Is there any further guidance you can give us  
5 about this kind of scenario?

6 Are you saying that it is not relevant as to what  
7 competitors charge for competitive products to the  
8 Commission?

9 A No, I am not.

10 Q In D we asked you if the assumption in the  
11 hypothetical question was accurate and you said you didn't  
12 have data to allow you to determine the portion of  
13 competitors' transactions that occur at discounted rates,  
14 correct?

15 A Correct.

16 Q Did you seek such data before you responded to  
17 this inquiry?

18 A I don't recall the exact timing but I was aware of  
19 the statistics on FedEx Government rates that Dr. Haldi had  
20 filed in his testimony but beyond that I did not seek other  
21 information along these lines.

22 Q So you didn't ask FedEx or Airborne or UPS or any  
23 other private carrier for information about the extent of  
24 their transactions that occur at discounted rates?

25 A That is correct.



1 Q Did you consult any other secondary sources of  
2 information on this topic if there is any research in the  
3 field? I don't really know.

4 A I did not locate any other information along these  
5 lines.

6 Q Are you aware that certain competitors of the  
7 Postal Service do have a policy in their negotiated  
8 contracts to require confidentiality of the rates?

9 A I believe I may have seen a reference to that  
10 somewhere, but I have no first hand knowledge of that.

11 Q Okay. Is there any reason you didn't ask for that  
12 information before you responded to these interrogatories?

13 A My reasoning was that if private competitors  
14 wanted this information to be public I presume they would  
15 have made it public and I was not aware of any public source  
16 for the information.

17 Q Let's assume that this is in fact the case, that  
18 competitors of the Postal Service have this provision in  
19 negotiated contracts requiring confidentiality on threat  
20 perhaps of voiding the contract or the rates that are being  
21 offered.

22 As an economist does that comport with normal  
23 behavior of suppliers in a competitive market?

24 A In general, I believe that is the case, and in  
25 fact it is well-accepted economic doctrine that you will get

1 more intense price competition when price concessions or  
2 price discounts are kept secret.

3 The reason is that if you make public the rates  
4 you are providing to each of your customers, then when you  
5 go to negotiate the next rate with your next customer they  
6 will say wait a minute, I want the same rate you gave to  
7 that guy over there, and recognizing that that is what is  
8 going to occur when you get into subsequent bargaining, the  
9 company in the first place will just not grant these rate  
10 discounts, and my understanding, for example, is that the  
11 Justice Department is very concerned about policies which  
12 are called "most favored customer" policies whereby you  
13 guarantee to any customer that you will give them the same  
14 price concession that you give to another one, because it  
15 can be anti-competitive and in fact reduce the intensity of  
16 price competition, so it is generally accepted that secrecy  
17 in prices is good for competition.

18 Q What industries are you talking about now? All  
19 industries?

20 A I don't recall the exact one in which I saw this  
21 reference to the Justice Department inquiry, but yes, it is  
22 a generally-accepted principle that applies to a variety of  
23 industries.

24 Q That secrecy in pricing promotes competition?

25 A Price competition. That is correct. Yes.

1 Q I am sorry, did you say you didn't recall where  
2 you saw this discussed in the literature or you didn't  
3 recall where the reference to the Justice Department  
4 occurred?

5 A It was the reference to the Justice Department I  
6 am not sure about.

7 There is one article that comes to mind in the  
8 Rand Journal of Economics by Professor Thomas Cooper, I  
9 believe it was around 1991, which discusses these sort of  
10 issues.

11 Q I think that is the one you are on the editorial  
12 staff of?

13 A Yes. Yes, I am.

14 Q Okay. It is therefore your opinion that having  
15 such provisions in contracts is not indicative of market  
16 power on behalf of the vendor who is demanding that term or  
17 condition?

18 A I think what I indicated was that secrecy in price  
19 negotiations is indicative of competitive markets.

20 Q And I am asking you the flip side of that. Is it  
21 then your position that it is not an indicator of market  
22 power by the company demanding that term or condition in the  
23 contract?

24 A I don't think it necessarily would need to be, no.

25 Q But it could be?

1 A That is conceivable, that a firm with market power  
2 could ask for that provision, yes.

3 Q Isn't it likely that a firm that would get that  
4 provision would be a firm with market power, as opposed to  
5 ask for it would actually get it?

6 A My guess is that it would depend a lot on what the  
7 industry custom is and if that is the policy of all the  
8 firms in the industry that any firm regardless of the degree  
9 of market power they may have would likely adopt the same  
10 sort of arrangement.

11 Q Following the people who had established that  
12 pattern in that industry?

13 A Following the prevailing standards in the  
14 industry, yes.

15 Q In your response to 2, you deal with B(5), or  
16 actually our question deals with Criterion 5 and the problem  
17 of having discounted volume rates that are not available to  
18 the public, correct? Or to the Commission.

19 A I'm sorry, which portion of the question are you  
20 on?

21 Q Well, let's take C. I was talking generally about  
22 the preface, but let me just take C. We say, "Assuming that  
23 the term reasonable costs from suppliers means the rates  
24 which suppliers charge mailers, please explain whether your  
25 reference is to published single piece rates or to

1 discounted volume rates." And you say the reference is to  
2 rates that the mailers actually pay.

3 By that, do you mean whether -- the rates they  
4 pay, whether they be published single piece rates or  
5 discounted volume rates?

6 A Yes, that's correct.

7 Q Would you take a look at your response to 10,  
8 APMU-10? And we will talk about the same thing that we  
9 talked about before for Parcel Post, for Priority Mail,  
10 which is to say volume changes under UPS proposed rates.  
11 Does your table on page 3 of your answer identify what the  
12 volume changes would be?

13 A Yes, the first column of data in the table talks  
14 about the volume in the base year, the test year before  
15 rates and the test year after rates.

16 Q And if you were to compare the base year to the  
17 test year after rates with UPS rates, you would have a  
18 reduction of about 104 million pieces, correct?

19 A Yes, that's correct.

20 Q And if you compare test year before rates with  
21 test year after rates, you have a reduction of about, what  
22 is it, 286 million?

23 A I believe that is roughly correct.

24 Q I haven't worked out the percentages, but you  
25 don't happen to know -- I don't want you to calculate them,

1 but you don't happen to have those, do you?

2 A Yes. Mr. Luciani does those calculations in his  
3 workpaper. For the decline in volume between the test year  
4 before rates and the after rates is 21 percent. And, again,  
5 so the comparison is to the case where we have no increase  
6 in rates versus the rate increase that I am recommending.

7 Q Right. Before rates and after rates.

8 A Correct.

9 Q Okay. Do you have an opinion as to whether that  
10 is a substantial reduction in volume?

11 A Yes, it is.

12 Q Okay. And if that substantial reduction in volume  
13 were to occur, do you have an opinion as to how that would  
14 affect the Postal Service's market share in the second day  
15 product category?

16 A Holding other factors constant, I presume that  
17 would decrease its market share.

18 Q Substantially?

19 A It is hard to say given that a lot of other  
20 factors will be changing, and, for example, if competitors  
21 also have rate increases around the same time that these  
22 rate increases would go into effect, their volumes may also  
23 go down relative to the case where they do not have rate  
24 increase. And, therefore, trying to estimate the impact on  
25 market share is difficult.

1 Q At least significant, however, reduction of market  
2 share, would you not agree?

3 A I hate to argue about semantics, but I am not sure  
4 what you mean by substantial. And, again, since I really  
5 can't estimate it, I would have difficulty classifying it as  
6 either substantial or insubstantial.

7 Q Take a look at your response to 12, please. You  
8 said I do not have -- this is at the very end of C, second  
9 sentence from the end -- I do not have any information  
10 regarding UPS's negotiated rates for one pound packages  
11 receiving second day delivery, correct?

12 A That's correct.

13 Q That means you don't have any idea as to the  
14 volume of pieces that go at negotiated rates?

15 A That's correct.

16 Q You don't have any information about the  
17 percentage of total UPS volume that goes at negotiated  
18 rates?

19 A No, I don't.

20 Q And you did not seek information about either of  
21 those?

22 A That is correct.

23 Q Is it because you did not find it relevant to  
24 responding to the question?

25 A No, it is more as I indicated before, that I

1 presume that if private competitors wanted these data to be  
2 publicly available, they would have made it available.

3 Q If UPS wanted you to know, they would have told  
4 you?

5 A UPS and all the other competitors in the market,  
6 yes.

7 Q Take a look at 16, please. You are asked a  
8 question about reliability and measures of reliability, or  
9 measures of service quality and how that translates into  
10 reliability, correct?

11 A That's correct.

12 Q Okay. And we asked you define the term  
13 "reliability." Did you have that in mind in an absolute  
14 sense or a relative sense?

15 A I have it in mind in an absolute sense.

16 Q So, in other words, how much Priority Mail was  
17 delivered in accordance with service standards as compared  
18 to 100 percent?

19 A No, it was more in terms of the distribution of  
20 delivery times around the average, and that average may  
21 differ from the service standard.

22 Q And that is where you talked about the variance,  
23 correct, if there was -- is a high failure rate versus  
24 service standards indicative of high variance

25 A No.



1 Q Why not?

2 A Because the failure rate could be systematic. So,  
3 for example, suppose you had a three day service standard  
4 and the mail was always delivered in four days, so you have  
5 100 percent failure rate, but it is a very reliable service  
6 in the sense that you know it gets there in four days with  
7 certainty.

8 Q I see. Okay. I got you. Is there any importance  
9 to understanding relative reliability of Priority Mail  
10 versus its competitive products?

11 A For what purpose?

12 Q For setting rates.

13 A I think that information could be useful, yes.

14 Q Do you have any information about the reliability  
15 of delivery of product, of parcels by UPS or any other  
16 companies?

17 A No, I don't.

18 Q Did you seek such information before responding to  
19 this question?

20 A No, I didn't, and, again, for the same reasons I  
21 mentioned.

22 Q If they wanted you to know, they would have told  
23 you.

24 A Or at least they would have made it public,  
25 probably not told me directly.

1           Q     From what you know about Priority Mail delivery,  
2 if someone absolutely, positively had to get it there the  
3 second day, would they use Priority Mail, if it was a two  
4 day area zip code pair?

5           A     This isn't an advertisement for FedEx, is it?

6           Q     It is just a question.

7           A     My understanding is that Priority Mail does not  
8 guarantee that the package will be there on a particular  
9 day. And so if it were absolutely essential that it be  
10 there on a particular day, Priority Mail may not be the  
11 first choice.

12          Q     Even if it had a guarantee, if it absolutely,  
13 positively had to get there in two days, would people choose  
14 Priority Mail?

15          A     As opposed to?

16          Q     Competitors of Priority Mail?

17          A     I am not sure since I don't know the relevant  
18 performance of the competitors.

19          Q     Shouldn't reliability be a hallmark of an  
20 expedited product?

21          A     Not necessarily, the way I have defined it here,  
22 because, for example, suppose you did guarantee that your  
23 package would be there in two days?

24                 Well, a package that arrived in one day, half the  
25 time and two days half the time, might be extremely good

1 service, but it wouldn't be reliable in the sense that I  
2 have defined it here, because there would be variance in the  
3 delivery time.

4 Q Well, if the variance is getting it there faster  
5 than promised, can we factor that out and say that other  
6 than cases where you get the mail there quicker than you  
7 promise, isn't it true that reliability is a hallmark of an  
8 expedited service?

9 A Well, I'm just not sure what you mean anymore by  
10 factoring out the times getting there early. That's no  
11 longer --

12 Q Well, very few people object if you get it there  
13 earlier, and if there is a variance for that reason -- and  
14 I'm trying to ask you to dismiss that situation because I  
15 don't think that's relevant to my question.

16 I just wanted to ask you if variability on the bad  
17 side is not an indicator of low reliability, and if  
18 reliability isn't the hallmark of an expedited service?

19 A Again, there's just a semantic issue. I just  
20 wouldn't use the term, reliability anymore, but getting it  
21 there when you said you would or earlier, is generally a  
22 good feature, yes.

23 MR. OLSON: Thank you, Mr. Chairman. Thank you,  
24 Dr. Sappington.

25 CHAIRMAN GLEIMAN: Parcel Shippers Association,

1 Mr. May?

2 MR. MAY: Thank you.

3 CROSS EXAMINATION

4 BY MR. MAY:

5 Q Dr. Sappington, before I begin other questioning,  
6 I'd like to follow up with just a few points that Mr. Olson  
7 went over with you, just the very last point, for example,  
8 reliability.

9 Your testimony at page 31 does speak of that as  
10 one of the features of measuring value of service. And you  
11 then go on to say that by reliability you meant, I think,  
12 consistency, that there was -- that the service was  
13 consistent; is that correct?

14 A That the variance in the delivery times was small,  
15 yes.

16 Q Yes, and so that what's desirable then is if it's  
17 bad, that it be consistently bad?

18 A There is value to consistency, even if the  
19 delivery time is after the stated time.

20 Q But, I mean, if, indeed --

21 MR. McKEEVER: Mr. Chairman, I'm not sure Dr.  
22 Sappington finished his answer. I thought I heard him say,  
23 and.

24 THE WITNESS: And the reason would be because even  
25 if a service standard, for example, is stated to be two

1 days, but the customer knew for sure it would be there  
2 within three days, then the customer could plan accordingly.

3 BY MR. MAY:

4 Q Well, let me put it very bluntly to you: Does  
5 that mean that if the service is always bad, that it has a  
6 higher value of service than if it's bad only half the time?

7 A It depends on what happens the other half of the  
8 time.

9 Q It's better, the service is better.

10 A Okay, then, there really are two concepts here.

11 One is the average time to delivery, and one is  
12 the variance around that average. The one that is faster,  
13 on average, would be better on that dimension, but for some  
14 customers, the consistency would also be of value.

15 So you need to take both of those considerations  
16 into account.

17 Q So reliability then becomes a totally subjective  
18 standard, depending upon the preferences of an individual  
19 customer; is that what you're saying?

20 A All dimensions of value are what customers care  
21 about.

22 Q Doesn't this make it a little more difficult for  
23 the Commission to follow your precepts in determining value  
24 of service with this kind of a malleable test?

25 A Could you define the sense in which it's

1 malleable?

2 Q It depends upon the beauty in the eye of beholder,  
3 the customer.

4 MR. McKEEVER: Mr. Chairman, I don't believe  
5 that's what Dr. Sappington said, but I certainly will permit  
6 him to answer the question.

7 CHAIRMAN GLEIMAN: Well, if you're going to permit  
8 him to answer the question --

9 MR. McKEEVER: I take that the question is, and  
10 I'm not clear what it is, that is his test, there's beauty  
11 in the eye of the beholder.

12 If that's the question Mr. May wants answered, I  
13 took that to be the question.

14 MR. MAY: No, Mr. Chairman. The witness asked me  
15 what did I mean by malleable, and by malleable, I said, does  
16 it depend upon whether the beauty of the object is in the  
17 eye of the beholder; that is, that it is a totally  
18 subjective standard that each customer, individually,  
19 applies to the service.

20 MR. McKEEVER: Then I'm not sure I know what the  
21 pending question is, Mr. Chairman.

22 MR. MAY: The question was, to which the witness  
23 asked me, Mr. Chairman, what I meant by malleable, was,  
24 isn't this a rather difficult standard for you to ask the  
25 Commission to apply, if your test of whether something is

1 reliable depends upon the totally subjective view of each  
2 individual customer? That was the question.

3 CHAIRMAN GLEIMAN: Does that help, Mr. McKeever?

4 MR. McKEEVER: I have no objection to that  
5 question, Mr. Chairman.

6 CHAIRMAN GLEIMAN: Thank you.

7 THE WITNESS: I don't believe -- I'm not sure I  
8 said that, but ultimately, what I think I did say was that  
9 the value of service, as the Commission is instructed to  
10 consider, is the value that customers perceive.

11 And if customers have different perceptions, I  
12 will certainly agree that the Commission has a very tough  
13 job in trying to formulate a single measure of value of  
14 service.

15 BY MR. MAY:

16 Q Another matter that Mr. Olson questioned you about  
17 and elicited a response from you which seems to be one of  
18 the tenets of your business about competition, that, quote,  
19 "secrecy in pricing promotes competition;" do you recall  
20 that testimony?

21 A I recall words to that effect, yes.

22 Q Yes. Does that mean that the public setting of  
23 Parcel Post and Priority Mail rates through this public  
24 proceeding and the publishing of the rates to all of the  
25 world is an anticompetitive act?

1           A     Could you define anticompetitive act for me,  
2     please?

3           Q     It's the opposite of what you said promotes  
4     competition, i.e., secrecy in pricing.

5           A     It's conceivable that price competition is  
6     somewhat lessened by public setting of rates, if there are  
7     no opportunities to diverge from that standard.

8           MR. MAY: Mr. Chairman, I want the record to note  
9     I didn't say that.

10           [Laughter.]

11           BY MR. MAY:

12           Q     Another question, just to follow up: I'd like you  
13     to turn to your testimony at page 40.

14           A     Yes.

15           Q     I direct your attention to the much discussed  
16     statement in the middle of that page where, and I quote  
17     lines 13 to 15, quote:

18                     "This substantial increase in Parcel Post's  
19     attributable costs since R97-1 necessitates a substantial  
20     increase in rates to ensure that revenues exceed  
21     attributable costs."

22                     Is it not the case that it may be that no increase  
23     in rates is required to cover attributable costs, merely  
24     because attributable costs, in gross, have substantially  
25     increased? Isn't that the case?



1 A I'm sorry, could you repeat the question, please?

2 Q Yes. Isn't it true that simply because  
3 attributable costs, the gross amount of attributable costs,  
4 have increased, it is theoretically just as possible that no  
5 increase in rates would be necessary in order to cover those  
6 attributable costs?

7 A I'm sorry, I think I'm not understanding the  
8 question. You're saying, if costs go up, could it be the  
9 case that rates don't have to rise to cover that increase in  
10 case?

11 Q I'll give you the example.

12 A Okay.

13 Q The attributable costs have doubled.

14 A Okay.

15 Q We start with the premise that the attributable  
16 costs were being covered by the rates in 1997. Now, the  
17 attributable costs have doubled and the volume has doubled,  
18 and, therefore, the revenues have doubled.

19 Would you need any increase in rates in order to  
20 cover attributable costs?

21 A You're starting with the presumption that revenues  
22 did cover costs, initially?

23 Q Well, at least the Commission thought they did  
24 when they issued their decision.

25 A Yes, but now we're back to the point Mr. Olson

1 raised earlier; there is a difference between predicted and  
2 actual, and in actuality, I believe revenues were below  
3 costs in 1997.

4 Q You mean, using your numbers?

5 A Using the Commission's numbers, I believe, in  
6 1997.

7 Q Well, we'll get to that. But using the RPW, what  
8 you call -- what you have loosely termed this morning, the  
9 Commission's methodology, which is a misnomer. It is the  
10 old, established RPW methodology that is being used in your  
11 testimony; is it not?

12 MR. McKEEVER: Mr. Chairman, I would object. I  
13 think if counsel would ask questions instead of making  
14 argument and trying to characterize things, I would not be  
15 required to object as frequently.

16 But when he does make argument and starts  
17 characterizing things and invites us to go off the  
18 reservation, so to speak, that creates an issue.

19 We're here to have counsel ask questions and the  
20 witness to provide answers.

21 MR. MAY: Mr. Chairman, I doubt that there is  
22 anything that would cause a diminishment of Mr. McKeever's  
23 interruptions, however, since I was trying to refresh the  
24 witness's recollection of what he was referring to as the  
25 Commission's methodology for RPW, I did not want the record

1 to go without my noting my objection to his characterization  
2 that way.

3 MR. McKEEVER: Mr. Chairman, one more sentence.

4 CHAIRMAN GLEIMAN: Thank you. I think I  
5 understand your point, Mr. May, and let me suggest that  
6 perhaps, whether it will result in fewer interruptions or  
7 not, that if you could ask the witness whether he  
8 characterized it as the Commission and then perhaps ask him  
9 if it was a proper characterization, that would overcome a  
10 potential objection, may result in a few more multipart  
11 questions on your part, but perhaps we can move things along  
12 that way.

13 I have no problems with the question, the point  
14 you're trying to make. I want to make that clear. It's  
15 just let's see if we can move things along.

16 MR. MAY: Fine.

17 BY MR. MAY:

18 Q Doctor, when you used the words, the terminology,  
19 the Commission's methodology for the RPW system, what did  
20 you intend to mean by that characterization?

21 A I was referring to the DRPW system, and my  
22 understanding was that that methodology has been endorsed by  
23 the Commission. And as far as I know, it has not endorsed  
24 the BRPW methodology, which is why I referred to it as the  
25 Commission's methodology.

1           Q     Is it your understanding that the Postal Service  
2 was the author of that methodology?

3           A     I'm not certain where it came from.

4           Q     The DRPW system?

5           A     Oh, the DRPW?

6           Q     Yes.

7           A     Again, I wasn't around when it was initiated, as  
8 far as I know.

9           Q     Well, since you seem to know whether the  
10 Commission, as you say, endorsed it, was the Commission  
11 using the Postal Service's methodology or did they invent  
12 one of their own, and therefore make it a Commission  
13 methodology?

14           MR. MCKEEVER:  Objection, Mr. Chairman, beyond the  
15 scope of this witness's testimony.  I might point out that I  
16 believe I interjected very rarely, if ever, when Mr. May  
17 cross examined Mr. Sellick.

18           But I believe that is beyond the scope of this  
19 witness's testimony, the DRPW system.

20           CHAIRMAN GLEIMAN:  And that you may have  
21 interjected yourself fewer times with Witness Sellick is  
22 beyond the scope of the current cross examination, too.

23           But there are some questions that may appear to be  
24 beyond the scope, and they may well be beyond the scope.  On  
25 the other hand, the witness may be able to enlighten us, so

1 if the witness can, I think we ought to let him or her do  
2 so, you know, until we get fairly far afield, in which case  
3 we'll draw the line.

4 MR. MAY: Well, perhaps I can move things along by  
5 simply asking the witness to assume that in 1997, the  
6 attributable costs were covered by the rates, the  
7 attributable costs, but that since that time the  
8 attributable costs have doubled, the gross amount of  
9 attributable costs have doubled, and the reason they have  
10 doubled is because the volume of Parcel Post has doubled,  
11 and the revenues have doubled.

12 BY MR. MAY:

13 Q So is it not true that even though the  
14 attributable costs will have doubled in that time, it would  
15 not be necessary to have any rate increase in order to cover  
16 attributable costs?

17 A That sounds plausible.

18 Q Thank you.

19 Now, I'd like to move along to direct your  
20 attention to some of the responses to Parcel Shippers'  
21 interrogatories.

22 If you would refer to your response to Question  
23 5(b), and have that in front of you, your testimony on page  
24 43 asserts that Parcel Post failed to cover costs between FY  
25 1989 and 1997, except for two years; do you see that in your

1 testimony on page 43?

2 A I don't see exactly the lines. If you could  
3 direct me to those, I'd appreciate it.

4 Q Yes.

5 [Pause.]

6 The last paragraph on the page, which says: In  
7 fact, with only two exceptions, Parcel Post revenues have  
8 fallen short of attributable costs in every year between FY  
9 1989 and FY 1997.

10 A I do see that, thank you.

11 Q Yes.

12 But in your answer to Parcel Shippers'  
13 Interrogatory 5(a), you concede that your statement on that  
14 page is based upon United States Postal Service costs and  
15 revenue analyses that attributed Alaska Costs, Alaska Air  
16 costs to Parcel Post, contrary to PRC rule; do you see that  
17 answer?

18 A I do see that answer to part (a), yes.

19 Q And in your answer to Part 5(b), you say that you  
20 do not have the data for any year from 1989 to 1996 in order  
21 to determine whether subtracting the Alaska Air costs, as  
22 does the Postal Rate Commission, whether that would show  
23 Parcel Post covering its costs for those years; is that not  
24 your answer?

25 A Yes, for the years 1989 through 1996, I do not

1 have the data that would allow me to make the correction for  
2 Alaska Air costs and all the other costs, the other  
3 differences between the Commission's methodology and the  
4 Postal Service's methodology.

5 However, in the two years in which I do have both  
6 sets of data, the conclusion I draw using -- originally  
7 drew, using Postal Service data, continues to be true, using  
8 the Commission's costing methodology.

9 Q But I asked you, since you do not have the data  
10 from any year from 1989 to 1996, is it not the case that  
11 your testimony on that page 43 is either wrong or you don't  
12 know whether it's wrong, since you do not have the data to  
13 make the determination for any of those years?

14 MR. McKEEVER: Mr. Chairman, objection, he is  
15 mischaracterizing the testimony. The witness made clear  
16 what he did, what he could testify to and what he couldn't  
17 testify to, both in the testimony and, as the process  
18 contemplates, in his interrogatory response.

19 MR. MAY: Mr. Chairman, this witness on page 43  
20 flatly said, and I am quoting him, and I am not  
21 characterizing or paraphrasing, quote, "In fact, with only  
22 two exceptions, Parcel Post revenues have fallen short of  
23 attributable costs in every year between FY 1989 and FY  
24 1997." And then the witness responded, in response to an  
25 interrogatory, saying he did not have the data for any year