RECEIVED
AUG 16 4 41 PM '00
POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

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

POSTAL RATE AND FEE CHANGES, 2000	Docket No. R2000–1

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS MAYES TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 18, QUESTION 2
(August 16, 2000)

The United States Postal Service hereby provides the response of witness Mayes to Presiding Officer's Information Request No. 18, question 2, issued on July 28, 2000. In response to the Postal Service's August 1st Motion for Clarification or Reconsideration, the Presiding Officer indicated that a response to Question 1 would not be necessary. Presiding Officer's Ruling No. R2000-1/110 (August 9, 2000).

The question is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its *attorneys:*

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

E. P. Koetting

Eric P. Koetting

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260–1137
(202) 268–2992 Fax –5402
August 16, 2000

Q. The Postal Service is requested to provide a comparison of the advantages and disadvantages of using 1999 billing determinants adjusted in this fashion, as opposed to using "hybrid billing determinants."

RESPONSE:

The rates and fees resulting from Docket No. R97-1 were implemented on January 10, 1999, a date which fell within postal quarter 2 of FY 1999. Prior to that time, the rates in effect were those resulting from Dockets No. R94-1, MC95-1 and MC96-2. For ease of reference, the portion of the fiscal year prior to January 10, 1999 can be referred to as the "pre-R97" portion of the year, and the portion of the fiscal year after R97-1 rate implementation is the "post-R97" part of the year.

Billing determinants represent the distribution of mail volume to each rate element (*e.g.*, zone, weight increment, presort category, shape, etc.) within each class and subclass of mail. The distribution of mail pieces to rate element permits the analysis of mail mix changes and allows for an understanding of the sources of revenue. In the context of billing determinants, a change in rate regime can create at least two types of complications. One type of complication arises when mailers shift the manner and/or categories in which they enter mail in response to changing price signals when relative prices change. A second type of complication arises when classification changes accompany the new rate regime, so that even if mailers are entering the exact same types of mail prepared in the exact same fashion, that mail pays postage and gets recorded in a different category than it would have under the previous rate regime. Therefore, when rate regimes change in the middle of the year, as they did in FY 1999, preparation of billing determinants is not a straightforward exercise, and the results of such effort are not easily interpreted.

Billing determinants for any given year are used to analyze the mail mix and sources of revenue for that year, but are also used to forecast revenue for future periods. The volume forecasting models provide a great deal of detail, but cannot provide meaningful forecasted volumes for each individual rate element. Thus, in developing revenue forecasts, the volumes provided by the volume forecasting models are distributed to rate element using a set of billing determinants. Billing determinants developed for a year in which the rate regime changed may be of less use in forecasting revenue than would be billing determinants from a year in which the rate regime was the same as that in the year for which revenues will be forecast. Complications arise because the mail piece characteristics reflected in the billing determinants for a year in which the rate regime changed are not necessarily constant throughout the year. Therefore, when rate regimes change in the middle of a year, billing determinants for the two portions of the year representing each of the rate regimes may be different because of factors such as the two examples discussed above, or may be different because of seasonality.

The pre-R97 billing determinants from FY 1999 clearly do not reflect the changes precipitated by the change in rate regimes on January 10, 1999. It is also clear that, because the full year billing determinants include the pre-R97 information as well, the full year data likewise fail to reflect those changes. For example, in the pre-R97 portion of the year, Periodicals could receive a discount for 3/5-digit presortation. In the post-R97 portion of the year, these pieces were reported as either 3-digit or 5-digit presorted pieces. The billing determinants for the full year would indicate in aggregate the number of pieces that were either presorted to the 3-digit or 5-digit or 3/5-digit level. Given the post-R97 rate design, revenue forecasting would require a separation of pieces into 3-digit and 5-digit presortation levels. But only in the post-R97 portion of the year did the billing determinants fully reflect the effects of those changes. Unfortunately, however, the post-R97 FY 1999 information relates to only a portion of the year, and therefore also reflects the potential effects of seasonality as well.

Even in years in which there were no changes in rates or classifications, the billing determinants may demonstrate different profiles at different times of the year. For instance, First-Class Mail tends to be heavier during tax season. The testimonies of witnesses Thress and Tolley discuss the seasonality concerns more fully, but the point is that the distributions of the forecasted total volumes to the rate elements will vary for some subclasses depending on the time of year. Thus, while the argument may be made that the post-R97 portion of FY 1999 would be more useful in forecasting the characteristics of mail in response to the changes in rates or classifications, due to the fact that it represents only part of a year, it would also reflect the profile of the mail associated with that time of year.

POIR No. 16 requested that the Postal Service "provide revenue estimates by subclass and service that reflect FY 1999 billing determinants in the manner it deems appropriate." In response, the Postal Service provided revenue estimates using a "hybrid" fiscal year composed of the billing determinants from the last two quarters of FY 1999 and the first two quarters of FY 2000. These four quarters represent the first four full quarters after the implementation of the R97-1 rates, thus giving a better picture of the behavior of customers in response to the changes in rates and classifications (the testimonies of witnesses Thress and Tolley discuss lagged effects of rates changes more fully). By combining the four quarters' worth of data, the resulting distributions provide the equivalent of a full year under the new rate regime and avoid any seasonality distortions resulting from using only the post-R97 portion of the fiscal year while retaining as much of the FY 1999 data as possible. In so doing, it was the belief of the Postal Service that the intent of the request was to develop the best possible forecasts of test year revenues while utilizing the FY 1999 information. (It conceivably may have been feasible to utilize a four-quarter period from FY99Q4 through FY00Q3, but that would have excluded an additional quarter, Postal Quarter 3, of FY 1999 information.)

POIR 16 suggested that the Postal Service "provide revenue estimates by subclass and service that reflect FY 1999 billing determinants in the manner it deems appropriate." And the Postal Service did so, with the understanding and belief that the intent was to assist in the development of the best possible test year revenue forecast. POIR 18 suggested that developing a revenue forecast was not their only purpose in requesting revenue based on FY 1999 billing determinants adjusted "in the manner [the Postal Service] deems appropriate." POIR 18 stated:

> There is a misalignment in the cost coverages provided in the Responses in that the costs relate to the mail sent in FY 1999, and the revenues reflect the "hybrid billing determinants" of the mail sent in the last half of FY 1999 and the first half of FY 2000. Furthermore, it does not appear that the Postal Service considered the alternative of using the post-implementation period of FY 1999 to adjust the pre-implementation period, much as the Postal Service's original filing used, in many cases, parts of the post-implementation period to adjust the billing determinants from FY 1998.

It would be incorrect to suggest that the Postal Service did not consider using the post-implementation period to adjust the pre-implementation period. The Postal Service did consider such an approach, but determined that it would be difficult to isolate and remove seasonality differences before using the distributions from the post-R97 portion of the year to adjust the pre-R97 part of the year. Furthermore, given that additional actual data (the Q1 and Q2 FY 2000 data) existed which would eliminate the need for making such adjustment, it seemed unnecessary to tackle the difficulties inherent in establishing which differences in mailer behavior were due to seasonality and which were due to mailer responses to rate and classification changes. In addition, given that actual information existed regarding, for example the shift of Standard A single-piece mail to other classifications, the use of estimates in developing an adjusted pre-R97 portion of FY 1999 seemed less useful or accurate.

POIR 18 suggested that the Postal Service could make such adjustments "much as the Postal Service's original filing used, in many cases, parts of the post-implementation period to adjust the billing determinants from FY 1998." For the most part, the adjustments in question were designed to take the little information available, Q3 and Q4 of FY 1999 in many cases, regarding the changes in classifications resulting from Docket No. R97-1. Again, given that actual data were available from Q1 and Q2 of FY 2000, which had not been not available at the time of the original filing, reverting back to estimates and adjustments to the pre-R97 period was not as attractive an option for purposes of revenue forecasting.

POIR 18 indicated that developing the best possible revenue forecast was not the only goal when requesting the revenue estimates developed based on FY 1999. POIR 18 indicated that the Postal Service's use of hybrid billing determinants created a "a misalignment in the cost coverages provided in the Responses in that the costs relate to the mail sent in FY 1999, and the revenues reflect the 'hybrid billing determinants' of the mail sent in the last half of FY 1999 and the first half of FY 2000." Of course there would be a misalignment in the cost coverages for FY 1999 when using the revenues from the hybrid billing determinants and the costs from the FY 1999 CRA. Similarly, however, **any** adjustment to the pre-R97 portion of the FY 1999 billing determinants would result in a misalignment of the revenues and costs for FY 1999. The only situation which would **not** result in a misalignment would be the comparison of the actual FY 1999 revenues and billing determinants and the FY 1999 CRA costs. Use of the full year FY 1999 billing determinants, however, as noted above, would not permit adequate revenue forecasting with regard to the impacts of the R97 rate and classification changes. As noted in the Postal Service's Motion for Reconsideration of POIR 18, in terms of creating a potential misalignment, it doesn't matter whether the pre-R97 period is adjusted on the basis of post-R97 FY 1999 data, or (in effect) on the basis of post-R97 FY 2000 data. Either type of adjustment is incongruous with the objective of complete harmony between the forecast base for costs and revenues. (The objective of harmony in this context is generally a worthwhile one. Under circumstances of a split rate regime base year, however, it is one which must also be balanced against other considerations.)

As noted in the Postal Service's Motion for Reconsideration of POIR 18, with respect to the cost coverages provided in response to POIR No. 16, neither the costs nor the revenues relate to either the mail sent in FY 1999, or the mail sent in the hybrid four quarters of FY99Q3-FY00Q2. Instead, in each instance, they relate to what has been forecasted for the same prospective time period, test year 2001, both using the information available. Given the lack of congruity between factors which will affect costs and factors which will affect revenues, the most rational approach is to focus on doing the best possible job forecasting test year costs, and to focus separately on doing the best possible job in forecasting test year revenues.

DECLARATION

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

Virginia J Mayes

Virginia J. Mayes

Dated: Aug 16, 2000

CERTIFICATE OF SERVICE

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

Eric P. Koetting

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260–1137
(202) 268–2992 Fax –5402
August 16, 2000